

SPECIALTY LABORATORIES  
Form DEF 14A  
April 03, 2003

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**SCHEDULE 14A INFORMATION**

Proxy Statement Pursuant to Section 14(a) of  
the Securities Exchange Act of 1934 (Amendment No. )

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

**SPECIALTY LABORATORIES, INC.**

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(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required
  - Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11
- (1) Title of each class of securities to which transaction applies:  
N/A

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(2) Aggregate number of securities to which transaction applies:  
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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):  
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- Fee paid previously with preliminary materials.
- Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:  
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(2) Form, Schedule or Registration Statement No.:  
N/A

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(3) Filing Party:  
N/A

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(4) Date Filed:  
N/A

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**SPECIALTY LABORATORIES, INC.**

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**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS  
TO BE HELD MAY 8, 2003**

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**TO THE SHAREHOLDERS OF SPECIALTY LABORATORIES, INC.:**

NOTICE IS HEREBY GIVEN that the Annual Meeting of Shareholders of Specialty Laboratories, Inc., a California corporation (the "Company"), will be held on Thursday, May 8, 2003, at 8:00 a.m. Pacific Time at Doubletree Hotel-Westwood, 10740 Wilshire Blvd., Los Angeles, California 90024, for the following purposes, as more fully described in the Proxy Statement accompanying this Notice:

1. To elect eight directors to serve on the Company's Board of Directors until the 2004 Annual Meeting of Shareholders or until their successors are duly elected and qualified;
2. To ratify the appointment of Ernst & Young LLP as independent accountants of the Company for the fiscal year ending December 31, 2003;
3. To approve and ratify an amendment to the Company's 2000 Stock Incentive Plan to increase the number of options annually granted to non-employee directors under the Automatic Grant Program; and
4. To transact such other business as may properly come before the meeting or any adjournment or adjournments thereof.

The foregoing matters are described in more detail in the enclosed Proxy Statement. The Board of Directors has fixed the close of business on March 17, 2003 as the record date for the determination of the shareholders entitled to notice of, and to vote at, the Annual Meeting and any postponement or adjournment thereof. Only those shareholders of record of the Company as of the close of business on that date will be entitled to vote at the Annual Meeting or any postponement or adjournment thereof. A list of shareholders entitled to vote at the Annual Meeting will be available for inspection at the executive offices of the Company.

All shareholders are cordially invited to attend the meeting in person. Whether or not you plan to attend, please sign and return the enclosed proxy as promptly as possible in the envelope enclosed for your convenience. Should you receive more than one proxy because your shares are registered in different names and addresses, each proxy should be signed and returned to assure that all of your shares will be voted. You may revoke your proxy at any time prior to the Annual Meeting. If you attend the Annual Meeting and vote by ballot, your proxy will be revoked automatically and only your vote at the Annual Meeting will be counted.

**YOUR VOTE IS VERY IMPORTANT, REGARDLESS OF THE NUMBER OF SHARES YOU OWN. PLEASE READ THE ATTACHED PROXY STATEMENT CAREFULLY AND THEN COMPLETE, SIGN AND DATE THE ENCLOSED PROXY CARD AS PROMPTLY AS POSSIBLE AND RETURN IT IN THE ENCLOSED ENVELOPE.**

By Order of the Board of Directors,

Thomas R. Testman  
*Chairman of the Board of Directors*

Santa Monica, California  
March 25, 2003

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## **SPECIALTY LABORATORIES, INC.**

2211 Michigan Avenue  
Santa Monica, California 90404  
(310) 828-6543

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### **PROXY STATEMENT FOR ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON MAY 8, 2003**

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The enclosed proxy card is solicited on behalf of the Board of Directors of Specialty Laboratories, Inc., a California corporation (the "Company"), for use at the Annual Meeting of Shareholders to be held on May 8, 2003, at 8 a.m. Pacific Time, or at any adjournment or postponement thereof, for the purposes set forth herein and in the accompanying Notice of Annual Meeting. The Annual Meeting will be held at Doubletree Hotel-Westwood, 10740 Wilshire Blvd., Los Angeles, California 90024.

Your vote at the Annual Meeting is important to us. Please vote your shares of common stock by completing the enclosed proxy card and returning it to us in the enclosed envelope. This Proxy Statement has information about the Annual Meeting and was prepared by our management for the Board of Directors. This Proxy Statement and the accompanying proxy card are first being mailed to you on or about April 3, 2003.

#### **GENERAL INFORMATION ABOUT VOTING**

*Who can attend the meeting?*

Attendance at the Annual Meeting is limited to shareholders. Admission to the meeting will be on a first-come, first-served basis. Registration will begin at 8 a.m. and each shareholder may be asked to present valid picture identification such as a driver's license or passport. If your shares are held in "street name," you need to present a letter or current statement from your broker, bank or other nominee to prove you are a shareholder. Cameras, recording devices and other electronic devices will not be permitted at the meeting.

*Who can vote?*

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You can vote your shares of common stock if our records show that you owned the shares at the close of business on March 17, 2003. A total of 22,094,832 shares of common stock can vote at the Annual Meeting. You get one vote for each share of common stock. You may not cumulate votes in the election of directors. The enclosed proxy card shows the number of shares you can vote.

### *How do I vote by proxy?*

Follow the instructions on the enclosed proxy card to vote on each proposal to be considered at the Annual Meeting. Sign and date the proxy card and mail it back to us in the enclosed envelope by following the instructions on your proxy card. If the proxy card is properly signed and returned, the proxy holders named on the proxy card will vote your shares as you instruct. If you sign and return the proxy card but do not vote on a proposal, the proxy holders will vote for you on that proposal. Unless you instruct otherwise, the proxy holders will vote "FOR" each of the director nominees and "FOR" each of the other proposals to be considered at the meeting. Signing and returning the proxy card does not affect your right to vote in person at the Annual Meeting.

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### *What if other matters come up at the Annual Meeting?*

The matters described in this Proxy Statement are the only matters we know will be voted on at the Annual Meeting. If other matters are properly presented at the meeting, the proxy holders will vote your shares as they see fit.

### *Can I change my vote after I return my proxy card?*

Yes. At any time before the vote on a proposal, you can change your vote either by filing with Deborah A. Estes, our Secretary, at our principal offices at 2211 Michigan Avenue, Santa Monica, California 90404, a written notice revoking your proxy card or by signing, dating and returning to us a new proxy card. We will honor the proxy card with the latest date. You may also revoke your proxy card by attending the Annual Meeting and voting in person.

### *Can I vote in person at the Annual Meeting rather than by completing the proxy card?*

Although we encourage you to complete and return the proxy card to ensure that your vote is counted, you can attend the Annual Meeting and vote your shares in person.

### *What do I do if my shares are held in "street name"?*

If your shares are held in the name of your broker, a bank, or other nominee, that party should give you instructions for voting your shares.

### *How are votes counted?*

So long as the required quorum is present, for Proposal No. 1, the election of directors, the eight candidates receiving the highest number of affirmative votes will be elected as directors. Proposal No. 2, the ratification of our independent accountants, requires the affirmative vote of a majority of the required quorum. Proposal No. 3, the amendment to our 2000 Stock Incentive Plan, requires the affirmative vote of a majority of the required quorum.

The required quorum for the transaction of business at the Annual Meeting is a majority of the shares of common stock entitled to vote. Shares that are voted "FOR," "AGAINST" or "ABSTAIN" in a matter are treated as being present at the meeting for purposes of establishing the quorum, but only shares voted "FOR" or "AGAINST" are treated as votes cast at the Annual Meeting with respect to such matter.

Abstentions and shares held by brokers that are present in person or represented by proxy but that are not voted because the brokers were prohibited from exercising discretionary authority ("broker non-votes"), will be counted for the purpose of determining whether a quorum is present for the transaction of business. Abstentions and broker non-votes can have the effect of preventing approval of a proposal where the number of affirmative votes, though a majority of the votes cast, does not constitute a majority of the required quorum. All votes will be tabulated by the inspector of election appointed for the Annual Meeting, who will separately tabulate affirmative and negative votes, abstentions and broker non-votes.

### *Who pays for this proxy solicitation?*

The Company will bear the entire cost of solicitation, including the preparation, assembly, printing and mailing of this Proxy Statement, the proxy card and any additional solicitation materials furnished to the shareholders. Copies of solicitation materials will be furnished to brokerage

houses, fiduciaries and custodians holding shares in their names that are beneficially owned by others so that they may forward this solicitation material to such beneficial owners. In addition, the Company may reimburse such persons for their costs in forwarding the solicitation materials to such beneficial owners. The

original solicitation of proxies by mail may be supplemented by a solicitation by telephone, telegram or other means by directors, officers or employees of the Company. No additional compensation will be paid to these individuals for any such services. Except as described above, the Company does not presently intend to solicit proxies other than by mail.

### **SHAREHOLDER PROPOSALS**

To be included in the Proxy Statement and form of proxy card relating to the Annual Meeting to be held in 2004, a shareholder proposal must be received by Deborah A. Estes, Secretary, Specialty Laboratories, Inc., 2211 Michigan Avenue, Santa Monica, California 90404 no later than December 4, 2003. If the Company is not notified of a shareholder proposal by February 16, 2004, then the proxies solicited by the Board of Directors for the 2004 Annual Meeting will confer discretionary authority to vote against such shareholder proposal.

### **MATTERS TO BE CONSIDERED AT ANNUAL MEETING**

#### **OVERVIEW OF PROPOSALS**

This Proxy Statement contains three proposals requiring shareholder action. Proposal No. 1 requests the election of eight nominees to our Board of Directors. Proposal No. 2 requests ratification of our independent accountants. Proposal No. 3 requests approval and ratification of the amendment to our 2000 Stock Incentive Plan to increase the number of options annually granted to non-employee directors under the Automatic Option Grant Program. Each of the proposals is discussed in more detail in the pages that follow.

#### **PROPOSAL NO. 1**

##### **ELECTION OF DIRECTORS**

###### **General**

Our Board of Directors currently consists of eight persons. All eight positions on our Board of Directors are to be elected at this meeting. Our Board of Directors has nominated the current directors to be re-elected to serve for a one-year term and until their successors are duly elected and qualified.

Holders of proxies solicited by this Proxy Statement will vote the proxies received by them as directed on the proxy card or, if no direction is made, for the election of the Board of Director's eight nominees below. Proxies cannot be voted for more than the eight named nominees.

Each nominee for election has agreed to serve if elected, and we have no reason to believe that any nominee will be unavailable to serve. If any nominee is unable or declines to serve as a director at the time of the Annual Meeting, the proxy holders will vote for a nominee designated by the present Board of Directors to fill the vacancy. Unless otherwise instructed, the proxy holders will vote the proxies received by them "FOR" the nominees named below.

The names of the nominees, and certain information about them, are set forth below.

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Name	Age	Director Since	Position
Thomas R. Testman(1)(2)(3)	66	1996	Chairman of the Board of Directors
Douglas S. Harrington	50	1996	Chief Executive Officer, Co-Laboratory Director and Director
Deborah A. Estes	46	1990	Secretary and Director
Richard E. Belluzzo(1)(2)	49	1996	Director
Nancy-Ann DeParle(3)(4)	46	2001	Director
Terrance H. Gregg(2)(4)	54	2002	Director
William J. Nydam(1)	52	1999	Director
James B. Peter(3)	69	1975	Founder and Emeritus Chairman of the Board of Directors

- (1) Member of the Audit Committee
- (2) Member of the Compensation Committee
- (3) Member of the Nominating Committee
- (4) Member of the Regulatory Committee

**Thomas R. Testman** has served as our Chairman of the Board since April 2002 and as a Director since October 1996. Since 1992, Mr. Testman has served on the Board of Directors of several public and private healthcare companies including ChromaVision Medical Systems, Inc., a public medical diagnostic company. Mr. Testman also serves as a director for Covenant Care, Pacific Health, National Health Sciences, AutoGenomics, Inc., and Amylin Pharmaceuticals. From 1962 to 1992, Mr. Testman served in several capacities with Ernst & Young LLP including his last position as Managing Partner. Mr. Testman received a B.A. in Business from Pacific Union College and an M.B.A. from Trinity University.

**Douglas S. Harrington, M.D.** has served as our Chief Executive Officer and Co-Laboratory Director since April 2002 and has been a Director since October 1996. Dr. Harrington served as Chief Executive Officer of ChromaVision Medical Systems, Inc. from December 1996 to April 2002, and Chairman of the Board since May 2000. Dr. Harrington served as Chairman and President of Strategic Business Solutions, Inc., a biotechnology company, and as a principal in Douglas S. Harrington and Associates, a strategic consulting firm, from February 1995 to December 1996. Dr. Harrington also serves on the Board of Directors of ChromaVision Medical Systems, Inc. and AutoGenomics, Inc. Dr. Harrington received a B.A. in Molecular Biology and an M.D. from the University of Colorado.

**Deborah A. Estes** has served as a Director and as Secretary since 1990. From 1994 to the present, Ms. Estes has been actively involved in managing the financial affairs of the Peter family. Ms. Estes is the daughter of our controlling shareholder, Founder and Emeritus Chairman, Dr. James B. Peter. Ms. Estes received a B.S. in Business Administration from Creighton University.

**Richard E. Belluzzo** has served as a Director since October 1996. Since September 2002, Mr. Belluzzo has served as the Chief Executive Officer of Quantum Corporation. Mr. Belluzzo served as President and Chief Operating Officer of Microsoft Corporation from February 2001 to September 2002. From September 1999 to February 2001, Mr. Belluzzo has served as Group Vice President of Microsoft Corporation. From January 1998 to September 1999, Mr. Belluzzo served as Chief Executive Officer of Silicon Graphics, Inc. From 1975 until January 1998, Mr. Belluzzo served in several senior capacities for Hewlett-Packard Corp. Mr. Belluzzo serves on the Board of Directors of Quantum Corporation. Mr. Belluzzo received a B.S. in Accounting from Golden Gate University.

**Nancy-Ann DeParle** has served as a Director since April 2001. Ms. DeParle is currently a private healthcare regulatory and policy consultant, an advisor to JPMorgan Partners, and an Adjunct Professor at the Wharton School of the University of Pennsylvania. From July 1997 to October 2000, Ms. DeParle administered the U.S. Health Care Financing Administration, recently renamed the Centers for Medicare and

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Medicaid Services, as an appointee of President Clinton. Ms. DeParle also serves as a director of Accredo Health Inc., a specialty pharmaceutical distribution company, Cerner Corporation, a clinical information systems provider, DaVita, Inc., a dialysis services provider, Guidant Corporation, a cardiovascular medical device company, and Triad Hospitals, Inc., which owns and operates hospitals. She also serves as a director of MedQuest Associates, Inc. Ms. DeParle received a J.D. from Harvard Law School, a B.A. and an M.A. in Politics and Economics from Oxford University, and a B.A. in History from the University of Tennessee.

**Terrance H. Gregg** has served as a Director since June 2002. Mr. Gregg is a Consultant for Medtronic MiniMed, a leading medical device company delivering solutions for the treatment of diabetes, where he served as President and Chief Operating Officer from August 2001 to July 2002 and as President, Chief Executive Officer, Chief Operating Officer and Office of Chief Executive of MiniMed, Inc. from March 1996 to August 2001. Mr. Gregg currently serves as a director for Vasogen, Inc., Amylin Pharmaceuticals, Inc., and Ocular Sciences, Inc. Mr. Gregg received a B.S. in Zoology from Colorado State University.

**William J. Nydam** has served as a Director since August 1999. Since March 2002, Mr. Nydam has served as the President and Chief Operating Officer of Endocare, Inc. a medical device company. From September 2001 to December 2002, Mr. Nydam served as the Chief Executive Officer and director of Pulse Metric, Inc., a healthcare device company. From September 1999 to September 2001, Mr. Nydam served as Senior Vice President of Science Applications International Corp., an information technology firm. From January 1986 to September 1999, Mr. Nydam served in various capacities at Premier, Inc., a healthcare company, including his last position as Executive Vice President. Mr. Nydam received a B.S. in Accounting and an M.B.A. from the University of California at Berkeley.

**James B. Peter, M.D., Ph.D.** is our founder and controlling shareholder and he served as the Chairman of the Board of Directors from our inception in 1975 to April 2002 and as our Chief Executive Officer from July 1995 to April 2002. Dr. Peter is the father of Deborah A. Estes, our Secretary and one of our directors. Dr. Peter received a B.S. in Biology from Creighton University, an M.D. from St. Louis University and a Ph.D. from the University of Minnesota. He is the author of over 400 publications in science and medicine.

### Board of Directors

Our Board of Directors is currently composed of eight members. Each director currently serves until the next annual meeting of shareholders or until his successor is duly elected and qualified. At each annual meeting of shareholders, the directors' successors will be elected to serve until the next annual meeting of shareholders. In addition, our Bylaws provide that the authorized number of directors will be between five and nine, with the exact number to be determined by a majority of our Board of Director or shareholders. Our Board of Directors held fourteen meetings and acted by unanimous written consent one time during 2002. Each director attended or participated in 75% or more of the aggregate of (i) the total number of meetings of our Board of Directors and (ii) the total number of meetings held by all committees of our Board of Directors on which such director served during 2002.

### Board Committees and Meetings

Our Board of Directors has four standing committees: the Audit Committee, Compensation Committee, Nominating Committee and Regulatory Committee.

*Audit Committee* We established our Audit Committee in January 1997. In connection with our initial public offering, our Board of Directors revised our charter for the Audit Committee in October 2000, and changed the composition of our Audit Committee. The charter for the Audit Committee was filed as Annex A to the Definitive Proxy Statement filed with the Securities and Exchange Commission on April 10, 2001. Our Audit Committee is currently composed of Messrs. Nydam, Testman, and Belluzzo. Ms. DeParle was a member from November 2001 until February 2003. The Audit Committee reviews our financial statements and accounting practices, makes recommendations to our Board of Directors regarding the selection of independent accountants, reviews the results and scope of our annual audit and other services provided by our independent accountants, and monitors the Company's legal and regulatory compliance. Our Audit Committee met in February 2003, in connection with the audit of our 2002 financial statements, and held eleven meetings in 2002. The Board of Directors has determined that all members of the Audit Committee are "independent" as that term is defined in Paragraph 303.01(B)(2)(a) and (3) of the New York Stock Exchange Manual.

*Compensation Committee* Our Compensation Committee was formed in January 1997. Currently our Compensation Committee is composed of Messrs. Gregg, Belluzzo, and Testman. The Compensation Committee is responsible for the design, review, recommendation, and approval of compensation arrangements for our directors, executive officers and key employees, and for the administration of our 2000 Stock Incentive Plan, including the approval of grants under such plan to our employees, consultants and directors. The Compensation Committee operates under a written compensation charter adopted by our Board of Directors. Our Compensation Committee met eight times in 2002 and acted by unanimous

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written consent two times during 2002.

*Nominating Committee* Our Nominating Committee was formed in May 2001. Currently our Nominating Committee is composed of Messrs. Peter, Testman, and Ms. DeParle. The Nominating Committee is responsible for the review, recommendation and approval of qualified candidates to serve as directors on the Company's Board of Directors. Our Nominating Committee operates under a written nominating committee charter adopted by our Board of Directors. Our Nominating Committee did not meet in 2002 and did not act by unanimous written consent during 2002.

*Regulatory Committee* Our Regulatory Committee was established in February 2003. The Regulatory Committee was established to provide review and oversight of regulatory affairs of the Company. The Regulatory Committee is composed of Ms. DeParle and Mr. Gregg.

### **Compensation Committee Interlocks and Insider Participation**

Our Board of Directors established our Compensation Committee in January 1997. From May 2001 to April 2002, our Compensation Committee was composed of Dr. Harrington and Messrs. Kane, Belluzzo and Testman. Dr. Harrington resigned from the Compensation Committee in April 2002 when he became our chief executive officer. In October 2002, Mr. Kane resigned as a member of our Board of Directors, including his position on the Compensation Committee. In June 2002, Mr. Gregg was appointed a member of our Board, and Mr. Gregg became a member and Chairperson of our Compensation Committee in November 2002. Our Compensation Committee currently consists of Messrs. Gregg, Belluzzo and Testman.

None of the members of our Compensation Committee was at any time since the formation of the Company an officer or employee of the Specialty. None of our executive officers serve as a member of the board of directors or compensation committee of any entity that has one or more of its executive officers serving on our Board of Directors or our Compensation Committee.

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### **Director Compensation**

We generally do not provide cash or equity compensation to employee directors for serving on our Board of Directors or for attendance of committee meetings of the Board of Directors. Each director is reimbursed for out-of-pocket expenses to attend each Board of Directors meeting and each committee meeting. Non-employee directors receive a retainer of \$2,500 per quarter, \$1,500 for each Board of Directors meeting attended, \$500 for each Board of Directors teleconference meeting attended, and \$500 for each teleconference meeting of a committee of the Board of Directors attended. In addition, the secretary of our Board of Directors meetings, Deborah Estes, receives an additional \$14,000 per year for her services. Non-employee directors will, upon their initial election or appointment to the Board of Directors, receive an automatic option grant to purchase 22,000 shares of common stock that will vest over a four-year period from the grant date. Elected by the Board of Directors in 2002, Mr. Gregg received such option grants for 22,000 shares of common stock in June 2002. Members of the Board of Directors also receive annual option grants of 11,000 shares of common stock vesting in a one-year period, which are granted on the first trading day of April of every year and have an exercise price equal to the fair market value of our common stock on the date of grant.

### **Vote Required**

The eight nominees for director receiving the highest number of affirmative votes of the shares entitled to be voted for them shall be elected as directors. Votes withheld from any director are counted for purposes of determining the presence or absence of the quorum, but have no other legal effect under California law.

### **Recommendation of the Board of Directors**

**Our Board of Directors unanimously recommends that the shareholders vote "FOR" the re-election of the nominees named above.**

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PROPOSAL NO. 2



**RATIFICATION OF APPOINTMENT OF INDEPENDENT ACCOUNTANTS**

During the fiscal year ended December 31, 2002, Ernst & Young LLP provided various audit, audit related and non-audit services to us as follows:

- a. Audit Fees: Aggregate fees billed for professional services rendered for the audit and review of our fiscal year 2002 annual and quarterly financial statements totaled approximately \$195,345.
- b. Financial Information Systems Design and Implementation Fees: None.
- c. All Other Fees:
  - Tax compliance and consulting services: approximately \$83,549.
  - Real estate advisory: approximately \$37,207.

Our Audit Committee has considered whether provision of the services described in sections (b) and (c) above are compatible with maintaining the independent accountants' independence and has determined that such services have not adversely affected Ernst & Young LLP's independence. Ernst & Young LLP has been selected by our Board of Directors as our independent accountants for the fiscal year ending December 31, 2003. If ratification of this selection of accountants is not approved by a majority of the shares of common stock voting thereon, management will review its future selection of accountants. Even if the selection is ratified, our Board of Directors in its discretion may direct the appointment of a different independent auditing firm at any time during the year if our Board of Directors believes that such a change would be in the best interests of us and our shareholders.

Representatives of Ernst & Young LLP are expected to be present at the Annual Meeting and will have the opportunity to make a statement if they desire to do so. They are also expected to be available to respond to appropriate questions. Unless marked to the contrary, proxies received will be voted "FOR" ratification of the appointment of Ernst & Young LLP as the independent accountants for the current year.

**Vote Required**

The ratification of the appointment of Ernst & Young LLP as our independent accountants for the fiscal year ending December 31, 2003 requires the affirmative vote of the holders of a majority of the shares of our common stock present at the Annual Meeting in person or by proxy and entitled to vote.

**Recommendation of the Board of Directors**

**Our Board of Directors unanimously recommends that the shareholders vote "FOR" ratification of the appointment of Ernst & Young LLP as our independent accountants for the fiscal year ending December 31, 2003.**

**PROPOSAL NO. 3**

**APPROVAL AND RATIFICATION OF AN AMENDMENT  
TO THE COMPANY'S 2000 STOCK INCENTIVE PLAN**

**Background**

In September 2000, the Company adopted the 2000 Stock Incentive Plan (the "Plan") that authorized automatic, non-discretionary awards of options to non-employee Board members (the "Automatic Option Grant Program"). Under the Automatic Option Grant Program, on the first trading day of April each non-employee Board member continuing to serve on the Board of Directors automatically receives a non-statutory option to purchase 5,500 shares of the Company's common stock. After considering the Company's interest in motivation and retention of

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qualified non-employee directors, examining its compensation policies and arrangements, and reviewing general factors, including, but not limited to, the capital markets and the Company's stock price, the Board of Directors decided to increase the number of option shares granted under the Automatic Option Grant Program. In February 2001, the Board of Directors adopted an amendment to the Plan providing for an increase in the number of option shares granted to non-employee Board members under the Automatic Option Grant Program (the "Amendment"). The Amendment provides that on the first trading day of April, each non-employee Board member continuing to serve on the Board shall be granted a non-statutory option to purchase 11,000 shares of the Company's common stock.

The Company's Board of Directors is seeking shareholder approval and ratification of the Amendment.

### Summary Description of the Plan

The Automatic Option Grant Program as amended authorizes the grant of stock options for 22,000 shares of common stock to each non-employee Board member upon their initial election or appointment and the grant of stock options for 11,000 shares of common stock to each non-employee Board member on the first trading day of April of every year; provided that such non-employee Board member has served at least 6 months. Such options are non-statutory options and, therefore, do not qualify as incentive stock options within the meaning of Section 422 of the Internal Revenue Code, as amended (the "Code").

Each automatic grant will have an exercise price per share equal to the fair market value per share of our common stock on the grant date and will have a term of 10 years, subject to earlier termination following the optionee's cessation of service on the Board of Directors. The option will be immediately exercisable for all of the option shares; however, the Company will have a repurchase right, at the exercise price paid per share, to purchase any shares purchased under the option which are not vested at the time of the optionee's cessation of service on the Board of Directors. The shares subject to each initial 22,000-share automatic option grant will vest in a series of four equal successive annual installments upon the optionee's completion of each year of service on the Board of Directors over the four-year period measured from the grant date. The shares subject to each annual 11,000-share automatic option grant will vest upon the optionee's completion of one year of service on the Board of Directors measured from the grant date. However, the shares will immediately vest in full upon certain changes of control or ownership or upon the optionee's death or disability while a director.

### Federal Income Tax Consequences

The following is a brief summary of certain federal income tax consequences of stock options to be granted under the Company's 2000 Stock Incentive Plan Automatic Option Grant Program, as proposed to be amended. This summary is not intended to be comprehensive or all-inclusive, and does not describe any state, local, estate or other tax consequences. AS A CONSEQUENCE, IF YOU ARE

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AN OPTION HOLDER, YOU STRONGLY ARE URGED TO CONSULT YOUR OWN TAX ADVISOR AND SEEK YOUR TAX ADVISOR'S OPINION AS TO THE SPECIFIC TAX CONSEQUENCES TO YOU, INCLUDING THE APPLICATION OF FEDERAL, STATE, LOCAL, FOREIGN AND OTHER TAX LAWS.

Stock options granted under the Automatic Option Grant Program shall be non-statutory options. Neither the option holder nor the Company will incur any federal income tax consequences upon the grant of such non-statutory options. The option holder will not recognize taxable income and the Company will not receive a tax deduction.

Upon exercise of the option, the option holder will recognize ordinary income and the Company will receive a tax deduction, in an amount equal to the difference between the exercise price and the fair market value of the shares that have vested (i.e., are not subject to the above described repurchase right) on the date of exercise. When the option holder sells shares of common stock received from exercising an option, any future gain or loss will be treated as short-term or long-term capital gain or loss, depending upon the length of time that the shares are held prior to sale.

Upon exercise of the option, the option holder will not recognize taxable income and the Company will not receive a tax deduction with respect to the shares that are unvested (i.e., subject to the above described repurchase right) unless the director makes an Code Section 83(b) election as of the date of exercise. If no Code Section 83(b) election is made, the option holder will recognize ordinary income and the Company will receive a tax deduction, in an amount equal to the difference between the exercise price and the fair market value of the unvested shares as of the date those shares become vested. When the option holder subsequently sells the vested shares of common stock, any future gain or loss will be treated as short-term or long-term capital gain or loss, depending upon the length of time from when the shares have become vested to when they are sold.

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If the director makes a timely Code Section 83(b) election upon exercise of the option, the option holder will recognize ordinary income and the Company will receive a tax deduction, in an amount equal to the difference between the exercise price and the fair market value of the shares that have not vested as of the date of exercise (using a value that assumes such shares were vested). When the option holder sells these shares of common stock, any future gain or loss will be treated as short-term or long-term capital gain or loss, depending upon the length of time that the shares are held prior to sale.

### Vote Required

The Amendment to the Plan requires the affirmative vote of the holders of a majority of the shares of common stock present at the Annual Meeting in person or by proxy and entitled to vote.

### Recommendation of the Board of Directors

**The Board of Directors unanimously recommends a vote "FOR" the approval and ratification of the amendment of the Company's stock option plan.**

## OTHER MATTERS

Our Board of Directors knows of no other business that will be presented at the Annual Meeting. If any other business is properly brought before the Annual Meeting, proxies received will be voted in respect thereof in accordance with the recommendation of the Board of Directors. Discretionary authority with respect to such other matters is granted by the execution of the enclosed proxy card.

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## MANAGEMENT

### Executive Officers, Directors and Other Key Employees

The following table sets forth certain information regarding our executive officers, directors and other key employees as of February 28, 2003.

Name	Age	Position
Thomas R. Testman(1)(2)(3)	66	Chairman of the Board of Directors
Douglas S. Harrington, M.D.	50	Chief Executive Officer, Co-Laboratory Director and Director
Frank J. Spina	48	Senior Vice President and Chief Financial Officer
Dan R. Angress	45	Senior Vice President, Marketing and Client Support
Michael C. Dugan	40	Vice President and Co-Laboratory Director
Cheryl G. Gallarda	48	Vice President, Business Operations
Robert M. Harman	39	Vice President and Chief Information Officer
Thomas J. Kosco	45	Vice President, Business Development
Nicholas R. Simmons	37	General Counsel
Mark R. Willig	44	Vice President, Sales
Deborah A. Estes	46	Secretary and Director
Richard E. Belluzzo (1)(2)	49	Director
Nancy-Ann DeParle (3)(4)	46	Director
Terrance H. Gregg (2)(4)	54	Director
William J. Nydam (1)	52	Director
James B. Peter, M.D., Ph.D. (3)	69	Founder and Emeritus Chairman of the Board

(1)

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Member of the Audit Committee

- (2) Member of the Compensation Committee
- (3) Member of the Nominating Committee
- (4) Member of the Regulatory Committee

**Thomas R. Testman.** See "Proposal No. 1: Election of Directors" for Mr. Testman's biography.

**Douglas S. Harrington, M.D.** See "Proposal No. 1: Election of Directors" for Dr. Harrington's biography.

**Frank J. Spina** has served as Senior Vice President and Chief Financial Officer since February 2003. From October 2000 to February 2003, Mr. Spina served as Chief Financial Officer. From October 1999 to October 2000, Mr. Spina served as Chief Financial Officer of MedicaLogic/Medscape, Inc., a healthcare and information technology company. From October 1997 to October 1999, Mr. Spina served as Chief Financial Officer of 3D Systems Corporation, an information technology company. Prior to October 1997, Mr. Spina served as Vice President and Controller at Qualcomm Incorporated. Mr. Spina received a B.A. in Political Science and a B.A. in Accounting from Baldwin-Wallace College.

**Dan R. Angress** has served as Senior Vice President, Marketing and Client Support since February 2003. From April 1997 to February 2003, Mr. Angress served as Vice President, Marketing. From June 1995 to April 1997, Mr. Angress served as Director, Marketing. Prior to joining Specialty, Mr. Angress served in several marketing capacities, including Vice President of Marketing at Oncogenetics, now owned by Impath, and Marketing Manager at Nichols Institute Reference

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Laboratories, which is now part of Quest Diagnostics. Mr. Angress received a B.S. in Biology from the University of California, Irvine and an M.B.A. from Willamette University.

**Michael C. Dugan, M.D.** has served as Vice President and Co-Laboratory Director since November 2002. Dr. Dugan recently served as Chief of Pathology and Medical Director of Clinical Laboratories at Santa Monica UCLA Medical Center. From 1997 to 2000, Dr. Dugan was with the Affiliated Pathologists Medical Group, one of the largest pathology groups in California and from 1995 to 1997, Dr. Dugan was Medical Director of Clinical Laboratories at Children's Hospital of Michigan. Dr. Dugan received his B.S. in Biology from the University of Notre Dame and his M.D. from the University of Arizona in Tucson. Dr. Dugan received his pathology training at Yale-New Haven Hospital, Children's Hospital Los Angeles and UCLA.

**Cheryl G. Gallarda** has served as Vice President, Business Operations since February 2003. From August 2001 to February 2003, Ms. Gallarda served as Asst. Vice President and Corporate Compliance Officer. From December 1996 to August 2001, Ms. Gallarda served in several management capacities at Specialty, including the Clinical Trials department. Prior to joining Specialty, Ms. Gallarda held several positions, including Director of Accounts Receivables and Revenue Services Auditor at Quest Diagnostics. Ms. Gallarda also served in several capacities with Unilab (now part of Quest) and Roche Biomedical Laboratories (now part of LabCorp). Ms. Gallarda received associate degrees in both Accounting and Computer Sciences.

**Robert M. Harman** has served as Vice President and Chief Information Officer since February 2002. From April 2001 to February 2002, Mr. Harman served as our Chief Technology Officer. Prior to joining Specialty, Mr. Harman served in various management capacities including director, Worldwide IT of 3D Systems, Inc., a 3D imaging company, and director, IT Consulting Services of LogicWorks, LLC, an information technology consulting services firm. Mr. Harman received a B.S. in Business from the University of LaVerne.

**Thomas J. Kosco** has served as Vice President, Business Development since November 2001. From February 2001 to November 2001, Mr. Kosco served as our General Counsel. Prior to joining Specialty, Mr. Kosco served in several management capacities, including President and Chief Executive Officer of Chicago Capital and Managing Director of the Moscow Office of Creditanstalt Investment Bank. Mr. Kosco received a B.A. in Material Science from Rice University, an M.A. in Material Science from Carnegie Mellon University and a J.D./M.B.A. from the University of Chicago.

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**Nicholas R. Simmons** has served as General Counsel since February 2003. From November 2001 through February 2003, Mr. Simmons served as our Associate General Counsel. Mr. Simmons also serves as our HIPAA Privacy Officer. From May 2000 to November 2001, Mr. Simmons served as Senior Counsel at Stamps.com Inc. in Santa Monica, California, and from 1998 to 2000 as an associate at the law firm of Irell & Manella LLP in Los Angeles. Mr. Simmons received a B.A. from the University of California, Los Angeles, an M.S. from Yale University, and a J.D. from Columbia University.

**Mark R. Willig** has served as Vice President, Sales since July 2002. Prior to joining Specialty, Mr. Willig served as Vice President of Sales at Myriad Genetics from 1997 to July 2002. He also served as Vice President of Sales and Marketing for Orca Medical Systems from 1995 to 1997. During his tenure from 1984 to 1995 at Abbott Diagnostics, a division of Abbott Laboratories, Mr. Willig held a variety of field sales and sales management responsibilities, including leadership of Abbott's integrated health systems sales force. Mr. Willig received his B.A. in Speech Communications from the University of Missouri.

**Deborah A. Estes.** See "Proposal No. 1: Election of Directors" for Ms. Estes' biography.

**Richard E. Belluzzo.** See "Proposal No. 1: Election of Directors" for Mr. Belluzzo's biography.

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**Nancy-Ann DeParle.** See "Proposal No. 1: Election of Directors" for Ms. DeParle's biography.

**Terrance H. Gregg.** See "Proposal No. 1: Election of Directors" for Mr. Gregg's biography.

**William J. Nydam.** See "Proposal No. 1: Election of Directors" for Mr. Nydam's biography.

**James B. Peter, M.D., Ph.D.** See "Proposal No. 1: Election of Directors" for Dr. Peter's biography.

### Relationships Among Executive Officers and Directors

Our executive officers are elected by the Board of Directors on an annual basis and serve until their successors have been duly elected and qualified. Except as otherwise disclosed in their respective biographies, there are no family relationships among any of the directors or executive officers of Specialty Laboratories.

### SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our executive officers and directors, and persons who own more than 10% of a registered class of our equity securities, to file an initial report of securities ownership on Form 3 and reports of changes in securities ownership on Form 4 or 5 with the Securities and Exchange Commission. Such executive officers, directors and 10% shareholders are also required by SEC rules to furnish us with copies of all Section 16(a) forms that they file. Based solely on our review of the copies of such forms received by us, or written representations from certain reporting persons that no Forms 4 or 5 were required for such persons, we believe that, for the reporting period from January 1, 2002 to December 31, 2002, our executive officers and directors complied with all their reporting requirements under Section 16(a) for such fiscal year, except that Dr. and Mrs. Peter filed three late Forms 4 with the SEC in connection with certain shares they gifted.

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### EXECUTIVE COMPENSATION AND RELATED INFORMATION

The following table sets forth the total compensation paid or accrued to our Chief Executive Officer and our four other most highly compensated executive officers for the fiscal years ended December 31, 2002, 2001 and 2000, respectively. Dr. James B. Peter and Paul F. Beyer are included because both persons would have been among our four highest compensated executives on December 31, 2002 had they not resigned earlier during that year. The individuals included in the following table are collectively referred to as the "named executive officer".

## Summary Compensation Table

Name and Principal Position	Year	Annual Compensation		Other Annual Compensation(\$)	Long Term Compensation Awards	All Other Compensation(\$)
		Salary(\$)	Bonus(\$)		Securities Underlying Options(#)	
Douglas S. Harrington Chief Executive Officer	2002	279,231		27,742(1)	611,000	
	2001				11,500	
	2000					
James B. Peter	2002	614,732(2)	252,000(3)			18,506(4)
Former Chief Executive	2001	600,000	480,000			76,864(5)
Officer and Chairman of the Board of Directors	2000	600,000	300,000			
Paul F. Beyer	2002	366,905(6)	120,120(3)	255,801(7)	45,000	3,318(8)
Former President, Chief	2001	286,000	228,800		39,000	17,409(9)
Operating Officer and Director	2000	286,000	231,200			16,400(10)
Frank J. Spina	2002	245,384	69,300(3)		105,000	5,500(11)
Senior Vice President and	2001	220,000	68,560		57,000	4,158(12)
Chief Financial Officer	2000	220,000(13)	25,000		110,000	
Dan R. Angress	2002	219,461	53,396(3)		55,000	5,109(14)
Senior Vice President,	2001	191,775	63,827	990,238(15)	24,200	4,013(16)
Marketing and Client Support	2000	177,101	55,911			3,153(17)
Thomas E. England	2002	217,316	42,888(3)	365,004(19)	55,000	3,587(20)
Vice President, Laboratory	2001	175,051	70,021	814,890(21)	24,200	4,081(22)
Operations(18)	2000	174,856	55,200			5,065(23)
Mark R. Willig	2002	262,000(24)	25,000	94,096(25)	75,000	
Vice President, Sales	2001					
	2000					

- (1) Consists of \$27,742 in living expenses paid by us.
- (2) Dr. Peter resigned his position as Chief Executive Officer effective April 22, 2002. His 2002 compensation represents his total annual compensation. Dr. Peter's prorated salary was \$224,732 and he received \$390,000 in severance paid by us.
- (3) Consists of incentive bonus for fiscal year 2001 paid in 2002 by us.
- (4) Consists of \$18,506 in life insurance premiums paid by us.
- (5) Consists of \$76,864 in life insurance premiums paid by us.

- (6) Mr. Beyer resigned his position as President and Chief Operating Officer effective June 7, 2002. Mr. Beyer's 2002 compensation represents his total annual compensation. Mr. Beyer's prorated salary was \$174,790 and he received \$192,115 of severance paid by us.
- (7) Consists of \$255,801 in ordinary income realized from exercise of stock options.
- (8) Consists of \$3,318 in 401(k) matching contribution paid by us.
- (9) Consists of \$5,244 in 401(k) matching contribution paid by us and \$12,165 in life insurance premiums paid by us.
- (10) Consists of \$5,000 in 401(k) matching contribution paid by us and \$11,400 in life insurance premiums paid by us.
- (11) Consists of \$5,500 in 401(k) matching contribution paid by us.
- (12) Consists of \$4,158 in 401(k) matching contribution paid by us.
- (13) Mr. Spina commenced his employment with the Company in October 2000. This figure represents his total annual salary. Mr. Spina's prorated annual salary for 2000 was \$59,231.
- (14) Consists of \$5,109 in 401(k) matching contribution paid by us.
- (15) Consists of \$990,238 in ordinary income realized from exercise of stock options.
- (16) Consists of \$4,013 in 401(k) matching contribution paid by us.
- (17) Consists of \$3,153 in 401(k) matching contribution paid by us.
- (18) Effective April 1, 2003, Mr. England's title was changed to Director, Research & Development and General Manager, Clinical Trials.
- (19) Consists of \$365,004 in ordinary income realized from exercise of stock options.
- (20) Consists of \$3,587 in 401(k) matching contribution paid by us.
- (21) Consists of \$814,890 in ordinary income realized from exercise of stock options.
- (22) Consists of \$4,081 in 401(k) matching contribution paid by us.
- (23) Consists of \$5,065 in 401(k) matching contribution paid by us.
- (24) Mark Willig commenced his employment with the Company in July 2002. This figure represents his total annual salary. Mr. Willig's prorated annual salary for 2002 was \$111,854.

(25)

Consists of \$75,000 relocation bonus and \$19,096 living expenses paid by us.

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### Stock Option Grants in Last Fiscal Year

The following table sets forth information regarding options granted to each executive officer listed in the Summary Compensation Table during the year ended December 31, 2002. We did not grant any stock appreciation rights during the year ended December 31, 2002.

Name	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
	Number of Shares of Common Stock Underlying Options Granted(#)	% of Total Options Granted to Employees in 2002	Exercise Price Per Share (\$/share)	Expiration Date	5% (\$)	10% (\$)
Douglas S. Harrington	11,000	.7% \$	23.37	3/31/12	161,670	409,703
	100,000	6.1% \$	8.13	4/23/12	511,291	1,295,713
	500,000	30.4% \$	7.74	5/16/12	2,433,822	6,167,783
James B. Peter						
Paul F. Beyer						
Frank J. Spina	30,000	1.8% \$	23.00	2/7/12	433,937	1,099,681
	75,000	4.6% \$	8.06	5/8/12	380,167	963,417
Dan R. Angress	30,000	1.8% \$	23.00	2/7/12	433,937	1,099,681
	25,000	1.5% \$	8.06	5/8/12	126,722	321,139
Thomas E. England	30,000	1.8% \$	23.00	2/7/12	433,937	1,099,681
	25,000	1.5% \$	8.06	5/8/12	126,722	321,139
Mark R. Willig	75,000	4.6% \$	7.64	7/14/12	360,357	913,214

Each option grant vests 25% on the first anniversary of the grant date with the remainder vesting in equal installments over next 36 months except for the grants to Dr. Harrington of 11,000 options, which vest 100% on the first anniversary of the grant date, and 100,000 options, which vest 25% upon grant and in twelve equal monthly installments thereafter. Each option has a maximum term of ten years, subject to earlier termination upon the optionee's cessation of service with us.

Potential realizable values are net of exercise price of the option, but before the payment of taxes associated with the exercise. Amounts represent hypothetical gains that could be achieved for the respective options if exercised at the end of the option term. The 5% and 10% assumed annual rates of compounded stock price appreciation are mandated by rules of the Securities and Exchange Commission and do not represent our estimate or projection of our future common stock prices. These amounts represent assumed rates of appreciation in the value of the common stock from the fair market value on the date of grant. Actual gains, if any, on stock option exercises are dependent on the future performance of the common stock and overall stock market conditions. The amounts reflected in the table may not necessarily be achieved.

### Aggregated Option Exercises and Year-End Values

The following table sets forth information with respect to each of our executive officers named in the Summary Compensation Table concerning their exercise of stock options during the fiscal year ended December 31, 2002 and the number of shares subject to unexercised stock options held by them as of the close of such fiscal year. No stock appreciation rights were exercised during the fiscal year ended December 31, 2002, and no stock appreciation rights were outstanding at the close of such year.



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In the following table, "Value Realized" is equal to the difference between the fair value of the shares at the time of exercise of the stock options, less the exercise price paid for the shares, and the

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"Value of Unexercised In-The-Money Options" is equal to the difference between the closing selling price per share at the close of the 2002 fiscal year less the exercise price payable per share.

Name	Shares Acquired on Exercise (#)	Value(1) Realized (\$)	Number of Shares of Common Stock Underlying Unexercised Options at December 31, 2002		Value of Unexercised In-the-Money Options at December 31, 2002(2)	
			Exercisable	Unexercisable	Exercisable(\$)	Unexercisable(\$)
Douglas S. Harrington			86,500	536,000	114,750	998,250
James B. Peter						
Paul F. Beyer	29,000	255,801	492,641		4,162,816	
Frank J. Spina			88,001	183,999		120,000
Dan R. Angress			163,053	68,108	1,284,070	40,000
Thomas E. England	15,000	365,004	152,153	68,108	1,191,965	40,000
Mark R. Willig				75,000		151,500

\*1. Based upon the market price of the purchased shares on the exercise date less the option exercise price paid for those shares.

\*2. Based upon the market price of \$9.66 per share as determined on the basis of the closing selling price per share of common stock on the New York Stock Exchange on the last day of 2002 fiscal year, less the option exercise price payable per share.

### EMPLOYMENT AGREEMENTS AND CHANGE IN CONTROL ARRANGEMENTS

In May 2002 we entered into an employment agreement with Douglas S. Harrington, M.D., which may be terminated at any time. Dr. Harrington's agreement provides for an annual base salary of \$420,000 and a potential maximum bonus of 60% of his annual salary.

Additionally, Dr. Harrington's agreement provides that if he is terminated other than for cause or resigns for good reason he will receive severance benefits (i) in the amount of twelve months continued base pay during the first two years of the agreement, and (ii) in the amount of twenty-four months continued base pay after the first two years of the agreement. In addition, if he is terminated other than for cause or resigns for good reason, Dr. Harrington is eligible for an incentive bonus equal to up to 30% of his annual base salary, but such bonus would only be applicable for the first year following such termination. Dr. Harrington also receives customary health and related benefits. Dr. Harrington's agreement also provides for the grant of options to purchase 500,000 shares at \$7.74 per share. Dr. Harrington also receives reimbursement from the company for rental of an apartment for the first twelve (12) months of the agreement in an amount not to exceed \$4,000 per month.

We entered into an employment agreement in September 2000 with Dan R. Angress, which may be terminated at any time. Mr. Angress' agreement provides for an annual base salary of \$225,000 and a potential maximum bonus of 60% of his annual salary.

Mr. Angress' agreement also provides for severance benefits in the amount of twelve months continued base pay if he is terminated other than for cause during the first three years of the agreement. Mr. Angress also receives customary health and related benefits.

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We also entered into an employment agreement in October 2000 with Frank J. Spina, which may be terminated at any time. Mr. Spina's agreement provides for an annual base salary of \$250,000 and a potential maximum bonus of 60% of his annual salary.

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Additionally, Mr. Spina's agreement provides for severance benefits in the amount of twelve months continued base pay and vesting of options if he is terminated other than for cause during the first three years of the agreement. Mr. Spina also receives customary health and related benefits. Mr. Spina's employment agreement provides for the grant of options to purchase 110,000 shares at \$14.00 per share.

### *Other Executive Officer Agreements*

Our other executive officers are generally provided with an offer of employment at the time they are hired, which letter provides for six to nine months of severance pay in the event they are terminated without cause. Other than compensation, job title, annual bonus eligibility, and the amount of options granted to each of Thomas J. Kosco, Robert M. Harman, Nicholas R. Simmons, and Mark R. Willig have entered into offer letters in substantially the form of which is attached to our Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002.

### EQUITY COMPENSATION PLAN INFORMATION

The following table provides information as of December 31, 2002 with respect to the shares of our common stock that may be issued under our existing equity compensation plans.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
	(a)	(b)	(c)
Equity Compensation Plans Approved by Shareholders(1)	2,828,691(2)	\$ 9.71	1,319,448(3)
Equity Compensation Plans Not Approved by Shareholders			
<b>Total</b>	<b>2,828,691</b>		<b>1,319,448</b>

(1) Consists of the 2000 Stock Incentive Plan and Employee Stock Purchase Plan.

(2) Excludes purchase rights accruing under our Employee Stock Purchase Plan. Under the Employee Stock Purchase Plan, each eligible employee may purchase up to 440 shares of common stock at semi-annual intervals on the last business day of October and April each year at a purchase price per share equal to 85% of the lower of (i) the closing selling price per share of common stock on the employee's start date of the offering period in which the employee is enrolled or (ii) the closing selling price per share on the semi-annual purchase date.

(3)

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Consists of shares available for future issuance under the 2000 Stock Incentive Plan. As of December 31, 2002, an aggregate of 5,292,621 shares of our common stock were available for issuance under the 2000 Stock Incentive Plan. The number of shares of common stock available for issuance under the 2000 Stock Incentive Plan automatically increases on the first trading day of January each calendar year by an amount equal to 3%, of the total number of shares of common stock outstanding on the last trading day in December of the prior calendar year, but in no event will any such annual increase exceed 1,100,000 shares of common stock.

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### **BENEFICIAL OWNERSHIP OF SECURITIES**

The following table sets forth information with respect to beneficial ownership of our common stock as of February 28, 2003 for:

each person known by us to beneficially own more than 5% of our common stock;

each executive officer named in the Summary Compensation Table;

each of our directors; and

all of our executive officers and directors as a group.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and includes voting or investment power with respect to the securities. Unless otherwise indicated, the address for those listed below is c/o Specialty Laboratories, Inc., 2211 Michigan Avenue, Santa Monica, California 90404. Except as indicated by footnote, and subject to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all shares of common stock shown as beneficially owned by them. The number of shares of common stock outstanding used in calculating the percentage for each listed person includes the shares of common stock underlying options held by such persons that are exercisable within 60 days of February 28, 2003, but excludes shares of common stock underlying options held by any other person. Percentnancial condition of the Reference Issuer and other factors. The financial condition of the Reference Issuer may become impaired or the general condition of the equity market may deteriorate, either of which may cause a decrease in the price of the Reference Share and thus in the value of the Notes. Common stocks are susceptible to general equity market fluctuations and to volatile increases and decreases in value, as market confidence in and perceptions regarding the Reference Issuer. Investor perceptions regarding the Reference Issuer are based on various and unpredictable factors, including expectations regarding government, economic, monetary and fiscal policies, inflation and interest rates, economic expansion or contraction, and global or regional political, economic, and banking crises. The price of the Reference Share is expected to fluctuate until maturity.

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**The historical performance of the Reference Share is not an indication of the future performance of the Reference Share.**

The historical performance of the Reference Share, which is included in this pricing supplement, should not be taken as an indication of the future performance of the Reference Share. It is impossible to predict whether the price of the Reference Share will fall or rise. The price of the Reference Share will be influenced by the complex and interrelated economic, financial, regulatory, geographic, judicial, political and other factors that can affect the capital markets generally and the equity trading markets on which the underlying common stocks are traded, and by various circumstances that can influence the price of the Reference Share.

**The price at which you will be able to sell your Notes prior to maturity will depend on a number of factors, and may be substantially less than the amount you had originally invested.**

If you wish to liquidate your investment in the Notes prior to maturity, your only alternative would be to sell them. At that time, there may be an illiquid market for Notes or no market at all. Even if you were able to sell your Notes, there are many factors outside of our control that may affect their trading value. We believe that the value of your Notes will be affected by the price and volatility of the Reference Share, whether the price of the Reference Share is greater than or equal to the Initial Share Price, changes in U.S. interest rates, the supply of and demand for the Notes and a number of other factors. Some of these factors are interrelated in complex ways; as a result, the effect of any one factor may be offset or magnified by the effect of another factor. The price, if any, at which you will be able to sell your Notes prior to maturity may be substantially less than the amount you originally invested if, at such time, the price of the Reference Share is less than, equal to or not sufficiently above the Initial Share Price. If you sell the Notes prior to maturity, you may receive less, and possibly significantly less, than your initial investment in the Notes. The following paragraphs describe the manner in which we expect the trading value of the Notes will be affected in the event of a change in a specific factor, assuming all other conditions remain constant.

·*Reference Share performance.* We expect that the value of the Notes prior to maturity will depend substantially on whether the Final Share Price is greater than the Initial Share Price. If you decide to sell your Notes when the price of the Reference Share exceeds the Initial Share Price, you may nonetheless receive substantially less than the amount that would be payable at maturity based on that Reference Share price because of expectations that the Reference Share price will continue to fluctuate until the Final Share Price is determined. Economic, financial, regulatory, geographic, judicial, political and other developments may affect the Reference Share and, thus, the value of the Notes.

·*Volatility of the Reference Share.* Volatility is the term used to describe the size and frequency of market fluctuations. If the volatility of the Reference Share increases or decreases, the trading value of the Notes may be adversely affected. This volatility may increase the risk that the price of the Reference Share will decline, which could negatively affect the trading value of Notes. The effect of the volatility of the Reference Share on the trading value of the Notes may not necessarily decrease over time during the term of the Notes.

·*Interest rates.* We expect that the trading value of the Notes will be affected by changes in U.S. interest rates. In general, if U.S. interest rates increase, the value of the Notes may decrease, and if U.S. interest rates decrease, the value of the Notes is expected to increase. Interest rates may also affect the economy and, in turn, the price of the Reference Share, which (for the reasons discussed above) would affect the value of the Notes. Rising interest rates may lower the price of the Reference Share and, thus, the value of the Notes. Falling interest rates may increase the price of the Reference Share and, thus, the value of the Notes.

- *Our credit ratings, financial condition and results of operations.* Actual or anticipated changes in our current credit ratings, A1 by Moody's Investor Service, Inc. and A+ by Standard & Poor's Rating Services, as well as our financial condition or results of operations may significantly affect the trading value of the Notes. However, because the return on the Notes is dependent upon factors in addition to our ability to pay our obligations under the Notes, such as the price of the Reference Share, an improvement in our credit ratings, financial condition or results of operations is not expected to have a positive effect on the trading value of the Notes.
- *Time remaining to maturity.* As the time remaining to maturity of the Notes decreases, the "time premium" associated with the Notes will decrease. A "time premium" results from expectations concerning the price of the Reference Share during the period prior to the maturity of the Notes. As the time remaining to the maturity of the Notes decreases, this time premium will likely decrease, potentially adversely affecting the trading value of the Notes. As the time remaining to maturity decreases, the trading value of the Notes and the supplemental return may be less sensitive to the volatility of the Reference Share.
- *Dividend yield.* The value of the Notes may also be affected by the dividend yield on the Reference Share. In general, because the Cash Settlement Value does not incorporate the value of dividend payments, higher dividend yields is expected to reduce the value of the Notes and, conversely, lower dividend yields is expected to increase the value of the Notes.
- *Events involving the Reference Issuer.* General economic conditions and earnings results of the Reference Issuer, and real or anticipated changes in those conditions or results, may affect the trading value of the Notes. For example, the Reference Issuer may be affected by mergers and acquisitions, which can contribute to volatility of the Reference Share. As a result of a merger or acquisition, the Reference Issuer may be replaced with a surviving or acquiring entity's securities. The surviving or acquiring entity's securities may not have the same characteristics as the Reference Share.
- *Size and liquidity of the trading market.* The Notes will not be listed on any securities exchange and we do not expect a trading market to develop. There may not be a secondary market in the Notes, which may affect the price that you receive for your Notes upon any sale prior to maturity. If a trading market does develop, there can be no assurance that there will be liquidity in the trading market. If the trading market for the Notes is limited, there may be a limited number of buyers for your Notes if you do not wish to hold your investment until maturity. This may affect the price you receive upon any sale of the Notes prior to maturity. If you sell the Notes prior to maturity, you may receive less, and possibly significantly less, than your initial investment in the Notes.

Bear Stearns has advised us that they intend under ordinary market conditions to indicate prices for the Notes on request. However, we cannot guarantee that bids for outstanding Notes will be made in the future, nor can we predict the price at which any such bids will be made.

We want you to understand that the effect of one of the factors specified above, such as an increase in interest rates, may offset some or all of any change in the value of the Notes attributable to another factor, such as an increase in the price of the Reference Share.

**The Calculation Agent is one of our affiliates, which could result in a conflict of interest.**

Bear Stearns will act as the Calculation Agent. The Calculation Agent will make certain determinations and judgments in connection with calculating the Final Share Price, or deciding whether a Market Disruption Event (as defined herein) has occurred. You should refer to the sections "Description of the Notes - Antidilution Adjustments" and "Description of the Notes - Market Disruption Events." Because Bear Stearns is our affiliate, conflicts of interest may arise in connection with Bear Stearns performing its role as Calculation Agent. Rules and regulations regarding

broker-dealers (such as Bear Stearns) require Bear Stearns to maintain policies and procedures regarding the handling and use of confidential proprietary information, and such policies and procedures will be in effect throughout the term of the Notes. Bear Stearns is obligated to carry out its duties and functions as Calculation Agent in good faith, and using its reasonable judgment. See the section “Description of the Notes - Calculation Agent.”

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Our affiliates, including Bear Stearns, may, at various times, engage in transactions involving the Reference Share for their proprietary accounts, and for other accounts under their management. These transactions may influence the price of the Reference Share. BSIL, an affiliate of Bear Stearns, or one of its subsidiaries will also be the counterparty to the hedge of our obligations under the Notes. You should refer to the section “Use of Proceeds and Hedging.” Accordingly, under certain circumstances, conflicts of interest may arise between Bear Stearns’ responsibilities as Calculation Agent with respect to the Notes and its obligations under our hedge.

**We cannot control actions by the Reference Issuer.**

We are not affiliated with the Reference Issuer. Actions by the Reference Issuer may have an adverse effect on the price of its stock, the Final Share Price, and the trading value of the Notes. The Reference Issuer is not involved in this offering and has no obligations with respect to the Notes, including any obligation to take our or your interests into consideration for any reason. The Reference Issuer will not receive any of the proceeds of this offering and is not responsible for, and has not participated in, the determination of the timing of, prices for, or quantities of, the Notes to be issued. The Reference Issuer is not involved with the administration, marketing or trading of the Notes and has no obligations with respect to the amount to be paid to you under the Notes on the Maturity Date.

We are not affiliated with the Reference Issuer and are not responsible for any disclosure by the Reference Issuer. However, we may currently, or in the future, engage in business with such companies. Neither we nor any of our affiliates, including Bear Stearns, assumes any responsibility for the adequacy or accuracy of any publicly available information about the Reference Share or the Reference Issuer. You should make your own investigation into the Reference Share and the Reference Issuer.

**Trading and other transactions by us or our affiliates could affect the price of the Reference Share, the trading value of the Notes or the amount you may receive at maturity.**

We and our affiliates may from time to time buy or sell the Reference Share or derivative instruments related to the Reference Share for our own accounts in connection with our normal business practices or in connection with hedging our obligations under the Notes and other instruments. These trading activities may present a conflict of interest between your interest in the Notes and the interests we and our affiliates may have in our proprietary accounts, in facilitating transactions, including block trades, for our other customers and in accounts under our management. The transactions could affect the price of the Reference Share in a manner that would be adverse to your investment in the Notes. See the section “Use of Proceeds and Hedging.”

The original issue price of the Notes includes the cost of hedging our obligations under the Notes. Such cost includes BSIL’s expected cost of providing such hedge and the profit BSIL expects to realize in consideration for assuming the risks inherent in providing such hedge. As a result, assuming no change in market conditions or any other relevant factors, the price, if any, at which Bear Stearns will be willing to purchase Notes from you in secondary market transactions, if at all, will likely be lower than the original issue price. In addition, any such prices may differ from values determined by pricing models used by Bear Stearns as a result of transaction costs. If you sell the Notes prior to maturity, you may receive less, and possibly significantly less, than your initial investment in the Notes.

Hedging activities we or our affiliates may engage in may affect the price of the Reference Share, including the Final Share Price, and, accordingly, increase or decrease the trading value of the Notes prior to maturity and the Cash Settlement Value you would receive at maturity. To the extent that we or any of our affiliates has a hedge position in the Reference Share, or derivative or synthetic instruments related to the Reference Share, we or any of our affiliates may liquidate a portion of such holdings at or about the time of the maturity of the Notes. Depending on, among other things, future market conditions, the aggregate amount and the composition of such hedge positions are likely to vary over time. Profits or losses from any of those positions cannot be ascertained until the position is closed out and any offsetting position or positions are taken into account. Although we have no reason to believe that any of those

activities will have a material effect on the price of the Reference Share, we cannot assure you that these activities will not affect such price and the trading value of the Notes prior to maturity or the Cash Settlement Value payable at maturity.

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In addition, we or any of our affiliates may purchase or otherwise acquire a long or short position in the Notes. We or any of our affiliates may hold or resell the Notes. We or any of our affiliates may also take positions in other types of appropriate financial instruments that may become available in the future.

**Research reports and other transactions may create conflicts of interest between you and us.**

We or one or more of our affiliates have published, and may in the future publish, research reports on the Reference Issuer. This research may be modified from time to time without notice and may express opinions or provide recommendations that are inconsistent with purchasing or holding the Notes. Any of these activities may affect the market price of the Reference Share and, therefore, the Final Share Price and the value of the Notes.

We or any of our affiliates may also issue, underwrite or assist unaffiliated entities in the issuance or underwriting of other securities or financial instruments with returns indexed to the Reference Share. By introducing competing products into the marketplace in this manner, we or our affiliates could adversely affect the value of the Notes.

We and our affiliates, at present or in the future, may engage in business with the Reference Issuer, including making loans to, equity investments in, or providing investment banking, asset management or other advisory services to the Reference Issuer. In connection with these activities, we may receive information about the Reference Issuer that we will not divulge to you or other third parties.

**The Cash Settlement Value you receive on the Notes may be delayed or reduced upon the occurrence of a Market Disruption Event, or an Event of Default.**

If the Calculation Agent determines that, on the Calculation Date, a Market Disruption Event has occurred or is continuing, the determination of the price of the Reference Share by the Calculation Agent may be deferred. You should refer to the section “Description of the Notes - Market Disruption Events.”

If the Calculation Agent determines that an Event of Default (as defined below) has occurred, a holder of the Notes will only receive an amount equal to the trading value of the Notes on the date of such Event of Default, adjusted by an amount equal to any losses, expenses and costs to us of unwinding any underlying hedging or funding arrangements, all as determined by the Calculation Agent. You should refer to the section “Description of the Notes—Event of Default and Acceleration.”

**You should decide to purchase the Notes only after carefully considering the suitability of the Notes in light of your particular financial circumstances. You should also carefully consider the tax consequences of investing in the Notes. You should refer to the section “Certain U.S. Federal Income Tax Considerations” and discuss the tax implications with your own tax advisor.**

## DESCRIPTION OF THE NOTES

The following description of the Notes supplements the description of the Notes in the accompanying prospectus supplement and prospectus. This is a summary and is not complete. You should read the indenture, dated as of May 31, 1991, as amended (the "Indenture"), between us and The Bank of New York as successor in interest to JPMorgan Chase Bank, N.A., as trustee (the "Trustee"). A copy of the Indenture is available as set forth under the section of the prospectus "Where You Can Find More Information."

### General

The Notes are part of a single series of debt securities under the Indenture described in the accompanying prospectus supplement and prospectus designated as Medium-Term Notes, Series B. The Notes are unsecured and will rank equally with all of our unsecured and unsubordinated debt, including the other debt securities issued under the Indenture. Because we are a holding company, the Notes will be structurally subordinated to the claims of creditors of our subsidiaries.

The aggregate principal amount of the Notes will be \$3,350,000. The Notes are expected to mature on April 28, 2008 and do not provide for earlier redemption. The Notes will be issued only in fully registered form, and in minimum denominations of \$1,000; provided, however, that the minimum purchase for any purchaser domiciled in a member state of the European Economic Area shall be \$100,000. Initially, the Notes will be issued in the form of one or more global securities registered in the name of DTC or its nominee, as described in the accompanying prospectus supplement and prospectus. When we refer to Note or Notes in this pricing supplement, we mean \$1,000 principal amount of Notes. The Notes will not be listed on any securities exchange.

You should refer to the section "Certain U.S. Federal Income Tax Considerations," for a discussion of certain federal income tax considerations to you as a holder of the Notes.

### Interest

We will not make any periodic payments of interest on the Notes. The only payment you will receive, if any, will be the Cash Settlement Value upon the maturity of the Notes.

### Payment at Maturity

Your investment may result in a loss because the Notes are not principal protected. On the Maturity Date you will receive the Cash Settlement Value, an amount in cash depending upon the relation of the Final Share Price to the Initial Share Price. At maturity, if the Final Share Price is less than the Initial Share Price, the Cash Settlement Value will be less than the initial offering price, in proportion to the percentage decline in the Reference Share. In such a case, the principal amount of your investment is not protected and you will receive less, and possibly significantly less, than the initial public offering price of \$1,000 per Note.

If, at maturity, the Final Share Price is greater than or equal to the Initial Share Price, the Cash Settlement Value is equal to, per Note, the lesser of:

Thus, if the Final Share Price is greater than 117.00% of the Initial Share Price, regardless of the extent to which the Final Share Price is greater than the Initial Share Price, the Cash Settlement Value will equal \$1,340.00 per Note, which represents a maximum return of 34.00%.



If, at maturity, the Final Share Price is less than the Initial Share Price, you will receive less, and possibly significantly less, than your initial investment in the Notes. In this case, the Cash Settlement Value is equal to, per Note:

The “Upside Participation Rate” is 200.00%.

The “Initial Share Price” equals 93.52, the closing price of the Reference Share on March 23, 2007.

The “Final Share Price” will be determined by the Calculation Agent and will equal the closing price of the Reference Share on the Calculation Date.

The “Calculation Date” will be April 23, 2008 unless such date is not a Reference Share Business Day, in which case the Calculation Date shall be the next Reference Share Business Day. The Calculation Date is subject to adjustment as described under “Description of the Notes - Market Disruption Events”.

The “Maturity Date” is expected to be April 28, 2008 unless such date is not a Reference Share Business Day, in which case the Maturity Date shall be the next Reference Share Business Day. If the Calculation Date is adjusted due to the occurrence of a Market Disruption Event, the Maturity Date will be three Reference Share Business Days following the adjusted Calculation Date.

“Related Exchange” means each exchange or quotation system where trading has a material effect (as determined by the Calculation Agent) on the overall market for futures or options contracts relating to the Reference Share.

“Primary Exchange” means the primary exchange or market of trading of the Reference Share.

“Reference Share Business Day” means any day on which the Primary Exchange and each Related Exchange are scheduled to be open for trading.

### **Illustrative Examples**

The following tables and graphs are for illustrative purposes and are not indicative of the future performance of the Reference Share or the future value of the Notes.

Because the price of the Reference Share may be subject to significant fluctuation over the term of the Notes, it is not possible to present a chart or table illustrating the complete range of all possible Cash Settlement Values. Therefore, the examples do not purport to be representative of every possible scenario concerning increases or decreases in the Reference Share. You should not construe these examples or the data included in table and graph as an indication or assurance of the expected performance of the Notes.

You can review the historical prices of the Reference Share in the section of this pricing supplement called “Description of the Reference Share.” The historical performance of the Reference Share included in this pricing supplement should not be taken as an indication of the future performance of the Reference Share during the term of the Notes. It is impossible to predict whether the Final Share Price will be greater than or less than the Initial Share Price.

The examples demonstrating the hypothetical Cash Settlement Value of a Note are based on the following assumptions:

- Investor purchases \$1,000 aggregate principal amount of Notes at the initial public offering price of \$1,000.

- Investor holds the Notes to maturity.
- The Initial Share Price is equal to 90.00.

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The Upside Participation Rate is 200.00%

The maximum return on the Notes is 34.00%

All returns are based on a 13-month term; pre-tax basis.

No Market Disruption Events occur during the term of the Notes.

**Example 1: The Final Share Price is greater than the Initial Share Price.**

In this example, the Reference Share rises over the term of the Notes. On the Calculation Date, the Final Share Price is 92.70, representing a 3.00% gain from the Initial Share Price. In this example, using the formula below, the Cash Settlement Value will equal \$1,060.00.

**Example 2: The Final Share Price is greater than 117.00% of the Initial Share Price, exceeding the maximum return on the Notes of 34.00%.**

In this example, the Reference Share rises over the term of the Notes. On the Calculation Date, the Final Share Price is 108.00 representing a 20.00% increase from the Initial Share Price. In this example, using the formula below, the Cash Settlement Value will equal \$1,340.00.

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**Example 3: The Final Share Price is equal to the Initial Share Price.**

In this example, the Reference Share remains unchanged over the term of the Notes. On the Calculation Date, the Final Share Price is 90.00, equal to the Initial Share Price. In this example, using the formula below, the Cash Settlement Value will equal \$1,000.00.

**Example 4: The Final Share Price is less than the Initial Share Price.**

In this example, the Reference Share declines over the term of the Notes. On the Calculation Date, the Final Share Price is 67.50, representing a 25.00% decrease in the price of the Reference Share from the Initial Share Price. The Cash Settlement Value, using the formula below, will equal \$750.00.

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**Summary of Examples 1 Through 4  
Reflecting the Cash Settlement Value**

	<b>Example 1</b>	<b>Example 2</b>	<b>Example 3</b>	<b>Example 4</b>
Initial Share Price	90.00	90.00	90.00	90.00
Hypothetical Final Share Price	92.70	108.00	90.00	67.50
Value of Final Share Price relative to the Initial Share Price	Higher	Higher	Equal	Lower
Principal fully repaid?	Yes	Yes	Yes	No
Cash Settlement Value per Note	\$1,060.00	\$1,340.00	\$1,000.00	\$750.00

**Table of Hypothetical Cash Settlement Values**

Initial Share Price	Final Share Price	Percentage Change in Reference Share	Cash Settlement Value Per Note	Return if Held to Maturity	Initial Share Price	Final Share Price	Percentage Change in Reference Share	Cash Settlement Value Per Note	Return if Held to Maturity
90.00	146.00	+62.22%	\$ 1,340.00	34.00%	90.00	88.00	-2.22%	\$ 977.78	-2.22%
90.00	144.00	+60.00%	\$ 1,340.00	34.00%	90.00	86.00	-4.44%	\$ 955.56	-4.44%
90.00	142.00	+57.78%	\$ 1,340.00	34.00%	90.00	84.00	-6.67%	\$ 933.33	-6.67%
90.00	140.00	+55.56%	\$ 1,340.00	34.00%	90.00	82.00	-8.89%	\$ 911.11	-8.89%
90.00	138.00	+53.33%	\$ 1,340.00	34.00%	90.00	80.00	-11.11%	\$ 888.89	-11.11%
90.00	136.00	+51.11%	\$ 1,340.00	34.00%	90.00	78.00	-13.33%	\$ 866.67	-13.33%
90.00	134.00	+48.89%	\$ 1,340.00	34.00%	90.00	76.00	-15.56%	\$ 844.44	-15.56%
90.00	132.00	+46.67%	\$ 1,340.00	34.00%	90.00	74.00	-17.78%	\$ 822.22	-17.78%
90.00	130.00	+44.44%	\$ 1,340.00	34.00%	90.00	72.00	-20.00%	\$ 800.00	-20.00%
90.00	128.00	+42.22%	\$ 1,340.00	34.00%	90.00	70.00	-22.22%	\$ 777.78	-22.22%
90.00	126.00	+40.00%	\$ 1,340.00	34.00%	90.00	68.00	-24.44%	\$ 755.56	-24.44%
90.00	124.00	+37.78%	\$ 1,340.00	34.00%	90.00	66.00	-26.67%	\$ 733.33	-26.67%
90.00	122.00	+35.56%	\$ 1,340.00	34.00%	90.00	64.00	-28.89%	\$ 711.11	-28.89%
90.00	120.00	+33.33%	\$ 1,340.00	34.00%	90.00	62.00	-31.11%	\$ 688.89	-31.11%
90.00	118.00	+31.11%	\$ 1,340.00	34.00%	90.00	60.00	-33.33%	\$ 666.67	-33.33%
90.00	116.00	+28.89%	\$ 1,340.00	34.00%	90.00	58.00	-35.56%	\$ 644.44	-35.56%
90.00	114.00	+26.67%	\$ 1,340.00	34.00%	90.00	56.00	-37.78%	\$ 622.22	-37.78%
90.00	112.00	+24.44%	\$ 1,340.00	34.00%	90.00	54.00	-40.00%	\$ 600.00	-40.00%
90.00	110.00	+22.22%	\$ 1,340.00	34.00%	90.00	52.00	-42.22%	\$ 577.78	-42.22%
90.00	108.00	+20.00%	\$ 1,340.00	34.00%	90.00	50.00	-44.44%	\$ 555.56	-44.44%
90.00	106.00	+17.78%	\$ 1,340.00	34.00%	90.00	48.00	-46.67%	\$ 533.33	-46.67%
90.00	104.00	+15.56%	\$ 1,311.11	31.11%	90.00	46.00	-48.89%	\$ 511.11	-48.89%
90.00	102.00	+13.33%	\$ 1,266.67	26.67%	90.00	44.00	-51.11%	\$ 488.89	-51.11%
90.00	100.00	+11.11%	\$ 1,222.22	22.22%	90.00	42.00	-53.33%	\$ 466.67	-53.33%
90.00	98.00	+8.89%	\$ 1,177.78	17.78%	90.00	40.00	-55.56%	\$ 444.44	-55.56%
90.00	96.00	+6.67%	\$ 1,133.33	13.33%	90.00	38.00	-57.78%	\$ 422.22	-57.78%
90.00	94.00	+4.44%	\$ 1,088.89	8.89%	90.00	36.00	-60.00%	\$ 400.00	-60.00%
90.00	92.00	+2.22%	\$ 1,044.44	4.44%	90.00	34.00	-62.22%	\$ 377.78	-62.22%
<b>90.00</b>	<b>90.00</b>	<b>0.00%</b>	<b>\$ 1,000.00</b>	<b>0.00%</b>	90.00	32.00	-64.44%	\$ 355.56	-64.44%



### **Determination of Closing Price**

The closing price for the Reference Share on any day will equal the closing sale price or last reported sale price, regular way, for the Reference Share, on a per-share or other unit basis:

- on the principal national securities exchange on which the Reference Share is listed for trading on that day,
- if the Reference Share is not listed on any national securities exchange, on the Nasdaq National Market System on that day, or
- if the Reference Share is not quoted on the Nasdaq National Market System on that day, on any other U.S. national market system that is the primary market for the trading of the Reference Share.

If the Reference Share is not listed or traded as described above, then the closing price for the Reference Share on any day will be the average, as determined by the Calculation Agent, of the bid prices for the security obtained from as many dealers in the Reference Share selected by the Calculation Agent as will make those bid prices available to the Calculation Agent. The number of dealers need not exceed three and may include the Calculation Agent or any of our affiliates.

### **Market Disruption Events**

If the Calculation Date is not a Reference Share Business Day (as defined below), the closing price of the Reference Share will be determined on the first following day that is a Reference Share Business Day. To the extent a Disrupted Day (as defined below) exists on a day on which the Final Share Price is to be determined, the closing price of the Reference Share will be determined on the first following Reference Share Business Day on which a Disrupted Day does not exist with respect to the Reference Share, provided that if a Disrupted Day exists on three consecutive Reference Share Business Days, the third Reference Share Business Day shall be the Calculation Date. The Calculation Agent shall determine the Final Share Price as of any such postponed date. In the event that the Calculation Date is postponed, the Maturity Date shall also be postponed to the third Reference Share Business Day following the postponed Calculation Date.

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A “Disrupted Day” is any Reference Share Business Day on which the Primary Exchange or any Related Exchange fails to open for trading during its regular trading session or on which a Market Disruption Event has occurred and is continuing, in both cases, which the Calculation Agent determines is material, where:

“Market Disruption Event” means, with respect to the Reference Share:

(a) the occurrence or existence of a condition specified below:

(i) any suspension of or limitation imposed on trading by the Primary Exchange or any Related Exchange or otherwise, and whether by reason of movements in price exceeding limits permitted by the Primary Exchange or any Related Exchanges or otherwise, (A) relating to the Reference Share or (B) in futures or options contracts relating to the Reference Share, on any Related Exchange; or

(ii) any event (other than an event described in (b) below) that disrupts or impairs (as determined by the Calculation Agent) the ability of market participants in general (A) to effect transactions in, or obtain market values for the Reference Share or (B) to effect transactions in, or obtain market values for, futures or options contracts relating to the Reference Share, on any Related Exchange; or

(b) the closure on any Reference Share Business Day of the Primary Exchange or any Related Exchange prior to its Scheduled Closing Time unless such earlier closing time is announced by the Primary Exchange or such Related Exchange at least one hour prior to the earlier of (i) the actual closing time for the regular trading session on the Primary Exchange or such Related Exchange on such Reference Share Business Day for the Primary Exchange or such Related Exchange and (ii) the submission deadline for orders to be entered into the Primary Exchange system for execution at the close of trading on such Reference Share Business Day for the Primary Exchange or such Related Exchange.

“Related Exchange” means each exchange or quotation system where trading has a material effect (as determined by the Calculation Agent) on the overall market for futures or options contracts relating to the Reference Share.

“Primary Exchange” means the primary exchange or market of trading of the Reference Share.

“Reference Share Business Day” means any day on which the Primary Exchange and each Related Exchange are scheduled to be open for trading.

“Scheduled Closing Time” means, with respect to the Primary Exchange or the Related Exchange, on any Reference Share Business Day, the scheduled weekday closing time of the Primary Exchange or such Related Exchange on such Reference Share Business Day, without regard to after hours or any other trading outside of the regular trading session hours.

For purposes of the above definition:

(a) limitation on the hours in a trading day and/or number of days of trading will not constitute a Market Disruption Event if it results from an announced change in the regular business hours of the relevant exchange, and

(b) for purposes of clause (a) above, any limitations on trading during significant market fluctuations, under NYSE Rule 80B, NASD Rule 4120 or any analogous rule or regulation enacted or promulgated by the NYSE, NASD or any other self regulatory organization or the SEC of similar scope as determined by the Calculation Agent, will be considered “material.”



## **Antidilution Adjustments**

If one of the corporate events described below occurs, the Calculation Agent will determine whether such corporate event will have a material effect on the Reference Share or the Notes, or in the case of a Potential Adjustment Event, whether such Potential Adjustment Event has a diluting or concentrative effect on the theoretical value of one Reference Share. To the extent the Calculation Agent makes such a determination, the Calculation Agent will make the adjustments and computations described below. The Calculation Agent will also determine the effective date of that adjustment, and the replacement of the Reference Share, if applicable. Upon making any such adjustment, the Calculation Agent will give notice as soon as practicable to the Trustee, stating the adjustment made. The Calculation Agent will provide information about the adjustments it makes upon your written request.

If more than one corporate event requiring adjustment occurs, the Calculation Agent will make such an adjustment for each event in the order in which the events occur, and on a cumulative basis. Thus, having adjusted the Initial Share Price, the Final Share Price, the Cash Settlement Value or any other variable for the first corporate event, the Calculation Agent will adjust the appropriate variables for the second event, applying the required adjustment cumulatively.

To the extent the Calculation Agent makes an adjustment, it will make the adjustment with a view to offsetting, to the extent practical, any change in your economic position relative to the Notes that results solely from that corporate event. The Calculation Agent may modify the antidilution adjustments as necessary to ensure an equitable result.

The following corporate events are those that may require an adjustment:

### *Merger Events and Tender Offers*

*Merger Events.* A “Merger Event” shall mean, in respect of the Reference Share, any (i) reclassification or change of such Reference Shares that results in a transfer of or an irrevocable commitment to transfer all of the outstanding Reference Share to another person or entity, (ii) consolidation, amalgamation, merger or binding share exchange of the Reference Issuer with or into another entity or person (other than a consolidation, amalgamation, merger or binding share exchange in which such Reference Issuer is the continuing entity and which does not result in a reclassification or change of all of such Reference Shares outstanding), (iii) takeover offer, tender offer, exchange offer, solicitation, proposal or other event by any entity or person to purchase or otherwise obtain 100% of the outstanding Reference Shares (other than such Reference Shares owned or controlled by such other entity or person), or (iv) consolidation, amalgamation, merger or binding share exchange of the Reference Issuer or its subsidiaries with or into another entity in which the Reference Issuer is the continuing entity and which does not result in a reclassification or change of the Reference Shares of the Issuer outstanding but results in the outstanding Reference Shares of the Issuer (other than Reference Shares owned or controlled by such other entity) immediately following such event collectively representing less than 50% of the outstanding Reference Shares of the Issuer immediately prior to such event, in each case if the closing date of the Merger Event is on or before the Calculation Date.

*Tender Offers.* A “Tender Offer” shall mean, in respect of the voting shares of the Reference Issuer, any takeover offer, tender offer, exchange offer, solicitation, proposal or other event by any entity or person that results in such entity or person purchasing, or otherwise obtaining or having the right to obtain, by conversion or other means, not less than 10% of the outstanding voting shares of the Reference Issuer as determined by the Calculation Agent, based upon the making of filings with governmental or self-regulatory agencies or such other information as the Calculation Agent deems relevant.

If a Merger Event or a Tender Offer occurs and the consideration for the Reference Share consists solely of new shares that are publicly quoted, traded or listed on the New York Stock Exchange, American Stock Exchange, or NASDAQ (the “New Reference Share”), then the Reference Share will be adjusted to comprise the number of New

Reference Shares to which a holder of one Reference Share immediately prior to the occurrence of the Merger Event or Tender Offer, as the case may be, would be entitled upon consummation of such Merger Event or Tender Offer, and the Calculation Agent shall adjust any or all of the Initial Share Price, the Final Share Price, the Cash Settlement Value or any other variable relevant to the terms of the Notes to account for the economic effect of such Merger Event or Tender Offer. The Calculation Agent will determine the effective date of any such adjustment (as described in this paragraph), and the replacement of the Reference Share, if applicable.

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If the Approval Date (as defined herein) for a Merger Event or a Tender Offer occurs, on or prior to the Calculation Date, and the distributions of property made in respect of the Reference Share includes property other than New Reference Shares (other than cash paid in lieu of fractional shares), in whole or in part, then a holder of the Notes will receive a cash amount on the Maturity Date equal to the Consideration Value (as defined herein).

“Consideration Value” per Reference Share means, with respect to an event (other than one in which consideration consists solely of New Reference Shares), the sum of (i) in the case of cash received in such event, the amount of cash so received, and (ii) for any property other than cash received in such event, the market value of such property so received as of the Calculation Date. Any market value determined pursuant to (ii) above shall be determined on the basis of market quotations from four leading dealers in the relevant market. If that property cannot be determined on the basis of market quotations by four leading dealers in the relevant market, then the Calculation Agent will determine the market value of such property.

The “Approval Date” is the closing date of a Merger Event, or, in the case of a Tender Offer, the date on which the person or entity making the Tender Offer acquires or otherwise obtains the relevant percentage of the voting shares of the Reference Issuer.

In the event of a Merger Event or Tender Offer in which a holder of Reference Shares may elect the form of consideration it receives in respect of such Merger Event or Tender Offer, the consideration shall be deemed to consist of the types and amounts of each type of consideration distributed to a holder that makes no election, as determined by the Calculation Agent.

#### *Nationalization, Delisting and Insolvency*

*Nationalization.* “Nationalization” shall mean all the assets or substantially all the assets of the Reference Issuer are nationalized, expropriated or are otherwise required to be transferred to any governmental agency, authority or entity.

*Insolvency.* “Insolvency” shall mean that, by reason of the voluntary or involuntary liquidation, bankruptcy or insolvency of, or any analogous proceeding involving, the Reference Issuer, (i) any of the Reference Shares of the Reference Issuer are required to be transferred to a trustee, liquidator or other similar official or (ii) holders of any of the Reference Share become legally prohibited from transferring the Reference Share.

*Delisting Event.* A “Delisting Event” shall occur, with respect to the Reference Share, if the Primary Exchange announces that pursuant to the rules of the Primary Exchange, the Reference Share cease (or will cease) to be listed, traded or publicly quoted on the Primary Exchange for any reason (other than a Merger Event or Tender Offer) and is not immediately re-listed, re-traded or re-quoted on an exchange or quotation system located in the same country as the Primary Exchange.

If the Announcement Date (as defined herein) for a Nationalization, Insolvency or Delisting Event occurs, on or prior to the Calculation Date, then a holder of the Notes will receive a cash amount on the Maturity Date equal to the Consideration Value (as defined above), which may be zero.

The “Announcement Date” means (i) in the case of a Nationalization, the day of the first public announcement by the relevant government authority that all or substantially all of the assets of the Reference Issuer are to be nationalized, expropriated or otherwise transferred to any governmental agency, authority or entity, (ii) in the case of a Delisting Event, the day of the first public announcement by the Primary Exchange that the Reference Share will cease to trade or be publicly quoted on such exchange, or (iii) in the case of an Insolvency, the day of the first public announcement of the institution of a proceeding or presentation of a petition or passing of a resolution (or other analogous procedure in any jurisdiction) that leads to an Insolvency with respect to the Reference Issuer. In the case of an acceleration of the maturity of the Notes, interest will be paid on the Notes through and excluding the related date of accelerated

payment.

*Potential Adjustment Events*

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*Potential Adjustment Events.* A “Potential Adjustment Event” shall mean, with respect to the Reference Share, any of the following (i) a subdivision, consolidation or reclassification of the Reference Share (other than a Merger Event or Tender Offer), or a free distribution or distribution of Reference Share to existing holders by way of bonus, capitalization or similar issue; (ii) a distribution to existing holders of the Reference Share of (A) Reference Shares, (B) other capital or securities granting the right to payment of distributions and/or proceeds of liquidation of the Reference Issuer equal, proportionate or senior to such payments to holders of such Reference Share or (C) any other type of securities, rights or warrants or other assets, in any case for payments (cash or other) at less than the prevailing market price, as determined by the Calculation Agent; (iii) an extraordinary distribution paid by the Reference Issuer; (iv) a call by the Reference Issuer in respect of Reference Share that are not fully paid; (v) a repurchase of Reference Shares or securities convertible into or exchangeable for Reference Shares, by the Reference Issuer whether out of profits or capital and whether the consideration for such repurchase is cash, securities or otherwise; or (vi) any other similar event that may have a diluting or concentrative effect on the theoretical value of the Reference Share other than Insolvency, Merger Event or Tender Offer, in each case if the Potential Adjustment Event occurs before the Calculation Date.

If a Potential Adjustment Event shall occur, then the Calculation Agent will determine whether such Potential Adjustment Event has a diluting or concentrative effect on the theoretical value of one Reference Share and, if so, will (i) make the corresponding adjustment(s), if any, to the Initial Share Price, the Final Share Price, the Cash Settlement Value and any other variable (or any combination thereof) as the Calculation Agent determines appropriate to account for that diluting or concentrative effect, and (ii) determine the effective date(s) of the adjustment(s).

### **Redemption; Defeasance**

The Notes are not subject to redemption before maturity, and are not subject to the defeasance provisions described in the section “Description of Debt Securities - Defeasance” in the accompanying prospectus.

### **Events of Default and Acceleration**

If an Event of Default (as defined in the accompanying prospectus) with respect to any Notes has occurred and is continuing, then the amount payable to you, as a holder of a Note, upon any acceleration permitted by the Notes will be equal to the Cash Settlement Value as though the date of early repayment were the Maturity Date of the Notes, adjusted by an amount equal to any losses, expenses and costs to us of unwinding any underlying or related hedging or funding arrangements, all as determined by the Calculation Agent. If a bankruptcy proceeding is commenced in respect of us, the claims of the holder of a Note may be limited under Title 11 of the United States Code.

### **Same-Day Settlement and Payment**

Settlement for the Notes will be made by Bear Stearns in immediately available funds. Payments of the Cash Settlement Value will be made by us in immediately available funds, so long as the Notes are maintained in book-entry form.

### **Calculation Agent**

The Calculation Agent for the Notes will be Bear Stearns. All determinations made by the Calculation Agent will be at the sole discretion of the Calculation Agent and will be conclusive for all purposes and binding on us and the holders of the Notes, absent manifest error and provided the Calculation Agent shall be required to act in good faith in making any determination. Manifest error by the Calculation Agent, or any failure by it to act in good faith, in making a determination adversely affecting the payment of principal, interest or premium on principal to holders would entitle the holders, or the Trustee acting on behalf of the holders, to exercise rights and remedies available under the Indenture. If the Calculation Agent uses its discretion to make any determination, the Calculation Agent will notify us



and the Trustee, who will provide notice to the registered holders of the Notes.

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## DESCRIPTION OF THE REFERENCE SHARE

Neither the Issuer nor any of its affiliates assumes any responsibility for the adequacy or accuracy of the information about the Reference Issuer contained in this Pricing Supplement or in any publicly available filings made by the Reference Issuer. You should make your own investigation into the Reference Issuer.

### **Apple Inc., (NASDAQ: AAPL)**

According to publicly available information, Apple Inc. (“Apple”), together with its subsidiaries, engages in the design, manufacture, and marketing of personal computers and related software, services, peripherals, and networking solutions worldwide. It also provides a line of portable digital music players, as well as related accessories and services, including online sale of third-party audio and video products. Apple’s products and services comprise the Macintosh line of desktop and portable computers; the Mac OS X operating system; the iPod line of portable digital music players; the iTunes Store, a portfolio of peripherals that support and enhance the Macintosh and iPod product lines; a portfolio of consumer and professional software applications; and the Xserve and Xserve RAID server and storage products. In addition, Apple offers various third-party Macintosh and iPod compatible products, such as application software, printers, storage devices, speakers, headphones, and other accessories and supplies. Apple provides an online service to distribute third-party music, audio books, music videos, short films, television shows, movies, and iPod games. Further, Apple offers products and services for the educational industry, which include iMac and the MacBook, video creation and editing solutions, wireless networking, professional development solutions, and one-to-one learning solutions. Apple sells its products to education, consumer, creative professional, business, and government customers through its online stores and retail stores, as well as through its direct sales force, third-party wholesalers, resellers, and value-added resellers.

The Reference Shares are registered under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Companies with securities registered under the Exchange Act are required to file periodically certain financial and other information specified by the Commission. Information provided to or filed with the Commission can be inspected and copied at the public reference facilities maintained by the Commission at Room 1024, 450 Fifth Street, N.W., Washington, D.C. 20549 or at its Regional Offices located at Suite 1400, Citicorp Center, 500 West Madison Street, Chicago, Illinois 60661 and at the Woolworth Building, 233 Broadway, New York, New York 10279, and copies of such material can be obtained from the Public Reference Section of the Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. In addition, information provided to or filed with the Commission electronically can be accessed through a website maintained by the Commission. The address of the Commission's website is <http://www.sec.gov>. In addition, information regarding the Company may be obtained from other sources including, but not limited to, press releases, newspaper articles and other publicly disseminated documents. We make no representation or warranty as to the accuracy or completeness of such reports.

This Pricing Supplement relates only to the Notes offered hereby and does not relate to the Reference Share or other securities of the Reference Issuer. The Issuer has derived all disclosures contained in this Pricing Supplement regarding the Reference Issuer from the publicly available documents described in the preceding paragraph. The Issuer has not participated in the preparation of such documents or made any due diligence inquiry with respect to the Reference Issuer in connection with the offering of the Notes. The Issuer makes no representation that such publicly available documents or any other any other publicly available information regarding the Reference Issuer are accurate or complete. Furthermore, the Issuer cannot give any assurance that all events occurring prior to the date hereof (including events that would affect the accuracy or completeness of the publicly available documents described in the preceding paragraph) that would affect the trading price of Reference Share (and therefore the Initial Share Price and the Cash Settlement Value) have been publicly disclosed. Subsequent disclosure of any such events or the disclosure of or failure to disclose material future events concerning the Reference Issuer could affect the value received on any date with respect to the Notes and, therefore, the trading value of the Notes. The Issuer does not have any obligation to disclose any information about the Reference Issuer or the Reference Share after the date of this Pricing Supplement.

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**Historical Performance of the Reference Share**

The following table sets forth the month ending closing prices of the Reference Share for each calendar month in the period from January 1, 1998 to February 28, 2007. The Reference Share closing prices listed below were obtained from the Bloomberg Financial Service, without independent verification by the Issuer. The historical prices of the Reference Share should not be taken as an indication of future performance, and no assurance can be given that the price of the Reference Share will not decrease to or below the Initial Share Price during the term of the Notes. In addition, no assurance can be given that the price of the Reference Share will perform sufficiently from year to year to cause the holders of the Notes to receive 100% of the principal amount of the Notes.

**Month-End Closing price of the Reference Share**

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
January	4.58	10.30	25.94	10.81	12.36	7.18	11.28	38.45	75.51	85.73
February	5.91	8.70	28.66	9.13	10.85	7.51	11.96	44.86	68.49	84.61
March	6.88	8.98	33.95	11.04	11.84	7.07	13.52	41.67	62.72	-
April	6.84	11.50	31.02	12.75	12.14	7.11	12.89	36.06	70.39	-
May	6.66	11.02	21.00	9.98	11.65	8.98	14.03	39.76	59.77	-
June	7.17	11.58	26.19	11.63	8.86	9.53	16.27	36.81	57.27	-
July	8.66	13.92	25.41	9.40	7.63	10.54	16.17	42.65	67.96	-
August	7.80	16.31	30.47	9.28	7.38	11.31	17.25	46.89	67.85	-
September	9.53	15.83	12.88	7.76	7.25	10.36	19.38	53.61	76.98	-
October	9.28	20.03	9.78	8.78	8.04	11.45	26.20	57.59	81.08	-
November	7.98	24.47	8.25	10.65	7.75	10.46	33.53	67.82	91.66	-
December	10.23	25.70	7.44	10.95	7.17	10.69	32.20	71.89	84.84	-

\* All historical prices are denominated in USD and rounded to the nearest penny.

\*\* All historical prices were calculated as of the last Reference Share Business Day of the relevant month.

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The following graph illustrates the historical performance of the Reference Share based on the closing price on the last Reference Share Business Day of each month from January 1998 to February 2007.

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## CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following discussion summarizes certain of the material U.S. federal income tax consequences of the purchase, beneficial ownership, and disposition of the Notes. For purposes of this summary, a “U.S. holder” is a beneficial owner of a Note that is:

- an individual who is a citizen or a resident of the United States, for federal income tax purposes;
- a corporation (or other entity that is treated as a corporation for federal tax purposes) that is created or organized in or under the laws of the United States or any State thereof (including the District of Columbia);
- an estate whose income is subject to federal income taxation regardless of its source; or
- a trust if a court within the United States is able to exercise primary supervision over its administration, and one or more United States persons (as defined for federal income tax purposes) have the authority to control all of its substantial decisions.

For purposes of this summary, a “non-U.S. holder” is a beneficial owner of a Note that is:

- a nonresident alien individual for federal income tax purposes;
- a foreign corporation for federal income tax purposes;
- an estate whose income is not subject to federal income tax on a net income basis; or
- a trust if no court within the United States is able to exercise primary jurisdiction over its administration or if United States persons (as defined for federal income tax purposes) do not have the authority to control all of its substantial decisions.

An individual may, subject to certain exceptions, be deemed to be a resident of the United States for federal income tax purposes by reason of being present in the United States for at least 31 days in the calendar year and for an aggregate of at least 183 days during a three year period ending in the current calendar year (counting for those purposes all of the days present in the current year, one third of the days present in the immediately preceding year, and one sixth of the days present in the second preceding year).

This summary is based on interpretations of the Code, regulations issued thereunder, and rulings and decisions currently in effect (or in some cases proposed), all of which are subject to change. Any of those changes may be applied retroactively and may adversely affect the federal income tax consequences described herein. This summary addresses only holders that purchase Notes at initial issuance, and own Notes as capital assets and not as part of a “straddle,” “hedge,” “synthetic security,” or “conversion transaction” for federal income tax purposes or as part of some other integrated investment. This summary does not discuss all of the tax consequences that may be relevant to particular investors or to investors subject to special treatment under the federal income tax laws (such as banks, thrifts or other financial institutions; insurance companies; securities dealers or brokers, or traders in securities electing mark-to-market treatment; regulated investment companies or real estate investment trusts; small business investment companies; S corporations; investors that hold their Notes through a partnership or other entity treated as a partnership for federal tax purposes; investors whose functional currency is not the U.S. dollar; certain former citizens or residents of the United States; persons subject to the alternative minimum tax; retirement plans or other tax-exempt entities, or persons holding the Notes in tax-deferred or tax-advantaged accounts; or “controlled foreign corporations” or “passive foreign investment companies” for federal income tax purposes). This summary also does not address the tax consequences to shareholders, or other equity holders in, or beneficiaries of, a holder, or any state, local or foreign tax

consequences of the purchase, ownership or disposition of the Notes.

**PROSPECTIVE PURCHASERS OF NOTES SHOULD CONSULT THEIR TAX ADVISORS AS TO THE FEDERAL, STATE, LOCAL, AND OTHER TAX CONSEQUENCES TO THEM OF THE PURCHASE, OWNERSHIP AND DISPOSITION OF NOTES.**

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## **In General**

There are no statutory provisions, regulations, published rulings or judicial decisions addressing the characterization for federal income tax purposes of securities with terms that are substantially the same as those of the Notes. Accordingly, the proper U.S. federal income tax treatment of the Notes is uncertain. Under one approach, the Notes would be treated as pre-paid cash-settled forward contracts with respect to the Reference Share. The Issuer intends to treat the Notes consistent with this approach, and pursuant to the terms of the Notes, you agree to treat the Notes consistent with this approach. Except as otherwise provided in “—Alternative Characterizations and Treatments,” the balance of this summary assumes that the Notes are so treated.

## **Federal Income Tax Treatment of U.S. Holders**

Upon the receipt of cash at the maturity of the Note or upon the sale, exchange or other disposition of a Note in a taxable transaction, a U.S. holder generally will recognize gain or loss equal to the difference between the amount realized at maturity or upon the sale, exchange or other disposition and the U.S. holder’s tax basis in the Note. A U.S. holder’s tax basis in a Note will generally be equal to the U.S. holder’s cost for the Note. Any such gain or loss generally will constitute capital gain or loss, and if the U.S. holder held the Notes for more than a year at the time of maturity, sale, exchange or other disposition, generally should be long-term capital gain or loss. Long-term capital gains of non-corporate taxpayers are generally eligible for reduced rates of taxation. The ability of U.S. holders to use capital losses to offset ordinary income is limited.

## **Alternative Characterizations and Treatments**

Although the Issuer intends to treat each Note as a pre-paid cash-settled forward contract as described above, there are no statutory provisions, regulations, published rulings or judicial decisions addressing the characterization of securities with terms that are substantially the same as those of the Notes, and therefore the Notes could be subject to some other characterization or treatment for federal income tax purposes. For example, each Note could be treated as a “contingent payment debt instrument” for federal income tax purposes. In this event, a U.S. holder would be required to accrue original issue discount income, subject to adjustments, at the “comparable yield” of the Notes and any gain recognized with respect to the Note generally would be treated as ordinary income. Alternatively, it is possible that each Note could be treated as consisting of a cash-settled forward contract with respect to the Reference Shares and a deposit with us of cash in an amount equal to the principal amount of a Note to secure the holder’s obligation to settle the forward contract, in which case a U.S. Holder would be required to accrue interest income or original issue discount on a current basis in respect of the deposit. Prospective investors should consult their tax advisors as to the federal income tax consequences to them if the Notes are treated as debt instruments for federal income tax purposes.

In addition, certain proposed Treasury regulations require the accrual of income on a current basis for contingent payments made under certain “notional principal contracts.” The preamble to the proposed regulations states that the “wait and see” method of accounting does not properly reflect the economic accrual of income on those contracts and requires current accrual of income for some contracts already in existence. While the proposed regulations do not apply to pre-paid cash-settled forward contracts, the preamble to the proposed regulations indicates that similar timing issues exist in the case of pre-paid cash-settled forward contracts. If the IRS or the U.S. Treasury Department publishes future guidance requiring current economic accrual for contingent payments on pre-paid cash-settled forward contracts, it is possible that a U.S. holder could be required to accrue income over the term of the Notes.

Other alternative federal income tax characterizations or treatments of the Notes are possible and, if applied, could also affect the timing and the character of the income, gain, or loss with respect to the Notes.

Prospective investors in the Notes should consult their tax advisors as to the tax consequences to them of purchasing Notes, including any alternative characterizations and treatments.



**Federal Income Tax Treatment of Non-U.S. Holders**

A non-U.S. holder that is not subject to U.S. federal income tax as a result of any direct or indirect connection to the United States other than its ownership of a Note should not be subject to U.S. federal income or withholding tax in respect of the Notes so long as (1) the non-U.S. holder provides an appropriate statement, signed under penalties of perjury, identifying the non-U.S. holder and stating, among other things, that the non-U.S. holder is not a United States person (as defined for federal income tax purposes), (2) the non-U.S. holder is not a bank that has purchased the Notes in the ordinary course of its trade or business of making loans, as described in section 881(c)(3)(A) of the Code, (3) the non-U.S. holder is not a “10-percent shareholder” within the meaning of section 871(h)(3)(B) of the Code or a “related controlled foreign corporation” within the meaning of section 881(c)(3)(C) of the Code with respect to the Issuer, and (4) the Reference Shares are actively traded within the meaning of section 871(h)(4)(C)(v) of the Code. Unless the applicable pricing supplement indicates otherwise, we expect that the Reference Shares will be treated as actively traded within the meaning of section 871(h)(4)(C)(v) of the Code.

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If any of these conditions are not met, a 30% withholding tax may apply to payments on the Notes, unless an income tax treaty reduces or eliminates such tax or the income is effectively connected with the conduct of a trade or business within the United States by such non-U.S. holder. In the latter case, such non-U.S. holder should be subject to U.S. federal income tax with respect to all income from the Notes at regular rates applicable to U.S. taxpayers, and, for a foreign corporation, possibly branch profits tax, unless an applicable treaty reduces or eliminates such tax.

In general, the gain realized on the maturity, sale, exchange or other disposition of the Notes by a non-U.S. holder should not be subject to U.S. federal income tax unless the gain is effectively connected with a trade or business conducted by the non-U.S. holder in the United States, in which case the non-U.S. holder will generally be subject to U.S. federal income tax on any income or gain in respect of the Note at the regular rates applicable to U.S. taxpayers, and, for a foreign corporation, possibly branch profits tax, unless an applicable treaty reduces or eliminates such tax, or the non-U.S. holder is an individual that is present in the United States for 183 days or more in the taxable year of the maturity, sale, exchange or other disposition and certain other conditions are satisfied, in which case the non-U.S. holder will generally be subject to tax at a rate of 30% on the amount by which the non-U.S. holder's capital gains derived from the maturity, sale, exchange, retirement or other disposition of the Notes and other assets that are from U.S. sources exceed capital losses allocable to U.S. sources.

### **Information Reporting and Backup Withholding**

Distributions made on the Notes and proceeds from the sale of Notes to or through certain brokers may be subject to a "backup" withholding tax on "reportable payments" unless, in general, the holder of Notes complies with certain procedures or is an exempt recipient. Any amounts so withheld from distributions on the Notes generally would be refunded by the IRS or allowed as a credit against the holder of Notes federal income tax, provided the holder of Notes makes a timely filing of an appropriate tax return or refund claim.

Reports will be made to the IRS and to holder of Notes that are not exempt from the reporting requirements.

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## CERTAIN ERISA CONSIDERATIONS

Section 4975 of the Code prohibits the borrowing of money, the sale of property and certain other transactions involving the assets of plans that are qualified under the Code (“Qualified Plans”) or individual retirement accounts (“IRAs”) and persons who have certain specified relationships to them. Section 406 of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), prohibits similar transactions involving employee benefit plans that are subject to ERISA (“ERISA Plans”). Qualified Plans, IRAs and ERISA Plans are referred to as “Plans.”

Persons who have such specified relationships are referred to as “parties in interest” under ERISA and as “disqualified persons” under the Code. “Parties in interest” and “disqualified persons” encompass a wide range of persons, including any fiduciary (for example, investment manager, trustee or custodian) of a Plan, any person providing services (for example, a broker) to a Plan, the Plan sponsor, an employee organization any of whose members are covered by the Plan, and certain persons related to or affiliated with any of the foregoing.

The purchase and/or holding of Notes by a Plan with respect to which we, Bear Stearns and/or certain of our affiliates is a fiduciary and/or a service provider (or otherwise is a “party in interest” or “disqualified person”) would constitute or result in a prohibited transaction under Section 406 of ERISA or Section 4975 of the Code, unless such Notes are acquired or held pursuant to and in accordance with an applicable statutory or administrative exemption. Each of us and Bear Stearns are considered a “disqualified person” under the Code or a “party in interest” under ERISA with respect to many Plans, although neither we nor Bear Stearns can be a “party in interest” to any IRA other than certain employer-sponsored IRAs, as only employer-sponsored IRAs are covered by ERISA.

Applicable administrative exemptions may include certain prohibited transaction class exemptions (for example, Prohibited Transaction Class Exemption (“PTCE”) 84–14 relating to qualified professional asset managers, PTCE 96–23 relating to certain in-house asset managers, PTCE 91–38 relating to bank collective investment funds, PTCE 90–1 relating to insurance company separate accounts and PTCE 95–60 relating to insurance company general accounts).

It should also be noted that the Pension Protection Act of 2006 contains a statutory exemption from the prohibited transaction provisions of Section 406 of ERISA and Section 4975 of the Code for transactions involving certain parties in interest or disqualified persons who are such merely because they are a service provider to a Plan, or because they are related to a service provider. Generally, the exemption would be applicable if the party to the transaction with the Plan is a party in interest or a disqualified person to the Plan but is not (i) an employer, (ii) a fiduciary who has or exercises any discretionary authority or control with respect to the investment of the Plan assets involved in the transaction, (iii) a fiduciary who renders investment advice (within the meaning of ERISA and Section 4975 of the Code) with respect to those assets, or (iv) an affiliate of (i), (ii) or (iii). Any Plan fiduciary relying on this new statutory exemption (Section 408(b)(17) of ERISA and Section 4975(d)(20) of the Code) and purchasing Notes on behalf of a Plan will be deemed to represent that (x) the fiduciary has made a good faith determination that the Plan is paying no more than, and is receiving no less than, adequate consideration in connection with the transaction and (y) neither we, Bear Stearns, nor any of our affiliates directly or indirectly exercises any discretionary authority or control or renders investment advice (as defined above) with respect to the assets of the Plan which such fiduciary is using to purchase the Notes, both of which are necessary preconditions to utilizing this exemption. Any purchaser that is a Plan is encouraged to consult with counsel regarding the application of this exemption.

A fiduciary who causes a Plan to engage, directly or indirectly, in a non-exempt prohibited transaction may be subject to a penalty under ERISA, and may be liable for any losses to the Plan resulting from such transaction. Code Section 4975 generally imposes an excise tax on disqualified persons who engage, directly or indirectly, in non-exempt transactions with the assets of Plans subject to such Section. If an IRA engages in a prohibited transaction, the assets of the IRA are deemed to have been distributed to the IRA beneficiaries.

In accordance with ERISA's general fiduciary requirements, a fiduciary with respect to any ERISA Plan who is considering the purchase of Notes on behalf of such plan should consider the foregoing information and the information set forth in the applicable prospectus supplement and any applicable pricing supplement, and should determine whether such purchase is permitted under the governing plan document and is prudent and appropriate for the ERISA Plan in view of its overall investment policy and the composition and diversification of its portfolio. Fiduciaries of Plans established with, or for which services are provided by, us, Bear Stearns, and/or certain of our affiliates should consult with counsel before making any acquisition. Each purchaser of any Notes, the assets of which constitute the assets of one or more Plans, and each fiduciary that directs such purchaser with respect to the purchase or holding of such Notes, will be deemed to represent that the purchase, holding and disposition of the Notes does not and will not constitute a prohibited transaction under Section 406 of ERISA or Section 4975 of the Code for which an exemption is not available.

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Certain employee benefit plans, such as governmental plans (as defined in Section 3(32) of ERISA) and, if no election has been made under Section 410(d) of the Code, church plans (as defined in Section 3(33) of ERISA), are not subject to Section 406 of ERISA or Section 4975 of the Code. However, such plans may be subject to the provisions of applicable federal, state or local law (“Similar Law”) similar to the foregoing provisions of ERISA or the Code. Fiduciaries of such plans (“Similar Law Plans”) should consider applicable Similar Law when investing in the Notes. Each fiduciary of a Similar Law Plan will be deemed to represent that the Similar Law Plan’s acquisition and holding of the Notes will not result in a non-exempt violation of applicable Similar Law.

The sale of any Note to a Plan or a Similar Law Plan is in no respect a representation by us or any of our affiliates that such an investment meets all relevant legal requirements with respect to investments by Plans or Similar Law Plans generally or any particular Plan or Similar Law Plan, or that such an investment is appropriate for a Plan or a Similar Law Plan generally or any particular Plan or Similar Law Plan.

### USE OF PROCEEDS AND HEDGING

We will use the net proceeds from the sale of the Notes for general corporate purposes. We or one or more of our subsidiaries (including BSIL) may hedge our obligations under the Notes by the purchase and sale of the Reference Share, exchange-traded and over-the-counter options on, or other derivative or synthetic instruments related to, the Reference Share, individual futures contracts on the Reference Share, futures contracts on the Reference Share and/or options on these futures contracts. At various times after the initial offering and before the maturity of the Notes, depending on market conditions (including the price of the Reference Share), in connection with hedging with respect to the Notes, we expect that we and/or one or more of our subsidiaries will increase or decrease those initial hedging positions using dynamic hedging techniques and may take long or short positions in any of these instruments. We or one or more of our subsidiaries may also take positions in other types of appropriate financial instruments that may become available in the future. If we or one or more of our subsidiaries has a long hedge position in any of these instruments then we or one or more of our subsidiaries may liquidate a portion of these instruments at or about the time of the maturity of the Notes. Depending on, among other things, future market conditions, the total amount and the composition of such positions are likely to vary over time. We will not be able to ascertain our profits or losses from any hedging position until such position is closed out and any offsetting position or positions are taken into account. Although we have no reason to believe that such hedging activity will have a material effect on the price of any of these instruments or on the price of the Reference Share, we cannot guarantee that we and one or more of our subsidiaries will not affect such prices as a result of its hedging activities. You should also refer to “Use of Proceeds” in the accompanying prospectus.

### SUPPLEMENTAL PLAN OF DISTRIBUTION

Subject to the terms and conditions set forth in the Distribution Agreement dated as of June 19, 2003, as amended, we have agreed to sell to Bear Stearns, as principal, and Bear Stearns has agreed to purchase from us, the aggregate principal amount of Notes set forth opposite its name below.

<u>Agent</u>	<b>Principal Amount of Notes</b>
Bear, Stearns & Co. Inc.	\$3,350,000
<b>Total</b>	<b>\$3,350,000</b>

The Agent intends to initially offer \$3,350,000 of the Notes to the public at the offering price set forth on the cover page of this pricing supplement, and to subsequently resell the remaining face amount of the Notes at prices related to the prevailing market prices at the time of resale. Potential investors should understand that, as described on the cover, investors who purchase an aggregate amount of at least \$1,000,000 of Notes in this initial distribution will be entitled

to purchase such Notes for 99.00% of the principal amount. In the future, the Agent may repurchase and resell the Notes in market-making transactions, with resales being made at prices related to prevailing market prices at the time of resale or at negotiated prices. We will offer the Notes to Bear Stearns at a discount of 1.25% of the price at which the Notes are offered to the public. Bear Stearns may reallow a discount to other agents not in excess of 1.25% of the public offering price.

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In order to facilitate the offering of the Notes, we may grant the Agent a 30-day option from the date of the final pricing supplement, to purchase from us up to an additional \$502,500 at the public offering price, less the agent's discount, to cover any over-allotments. The Agent may over-allot or effect transactions which stabilize or maintain the market price of the Notes at a price higher than that which might otherwise prevail in the open market. Specifically, the Agent may over-allot or otherwise create a short position in the Notes for its own account by selling more Notes than have been sold to it by us. If this option is exercised, in whole or in part, subject to certain conditions, the Agent will become obligated to purchase from us and we will be obligated to sell to the Agent an amount of Notes equal to the amount of the over-allotment exercised. The Agent may elect to cover any such short position by purchasing Notes in the open market. No representation is made as to the magnitude or effect of any such stabilization or other transactions. Such stabilizing, if commenced, may be discontinued at any time and in any event shall be discontinued within a limited period. No other party may engage in stabilization.

Payment of the purchase price shall be made in funds that are immediately available in New York City.

The agents may be deemed to be "underwriters" within the meaning of the Securities Act of 1933, as amended (the "Securities Act"). We have agreed to indemnify the agents against or to make contributions relating to certain civil liabilities, including liabilities under the Securities Act. We have agreed to reimburse the agents for certain expenses.

The Notes are a new issue of securities with no established trading market. The Notes will not be listed on any securities exchange and we do not expect a trading market will develop. Bear Stearns has advised us that, following completion of the offering of the Notes, it intends under ordinary market conditions to indicate prices for the Notes on request, although it is under no obligation to do so and may discontinue any market-making activities at any time without notice. Accordingly, no guarantees can be given as to whether an active trading market for the Notes will develop or, if such a trading market develops, as to the liquidity of such trading market. We cannot guarantee that bids for outstanding Notes will be made in the future; nor can we predict the price at which any such bids will be made. The Notes will cease trading as of the close of business on the Maturity Date.

Because Bear Stearns is our wholly-owned subsidiary, each distribution of the Notes will conform to the requirements set forth in Rule 2720 of the NASD Conduct Rules.

#### **LEGAL MATTERS**

The validity of the Notes will be passed upon for us by Cadwalader, Wickersham & Taft LLP, New York, New York.

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**You should only rely on the information contained in this pricing supplement, the accompanying prospectus supplement and prospectus. We have not authorized anyone to provide you with information or to make any representation to you that is not contained in this pricing supplement, the accompanying prospectus supplement and prospectus. If anyone provides you with different or inconsistent information, you should not rely on it. This pricing supplement, the accompanying prospectus supplement and prospectus are not an offer to sell these Notes, and these documents are not soliciting an offer to buy these Notes, in any jurisdiction where the offer or sale is not permitted. You should not under any circumstances assume that the information in this pricing supplement, the accompanying prospectus supplement and prospectus is correct on any date after their respective dates.**

**The Bear Stearns  
Companies Inc.**

**\$3,350,000**

**Medium-Term Notes, Series B**

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**Accelerated Market  
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**Linked to the common stock of Apple Inc.  
Due April 28, 2008**

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**PRICING SUPPLEMENT**

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**Bear, Stearns & Co. Inc.**

**March 23, 2007**

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