**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

# FORM 10-Q

*(Mark One)*

**[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Quarterly Period Ended March 31, 2000**

**OR**

**[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from _____to _____**

**Commission file number 0-19756**

# PROTEIN DESIGN LABS, INC.

(Exact name of Registrant as specified in its Charter)

**34801 Campus Drive**

**Fremont, California, 94555**

(Address of Principal Executive Offices including Zip Code)

**(510) 574-1400**

(Registrant's Telephone Number, Including Area Code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file reports), and (2) has been subject to such filing requirements for the past 90 days. YES [X] NO [ ]

As of March 31, 2000, there were 19,573,677 shares of the Registrant's Common Stock outstanding.

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**PROTEIN DESIGN LABS, INC.**

**QUARTERLY REPORT ON FORM 10-Q FOR THE PERIOD ENDED MARCH 31, 2000**

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| **Delaware** | **94-3023969** |
|---|---|
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification Number) |

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**PROTEIN DESIGN LABS, INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except net income (loss) per share data)

(unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2000 | 1999 |
| Revenues: | | |
| Revenue under agreements with third parties | $12,450 | $6,462 |
| Interest and other income | 3,050 | 2,373 |
| Total revenues | 15,500 | 8,835 |
| Costs and expenses: | | |
| Research and development | 11,069 | 8,280 |
| General and administrative | 2,458 | 2,445 |
| Interest expense | 1,203 | -- |
| Total costs and expenses | 14,730 | 10,725 |
| Net income (loss) | $770 | ($1,890) |
| Net income (loss) per share: | | |
| Basic | $0.04 | ($0.10) |
| Diluted | $0.04 | ($0.10) |
| Weighted average number of shares: | | |
| Basic | 19,460 | 18,618 |
| Diluted | 21,526 | 18,618 |

See accompanying notes

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**PROTEIN DESIGN LABS, INC.**

**CONSOLIDATED BALANCE SHEETS**

(In thousands, except par value per share)

March 31, December 31,

| | 2000 | 1999 |
|---|---|---|
| | (unaudited) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $177,188 | $17,138 |
| Marketable securities | 114,438 | 120,098 |
| Other current assets | 6,290 | 6,719 |
| Total current assets | 297,916 | 143,955 |
| Property and equipment, net | 37,998 | 38,047 |
| Other assets | 5,333 | 549 |
| | $341,247 | $182,551 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $541 | $877 |
| Accrued compensation | 1,137 | 1,090 |
| Accrued clinical trials | 883 | 712 |
| Other accrued liabilities | 2,251 | 2,762 |
| Deferred revenue | 2,792 | 2,275 |
| Current portion of long-term debt | 377 | 368 |
| Accured interest | 1,007 | -- |
| Total current liabilities | 8,988 | 8,084 |
| Convertible notes | 150,000 | -- |
| Long-term debt | 9,624 | 9,724 |
| Total liabilities | 168,612 | 17,808 |
| Stockholders' equity: | | |
| Preferred stock, par value $0.01 per share, 10,000 shares authorized; no shares issued and outstanding | -- | -- |
| Common stock, par value $0.01 per share, 40,000 shares authorized; 19,574 and 19,281 issued and outstanding at March 31, 2000 and December 31, 1999, respectively | 196 | 193 |
| Additional paid-in capital | 253,454 | 245,812 |
| Accumulated deficit | (78,447) | (79,217) |
| Accumulated other comprehensive income (loss) | (2,568) | (2,045) |
| Total stockholders' equity | 172,635 | 164,743 |
| | $341,247 | $182,551 |

See accompanying notes

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**PROTEIN DESIGN LABS, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(unaudited)

(In thousands)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2000 | 1999 |
| Cash flows from operating activities: | | |
| Net income (loss) | $770 | ($1,890) |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: | | |
| Depreciation and amortization | 761 | 857 |
| Amortization of convertible debt offering costs | 90 | -- |
| Other | 301 | 185 |
| Changes in assets and liabilities: | | |
| Other current assets | (291) | (827) |
| Accounts payable | (337) | 164 |
| Accrued liabilities | 714 | (2,131) |
| Deferred revenue | 517 | 1,791 |
| Total adjustments | 1,755 | 39 |
| Net cash provided by (used in) operating activities | 2,525 | (1,851) |
| Cash flows from investing activities: | | |
| Purchases of marketable securities | -- | (59,500) |
| Maturities of marketable securities | 5,000 | 61,400 |
| Property, plant and equipment | (876) | (770) |
| Proceeds from sale of equipment | -- | -- |
| Increase in other assets | (4,154) | (296) |
| Net cash provided by (used in) investing activities | (30) | 834 |
| Cash flows from financing activities: | | |
| Proceeds from convertible debt | 150,000 | -- |
| Proceeds from issuance of capital stock | 7,645 | 462 |
| Payments on long-term debt | (90) | -- |
| Net cash provided by financing activities | 157,555 | 462 |
| Net increase (decrease) in cash and cash equivalents | 160,050 | (555) |
| Cash and cash equivalents at beginning of period | 17,138 | 27,907 |
| Cash and cash equivalents at end of period | $177,188 | $27,352 |

See accompanying notes

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**PROTEIN DESIGN LABS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2000**

(unaudited)

**Summary of Significant Accounting Policies**

***Organization and Business***

Since our founding in 1986, a primary focus of our operations has been research and development. Achievement of successful research and development and commercialization of products derived from our efforts is subject to high levels of risk and significant resource commitments. Our expenses have generally exceeded revenues. As of March 31, 2000, we had an accumulated deficit of approximately $78.4 million. We believe that our losses may increase because of the extensive resource commitments required to achieve regulatory approval and commercial success for any individual product. For example, over the next several years, we will incur substantial additional expenses as we continue to develop and manufacture our potential products, invest in new research areas and improve and expand our manufacturing capabilities. Since we or our collaborative partners or licensees may not be able to successfully develop additional products, obtain required regulatory approvals, manufacture products at an acceptable cost and with appropriate quality, or successfully market such products with desired margins, we may never achieve profitable operations. The amount of net losses and the time required to reach sustained profitability are highly uncertain. We cannot assure you that we will be able to achieve or sustain profitability.

Our commitment of resources to the development of Zenapax[R] and the humanized anti-IL-4 antibody, two humanized antibodies with respect to which we recently obtained development rights, taken together with the continued development of our existing products, will require significant additional funds for development. These operating expenses may also increase as some of our earlier stage potential products move into later stage clinical development, as additional potential products are selected as clinical candidates for further development, as we invest in additional manufacturing capacity, as we defend or prosecute our patents and patent applications, and as we invest in research or acquire additional technologies, product candidates or businesses.

In the absence of substantial revenues from new corporate collaborations or patent licensing or humanization agreements, significant royalties on sales of products licensed under our intellectual property rights, product sales or other uncertain sources of revenue, we will incur substantial operating losses.

Our revenues have varied in the past and will likely continue to fluctuate considerably from quarter to quarter and from year to year. As a result, our revenues in any period may not be predictive of revenues in any subsequent period. Our royalty revenues may be unpredictable and may fluctuate since they depend upon the seasonality of sales of licensed products, the existence of competing products, the marketing efforts of our licensees, potential reductions in royalties payable to us due to credits for prior payments to us, the timing of royalty reports, some of which are required quarterly and others semi-annually, our method of accounting for royalty revenues from our licensees and our ability to successfully defend and enforce our patents. Other revenue may also be unpredictable and may fluctuate due to the timing of payments of non-recurring licensing and signing fees and payments for manufacturing services and achievement of milestones under new and existing collaborative, humanization, and patent licensing agreements. Revenue historically recognized under our prior agreements may not be an indicator of revenue from any future collaborations.

In addition, our expenses may be unpredictable and may fluctuate from quarter to quarter due to the timing of expenses, which may include payments owed by us under licensing arrangements and due to our policy of recording expenses under certain collaborative agreements during the quarter in which such expenses are reported to us.

***Basis of Presentation and Responsibility for Quarterly Financial Statements***

The consolidated balance sheet as of March 31, 2000, and the consolidated statements of operations and cash flows for the three month periods ended March 31, 2000 and 1999 are unaudited, but include all adjustments (consisting only of normal recurring adjustments) which we consider necessary for a fair presentation of our financial position at such dates and the operating results and cash flows for those periods. Although we believe that the disclosures in our financial statements are adequate to make the information presented not misleading, certain information and footnote information normally included in financial statements prepared in accordance with accounting principles generally accepted in the U.S. have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The accompanying financial statements should be read in conjunction with the our Annual Report on Form 10-K, filed with the Securities and Exchange Commission, for the year ended December 31,

1999. The balance sheet as of December 31, 1999 is derived from audited financial statements. Results for any quarterly period are not necessarily indicative of results for any other quarterly period or for the entire year.

***Cash Equivalents, Marketable Securities and Concentration of Credit Risk***

We consider all highly liquid investments with a maturity of three months or less at the date of purchase to be cash equivalents. The "Other" adjustments line item in the Statements of Cash Flows represents the accretion of the book value of certain debt securities. We place our cash, and marketable securities with high-credit-quality financial institutions and in securities of the U.S. government and U.S. government agencies and, by policy, limit the amount of credit exposure in any one financial instrument. To date, we have not experienced credit losses on investments in these instruments.

***Revenue Recognition***

Contract revenues from research and development arrangements are recorded as earned based on the performance requirements of the contracts. Revenues from achievement of milestone events are recognized when the funding party agrees that the scientific or clinical results stipulated in the agreement have been met. Deferred revenue arises principally due to timing of cash payments received under research and development contracts.

Our collaborative, humanization and patent licensing agreements with third parties provide for the payment of royalties to us based on net sales of the licensed product under the agreement. The agreements generally provide for royalty payments to us following completion of each calendar quarter or semi-annual period and royalty revenue is recognized when royalty reports are received from the third party. Non-refundable signing and licensing fees under collaborative and humanization agreements are recognized over the period in which performance obligations are achieved. Non-refundable signing and licensing fees under patent licensing agreements are recognized as revenue when there are no future performance obligations remaining with respect to such fees.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" (SAB 101). We are evaluating the effects, if any, that the adoption of SAB 101 in the second quarter of 2000 may have on the results of our operations or our financial position. We have been advised that the Securities and Exchange Commission intends to provide additional guidance during the second quarter of 2000 with respect to the implementation of SAB 101. It is currently unknown whether such guidance and implementation of SAB 101 will require us to revise our revenue recognition practices or to restate revenues for the first quarter of 2000.

***Net Income (Loss) Per Share***

In accordance with Financial Accounting Standards Board Statement No. 128, "Earnings Per Share" ("FAS 128"), basic and diluted net income (loss) per share amounts have been computed using the weighted average number of shares of common stock outstanding during the periods presented. Calculation of diluted net income per share includes the dilutive effect of outstanding stock options, but does not include outstanding convertible debt as its effect is anti-dilutive. We incurred a net loss for the three month period ended March 31, 1999, and as such, we did not include the effect of outstanding stock options in the diluted net loss per share calculation as their effect is anti-dilutive.

The following is a reconciliation of the numerators and denominators of the basic and diluted net income (loss) per share computations for the periods presented below:

(In thousands, except basic and diluted net income (loss) per share)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2000 | 1999 |
| Numerator: | | |

| | | |
|---|---|---|
| Net income (loss) | $770 | ($1,890) |
| Denominator: | | |
| Basic net income (loss) per share - weighted-average shares | 19,460 | 18,618 |
| Dilutive potential common shares: | | |
| Stock Options | 2,066 | -- |
| Denominator for diluted net income (loss) per share | 21,526 | 18,618 |
| Basic net income (loss) per share | $0.04 | ($0.10) |
| Diluted net income (loss) per share | $0.04 | ($0.10) |

***Comprehensive Income (Loss)***

During the three months ended March 31, 2000 and 1999, total comprehensive income (loss) was $0.2 million and $(2.4) million, respectively. The Company's other comprehensive income (loss) is comprised of unrealized gains and losses on the Company's available-for-sale securities.

***Derivative Instruments and Hedging Activities***

In June 1998, the Financial Accounting Standards Board issued Statement No. 133 "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"). FAS 133 is not required to be adopted until 2001. However, the Company has reviewed FAS 133 and because it does not use derivatives, the adoption of FAS 133 is not expected to effect the results of operations or the financial position of the Company.

***Management Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the use of management's estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. For example, we have a policy of recording expenses for clinical trials based upon pro rating estimated total costs of a clinical trial over the estimated length of the clinical trial and the number of patients anticipated to be enrolled in the trial. Expenses related to each patient are recognized ratably beginning upon entry into the trial and over the course of the trial. In the event of early termination of a clinical trial, management accrues an amount based on its estimate of the remaining non-cancellable obligations associated with the winding down of the clinical trial. Our estimates and assumptions could differ significantly from the amounts which may actually be realized.

***Convertible Notes***

In February 2000, we issued 5.50% Convertible Subordinated Notes due February 15, 2007 with a principal amount of $150 million (the Convertible Notes). The Convertible Notes are convertible into our common stock at a conversion price of $151.00 per share, subject to adjustment as a result of certain events and at the holders' option. Interest on the Convertible Notes is payable semiannually in arrears on February 15 and August 15 of each year. The Convertible Notes are unsecured and are subordinated to all our existing and future Senior Indebtedness (as defined in the indenture relating to the Convertible Notes). The Convertible Notes may be redeemed at our option, in whole or in part, beginning on February 15, 2003 at the redemption prices set forth in the Convertible Notes indenture. In May 2000, we filed a shelf registration statement covering resales of the Convertible Notes and the common stock issuable upon conversion of the Convertible Notes. Issuance costs associated with the Convertible Notes are included in other assets and are amortized to interest expense over the term of the debt.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*This Quarterly Report contains forward-looking statements which involve risks and uncertainties. The Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a difference include, but are not limited to those discussed in "Risk Factors" as well as those discussed elsewhere in*

*this document and the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission for the year ended December 31, 1999.*

***OVERVIEW***

Since our founding in 1986, a primary focus of our operations has been research and development. Achievement of successful research and development and commercialization of products derived from our efforts is subject to high levels of risk and significant resource commitments. Our expenses have generally exceeded revenues. As of March 31, 2000, we had an accumulated deficit of approximately $78.4 million. We believe that our losses may increase because of the extensive resource commitments required to achieve regulatory approval and commercial success for any individual product. For example, over the next several years, we will incur substantial additional expenses as we continue to develop and manufacture our potential products, invest in new research areas and improve and expand our manufacturing capabilities. Since we or our collaborative partners or licensees may not be able to successfully develop additional products, obtain required regulatory approvals, manufacture products at an acceptable cost and with appropriate quality, or successfully market such products with desired margins, we may never achieve profitable operations. The amount of net losses and the time required to reach sustained profitability are highly uncertain. We cannot assure you that we will be able to achieve or sustain profitability.

Our commitment of resources to the development of Zenapax[R] and the humanized anti-IL-4 antibody, two humanized antibodies with respect to which we recently obtained development rights, taken together with the continued development of our existing products, will require significant additional funds for development. These operating expenses may also increase as some of our earlier stage potential products move into later stage clinical development, as additional potential products are selected as clinical candidates for further development, as we invest in additional manufacturing capacity, as we defend or prosecute our patents and patent applications, and as we invest in research or acquire additional technologies, product candidates or businesses.

In the absence of substantial revenues from new corporate collaborations or patent licensing or humanization agreements, significant royalties on sales of products licensed under our intellectual property rights, product sales or other uncertain sources of revenue, we will incur substantial operating losses.

Our revenues have varied in the past and will likely continue to fluctuate considerably from quarter to quarter and from year to year. As a result, our revenues in any period may not be predictive of revenues in any subsequent period. Our royalty revenues may be unpredictable and may fluctuate since they depend upon the seasonality of sales of licensed products, the existence of competing products, the marketing efforts of our licensees, potential reductions in royalties payable to us due to credits for prior payments to us, the timing of royalty reports, some of which are required quarterly and others semi-annually, our method of accounting for royalty revenues from our licensees and our ability to successfully defend and enforce our patents. Other revenue may also be unpredictable and may fluctuate due to the timing of payments of non-recurring licensing and signing fees and payments for manufacturing services and achievement of milestones under new and existing collaborative, humanization, and patent licensing agreements. Revenue historically recognized under our prior agreements may not be an indicator of revenue from any future collaborations.

PDL has recognized revenue during the quarter ended March 31, 2000, in accordance with its historical practice. In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" (SAB 101). We are evaluating the effects, if any, that the adoption of SAB 101 in the second quarter of 2000 may have on the results of our operations or our financial position. We have been advised that the Securities and Exchange Commission intends to provide additional guidance during the second quarter of 2000 with respect to the implementation of SAB 101. It is currently unknown whether such guidance and the implementation of SAB 101 will require us to revise our revenue recognition practices or to restate revenues for the first quarter of 2000.

In addition, our expenses may be unpredictable and may fluctuate from quarter to quarter due to the timing of expenses, which may include payments owed by us under licensing arrangements and due to our policy of recording expenses under collaborative agreements during the quarter in which such

expenses are reported to us.

***RESULTS OF OPERATIONS***

**Three Months Ended March 31, 2000 and 1999**

The Company's total revenues for the three months ended March 31, 2000 were $15.5 million compared to $8.8 million in the first quarter of 1999. Total revenues recognized under agreements with third parties were $12.5 million in the first quarter of 2000 compared to $6.5 million in the comparable period in 1999. Interest and other income was $3.0 million in the first quarter of 2000 compared to $2.4 million in the comparable period in 1999, reflecting the increased interest earned on our cash, cash equivalents and marketable securities balances as a result of our private placement of $150 million in convertible subordinated notes in February 2000.

Revenues under agreements with third parties of $12.5 million for the three months ended March 31, 2000 consisted principally of royalties, signing and licensing fees, research and development reimbursement funding, milestone payments earned under licensing agreements and a license maintenance fee. In the first quarter of 1999, revenues of $6.5 million under agreements with third parties consisted principally of a $3.0 million non-refundable, non-creditable signing and licensing fee from Scil Biomedicals GmbH (Scil) for rights to develop and market our SMART[TM] (humanized) Anti-L-Selectin Antibody in Europe, royalties and research and development reimbursement funding.

Total costs and expenses for the three months ended March 31, 2000 were $14.7 million compared with $10.7 million in the comparable period in 1999.

Research and development expenses for the three month period ended March 31, 2000 were $11.1 million compared with $8.3 million in the year-earlier quarter. Research and development costs increased primarily due to the addition of staff, the expansion of clinical development programs, research and pharmaceutical development capabilities, including support for both clinical development and manufacturing process development and payments related to manufacturing of humanized anti-IL-4.

General and administrative expenses for the three months ended March 31, 2000 increased to $2.5 million from $2.4 million in the comparable period in 1999.

Interest expense for the three month period ended March 31, 2000 increased to $1.2 million primarily due to the interest expense associated with our convertible subordinated notes issued on February 15, 2000.

***LIQUIDITY AND CAPITAL RESOURCES***

To date we have financed our operations primarily through public and private placements of equity securities, research and development revenues, interest income on invested capital and a private placement of $150 million in convertible subordinated notes in February 2000. At March 31, 2000, we had cash, cash equivalents and marketable securities in the aggregate of $291.6 million, compared to $137.2 million at December 31, 1999.

As set forth in the Consolidated Statements of Cash Flows, net cash provided by operating activities was $2.5 million for the three months ended March 31, 2000 compared to net cash used in operating activities of $1.9 million in the same period in 1999. This change was primarily the result of our net income for the first quarter of 2000 as compared to a net loss in the comparable period of 1999.

As set forth in the Consolidated Statements of Cash Flows, net cash provided by financing activities for the three months ended March 31, 2000 was $157.6 million, resulting primarily from the proceeds of a private placement of $150 million in convertible subordinated notes in February 2000 and the exercise of outstanding stock options.

Our future capital requirements will depend on numerous factors, including, among others, royalties from sales of products of third party licensees, including Synagis[R], Herceptin[R] and Zenapax; our ability to enter into additional collaborative, humanization and patent licensing

arrangements; progress of product candidates in clinical trials; the ability of our licensees to obtain regulatory approval and successfully manufacture and market products licensed under our patents; the continued or additional support by our collaborative partners or other third parties of research and development efforts and clinical trials; enhancement of existing and investment in new research and development programs; time required to gain regulatory approvals; resources we devote to self-funded products, manufacturing facilities and methods and advanced technologies; our ability to obtain and retain funding from third parties under collaborative arrangements; our continued development of internal marketing and sales capabilities; the demand for our potential products, if and when approved; potential acquisitions of technology, product candidates or businesses by us; and the costs of defending or prosecuting any patent opposition or litigation necessary to protect our proprietary technology. In order to develop and commercialize our potential products we may need to raise substantial additional funds through equity or debt financings, collaborative arrangements, the use of sponsored research efforts or other means. No assurance can be given that such additional financing will be available on acceptable terms, if at all, and such financing may only be available on terms dilutive to existing stockholders. We believe that existing capital resources including the proceeds of the issue and sale in February 2000 of $150 million of our 5.50% Convertible Subordinated Notes due February 15, 2007, will be adequate to satisfy our capital needs through at least 2002.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company maintains a non-trading investment portfolio of investment grade, highly liquid, debt securities which limits the amount of credit exposure to any one issue, issuer, or type of instrument. The Company does not use derivative financial instruments for speculative or trading purposes. The securities in the Company's investment portfolio are not leveraged and are classified as available for sale and therefore are subject to interest rate risk. The Company does not currently hedge interest rate exposure. As of March 31, 2000, there has been no material change in the Company's interest rate exposure from that described in the Company's Annual Report on Form 10-K for the year ended December 31, 1999.

## PART II. OTHER INFORMATION

**ITEM 5. OTHER INFORMATION - RISK FACTORS**

*This Quarterly Report contains, in addition to historical information, forward-looking statements which involve risks and uncertainties. The Company's actual results may differ significantly from the results discussed in forward-looking statements. Factors that may cause such a difference include those discussed in the material set forth in this document and in the discussion captioned "Risk Factors" in the Company's Annual Report on Form 10-K for the year ending December 31, 1999.*

**We have a history of operating losses and may not achieve profitability.**

Our expenses have generally exceeded revenues. As of December 31, 1999, we had an accumulated deficit of approximately $79.2 million. We believe that our losses may increase because of the extensive resource commitments required to achieve regulatory approval and commercial success for any individual product. For example, over the next several years, we will incur substantial additional expenses as we continue to develop and manufacture our potential products, invest in new research areas and improve and expand our manufacturing capabilities. Since we or our collaborative partners or licensees may not be able to successfully develop additional products, obtain required regulatory approvals, manufacture products at an acceptable cost and with appropriate quality, or successfully market such products with desired margins, we may never achieve profitable operations. The amount of net losses and the time required to reach sustained profitability are highly uncertain. We cannot assure you that we will be able to achieve or sustain profitability.

Our commitment of resources to the development of Zenapax and the humanized anti-IL-4 antibody, two humanized antibodies with respect to which we recently obtained development rights, taken together with the continued development of our existing products, will require significant additional funds for development. Our operating expenses may also increase as:

- some of our earlier stage potential products move into later stage clinical development
- additional potential products are selected as clinical candidates for further development
- we invest in additional manufacturing capacity
- we defend or prosecute our patents and patent applications, and
- we invest in research or acquire additional technologies, product candidates or businesses.

In the absence of substantial revenues from new corporate collaborations or patent licensing or humanization agreements, significant royalties on sales of products licensed under our intellectual property rights, product sales or other uncertain sources of revenue, we will incur substantial operating losses.

**Our revenues, expenses and operating results will likely fluctuate in future periods.**

Our revenues have varied in the past and will likely continue to fluctuate considerably from quarter to quarter and from year to year. As a result, our revenues in any period may not be predictive of revenues in any subsequent period. Our royalty revenues may be unpredictable and may fluctuate since they depend upon:

- the seasonality of sales of licensed products
- the existence of competing products
- the marketing efforts of our licensees
- potential reductions in royalties payable to us due to credits for prior payments to us
- the timing of royalty reports, some of which are required quarterly and others semi-annually,
- our method of accounting for royalty revenues from our licensees, and
- our ability to successfully defend and enforce our patents.

Other revenue may also be unpredictable and may fluctuate due to the timing of payments of non-recurring licensing and signing fees and payments for manufacturing services and achievement of milestones under new and existing collaborative, humanization, and patent licensing agreements. Revenue historically recognized under our prior agreements may not be an indicator of non-royalty revenue from any future collaborations.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" (SAB 101). We are evaluating the effects, if any, that the adoption of SAB 101 in the second quarter of 2000 may have on the results of our operations or our financial position. We have been advised that the Securities and Exchange Commission intends to provide additional guidance during the second quarter of 2000 with respect to the implementation of SAB 101. It is currently unknown whether such guidance and the implementation of SAB 101

will require us to revise our revenue recognition practices or to restate revenues for the first quarter of 2000.

In addition, our expenses may be unpredictable and may fluctuate from quarter to quarter due to the timing of expenses, which may include payments owed by us under licensing arrangements.

**Our humanization patents are being opposed and a successful challenge could limit our future revenues.**

PDL's two humanization patents issued by the European Patent Office (EPO) apply in the United Kingdom, Germany, France, Italy and eight other European countries. The EPO procedures provide for an opposition period in which other parties may submit arguments as to why a patent was incorrectly granted and should be withdrawn or limited. Eighteen notices of opposition to our first European patent were filed during the opposition period for the patent, including oppositions by major pharmaceutical and biotechnology companies. At an oral hearing in March 2000, the Opposition Division (OD) of the EPO decided to revoke the broad claims in our first European patent based on formal matters of European patent law, specifically that there had been an impermissible addition of subject matter after the filing of the original European patent application, but did not provide the rationale behind its decision. The decision upheld claims that protect Zenapax. The OD did not otherwise announce a decision on the issue of whether the claims in our patent are inventive in light of the prior art or other issues of patentability. We plan to appeal the OD's decision to the Technical Board of Appeals at the EPO. The Technical Board of Appeals will consider all issues anew. The appeal suspends the decision of the OD during the appeals process, which is likely to take several years.

Until our appeal regarding our first European patent is resolved, we may be limited in our ability to collect royalties or to negotiate future licensing or collaborative research and development arrangements based on this and our other humanization patents. Moreover, if our appeal is unsuccessful, our ability to collect royalties on European sales of antibodies humanized by others would depend on the scope and validity of our second European patent, whether the antibodies are manufactured in a country outside of Europe where they are covered by one of our patents, and in that case the terms of our license agreements with respect to that situation. Also, the OD's decision could encourage challenges of our related patents in other jurisdictions, including the U.S. The OD's decision may lead some of our licensees to stop making royalty payments or lead potential licensees not to take a license, which might result in us initiating formal legal actions to enforce our rights under our various humanization patents. In such a situation, a likely defensive strategy to our action would be to challenge our patents in that jurisdiction. During the appeals process with respect to our first European patent, if we were to commence an infringement action to enforce that patent, such an action would likely be stayed until the appeal is decided by the EPO. We have no assurance that we will successfully enforce our rights under our European or related U.S. and Japanese patents. The nine month opposition period for our second European antibody humanization patent ends in May 2000, and we expect that a significant number of notices of opposition will be filed with respect to this patent. We have also been advised that three opposition statements have been filed with the Japanese Patent Office with respect to our humanization patent issued in Japan in late 1998.

We intend to vigorously defend the European patents and the Japanese patent in these proceedings; however, we may not prevail in the opposition proceedings or any litigation contesting the validity of these patents. If our appeal with respect to our first European patent is unsuccessful or if the outcome of the other European or Japanese opposition proceedings or any litigation involving our antibody humanization patents were to be unfavorable, our ability to collect royalties on existing licensed products and to license our patents relating to humanized antibodies may be materially harmed. In addition, these proceedings or any other litigation to protect our intellectual property rights or defend against infringement claims by others, could result in substantial costs and diversion of management's time and attention, which could materially harm our business and financial condition.

**If we are unable to protect our patents and proprietary technology, we may not be able to compete successfully.**

Our success depends significantly on our ability to obtain and maintain patent protection for our products and technologies, to preserve our trade secrets and to operate without infringing on the proprietary rights of third

parties. While we file and prosecute patent applications to protect our inventions, our pending patent applications may not result in the issuance of valid patents or our issued patents may not provide competitive advantages. Also, our patent protection may not prevent others from developing competitive products using related or other technology.

A number of companies, universities and research institutions have filed patent applications or received patents in the areas of antibodies and other fields relating to our programs. Some of these applications or patents may be competitive with our applications or contain material that could prevent the issuance of patents to us or result in a significant reduction in the scope of our issued patents.

The scope, enforceability and effective term of patents issued to companies, universities and research institutions can be highly uncertain and often involve complex legal and factual questions. No consistent policy has emerged regarding the breadth of claims in biotechnology patents, so that even issued patents may later be modified or revoked by the relevant patent authorities or courts. Moreover, the issuance of a patent in one country does not assure the issuance of a patent with similar claims in another country, and claim interpretation and infringement laws vary among countries, so we are unable to predict the extent of any patent protection in different countries.

In addition to seeking the protection of patents and licenses, we also rely upon trade secrets, know-how and continuing technological innovation which we seek to protect, in part, by confidentiality agreements with employees, consultants, suppliers and licensees. If these agreements are not honored, we might not have adequate remedies for any breach. Additionally, our trade secrets might otherwise become known or patented by our competitors.

**We may require additional patent licenses in order to manufacture or sell our potential products.**

Other companies, universities and research institutions may obtain patents that could limit our ability to use, import, manufacture, market or sell our products or impair our competitive position. As a result, we might be required to obtain licenses from others before we could continue using, importing, manufacturing, marketing, or selling our products. We may not be able to obtain required licenses on terms acceptable to us, if at all. If we do not obtain required licenses, we may encounter significant delays in product development while we redesign potentially infringing products or methods or may not be able to market our products at all.

Celltech Chiroscience plc has been granted a patent by the EPO covering humanized antibodies (European Adair Patent), which we have opposed. Celltech has also been issued a corresponding U.S. patent (U.S. Adair Patent) that contains claims that may be considered broader in scope than the European Adair Patent. Recently, we entered into an agreement with Celltech providing each company with the right to obtain nonexclusive licenses for up to three antibody targets under the other company's humanization patents. Nevertheless, if our SMART antibodies were covered by the European or U.S. Adair Patent and if we were to need more than the three licenses under those patents currently available to us under the agreement, we would be required to negotiate additional licenses under those patents or to significantly alter our processes or products. We might not be able to successfully alter our processes or products to avoid conflict with these patents or to obtain the required additional licenses on commercially reasonable terms, if at all.

In addition, if U.S. Adair Patent or any related patent applications conflict with our U.S. patents or patent applications, we may become involved in proceedings to determine which company was the first to invent the products or processes contained in the conflicting patents. These proceedings could be expensive, last several years and either prevent issuance of additional patents to us relating to humanization of antibodies or result in a significant reduction in the scope or invalidation of our patents. Any limitation would reduce our ability to negotiate or collect royalties or to negotiate future collaborative research and development agreements based on these patents.

Lonza Biologics, Inc. has a patent issued in Europe to which we do not have a license (although we have been advised by Roche that it has a license covering Zenapax) that may cover a process that we use to produce our potential products. If our processes were covered by this patent, we might

be required to obtain a license under this patent or to significantly alter our processes or products in Europe. We might not be able to successfully alter our processes or products to avoid conflict with this patent or to obtain a license on commercially reasonable terms.

We do not have a license to an issued U.S. patent assigned to Stanford University and Columbia University, which may cover a process we use to produce our potential products. We have been advised that an exclusive license has been previously granted to a third party under this patent. If our processes were covered by this patent, we might be required to obtain a license or to significantly alter our processes or products in the U.S. We might not be able to successfully alter our processes or products to avoid conflict with this patent or to obtain a license on acceptable terms. Moreover, if we do not obtain the required licenses, any alteration of processes or products to avoid conflict with a competitive patent could result in a significant delay in our achieving regulatory approval for the products affected by these alterations.

**If we cannot successfully complete our clinical trials, we will be unable to obtain regulatory approvals required to market our products.**

To obtain regulatory approval for the commercial sale of any of our potential products or to promote these products for expanded indications, we must demonstrate through preclinical testing and clinical trials that each product is safe and effective for use in indications for which approval is requested. We have conducted only a limited number of clinical trials to date. We may not be able to successfully commence and complete all of our planned clinical trials without significant additional resources and expertise. Our potential inability to commence or continue clinical trials, to complete the clinical trials on a timely basis or to demonstrate the safety and efficacy of our potential products, further adds to the uncertainty of regulatory approval for our potential products.

Larger and later stage clinical trials may not produce the same results as early stage trials. Many companies in the pharmaceutical and biotechnology industries, including PDL, have suffered significant setbacks in clinical trials, including advanced clinical trials, even after promising results had been obtained in earlier trials.

Research, preclinical testing and clinical trials may take many years to complete and the time required can vary depending on the indication being addressed and the nature of the product. We may at times elect to use aggressive clinical strategies in order to advance potential products through clinical development as rapidly as possible. For example, we may commence clinical trials without conducting preclinical animal testing, where an appropriate animal testing model does not exist, or we may conduct later stage trials based on limited early stage data. As a result, we anticipate that only some of our potential products may show safety and efficacy in clinical trials and some may encounter difficulties or delays during clinical development.

For example, we have entered the SMART M195 Antibody into a Phase III clinical trial in acute myelogenous leukemia with a clinical regimen that has not been tested previously with this antibody. Results from our prior Phase II and Phase II/III studies showed only a limited number of complete and partial remissions. In addition, we initiated a Phase III study without a meeting with the FDA or European regulatory authorities to discuss the protocol and its adequacy to support approval of the SMART M195 Antibody. We believe that our Phase III program is reasonable in view of the nature and severity of the disease. We cannot assure you that the study will be successful or that the FDA or European regulatory authorities will agree that the study will be adequate to obtain regulatory approval, even if the study is successful. In addition, the protocol for our Phase III trial includes an interim review by an independent data safety monitoring board. It is possible that the trial could be terminated upon such a review if the interim data do not show a sufficient probability of the trial being successful or if specified safety criteria are not met.

As a second example, the FDA recently placed a clinical hold on clinical trials of our SMART Anti-CD3 Antibody for kidney transplant indications due to their belief that we have not supplied adequate data from our prior trials to support our proposed dosage modifications to the Phase II study for prevention of kidney transplant rejection. Although our clinical trials of this antibody in other indications, such as psoriasis, are not affected by this hold, our clinical studies of this potential product for prevention or treatment of kidney transplant rejection will be delayed in the U.S.

until we supply sufficient data to the FDA to justify our desired clinical study designs. Also, we may be required to further modify our clinical study designs to comply with FDA requirements and possibly to conduct additional Phase I trials before proceeding with Phase II trials. Accordingly, there can be no assurance that we will be able, or will choose, to proceed with development of this antibody for either or both of the transplant indications.

**We may be unable to enroll sufficient patients to complete our clinical trials.**

The rate of completion of our clinical trials, and those of our collaborators, is significantly dependent upon the rate of patient enrollment. Patient enrollment is a function of many factors, including:

- the size of the patient population
- perceived risks and benefits of the drug under study
- availability of competing therapies
- availability of clinical trial sites
- design of the protocol
- proximity of and access by patients to clinical sites
- patient referral practices of physicians
- eligibility criteria for the study in question, and
- efforts of the sponsor of and clinical sites involved in the trial to facilitate timely enrollment.

We may have difficulty obtaining sufficient patient enrollment or clinician support to conduct our clinical trials as planned, and we may have to expend substantial additional funds to obtain access to resources or delay or modify our plans significantly. These considerations may lead us to consider the termination of ongoing clinical trials or development of a product for a particular indication.

**We may be unable to obtain or maintain regulatory approval for our products.**

The manufacturing, testing and marketing of our products are subject to regulation by numerous governmental authorities in the U.S. and other countries. In the U.S., pharmaceutical products are subject to rigorous FDA regulation. Additionally, other federal, state and local regulations govern the manufacture, testing, clinical and nonclinical studies to assess safety and efficacy, approval, advertising and promotion of pharmaceutical products. The process of obtaining approval for a new pharmaceutical product or for additional therapeutic indications within this regulatory framework requires a number of years and the expenditure of substantial resources. Companies in the pharmaceutical and biotechnology industries, including us, have suffered significant setbacks in various stages of clinical trials, even in advanced clinical trials after promising results had been obtained in earlier trials.

In addition to the requirement for FDA approval of each pharmaceutical product, each pharmaceutical product manufacturing facility must be registered with, and approved by, the FDA. The manufacturing and quality control procedures must conform to rigorous guidelines in order to receive FDA approval. Pharmaceutical product manufacturing establishments are subject to inspections by the FDA and local authorities as well as inspections by authorities of other countries. To supply pharmaceutical

products for use in the U.S., foreign manufacturing establishments must comply with these FDA approved guidelines. These foreign manufacturing establishments are subject to periodic inspection by the FDA or by corresponding regulatory agencies in these countries under reciprocal agreements with the FDA. Moreover, pharmaceutical product manufacturing facilities may also be regulated by state, local and other authorities.

For the marketing of pharmaceutical products outside the U.S., we and our collaborative partners are subject to foreign regulatory requirements and, if the particular product is manufactured in the U.S., FDA and other U.S. export provisions. Requirements relating to the manufacturing, conduct of clinical trials, product licensing, promotion, pricing and reimbursement vary widely in different countries. Difficulties or unanticipated costs or price controls may be encountered by us or our licensees or marketing partners in our respective efforts to secure necessary governmental approvals. This could delay or prevent us or our licensees or our marketing partners from marketing potential pharmaceutical products.

Both before and after approval is obtained, a pharmaceutical product, its manufacturer and the holder of the Biologics License Application (BLA) for the pharmaceutical product are subject to comprehensive regulatory oversight. The FDA may deny a BLA if applicable regulatory criteria are not satisfied. Moreover, even if regulatory approval is granted, such approval may be subject to limitations on the indicated uses for which the pharmaceutical product may be marketed. Further, marketing approvals may be withdrawn if compliance with regulatory standards is not maintained or if problems with the pharmaceutical product occur following approval. In addition, under a BLA, the manufacturer continues to be subject to facility inspection and the applicant must assume responsibility for compliance with applicable pharmaceutical product and establishment standards. Violations of regulatory requirements at any stage may result in various adverse consequences, which may include, among other adverse actions, withdrawal of the previously approved pharmaceutical product or marketing approvals and/or the imposition of criminal penalties against the manufacturer and/or BLA holder.

**Our revenues from licensed technologies depend on the efforts and successes of our licensees.**

In those instances where we have licensed rights to our technologies, the product development and marketing efforts and successes of our licensees will determine the amount and timing of royalties we may receive, if any. We have no assurance that any licensee will successfully complete the product development, regulatory and marketing efforts required to sell products. The success of products sold by licensees, such as Roche, will be affected by competitive products, including potential competing therapies that are marketed by the licensee or others.

**If our collaborations are not successful, we may not be able to effectively develop and market some of our products.**

We have collaborative agreements with several pharmaceutical and other companies to develop, manufacture and market Zenapax and some of our potential products. In some cases, we are relying on our collaborative partners to manufacture such products, to conduct clinical trials, to compile and analyze the data received from these trials, to obtain regulatory approvals and, if approved, to market these licensed products. As a result, we may have little or no control over the manufacturing, development and marketing of these potential products and little or no opportunity to review clinical data prior to or following public announcement.

Our collaborative agreements can generally be terminated by our partners on short notice. A collaborator may terminate its agreement with us or separately pursue alternative products, therapeutic approaches or technologies as a means of developing treatments for the diseases targeted by us or our collaborative effort. Even if a collaborator continues its contributions to the arrangement, it may nevertheless determine not to actively pursue the development or commercialization of any resulting products. In these circumstances, our ability to pursue potential products could be severely limited.

Continued funding and participation by collaborative partners will depend on the timely achievement of our research and development objectives, the retention of key personnel performing work under those agreements and on each collaborative partner's own financial, competitive, marketing and

strategic considerations. Such considerations include:

the commitment of management of the collaborative partners to the continued development of the licensed products or technology
the relationships among the individuals responsible for the implementation and maintenance of the collaborative efforts, and
the relative advantages of alternative products or technology being marketed or developed by the collaborators or by others, including their relative patent and proprietary technology positions, and their ability to manufacture potential products successfully.

- the commitment of management of the collaborative partners to the continued development of the licensed products or technology
- the relationships among the individuals responsible for the implementation and maintenance of the collaborative efforts, and
- the relative advantages of alternative products or technology being marketed or developed by the collaborators or by others, including their relative patent and proprietary technology positions, and their ability to manufacture potential products successfully.

Our ability to enter into new collaborations and the willingness of our existing collaborators to continue development of our potential products depends upon, among other things, our patent position with respect to such products. If we are unable to successfully maintain our patents we may be unable to collect royalties on existing licensed products or enter into additional collaborations and agreements.

**Our lack of experience in sales, marketing and distribution may hamper market introduction and acceptance of our products.**

We intend to market and sell a number of our products either directly or through sales and marketing partnership arrangements with collaborative partners. To market products directly, we must either establish a marketing group and direct sales force or obtain the assistance of another company. We may not be able to establish marketing, sales and distribution capabilities or succeed in gaining market acceptance for our products. If we were to enter into co-promotion or other marketing arrangements with pharmaceutical or biotechnology companies, our revenues would be subject to the payment provisions of these arrangements and dependent on the efforts of third parties.

**Manufacturing difficulties could delay commercialization of our products.**

Of the products that we currently have in clinical development, Roche is responsible for manufacturing Zenapax, SmithKline Beecham is responsible for manufacturing the humanized anti-IL-4 antibody and Scil is responsible for manufacturing the SMART Anti-L-Selectin Antibody. We are responsible for manufacturing our other products for our own development. We intend to continue to manufacture potential products for use in preclinical and clinical trials using our manufacturing facility in accordance with standard procedures that comply with appropriate regulatory standards. The manufacture of sufficient quantities of antibody products that comply with these standards is an expensive, time-consuming and complex process and is subject to a number of risks that could result in delays. For example, we and our collaborative partners have experienced some manufacturing difficulties. Product supply interruptions could significantly delay clinical development of our potential products, reduce third party or clinical researcher interest and support of proposed clinical trials, and possibly delay commercialization and sales of these products. Manufacturing difficulties can even interrupt the supply of marketed products, thereby reducing revenues and risking loss of market share. For example, Roche has received a warning letter from the FDA regarding deficiencies in the manufacture of various products. Although the letter primarily related to products other than Zenapax, at least two deviations in the manufacture of Zenapax were noted. If Roche were not able to correct these and any other deficiencies in the manufacture of Zenapax in a timely manner, Zenapax supplies could be interrupted, which could cause a delay or termination of our clinical trials of Zenapax in autoimmune disease and could force Roche to withdraw Zenapax from the market temporarily or permanently, resulting in

loss of revenue to us. These occurrences could materially impair our competitive position.

We do not have experience in manufacturing commercial quantities of our potential products, nor do we currently have sufficient capacity to manufacture all of our potential products on a commercial scale. In order to obtain regulatory approvals and to create capacity to produce our products for commercial sale at an acceptable cost, we will need to improve and expand our existing manufacturing capabilities. We are reviewing plans to expand our manufacturing capacity, including possible acquisition and conversion of an existing building into a manufacturing plant. If we implement these plans we will incur substantial costs. Any construction delays could impair our ability to produce adequate supplies of our potential products for clinical use or commercial sale on a timely basis. Further, we may be unable to improve and expand our manufacturing capability sufficiently to obtain necessary regulatory approvals and to produce adequate commercial supplies of our potential products on a timely basis. Failure to do so could delay commercialization of these products and could impair our competitive position.

**Manufacturing changes may result in delays in obtaining regulatory approval or marketing for our products.**

Manufacturing of antibodies for use as therapeutics in compliance with regulatory requirements is complex, time-consuming and expensive. If we make changes in the manufacturing process, we may be required to demonstrate to the FDA and corresponding foreign authorities that the changes have not caused the resulting drug material to differ significantly from the drug material previously produced. This is particularly important if we want to rely on results of prior preclinical studies and clinical trials performed using the previously produced drug material. Depending upon the type and degree of differences between the newer and older drug material, we may be required to conduct additional animal studies or human clinical trials to demonstrate that the newly produced drug material is sufficiently similar to the previously produced drug material. We have made manufacturing changes and are likely to make additional manufacturing changes for the production of our products currently in clinical development, such as the SMART M195 and SMART Anti-CD3 Antibodies. These manufacturing changes could result in delays in development or regulatory approvals or in reduction or interruption of commercial sales and could impair our competitive position.

**Our business may be harmed if we cannot obtain sufficient quantities of raw materials.**

We depend on outside vendors for the supply of raw materials used to produce our product candidates. Once a supplier's materials have been selected for use in our manufacturing process, the supplier in effect becomes a sole or limited source of that raw material due to regulatory compliance procedures. If the third party suppliers were to cease production or otherwise fail to supply us with quality raw materials and we were unable to contract on acceptable terms for these services with alternative suppliers, our ability to produce our products and to conduct preclinical testing and clinical trials of product candidates would be adversely affected. This could impair our competitive position.

**Our revenue may be adversely affected by competition and rapid technological change.**

We are aware that potential competitors have developed and are developing human and humanized antibodies or other compounds for treating autoimmune diseases, transplantation, inflammatory conditions and cancers. In addition, a number of academic and commercial organizations are actively pursuing similar technologies, and several companies have developed or may develop technologies that may compete with our SMART antibody technology. Competitors may succeed in more rapidly developing and marketing technologies and products that are more effective than our products or that would render our products or technology obsolete or noncompetitive. Our collaborative partners may also independently develop products that are competitive with products that we have licensed to them. This could reduce our revenues under our agreements with these partners.

Any product that we or our collaborative partners succeed in developing and for which regulatory approval is obtained must then compete for market acceptance and market share. The relative speed with which we and our collaborative partners can develop products, complete the clinical testing and approval processes, and supply commercial quantities of the products to the market compared to competitive companies will affect market success.

For example, Novartis, which has a significant marketing and sales force directed to the transplantation market, has received approval to market Simulect[R], a product competitive with Zenapax, in the U.S. and Europe. Since Novartis launched Simulect in the European Union earlier than Roche, Zenapax may have a smaller market share than Simulect and other available products.

Other competitive factors include:

- the capabilities of our collaborative partners
- product efficacy and safety
- timing and scope of regulatory approval
- product availability, marketing and sales capabilities
- reimbursement coverage
- the amount of clinical benefit of our products relative to their cost
- method of and frequency of administration of our products
- price of our products, and
- patent protection of our products.

**If we do not attract and retain key employees, our business could be impaired.**

To be successful, we will have to retain our qualified clinical, manufacturing, scientific and management personnel. Because we are located in a high technology area, we face competition for personnel from other companies, academic institutions, government entities and other organizations. We are currently conducting a search for a chief financial officer and a vice president of marketing, as well as other senior management personnel. If we are unsuccessful in filling these positions or retaining qualified personnel, our business could be impaired.

**We may be subject to product liability claims, and our insurance coverage may not be adequate to cover these claims.**

We face an inherent business risk of exposure to product liability claims in the event that the use of products during research and development efforts or after commercialization results in adverse effects. This risk will exist even with respect to any products that receive regulatory approval for commercial sale. While we have obtained liability insurance for our products, it may not be sufficient to satisfy any liability that may arise. Also, adequate insurance coverage may not be available in the future at acceptable cost, if at all.

**We may require additional funds that may be difficult to obtain in order to continue our business activities as planned.**

Our operations to date have consumed substantial amounts of cash. We will be required to spend substantial funds in conducting clinical trials, to expand our marketing capabilities and efforts, to expand existing research and development programs, to develop and expand our development and manufacturing capabilities and to defend or prosecute our patents and patent applications.

In order to develop and commercialize our products, we may need to raise substantial additional funds through equity or debt financings, collaborative arrangements, the use of sponsored research efforts or other means. Additional financing may not be available on acceptable terms, if at

all, and may only be available on terms dilutive to existing stockholders or that would increase the amount of our indebtedness. Our inability to secure adequate funds on a timely basis could result in the delay or cancellation of programs that we might otherwise pursue.

**We may incur significant costs in order to comply with environmental regulations or to defend claims arising from accidents involving the use of hazardous materials.**

We are subject to federal, state and local laws and regulations governing the use, discharge, handling and disposal of materials and wastes used in our operations. As a result, we may be required to incur significant costs to comply with these laws and regulations. We cannot eliminate the risk of accidental contamination or injury from these materials. In the event of such an accident, we could be held liable for any resulting damages and incur liabilities which exceed our resources. In addition, we cannot predict the extent of the adverse effect on our business or the financial and other costs that might result from any new government requirements arising out of future legislative, administrative or judicial actions.

**Changes in the U.S. and international health care industry could adversely affect our revenues.**

The U.S. and international health care industry is subject to changing political, economic and regulatory influences that may significantly affect the purchasing practices and pricing of pharmaceuticals. Cost containment measures, whether instituted by health care providers or imposed by government health administration regulators or new regulations, could result in greater selectivity in the purchase of drugs. As a result, third-party payors may challenge the price and cost effectiveness of our products. In addition, in many major markets outside the U.S., pricing approval is required before sales can commence. As a result, significant uncertainty exists as to the reimbursement status of approved health care products.

We may not be able to obtain or maintain our desired price for our products. Our products may not be considered cost effective relative to alternative therapies. As a result, adequate third-party reimbursement may not be available to enable us to maintain prices sufficient to realize an appropriate return on our investment in product development. Also, the trend towards managed health care in the U.S. and the concurrent growth of organizations such as health maintenance organizations, as well as legislative proposals to reform health care or reduce government insurance programs, may all result in lower prices, reduced reimbursement levels and diminished markets for our products. These factors will also affect the products that are marketed by our collaborative partners.

**Our common stock price is volatile and an investment in our company could decline in value.**

Market prices for securities of biotechnology companies (including PDL) have been highly volatile so that investment in our securities involves substantial risk. Additionally, the stock market from time to time has experienced significant price and volume fluctuations that may be unrelated to the operating performance of particular companies. The following are some of the factors that may have a significant effect on the market price of our common stock:

- developments or disputes as to patent or other proprietary rights
- disappointing sales of approved products
- approval or introduction of competing products and technologies
- results of clinical trials
- failures or unexpected delays in obtaining regulatory approvals or FDA advisory panel recommendations
- delays in manufacturing or clinical trial plans

- fluctuations in our operating results
- disputes or disagreements with collaborative partners
- market reaction to announcements by other biotechnology or pharmaceutical companies
- announcements of technological innovations or new commercial therapeutic products by us or our competitors
- initiation, termination or modification of agreements with our collaborative partners
- loss of key personnel
- litigation or the threat of litigation
- public concern as to the safety of drugs developed by us
- sales of our common stock held by collaborative partners or insiders
- comments and expectations of results made by securities analysts, and
- general market conditions.

If any of these factors causes us to fail to meet the expectations of securities analysts or investors, or if adverse conditions prevail or are perceived to prevail with respect to our business, the price of the common stock would likely drop significantly. A significant drop in the price of a company's common stock often leads to the filing of securities class action litigation against the company. This type of litigation against us could result in substantial costs and a diversion of management's attention and resources.

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

***(a) Exhibits***

***(b) Reports on Form 8-K***

**The Company filed a Current Report on Form 8-K on February 14, 2000 (SEC File No. 000-19756) announcing:**

Preliminary financial results for the quarter and year ended December 31, 1999.

The Company's intention to make a private offering of $100 million of Convertible Subordinated Notes, due 2007, with an option to issue an additional $25 million of notes.

The Company was delaying the pricing of its private offering of Convertible Subordinated Notes in order to provide time to complete quality control testing of a new lot of an antibody product.

The Company had been advised that an independent regulatory consultant had approved the report of additional quality tests for the lot of antibody product.

The private placement of $125 million principal amount of 5.5% Convertible Subordinated Notes due 2007, and the granting to the initial purchasers an option to purchase up to an additional $25 million in principal amount of notes.

**The Company filed a Current Report on Form 8-K on March 1, 2000 (SEC File No. 000-19756) announcing the completion of the offering of Convertible Subordinated Notes on February 15, 2000.**

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**PROTEIN DESIGN LABS, INC.**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its be half by the undersigned thereunto duly authorized.

| **Exhibit Number** | **Description** |
|---|---|
| 3.1 | Amended and Restated Bylaws |
| 27.1 | Financial Data Schedule |

PROTEIN DESIGN LABS, INC.

Dated: May 11, 2000

*(Registrant)*
By: /s/Laurence Jay Korn

Laurence Jay Korn
*Chairperson of the Board of Directors*
*(Principal Executive Officer)*
By: /s/Robert Kirkman

**AMENDED AND RESTATED**

**BYLAWS**

**OF**

**PROTEIN DESIGN LABS, INC.**

## ARTICLE I

## OFFICES

Section 1. Principal Executive Office. The Board of Directors shall fix the location of the principal executive office of the Corporation at any place within or outside the State of Delaware. The Board of Directors shall fix and designate a registered business office and registered agent in the State of Delaware regardless of whether the Corporation maintains a place of business there.

Section 2. Other Offices. The Board of Directors may at any time establish branch or subordinate offices at any place or places where the Corporation is qualified to do business.

## ARTICLE II

## MEETINGS OF STOCKHOLDERS

Section 1. Place of Meetings. Meetings of stockholders shall be held at any place within or outside the State of Delaware designated by the Board of Directors. In the absence of any such designation, stockholders' meetings shall be held at the principal executive office of the Corporation.

Section 2. Annual Meetings. The annual meetings of stockholders shall be held on such day and at such hour as may be fixed by the Board of Directors within thirteen months subsequent to the later of the date of incorporation of the Corporation or the last annual meeting of stockholders. At such meeting, directors shall be elected and any other proper business may be transacted.

Section 3. Special Meeting. A special meeting of the stockholders for any purpose or purposes described in the notice of the meeting may be called at any time by a majority of the number of authorized directors of the Board of Directors or the holders of not less than a majority of the number of shares entitled to vote at the meeting. Notice of such special meeting shall be given in the same manner as for the annual meeting of stockholders.

Section 4. Notice of Stockholders' Meetings. All notices of meetings of stockholders shall be sent or otherwise given in accordance with Section 5 of this Article II not fewer than ten (10) nor more than sixty (60) days before the date of the meeting. The

notice shall specify the place, date and hour of the meeting and (i) in the case of a special meeting, the nature of the business to be transacted, or (ii) in the case of the annual meeting, those matters which the Board of Directors, at the time of giving the notice, intends to present for action by the stockholders. The notice of any meeting at which directors are to be elected shall include the name of any nominee or nominees whom, at the time of the notice, management intends to present for election.

Section 5. Manner of Giving Notice; Affidavit of Notice. Written notice of any meeting of stockholders shall be given. If mailed, notice shall be deemed to have been given at the time when delivered personally or deposited in the United States mail, postage prepaid.

An affidavit of the mailing or other means of giving any notice of any stockholders' meeting shall be executed by the secretary, assistant secretary, or any transfer agent of the Corporation giving the notice, and shall be filed and maintained in the minute book of the Corporation.

Section 6. Quorum. The presence in person or by proxy of the holders of a majority of the shares entitled to vote at any meeting of stockholders shall constitute a quorum for the transaction of business. If a quorum shall fail to attend any meeting, the chairperson of the meeting or the holders of a majority of the shares of stock entitled to vote who are present, in person or by proxy, may adjourn the meeting to another place, date, or time.

Section 7. Conduct of the Stockholders' Meeting. At every meeting of the stockholders, the Chairperson of the Board of Directors, or in his or her absence, the Chief Executive Officer of the Corporation, or in his or her absence, the person designated by the Chairperson of the Board of Directors, or in the absence of such designation, a chairperson chosen by the majority of the voting shares represented in person or by proxy, shall act as Chairperson of the meeting. The Secretary of the Corporation or a person designated by the Chairperson of the meeting shall act as Secretary of the meeting. Unless otherwise approved by the Chairperson, attendance at the Stockholders' Meeting is restricted to stockholders of record, persons authorized in accordance with Section 14 of this Article II to act by proxy, and officers of the Corporation.

Section 8. Conduct of Business. The Chairperson of the meeting shall call the meeting to order, establish the agenda, and conduct the business of the meeting in accordance therewith or, at the Chairperson's discretion, it may be conducted otherwise in accordance with the wishes of the stockholders in attendance. The date and time of the opening and closing of the polls for each matter upon which the stockholders will vote at the meeting shall be announced at the meeting.

The Chairperson of the meeting shall also conduct the meeting in an orderly manner, rule on the precedence of, and procedure on, motions and other procedural matters, and exercise discretion with respect to such procedural matters with fairness and good faith toward all those entitled to take part. The Chairperson may impose reasonable limits on the amount of time taken up at the meeting on discussion in general or on remarks by any one stockholder. Should any person in attendance become unruly or obstruct the meeting proceedings, the Chairperson shall have the power to have such person removed from participation. Notwithstanding anything in the bylaws to the contrary, no business shall be conducted at a meeting except in accordance with the procedures set forth in this Section 8 and Section 9, below. The Chairperson of a meeting shall, if the facts warrant, determine and declare to the meeting that business was not properly brought before the meeting and in accordance with the provisions of this Section 8 and Section 9, and if he or she should so determine, he or she shall so declare to the meeting and any such business not properly brought before the meeting shall not be transacted.

Section 9. Notice of Stockholder Business. At an annual or special meeting of the stockholders, only such business shall be conducted as shall have been properly brought before the meeting. To be properly brought before a meeting, business must be (a) specified

in the notice of meeting (or any supplement thereto) given by or at the direction of the Board of Directors, (b) properly brought before the meeting by or at the direction of the Board of Directors, (c) properly brought before an annual meeting by a stockholder, or (d) properly brought before a special meeting by a stockholder, but if, and only if, the notice of a special meeting provides for business to be brought before the meeting by stockholders. For business to be properly brought before a meeting by a stockholder, the stockholder must have given timely notice thereof in writing to the Secretary of the Corporation. To be timely, a stockholder proposal to be presented at an annual meeting shall be received at the Corporation's principal executive office not less than one hundred twenty (120) calendar days in advance of the date that the Corporation's (or the Corporation's predecessor's) proxy statement was released to stockholders in connection with the previous year's annual meeting of stockholders. However, if no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than thirty (30) calendar days from the date contemplated at the time of the previous year's proxy statement, or in the event of a special meeting, notice by the stockholder to be timely must be received not later than the close of business on the tenth (10th) day following the day on which such notice of the date of the meeting was mailed or such public disclosure was made. A stockholder's notice to the Secretary shall set forth as to each matter the stockholder proposes to bring before the annual or special meeting (a) a brief description of the business desired to be brought before the annual or special meeting and the reasons for conducting such business at the annual or special meeting, (b) the name and address, as they appear on the Corporation's books, of the stockholder proposing such business, (c) the class and number of shares of the Corporation which are beneficially owned by the stockholder, and (d) any material interest of the stockholder in such business.

Section 10. Adjourned Meetings and Notice Thereof. When a stockholders' meeting is adjourned to another time or place, notice of the adjourned meeting need not be given if the time and place thereof are announced at the meeting at which the adjournment is taken; except that if the adjournment is for more than thirty (30) days or if the Board of Directors shall set a new record date, notice of any adjourned meeting shall be given to each stockholder of record entitled to vote at the adjourned meeting in accordance with Sections 4 and 5 of this Article II.

At the adjourned meeting, the Corporation may transact any business which might have been transacted at the original meeting.

Section 11. Voting. Except as otherwise required by the Certificate of Incorporation or the General Corporation Law of Delaware, each outstanding share, regardless of class, shall be entitled to one vote on each matter submitted to a vote of stockholders. All voting, including on the election of directors but excepting where otherwise required by law, may be by a voice vote; provided, however, that upon demand therefor by a stockholder entitled to vote or his or her proxy, a stock vote shall be taken. Every stock vote shall be taken by ballots, each of which shall state the name of the stockholder or proxy voting and such other information as may be required under the procedure established for the meeting. Every vote taken by ballots shall be counted by an inspector or inspectors appointed by the chairperson of the meeting. The Corporation may, and to the extent required by law, shall, in advance of any meeting of stockholders, appoint one or more inspectors to act at the meeting and make a written report thereof. The Corporation may designate one or more persons as alternate inspectors to replace any inspector who fails to act. If no inspector or alternate is able to act at a meeting of stockholders, the person presiding at the meeting may, and to the extent required by law, shall, appoint one or more inspectors to act at the meeting. Each inspector, before entering upon the discharge of his or her duties, shall take and sign an oath faithfully to execute the duties of inspector with strict impartiality and according to the best of his or her ability. Each inspector shall:

(a) Determine the number of shares outstanding and the voting power of each, the shares represented at the meeting, the existence of a quorum, and the authenticity, validity, and effect of proxies;

(b) Receive votes, ballots, or consents;

(c) Hear and determine all challenges and questions in any way arising in connection with the right to vote;

(d) Count and tabulate all votes or consents;

(e) Determine when the polls shall close;

(f) Determine the results; and

(g) Do any other acts that may be proper to conduct the elections or votes with fairness to all stockholders.

Any holder of shares entitled to vote on any matter may vote part of the shares in favor of the proposal and refrain from voting the remaining shares or vote them against the proposal but if the stockholder fails to specify the number of shares such stockholder is voting affirmatively, it shall be conclusively presumed that the stockholder's approving vote is with respect to all shares said stockholder is entitled to vote.

All elections shall be determined by a plurality of the votes cast, and except as otherwise required by law, all other matters shall be determined by a majority of the votes cast affirmatively or negatively.

Section 12. Waiver of Notice or Consent by Absent Stockholders. The transactions of any meeting of stockholders, either annual or special, however called and noticed, and wherever held, shall be as valid as though had at a meeting duly held after regular call and notice, if a quorum is present either in person or by proxy, and if, either before or after the meeting, each person entitled to vote, not present in person or by proxy, signs a written waiver of notice, or a consent to the holding of such meeting, or an approval of the minutes thereof. The waiver of notice or consent need not specify either the business to be transacted or the purpose of any annual or special meeting of stockholders. All such waivers, consents, or approvals shall be filed with the corporate records or made a part of the minutes of the meeting.

Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when a person objects, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened; and except that attendance at a meeting is not a waiver of any right to object to the consideration of matters not included in the notice of the meeting if that objection is expressly made at the meeting.

Section 13. Stockholder Action by Written Consent. Any action which may be taken at any annual or special meeting of stockholders may be taken without a meeting and without prior notice, if a consent in writing, setting forth the actions so taken, is signed by the holders of outstanding shares having not less than the minimum number of votes which would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. All such consents shall be filed with the Secretary of the Corporation and shall be maintained in the corporate records. Prompt notice of the taking of a corporate action without a meeting by less than unanimous written consent shall be given to those stockholders who have not consented in writing.

Section 14. Proxies. At any meeting of the stockholders, every stockholder entitled to vote may vote in person or by proxy authorized by an instrument in writing or by a transmission permitted by law filed in accordance with the procedure established for the meeting. Any copy, facsimile telecommunication or other reliable reproduction of the writing or transmission created pursuant to this paragraph may be substituted or used in lieu of the original writing or transmission for any and all purposes for which the original writing or transmission could be used, provided that such copy,

facsimile transmission or other reproduction shall be a complete reproduction of the entire original writing or transmission. A validly executed proxy which does not state that it is irrevocable and is not coupled with an interest shall continue in full force and effect unless (i) revoked by the person executing it, before the vote pursuant to that proxy, by a writing delivered to the Corporation stating that the proxy is revoked, or by a subsequent proxy executed by, or attendance at the meeting and voting in person by, the person executing the proxy; or (ii) written notice of the death or incapacity of the maker of that proxy is received by the Corporation before the vote pursuant to that proxy is counted; provided, however, that no proxy shall be valid after the expiration of three years from the date of the proxy, unless otherwise provided in the proxy.

Section 15. Stock List. A complete list of stockholders entitled to vote at any meeting of stockholders, arranged in alphabetical order for each class of stock and showing the address of each such stockholder and the number of shares registered in his or her name, shall be open to the examination of any such stockholder, for any purpose germane to the meeting, during ordinary business hours for a period of at least ten (10) days prior to the meeting, either at a place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting, or if not so specified, at the place where the meeting is to be held.

The stock list shall also be kept at the place of the meeting during the whole time thereof and shall be open to the examination of any such stockholder who is present. This list shall presumptively determine the identity of the stockholders entitled to vote at the meeting and the number of shares held by each of them.

**ARTICLE III**

**BOARD OF DIRECTORS**

Section 1. Powers. Subject to the limitations stated in the Certificate of Incorporation, these bylaws, and the General Corporation Law of Delaware as to actions which shall be approved by the stockholders or by the affirmative vote of a majority of the outstanding shares entitled to vote, all corporate powers shall be exercised by, or under the direction of, and the business and affairs of the Corporation shall be managed by, the Board of Directors.

Section 2. Number and Term of Office. The number of directors shall be fixed from time to time exclusively by the Board of Directors pursuant to a resolution adopted by a majority of the total number of authorized directors (whether or not there exist any vacancies in previously authorized directorships at the time any such resolution is presented to the Board for adoption). The directors shall be divided into three classes, as nearly equal in number as reasonably possible, with the term of office of the first class to expire at the 1993 annual meeting of stockholders, the term of office of the second class to expire at the 1994 annual meeting of stockholders and the term of office of the third class to expire at the 1995 annual meeting of stockholders. At each annual meeting of stockholders following such initial classification and election, directors elected to succeed those directors whose terms expire shall be elected for a term of office to expire at the third succeeding annual meeting of stockholders after their election. All directors shall hold office until the expiration of the term for which elected, and until their respective successors are elected, except in the case of the death, resignation or removal of any director.

Section 3. Vacancies and Newly Created Directorships. Subject to the rights of the holders of any series of Preferred Stock then outstanding, newly created directorships resulting from any increase in the authorized number of directors or any vacancies in the Board of Directors resulting from death, resignation, retirement, removal from office, disqualification or other cause may be filled only by a majority vote of the directors then in office, though less than a quorum, and directors so chosen shall hold office for a term expiring

at the annual meeting of stockholders at which the term of office of the class to which they have been elected expires. No decrease in the number of directors constituting the Board of Directors shall shorten the term of any incumbent director.

Section 4. Resignations. Any director may resign effective on giving written notice to the Chairperson of the Board, the Chief Executive Officer, the Secretary, or the Board of Directors, unless the notice specifies a later time for that resignation to become effective. If the resignation of a director is effective at a future time, the Board of Directors may elect a successor to take office when the resignation becomes effective.

Section 5. Place of Meetings and Meetings by Telephone. Meetings of the Board of Directors shall be held at any place within or without the State of Delaware which may be designated in the notice of the meeting, or, if not stated in the notice or there is no notice, designated by resolution of the Board. In the absence of such designation, meetings of the Board of Directors shall be held at the principal executive office of the Corporation. Members of the Board may participate in a regular or special meeting through use of conference telephone or similar communications equipment, so long as all members participating in such meeting can hear one another. Participation in a meeting pursuant to this Section 5 of this Article III constitutes presence in person at such meeting.

Section 6. Annual Meeting. Immediately following each annual meeting of stockholders, the Board of Directors shall hold a regular meeting for the purpose of organization, the election of officers and the transaction of other business. No notice of such meeting need be given.

Section 7. Other Regular Meetings. The Board of Directors may provide by resolution the time and place for the holding of regular meetings of the Board; provided, however, that if the date so designated falls upon a legal holiday, then the meeting shall be held at the same time and place on the next succeeding day which is not a legal holiday. No notice of such regular meetings of the Board need be given.

Section 8. Special Meetings. Special meetings of the Board of Directors for any purpose or purposes may be called at any time by the Chairperson of the Board or the Chief Executive Officer or the President or any Vice President or the Secretary or any two directors.

Notice of the time and place of special meetings shall be delivered personally or by telephone to each director or sent by first-class mail or telegram, charges prepaid, addressed to each director at that director's address as it is shown on the records of the Corporation. In case the notice is mailed, it shall be deposited in the United States mail at least four (4) days before the time of the holding of the meeting. In case the notice is delivered personally, or by telephone or telegram, it shall be delivered personally or by telephone or to the telegraph company at least forty-eight (48) hours before the time of the holding of the meeting. Any oral notice given personally or by telephone may be communicated either to the director or to a person at the office of the director who the person giving the notice has reason to believe will promptly communicate it to the director. The notice need not specify the purpose of the meeting nor the place if the meeting is to be held at the principal executive office of the Corporation.

Section 9. Quorum. A majority of the total number of authorized directors shall constitute a quorum for all purposes at any meeting of the Board of Directors. If a quorum shall fail to attend any meeting, a majority of those present may adjourn the meeting to another place, date, or time, without further notice or waiver thereof.

Section 10. Waiver of Notice. Notice of a meeting shall be deemed given to any director who attends the meeting without protesting before or at its commencement, the lack of notice to such

director.

The transactions of any meeting of the Board of Directors, however called and noticed or wherever held, shall be as valid as though had at a meeting duly held after regular call and notice if a quorum is present and if, either before or after the meeting, each of the directors not present signs a written waiver of notice, a consent to holding the meeting or an approval of the minutes thereof. The waiver of notice or consent need not specify the purpose of the meeting. All such waivers, consents and approvals shall be filed with the corporate records or made a part of the minutes of the meeting.

Section 11. Adjournment. Any meeting of the Board of Directors, whether or not a quorum is present, may be adjourned to another time and place by the vote of a majority of the votes of the directors present. If a meeting is adjourned for more than twenty-four (24) hours, notice of the time and place of the reconvened adjourned meeting shall be given to directors absent at the time of adjournment before the time of the reconvened adjourned meeting.

Section 12. Conduct of Business and Action Without Meeting. At any meeting of the Board of Directors, business shall be transacted in such order and manner as the Board may from time to time determine, and all matters shall be determined by the vote of a majority of the directors then present, except as otherwise provided herein or required by law. Any action required or permitted to be taken at any meeting of the Board of Directors may be taken without a meeting, if all members of the Board shall individually or collectively consent in writing to such action. Such written consent or consents shall be filed with the minutes of the proceedings of the Board of Directors. Such action by written consent shall have the same force and effect as a unanimous vote of such directors.

Section 13. Fees and Compensation of Directors. Directors shall not receive any stated salary for their services as directors, but, by resolution of the Board, a fixed fee, with or without expenses of attendance, may be allowed for attendance at each meeting. Nothing herein contained shall be construed to preclude any director from serving the Corporation in any other capacity as an officer, agent, employee, member of a committee of the Board of Directors or otherwise, and receiving compensation therefor.

Section 14. Nomination of Director Candidates. Subject to the rights of holders of any Preferred Stock then outstanding, nominations for the election of directors may be made by the Board of Directors or a proxy committee appointed by the Board of Directors or by any stockholder entitled to vote in the election of directors generally. However, any stockholder entitled to vote in the election of directors generally may nominate one or more persons for election as directors at a meeting only if timely notice of such stockholder's intent to make such nomination or nominations has been given in writing to the Secretary of the Corporation. To be timely, a stockholder nomination for a director to be elected at an annual meeting shall be received at the Corporation's principal executive offices not less than one hundred twenty (120) calendar days in advance of the date that the Corporation's (or Corporation's predecessor's) proxy statement was released to stockholders in connection with the previous year's annual meeting of stockholders. However, if no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than thirty (30) calendar days from the date contemplated at the time of the previous year's proxy statement, or in the event of a nomination for director to be elected at a special meeting, notice by the stockholders to be timely must be received not later than the close of business on the tenth (10th) day following the day on which such notice of the date of the special meeting was mailed or such public disclosure was made. Each such notice shall set forth: (a) the name and address of the stockholder who intends to make the nomination and of the person or persons to be nominated; (b) a representation that the stockholder is a holder of record of stock of the Corporation entitled to vote for the election of directors on the date of such notice and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice; (c) a description of all arrangements or understandings between the stockholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are to be

made by the stockholder; (d) such other information regarding each nominee proposed by such stockholder as would be required to be included in a proxy statement filed pursuant to the proxy rules of the Securities and Exchange Commission, had the nominee been nominated, or intended to be nominated, by the Board of Directors; and (e) the consent of each nominee to serve as a director of the Corporation if so elected.

In the event that a person is validly designated as a nominee in accordance with this Section 14 and shall thereafter become unable or unwilling to stand for election to the Board of Directors, the Board of Directors or the stockholder who proposed such nominee, as the case may be, may designate a substitute nominee upon delivery, not fewer than thirty (30) days prior to the date of the meeting for the election of such nominee, of a written notice to the Secretary setting forth such information regarding such substitute nominee as would have been required to be delivered to the Secretary pursuant to this Section 14 had such substitute nominee been initially proposed as a nominee. Such notice shall include a signed consent to serve as a director of the Corporation, if elected, of each such substitute nominee.

If the chairperson of the meeting for the election of directors determines that a nomination of any candidate for election as a director at such meeting was not made in accordance with the applicable provisions of this Section 14, such nomination shall be void.

**ARTICLE IV**

**COMMITTEES**

Section 1. Committees. The Board of Directors may, by resolution adopted by a majority of the authorized number of directors, designate such committees, each consisting of one or more directors, as it may from time to time deem advisable to perform such general or special duties as may from time to time be delegated to any such committee by the Board of Directors, subject to the limitations contained in the General Corporations Law of Delaware, or imposed by the Certificate of Incorporation or by these bylaws. Any committee so designated may exercise the power and authority of the Board of Directors to declare a dividend, to authorize the issuance of stock or to adopt a certificate of ownership and merger pursuant to Section 253 of the General Corporation Law of Delaware if the resolution which designates the committees or a supplemental resolution of the Board of Directors so provides. The Board may designate one or more directors as alternate members of any committee, who may replace any absent member at any meeting of the committee.

Section 2. Minutes. Each committee shall keep regular minutes of its proceedings, which shall be filed with the Secretary.

Section 3. Conduct of Business. Each committee may determine the procedural rules for meeting and conducting its business and shall act in accordance therewith, except as otherwise provided herein or required by law. Adequate provision shall be made for notice to members of all meetings; one-third (1/3) of the authorized members shall constitute a quorum unless the committee shall consist of one or two members, in which event one member shall constitute a quorum; and all matters shall be determined by a majority vote of the members present. Action may be taken by any committee without a meeting if all members thereof consent thereto in writing, and the writing or writings are filed with the minutes of the proceedings of such committee.

**ARTICLE V**

**OFFICERS**

Section 1. Officers. The officers of the Corporation shall be a Chief Executive Officer, one or more Presidents, one or more Vice Presidents, a Secretary, and a Chief Financial Officer of the Corporation. The Corporation may also have, at the discretion of the Board of Directors, a Chairperson of the Board, a Treasurer, one or more Assistant Secretaries, a General Counsel and such other officers as may be appointed in accordance with the provisions of Section 3 of this Article V. The Chairperson of the Board, if there shall be such an officer, shall be a member of the Board of Directors. One person may hold two or more offices.

Section 2. Election. The officers of the Corporation, except such officers as may be appointed in accordance with the provisions of Sections 3 and 5 of this Article V, shall be chosen annually by the Board of Directors and each shall hold office until such officer shall resign or shall be removed or otherwise disqualified to serve, or such officer's successor shall be elected and qualified.

Section 3. Subordinate Officers, etc. The Board of Directors may appoint, or may empower the Chief Executive Officer to appoint, such other officers as the business of the Corporation may require, each of whom shall hold office for such period, have such authority and perform such duties as are provided in these bylaws or as the Board of Directors may from time to time determine.

Section 4. Removal and Resignation of Officers. Any officer may be removed, either with or without cause, by a majority of the directors at the time in office, at any regular or special meeting of the Board, or by an officer upon whom such power of removal may be conferred by the Board of Directors.

Any officer may resign at any time by giving written notice to the Corporation. Any such resignation shall take effect at the date of the receipt of such notice or at any later time specified therein; and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

Section 5. Vacancies in Office. A vacancy in any office because of death, resignation, removal, disqualification or any other cause shall be filled in the manner prescribed in these bylaws for regular appointments to such office.

Section 6. Chairperson of the Board. The Chairperson of the Board, if there shall be such an officer, shall, if present, preside at all meetings of the Board of Directors, and exercise and perform such other powers and duties as may be from time to time assigned to him or her by the Board of Directors or prescribed by these bylaws. He or she shall preside at all meetings of the stockholders.

Section 7. Chief Executive Officer. Subject to the powers, if any, as may be given by the Board of Directors to the Chairperson of the Board, if there be such an officer, the Chief Executive Officer shall be the general manager and chief executive officer of the Corporation and shall, subject to the control of the Board of Directors, have general supervision, direction, and control of the business and affairs of the Corporation. In the absence of a Chairperson of the Board, he or she shall preside at all meetings of the stockholders. He or she shall have the general powers and duties of management usually vested in the office of Chief Executive Officer of a corporation, and shall have such other powers and duties as may be prescribed by the Board of Directors or by these bylaws.

Section 8. Presidents. Each President shall, subject to the control of the Chief Executive Officer and the Board of Directors, have the responsibility for the supervision, direction, and control of such portions of the business and such officers of the Corporation as report to him or her and shall exercise such powers and perform such duties as may from time to time be assigned to him or her by the Board of Directors, the Chairperson of the Board or the Chief

Executive Officer, or as may be prescribed by these bylaws.

Section 9. Vice Presidents. . Each Vice President shall , subject to the control of the Chief Executive Officer and the Board of Directors and any officer to whom he or she reports, have the responsibility for the supervision, direction, and control of such portions of the business and such officers of the Corporation as report to him or her and shall exercise such powers and perform such duties as may from time to time be assigned to him or her by the Board of Directors, the Chairperson of the Board or the Chief Executive Officer or any officer to whom he or she reports, or as may be prescribed by these bylaws. "Vice President(s)" as used in these bylaws shall include Senior Vice President(s).

Section 10. Secretary. The Secretary shall keep, or cause to be kept, a book of minutes in written form of the proceedings of the Board of Directors, committees of the Board, and stockholders. Such minutes shall include all waivers of notice, consents to the holding of meetings, or approvals of the minutes of meetings executed pursuant to these bylaws or the General Corporation Law of Delaware. The Secretary shall keep, or cause to be kept at the principal executive office or at the office of the Corporation's transfer agent or registrar, a record of its stockholders, giving the names and addresses of all stockholders and the number and class of shares held by each.

The Secretary shall give or cause to be given, notice of all meetings of the stockholders and of the Board of Directors required by these bylaws or by law to be given, and shall keep the seal of the Corporation in safe custody, and shall have such other powers and perform such other duties as may be prescribed by the Board of Directors or these bylaws.

Section 11. Chief Financial Officer. The Chief Financial Officer shall keep and maintain, or cause to be kept and maintained, adequate and correct books and records of account in written form or any other form capable of being converted into written form.

The Chief Financial Officer shall deposit all monies and other valuables in the name and to the credit of the Corporation with such depositaries as may be designated by the Board of Directors. He or she shall disburse all funds of the Corporation as may be ordered by the Board of Directors, shall render to the Chief Executive Officer and directors, whenever they request it, an account of all of his or her transactions as Chief Financial Officer and of the financial condition of the Corporation, and shall have such other powers and duties as may be prescribed by the Board of Directors or by these bylaws.

Section 12. Treasurer. The Treasurer shall have the powers and duties prescribed by these bylaws, the Chief Executive Officer, the Chief Financial Officer or by the Board of Directors. In the absence or disability of the Chief Financial Officer, she or he shall have all of her or his powers and duties.

Section 13. Assistant Treasurers. The Assistant Treasurers shall have the powers and duties prescribed by these bylaws or assigned by the Chief Financial Officer, if there be such an officer, or the Treasurer. In the absence or disability of the Treasurer, they shall have all of his or her powers and duties.

Section 14. Assistant Secretaries. The Assistant Secretaries shall have the powers and duties prescribed by these bylaws or assigned by these bylaws or assigned by the Secretary. In the absence or disability of the Secretary, they shall have all of the powers and duties of such officer.

Section 15. General Counsel. Subject to the control and supervision by the Chief Executive Officer or such officer as the Chief Executive Officer may designate, and by the Board of Directors, the General Counsel shall be the chief legal officer of the Company, and she or he shall have such other powers and duties as may be prescribed by these bylaws or by the Board of Directors, the Chief Executive Officeror such officer as the Chief Executive Officer may

designate, and the usual powers and duties pertaining to her or his office.

Section 16. Compensation. The compensation of the officers shall be fixed from time to time by the Board of Directors or by a committee of the Board of Directors authorized to do so, and no officer shall be prevented from receiving such compensation by reason of the fact that he or she is also a director of the Corporation.

**ARTICLE VI**

**INDEMNIFICATION**

Section 1. Right to Indemnification. Each person who was or is made a party or is threatened to be made a party to or is involved in any action, suit or proceeding, whether civil, criminal, administrative or investigative ("Proceeding"), by reason of the fact that he or she, or a person of whom he or she is the legal representative, is or was a director, officer or employee of the Corporation or is or was serving at the request of the Corporation as a director, officer or employee of another Corporation or of a partnership, joint venture, trust or other enterprise, including service with respect to employee benefit plans, whether the basis of such Proceeding is alleged action in an official capacity as a director, officer or employee or in any other capacity while serving as a director, officer or employee, shall be indemnified and held harmless by the Corporation to the fullest extent authorized by the General Corporation Law of Delaware, as the same exists or may hereafter be amended (but, in the case of any such amendment, only to the extent that such amendment permits the Corporation to provide broader indemnification rights than said Law permitted the Corporation to provide prior to such amendment) against all expenses, liability and loss (including attorneys' fees, judgments, fines, ERISA excise taxes or penalties and amounts paid or to be paid in settlement and amounts expended in seeking indemnification granted to such person under applicable law, this bylaw or any agreement with the Corporation) reasonably incurred or suffered by such person in connection therewith and such indemnification shall continue as to a person who has ceased to be a director, officer or employee and shall inure to the benefit of his or her heirs, executors and administrators; provided, however, that, except as provided in Section 2 of this Article VI, the Corporation shall indemnify any such person seeking indemnity in connection with an action, suit or Proceeding (or part thereof) initiated by such person only if (a) such indemnification is expressly required to be made by law, (b) the action, suit or Proceeding (or part thereof) was authorized by the Board of Directors of the Corporation, (c) such indemnification is provided by the Corporation, in its sole discretion, pursuant to the powers vested in the Corporation under the General Corporation Law of Delaware, or (d) the action, suit or Proceeding (or part thereof) is brought to establish or enforce a right to indemnification under an indemnity agreement or any other statute or law or otherwise as required under Section 145 of the General Corporation Law of Delaware. Such right shall be a contract right and shall include the right to be paid by the Corporation expenses incurred in defending any such Proceeding in advance of its final disposition; provided, however, that, if required by the General Corporation Law of Delaware, the payment of such expenses incurred by a director or officer in his or her capacity as a director or officer (and not in any other capacity in which service was or is rendered by such person while a director or officer, including, without limitation, service to an employee benefit plan) in advance of the final disposition of such Proceeding, shall be made only upon delivery to the Corporation of an undertaking, by or on behalf of such director or officer, to repay all amounts so advanced if it should be determined ultimately that such director or officer is not entitled to be indemnified under this Section or otherwise.

Section 2. Right of Claimant to Bring Suit. If a claim under Section 1 of this Article VI is not paid in full by the Corporation within ninety (90) days after a written claim has been received by

the Corporation, the claimant may at any time thereafter bring suit against the Corporation to recover the unpaid amount of the claim and, if such suit is not frivolous or brought in bad faith, the claimant shall be entitled to be paid also the expense of prosecuting such claim. It shall be a defense to any such action (other than an action brought to enforce a claim for expenses incurred in defending any Proceeding in advance of its final disposition where the required undertaking, if any, has been tendered to the Corporation) that the claimant has not met the standards of conduct which make it permissible under the General Corporation Law of Delaware for the Corporation to indemnify the claimant for the amount claimed, but the burden of proving such defense shall be on the Corporation. Neither the failure of the Corporation (including its Board of Directors, independent legal counsel, or it stockholders) to have made a determination prior to the commencement of such action that indemnification of the claimant is proper in the circumstances because he or she has met the applicable standard of conduct set forth in the General Corporation Law of Delaware, nor an actual determination by the Corporation (including its Board of Directors, independent legal counsel, or its stockholders) that the claimant has not met such applicable standard of conduct, shall be a defense to the action or create a presumption that claimant has not met the applicable standard of conduct.

Section 3. Non-Exclusivity of Rights. The rights conferred on any person by Sections 1 and 2 of this Article VI shall not be exclusive of any other right which such person may have or hereafter acquire under any statute, provision of the Certificate of Incorporation or these bylaws, agreement, vote of stockholders or disinterested directors or otherwise.

Section 4. Indemnification Contracts. The Board of Directors is authorized to enter into a contract with any director, officer, employee or agent of the Corporation, or any person serving at the request of the Corporation as a director, officer, employee or agent of another Corporation, partnership, joint venture, trust or other enterprise, including employee benefit plans, providing for indemnification rights equivalent to or, if the Board of Directors so determines, greater than, those provided for in this Article VI.

Section 5. Insurance. The Corporation may maintain insurance to the extent reasonably available, at its expense, to protect itself and any such director, officer, employee or agent of the Corporation or another corporation, partnership, joint venture, trust or other enterprise against any such expense, liability or loss, whether or not the Corporation would have the power to indemnify such person against such expense, liability or loss under the General Corporation Law of Delaware.

Section 6. Effect of Amendment. Any amendment, repeal or modification of any provision of this Article VI by the stockholders or the directors of the Corporation shall not adversely affect any right or protection of a director or officer of the Corporation existing at the time of such amendment, repeal or modification.

Section 7. Savings Clause. In the event that a court of competent jurisdiction should, by a decision which the Corporation chooses not to appeal or which is beyond all right of review, declare any portion or all of this Article VI invalid or unenforceable by reason of the operation of California Corporations Code Section 2115, or for any other reason, then the provisions of this Article VI and the corresponding provisions of any indemnification contracts entered into pursuant hereto shall be automatically amended and modified to eliminate any provision thereof which is found to be invalid or unenforceable and shall be deemed and construed to grant indemnification to the fullest extent permitted by applicable law, including the Corporations Code of the State of California if held to be controlling.

**ARTICLE VII**

**NOTICES**

Section 1. Notices. Except as otherwise specifically provided herein or required by law, all notices required to be given to any stockholder, director, officer, employee or agent shall be in writing and may in every instance be effectively given by hand delivery to the recipient thereof, by depositing such notice in the mails, postage paid, or by sending such notice by prepaid telegram, mailgram, telecopy or commercial courier service. Any such notice shall be addressed to such stockholder, director, officer, employee or agent at his or her last known address as the same appears on the books of the Corporation. The time when such notice shall be deemed to be given shall be the time such notice is received by such stockholder, director, officer, employee or agent, or by any person accepting such notice on behalf of such person, if hand delivered, or the time such notice is dispatched, if delivered through the mails or by telegram or mailgram.

Section 2. Waivers. A written waiver of any notice, signed by a stockholder, director, officer, employee or agent, whether before or after the time of the event for which notice is to be given, shall be deemed equivalent to the notice required to be given to such stockholder, director, officer, employee or agent. Neither the business nor the purpose of any meeting need be specified in such a waiver.

**ARTICLE VIII**

**STOCK**

Section 1. Certificates of Stock. Each stockholder shall be entitled to a certificate signed by, or in the name of the Corporation by, the Chairperson of the Board, President or a Vice President, and by the Secretary or an Assistant Secretary, or the Treasurer or an Assistant Treasurer, certifying the number of shares owned by him or her. Any of or all the signatures on the certificate may be facsimile.

Section 2. Transfers of Stock. Transfers of stock shall be made only upon the transfer books of the Corporation kept at an office of the Corporation or by transfer agents designated to transfer shares of the stock of the Corporation. Except where a certificate is issued in accordance with Section 4 of this Article VIII of these bylaws, an outstanding certificate for the number of shares involved shall be surrendered for cancellation before a new certificate is issued therefor.

Section 3. Record Date. The Board of Directors may fix a record date, which shall not be more than sixty (60) nor fewer than ten (10) days before the date of any meeting of stockholders, nor more than sixty (60) days prior to the time for the other action hereinafter described, as of which there shall be determined the stockholders who are entitled: to notice of or to vote at any meeting of stockholders or any adjournment thereof; to receive payment of any dividend or other distribution or allotment of any rights; or to exercise any rights with respect to any change, conversion or exchange of stock or with respect to any other lawful action.

Section 4. Lost, Stolen or Destroyed Certificates. In the event of the loss, theft or destruction of any certificate of stock, another may be issued in its place pursuant to such regulations as the Board of Directors may establish concerning proof of such loss, theft or destruction and concerning the giving of a satisfactory bond or bonds of indemnity.

Section 5. Regulations. The issue, transfer, conversion and registration of certificates of stock shall be governed by such other regulations as the Board of Directors may establish.

**ARTICLE IX**

**GENERAL CORPORATE MATTERS**

Section 1. Checks, Drafts, Evidences of Indebtedness. All checks, drafts, or other orders for payment of money, notes, or other evidences of indebtedness, issued in the name of or payable to the Corporation, shall be signed or endorsed by such person or persons and in such manner as, from time to time, shall be determined by resolution of the Board of Directors.

Section 2. Corporate Contracts and Instruments; How Executed. The Board of Directors, except as otherwise provided in these bylaws, may authorize any officer or officers, agent or agents, to enter into any contract or execute any instrument in the name of and on behalf of the Corporation, and this authority may be general or confined to specific instances; and, unless so authorized or ratified by the Board of Directors or within the agency power of an officer, no officer, agent, or employee shall have any power or authority to bind the Corporation by any contract or engagement or to pledge its credit or to render it liable for any purpose or for any amount.

Section 3. Representation of Shares of Other Corporations. The Chairperson of the Board, the Chief Executive Officer, any President, or any Vice President, or any other person authorized by resolution of the Board of Directors or by any of the foregoing designated officers, is authorized to vote on behalf of the Corporation, in person or by proxy, at any meeting of stockholders of or with respect to any action of stockholders of any other corporation, any and all shares of any other corporation or corporations, foreign or domestic, standing in the name of the Corporation. The authority granted to these officers to vote or represent on behalf of the Corporation any and all shares held by the Corporation in any other corporation or corporations may be exercised by any of these officers in person or by any person authorized to do so by a proxy duly executed by these officers.

Section 4. Construction and Definitions. Unless the context requires otherwise, the general provisions, rules of construction, and definitions in the General Corporation Law of Delaware shall govern the construction of these bylaws. Without limiting the generality of this provision, the singular number includes the plural, the plural number includes the singular, and the term "person" includes both a corporation and a natural person.

Section 5. Maintenance and Inspection of Books and Records. The Corporation shall keep at its principal executive office, or at the office of its transfer agent or registrar, if either be appointed and as determined by resolution of the Board of Directors, a record of its stockholders, giving the names and addresses of all stockholders and the number and class of shares held by each stockholder. The Corporation shall also keep at its principal executive office the original or a copy of the bylaws as amended to date and its other books and records.

Any stockholder of the Corporation of record, in person or by attorney or other agent shall, upon written demand under oath stating the purpose thereof, have the right during the usual hours for business to inspect for any proper purpose the Corporation's stock ledger, a list of its stockholders, and its other books and records and to make copies or extracts therefrom. A proper purpose shall mean a purpose reasonably related to such person's interest as a stockholder. In every instance where an attorney or other agent shall be the person who seeks the right to inspection, the demand under oath shall be accompanied by a power of attorney or such other writing which authorizes the attorney or other agent to so act on behalf of the stockholder.

Section 6. Inspection by Directors. Any director shall have the right to examine the Corporation's stock ledger, a list of its stockholders and its other books and records for a purpose reasonably

related to his or her position as a director.

**ARTICLE X**

**AMENDMENTS**

Section 1. Amendments. The Board of Directors is expressly empowered to adopt, amend or repeal bylaws of the Corporation. Any adoption, amendment or repeal of bylaws of the Corporation by the Board of Directors shall require the approval of a majority of the total number of authorized directors (whether or not there exist any vacancies in previously authorized directorships at the time any resolution providing for adoption, amendment or repeal is presented to the Board). The stockholders shall also have power to adopt, amend or repeal the bylaws of the Corporation.

**AMENDMENTS TO BYLAWS**

July 24, 1986

Original bylaws were adopted by the Action of Sole Incorporator.

April 19, 1989

Board adopted amendments to Article II, Section 3, and Article VI, Sections 1 and 2, to reflect comments received from the California Department of Corporations in connection with qualification of the 1986 Stock Purchase Plan (see UWC dated 04-19-89).

October 27, 1989

Board adopted amendment to Article VI to add Section 7, entitled "Savings Clause" (see 10-27-89 Minutes).

August 24, 1992

Board adopted amendments to Sections 2 and 3 of Article III to provide for the establishment of a classified board of directors (see UWC dated 08-24-92).

October 20, 1992

Amendments to Article III were adopted by the stockholders at the 1992 Annual Meeting (see 10-20-92 Minutes of Annual Meeting).

February 16, 1995

Board adopted amendments to Article V, including the addition of a new Section 7 (Chief Executive Officer, 12 (Treasurer), 13 (Assistant Treasurers), 14 (Assistant Secretaries), 15 (General Counsel), 16 (Controller) and the revision of Section 8 (President) as well as certain other conforming changes throughout the text (see Minutes of Meeting of 02-16-95).

February 11, 1999

Board adopted amendments removing Section 16 (Controller) of Article V, and certain related conforming changes throughout the text (see Minutes of Meeting February 11, 1999).

April 26, 2000

Board adopted amendments providing for one or more Presidents by amending Article V, Section 8, and made certain related and conforming changes throughout the text (see Unanimous Written Consent dated April 26, 2000).

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM
THE ACCOMPANYING CONSOLIDATED FINANCIAL STATEMENTS AND IS QUALIFIED
IN ITS ENTIRETY BY REFERENCE TO SUCH CONSOLIDATED FINANCIAL STATEMENTS.

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3-MOS
DEC-31-2000
Jan-01-2000
Mar-31-2000
177,188
114,438
6,290
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297,916
37,998
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8,988
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341,247
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15,500
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14,730
0
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770
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770
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770
0.04
0.04

Robert Kirkman
*Vice President Corporate Communications and Business Development*
*(Principal Accounting Officer)*