UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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FORM 10-K

/X/ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1999

/X/ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____________ TO _____________

COMMISSION FILE NO. 1-6639

MAGELLAN HEALTH SERVICES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE                      58-1076937
---------------------------------------  -------------------
(State or other jurisdiction of       (I.R.S. Employer
incorporation or organization)       Identification No.)

6950 COLUMBIA GATEWAY DRIVE
SUITE 400
COLUMBIA, MARYLAND                    21046
---------------------------------------  -------------------
(Address of principal executive
offices)                      (Zip Code)

Registrant's telephone number, including area code: (410) 953-1000

---------------------------------------------------------------------

Securities registered pursuant to Section 12(b) of the Act:

TITLE OF EACH CLASS
-------------------
Common Stock ($0.25 par value)

NAME OF EACH EXCHANGE ON
WHICH REGISTERED
-------------------
New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None
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 such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes /X/ No / /

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. / /

The aggregate market value of the voting stock held by non-affiliates of the registrant at November 30, 1999 was approximately $178 million.

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes / / No / /

The number of shares of the registrant's common stock outstanding as of November 30, 1999 was 31,979,324.

DOCUMENTS INCORPORATED BY REFERENCE: The registrant's definitive proxy materials on Schedule 14A relating to its annual meeting of stockholders on February 17, 2000 are incorporated by reference into Part III as set forth herein.

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MAGELLAN HEALTH SERVICES, INC.
ANNUAL REPORT ON FORM 10-K
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1999
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PART I

ITEM 1. BUSINESS

Magellan Health Services, Inc. (the "Company"), which was incorporated in 1969 under the laws of the State of Delaware, is a national healthcare company. The Company operates through three principal segments engaging in (i) the behavioral managed healthcare business, (ii) the human services business and (iii) the specialty managed healthcare business. The Company's executive offices are located at Suite 400, 6950 Columbia Gateway Drive, Columbia, Maryland 21046, and its telephone number at that location is (410) 953-1000.
RECENT DEVELOPMENTS

SALE OF EUROPEAN PROVIDER OPERATIONS. On April 9, 1999, the Company sold its European psychiatric provider operations to Investment AB Bure of Sweden for approximately $57.0 million (before transaction costs of approximately $2.5 million) which resulted in a non-recurring gain of approximately $23.9 million before provision for income taxes.

The Company used approximately $38.2 million of the net proceeds to make a mandatory unscheduled principal payment on indebtedness outstanding under the Term Loan Facility (as defined). The remaining proceeds were used to reduce borrowings outstanding under the Revolving Facility (as defined).

TPG INVESTMENT. On July 19, 1999, the Company entered into a definitive agreement to issue approximately $75.4 million of cumulative convertible preferred stock to TPG Magellan, LLC, an affiliate of the investment firm Texas Pacific Group ("TPG") (the "TPG Investment"). On December 15, 1999, the Company and TPG amended and restated the definitive agreement and consummated the TPG Investment.

Pursuant to the amended and restated definitive agreement, TPG purchased approximately $59.1 million of the Company's Series A Cumulative Convertible Preferred Stock (the "Series A Preferred Stock") and an Option (the "Option") to purchase an additional approximately $21.0 million of Series A Preferred Stock. Net proceeds from issuance of the Series A Preferred Stock were $54.0 million. Approximately 50% of the net proceeds received from the issuance of the Series A Preferred Stock was used to reduce debt outstanding under the Term Loan Facility (as defined) with the remaining 50% of the proceeds being used for general corporate purposes. The Series A Preferred Stock carries a dividend of 6.5% per annum, payable in quarterly installments in cash or common stock, subject to certain conditions. Dividends not paid in cash or common stock will accumulate. The Series A Preferred Stock is convertible at any time into approximately 6.3 million shares of the Company's common stock at a conversion price of $9.375 per share and carries "as converted" voting rights. The Company may, under certain circumstances, require the holders of the Series A Preferred Stock to convert such stock into common stock. The Series A Preferred Stock, plus accrued and unpaid dividends thereon, must be redeemed by the Company on December 15, 2009. The Options will expire unless exercised by June 15, 2002. TPG may exercise the Options in whole or in part. The Company may, under certain circumstances, require TPG to exercise the Options. The terms of the shares of Series A Preferred Stock issuable pursuant to the Options are identical to the terms of the shares of Series A Preferred Stock issued to TPG at the closing of the TPG Investment.

TPG has three representatives on the Company's twelve-member Board of Directors.

The issuance of common stock in respect of accrued and unpaid dividend obligations on the Series A Preferred Stock and the issuance of common stock underlying the Options are subject to approval by the Company's stockholders. The Company intends to seek such approval no later than the next annual meeting of its stockholders, which is expected to be held on February 17, 2000.

DISPOSITION OF HEALTHCARE PROVIDER AND FRANCHISING BUSINESSES. On September 10, 1999, the Company consummated the transfer of certain assets and other interests pursuant to a Letter Agreement dated
August 10, 1999 with Crescent Real Estate Equities ("Crescent"), Crescent Operating, Inc. ("COI") and Charter Behavioral Health Systems, LLC ("CBHS"). The transfer effected the Company's exit from its healthcare provider and healthcare franchising businesses (the "CBHS Transactions"). The terms of the CBHS Transactions are summarized as follows:

- CBHS redeemed 80% of the Company's CBHS common interest and all of its CBHS preferred interest, leaving the Company with a 10% non-voting common interest in CBHS.

- The Company agreed to transfer to CBHS its interests in five of its six hospital-based joint ventures ("Provider JVs") and related real estate as soon as practicable.

- The Company transferred to CBHS the right to receive approximately $7.1 million from Crescent for the sale of two psychiatric hospitals that were acquired by the Company (and leased to CBHS) in connection with CBHS' acquisition of certain businesses from Ramsay Healthcare, Inc. in fiscal 1998.

- The Company forgave receivables due from CBHS of approximately $3.3 million for payments received by CBHS for patient services prior to the formation of CBHS on June 17, 1997. The receivables related primarily to patient stays that "straddled" the formation date of CBHS.

- The Company agreed to pay $2.0 million to CBHS in 12 equal monthly installments beginning on the first anniversary of the closing date.

- CBHS agreed to indemnify the Company for 20% of up to the first $50 million (i.e., $10 million) for expenses, liabilities and settlements related to government investigations for events that occurred prior to June 17, 1997 (the "CBHS Indemnification"). CBHS will be required to pay the Company a maximum of $500,000 per year under the CBHS Indemnification.

- Crescent, COI, CBHS and Magellan provided each other with mutual releases of claims among all of the parties with respect to the original transactions that effected the formation of CBHS and the operation of CBHS since June 17, 1997 with certain specified exceptions.

- The Company transferred certain other real estate and interests related to the healthcare provider business to CBHS.

- The Company transferred its healthcare franchising interests, which included Charter Advantage, LLC, the Charter call center operation, the Charter name and related intellectual property to CBHS. The Company has been released from performing any further franchise services or incurring future franchising expenses.

- The Company forgave prepaid call center management fees of approximately $2.7 million.

- The Company forgave unpaid franchise fees of approximately $115 million.
The CBHS Transactions, together with the formal plan of disposal authorized by the Company's Board of Directors on September 2, 1999, represents the disposal of the Company's healthcare provider and healthcare franchising business segments under Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations--Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" ("APB 30"). APB 30 requires that the results of continuing operations be reported separately from those of discontinued operations for all periods presented and that any gain or loss from disposal of a segment of a business be reported in conjunction with the related results of discontinued operations. Accordingly, the Company has restated its results of operations for all prior periods. The Company recorded an after-tax loss on disposal of its healthcare provider and healthcare franchising business segments of approximately $47.4 million (primarily non-cash), in the fourth quarter of fiscal 1999.

HISTORY

OVERVIEW Prior to June 1997, the Company derived the majority of its revenue and earnings from providing behavioral healthcare services in an inpatient setting. Payments from third-party payors are the principal source of revenue for most healthcare providers. In the early 1990's, many third-party payors sought to control the cost of providing care to their patients by instituting managed care programs or seeking the assistance of managed care companies. Providers participating in managed care programs agree to provide services to patients for a discount from established rates, which generally results in pricing concessions by the providers and lower margins. Additionally, managed care programs generally encourage alternatives to inpatient treatment settings and reduce utilization of inpatient services. As a result, third-party payors established managed care programs or engaged managed care companies in many areas of healthcare, including behavioral healthcare. The Company, which, until June 1997, was the largest operator of psychiatric hospitals in the United States, was adversely affected by the adoption of managed care programs as the principal cost control measure of third party payors.

Prior to the first quarter of fiscal 1996, the Company was not engaged in the behavioral managed healthcare business. During the first quarter of fiscal 1996, the Company acquired a 61% ownership interest in Green Spring Health Services, Inc. ("Green Spring"), a managed care company specializing in mental health and substance abuse/dependence services. At that time, the Company intended to become a fully integrated behavioral healthcare provider by combining the behavioral managed healthcare products offered by Green Spring with the direct treatment services offered by the Company's psychiatric hospitals. The Company believed that an entity that participated in both the managed care and provider segments of the behavioral healthcare industry could more efficiently provide and manage behavioral healthcare for insured populations than an entity that was solely a managed care company. The Company also believed that earnings from its behavioral managed care business would offset, in part, the negative impact on the financial performance of its psychiatric hospitals caused by managed care.

Subsequent to the Company's acquisition of Green Spring, the growth of the behavioral managed healthcare industry accelerated. Under the Company's majority ownership, Green Spring increased its base of covered lives from 12.0 million at the end of calendar 1995 to 21.1 million at the end of calendar 1997, a compound annual growth rate of over 32%. While growth in the industry was accelerating, the behavioral managed healthcare industry also began to consolidate. The Company concluded that this consolidation presented an opportunity for it to increase its participation in the behavioral managed healthcare industry, which
the Company believed offered growth and earnings prospects superior to those of the psychiatric hospital industry. Therefore, the Company decided to sell its domestic psychiatric facilities to obtain capital for expansion of its behavioral managed healthcare business.

The Company took a significant step toward implementing this strategy during fiscal 1997, when it sold substantially all of its domestic acute-care psychiatric hospitals and residential treatment facilities (collectively, the "Psychiatric Hospital Facilities") to Crescent for $417.2 million in cash (before costs of approximately $16.0 million) and certain other consideration (the "Crescent Transactions"). Simultaneously with the sale of the Psychiatric Hospital Facilities, the Company and COI, an affiliate of Crescent, formed CBHS to conduct the operations of the Psychiatric Hospital Facilities and certain other facilities transferred to CBHS by the Company. The Company retained a 50% ownership of CBHS; the other 50% of the equity of CBHS was owned by COI.

The Crescent Transactions provided the Company with approximately $200 million of net cash proceeds, after debt repayment, for use in implementing its business strategy of expanding its managed care operations. The Company used the proceeds to finance the acquisitions of HAI (as defined) and Allied (as defined) in December 1997 and further implemented its business strategy through the Merit (as defined) acquisition (collectively, the "Managed Care Acquisitions"). A summary of the Managed Care Acquisitions and related transactions are as follows:

**HUMAN AFFAIRS INTERNATIONAL, INCORPORATED ACQUISITION.** On December 4, 1997, the Company consummated the purchase of Human Affairs International, Incorporated ("HAI"), formerly a unit of Aetna/U.S. Healthcare ("Aetna"), for approximately $122.1 million, which the Company funded from cash on hand. HAI managed behavioral healthcare programs primarily through employee assistance programs ("EAPs") and other behavioral managed healthcare plans. The Company may be required to make additional contingent payments of up to $60.0 million annually to Aetna over the five year period subsequent to closing. The amount and timing of the payments will be contingent upon net increases in the number of HAI's covered lives in specified products. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Outlook--Liquidity and Capital Resources."

**ALLIED HEALTH GROUP, INC. ACQUISITION.** On December 5, 1997, the Company purchased the assets of Allied Health Group, Inc. and certain of its affiliates ("Allied"). Allied provides specialty managed care products, including risk-based products and administrative services to a variety of insurance companies and other customers, including Prudential and Cigna. The Company paid approximately $54.5 million for Allied. The Company may be required to make additional contingent payments to the former owners of Allied depending on Allied’s future performance. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Outlook--Liquidity and Capital Resources."

**MERIT ACQUISITION.** On February 12, 1998, the Company consummated the acquisition of Merit Behavioral Care Corporation ("Merit") for cash consideration of approximately $448.9 million plus the repayment of Merit's debt. Merit managed behavioral healthcare programs across all segments of the healthcare industry, including health maintenance organizations ("HMO's"), Blue Cross/Blue Shield organizations and other insurance companies, corporations and labor unions, federal, state and local governmental agencies and various state Medicaid programs.
In connection with the consummation of the Merit acquisition, the Company consummated certain related transactions (together with the Merit acquisition, collectively, the "Transactions"), as follows: (i) the Company terminated its existing credit agreement (the "Magellan Existing Credit Agreement"); (ii) the Company repaid all loans outstanding pursuant to and terminated Merit's existing credit agreement (the "Merit Existing Credit Agreement") (the Magellan Existing Credit Agreement and the Merit Existing Credit Agreement are hereinafter referred to as the "Existing Credit Agreements"); (iii) the Company consummated a tender offer for its 11 1/4% Series A Senior Subordinated Notes due 2004 (the "Magellan Outstanding Notes"); (iv) Merit consummated a tender offer for its 11 1/2% Senior Subordinated Notes due 2005 (the "Merit Outstanding Notes") (the Magellan Outstanding Notes and the Merit Outstanding Notes are hereinafter referred to collectively as the "Outstanding Notes" and such tender offers are hereinafter referred to collectively as the "Debt Tender Offers"); (v) the Company entered into a new senior secured bank credit agreement (the "Credit Agreement"), providing for a revolving credit facility (the "Revolving Facility") and a term loan facility (the "Term Loan Facility") which provides for borrowings of up to $700 million; and (vi) the Company issued the 9% Series A Senior Subordinated Notes due 2008 (the "Notes") pursuant to an indenture which governs the Notes ("Indenture").

The following table sets forth the sources and uses of funds for the Transactions (in millions):

<table>
<thead>
<tr>
<th>SOURCES:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents</td>
<td>$ 59.3</td>
</tr>
<tr>
<td>Credit Agreement:</td>
<td></td>
</tr>
<tr>
<td>Revolving Facility(1)</td>
<td>$ 20.0</td>
</tr>
<tr>
<td>Term Loan Facility</td>
<td>$ 550.0</td>
</tr>
<tr>
<td>The Notes</td>
<td>$ 625.0</td>
</tr>
<tr>
<td>Total sources</td>
<td>$1,254.3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>USES:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Cash Merger Consideration</td>
<td>$ 448.9</td>
</tr>
<tr>
<td>Repayment of Merit Existing Credit Agreement(2)</td>
<td>$ 196.4</td>
</tr>
<tr>
<td>Purchase of Magellan Outstanding Notes(3)</td>
<td>$ 432.1</td>
</tr>
<tr>
<td>Purchase of Merit Outstanding Notes(4)</td>
<td>$ 121.6</td>
</tr>
<tr>
<td>Transaction costs(5)</td>
<td>$  55.3</td>
</tr>
<tr>
<td>Total uses</td>
<td>$1,254.3</td>
</tr>
</tbody>
</table>

(1) The Revolving Facility provides for borrowings of up to $150.0 million.

(2) Includes principal amount of $193.7 million and accrued interest of $2.7 million.

(3) Includes principal amount of $375.0 million, tender premium of $43.4 million and accrued interest of $13.7 million.

(4) Includes principal amount of $100.0 million, tender premium of $18.8 million and accrued interest of $2.8 million.
DISPOSITION OF PROVIDER AND FRANCHISE OPERATIONS. The Company completed its exit from the healthcare provider and franchising businesses during fiscal 1999. In April 1999, the Company sold its European psychiatric provider operations to Investment AB Bure of Sweden for approximately $57.0 million and, in September 1999, the Company consummated the CBHS Transactions.

INDUSTRY OVERVIEW

Behavioral healthcare costs have increased significantly in the United States in recent years. According to industry sources, direct medical costs of behavioral health problems, combined with certain indirect costs, were conservatively estimated at more than $160.0 billion in 1990, the latest year for which statistics are available. In addition, according to industry sources, in 1994 (the most recent year for which such information was available), direct behavioral healthcare services treatment costs amounted to approximately $82.0 billion, or approximately 8% of total healthcare industry spending. These direct costs have grown, in part, as society has begun to recognize and address behavioral health concerns and employers have realized that rehabilitation of employees suffering from substance abuse and relatively mild mental health problems can reduce losses due to absenteeism and decreased productivity.

In response to these escalating costs, behavioral managed healthcare companies such as Green Spring, HAI and Merit were formed. Behavioral managed healthcare companies focus on care management techniques with the goal of arranging for the provision of an appropriate level of care in a cost-efficient and effective manner by improving early access to care and assuring an effective match between the patient and the behavioral healthcare provider’s specialty. As the growth of behavioral managed healthcare has increased, there has been a significant decrease in occupancy rates and average lengths of stay for inpatient psychiatric facilities and an increase in outpatient treatment and alternative care services.

According to an industry trade publication entitled "Open Minds Year Book of Managed Behavioral Health Market Share in the United States 1999-2000" published by Open Minds, Gettysburg, Pennsylvania (hereinafter referred to as "OPEN MINDS"), as of January 1999, approximately 176.8 million beneficiaries were covered by some form of behavioral managed healthcare plan and an additional 18.8 million beneficiaries were enrolled in internally-managed behavioral healthcare programs within HMOs. The number of covered beneficiaries has grown from approximately 86.3 million beneficiaries in 1993 to approximately 176.8 million as of January 1999, representing an approximate 13% compound annual growth rate since 1993. In addition, according to OPEN MINDS, beneficiaries covered under risk-based programs are growing even more rapidly, from approximately 13.6 million as of January 1993 to approximately 49.0 million as of January 1999, representing a compound annual growth rate of over 25%. OPEN MINDS estimates that the revenues of behavioral managed healthcare companies totaled approximately $4.4 billion in 1999.

OPEN MINDS divides the managed behavioral healthcare industry as of January 1999 into the following categories of care, based on services provided, extent of care management and level of risk assumption:
<table>
<thead>
<tr>
<th>CATEGORY OF CARE</th>
<th>BENEFICIARIES (IN MILLIONS)</th>
<th>PERCENT OF TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Utilization Review/Care Management Programs............</td>
<td>35.1</td>
<td>19.9%</td>
</tr>
<tr>
<td>Risk-Based Network Products................................</td>
<td>49.0</td>
<td>27.7</td>
</tr>
<tr>
<td>Non-Risk-Based Network Products..........................</td>
<td>36.7</td>
<td>20.8</td>
</tr>
<tr>
<td>EAPs.....................................................</td>
<td>41.8</td>
<td>23.6</td>
</tr>
<tr>
<td>Integrated Programs......................................</td>
<td>14.2</td>
<td>8.0</td>
</tr>
<tr>
<td>Total....................................................</td>
<td>176.8</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Management believes the current trends in the behavioral healthcare industry include increased utilization of risk-based network managed care products and the integration of EAPs with such managed care products. Management believes that these trends have developed in response to the attempt by payors to reduce rapidly escalating behavioral healthcare costs and to limit their risk associated with such costs while continuing to provide access to high quality care. According to OPEN MINDS, risk-based network products, integrated programs and EAPs are the most rapidly growing segments of the behavioral managed healthcare industry.

UTILIZATION REVIEW/CARE MANAGEMENT PRODUCTS. Under utilization review/care management products, a managed behavioral healthcare company manages and often arranges for treatment, but does not maintain a network of providers or assume any of the responsibility for the cost of providing treatment services. The Company categorizes its products within this segment of the managed behavioral healthcare industry (as it is defined by OPEN MINDS) as administrative services only ("ASO") products. The Company does not expect this segment of the industry to experience significant growth.

NON-RISK-BASED NETWORK PRODUCTS. Under non-risk-based network products, the behavioral managed healthcare company provides a full array of managed care services, including selecting, credentialing and managing a network of providers (such as psychiatrists, psychologists, social workers and hospitals), and performs utilization review, claims administration and care management functions. The third-party payor remains responsible for the cost of providing the treatment services rendered. The Company categorizes its products within this segment of the behavioral managed healthcare industry (as it is defined by OPEN MINDS) as ASO products.

RISK-BASED NETWORK PRODUCTS. Under risk-based network products, the behavioral managed healthcare company assumes all or a portion of the responsibility for the cost of providing a full or specified range of behavioral healthcare treatment services. Most of these programs have payment arrangements in which the managed care company agrees to arrange for services in exchange for a fixed fee per member per month that varies depending on the profile of the beneficiary population or otherwise shares the responsibility for arranging for all or some portion of the treatment services at a specific cost per person. Under these products, the behavioral managed healthcare company not only reviews and monitors a course of treatment, but also arranges and pays for the provision of patient care. Therefore, the behavioral managed healthcare company must contract with, credential and manage a network of specialized providers and facilities that covers the complete continuum of care. The behavioral managed healthcare company must also see that the appropriate level of care is delivered in the appropriate setting. Given the ability of payors of behavioral healthcare benefits to reduce their risk with respect to the cost of treatment services through risk-based network products while continuing to provide access to high quality care, this market segment has grown rapidly in recent years. In addition to the expected growth in total beneficiaries covered under behavioral managed healthcare products, this shift of beneficiaries into risk-based network products should further contribute to revenue growth for the behavioral managed healthcare industry because such contracts generate significantly higher revenue than ASO contracts. The higher revenue is
intended to compensate the behavioral managed healthcare company for bearing the financial responsibility for the cost of delivering care. The Company's risk-based products are risk-based network products as defined by OPEN MINDS.

EMPLOYEE ASSISTANCE PROGRAMS. An EAP is a worksite-based program designed to assist in the early identification and resolution of productivity problems associated with behavioral conditions or other personal concerns of employees and their dependants. Under an EAP, staff or network providers or other affiliated clinicians provide assessment and referral services to employee beneficiaries and their dependants. These services consist of evaluating a patient's needs and, if indicated, providing limited counseling and/or identifying an appropriate provider, treatment facility or other resource for more intensive treatment services. The EAP industry developed largely out of employers' efforts to combat alcoholism and substance abuse problems afflicting workers. A 1990 industry survey estimated the total costs of this dependency at approximately $98.6 billion per year. Many businesses have implemented alcoholism and drug abuse treatment programs in the workplace, and in some cases have expanded those services to cover a wider spectrum of personal problems experienced by workers and their families. As a result, EAP products now typically include consultation services, evaluation and referral services, employee education and outreach services. The Company believes that federal and state "drug-free workplace" measures and Federal Occupational Health and Safety Act requirements, taken together with the growing public perception of increased violence in the workplace, have prompted many companies to implement EAPs. Although EAPs originated as a support tool to assist managers in dealing with troubled employees, payors increasingly regard EAPs as an important component in the continuum of behavioral healthcare services.

INTEGRATED EAP/MANAGED BEHAVIORAL HEALTHCARE PRODUCTS. EAPs are utilized in a preventive role and in facilitating early intervention and brief treatment of behavioral healthcare problems before more extensive treatment is required. Consequently, EAPs often are marketed and sold in tandem with managed behavioral healthcare programs through "integrated" product offerings. Integrated products offer employers comprehensive management and treatment of all aspects of behavioral healthcare. In an effort to both reduce costs and increase accessibility and ease of treatment, employers are increasingly attempting to consolidate EAP and behavioral managed healthcare services into a single product. Although integrated EAP/managed behavioral healthcare products are currently only a small component of the overall industry, the Company expects this market segment to grow.

AREAS OF GROWTH

Management believes that the growth of the behavioral managed healthcare industry will continue, as payors of behavioral healthcare benefits attempt to reduce the costs of behavioral healthcare while maintaining high quality care. Management also believes that a number of opportunities exist in the behavioral managed healthcare industry for continued growth, primarily for risk-based products. The following paragraphs discuss factors contributing to the growth of risk-based products and the increase in the number of covered lives in certain markets.

RISK-BASED PRODUCTS. According to OPEN MINDS, industry enrollment in risk-based products has grown from approximately 13.6 million covered lives in 1993 to approximately 49.0 million covered lives in 1999, a compound annual growth rate of over 25%. Despite this growth, only approximately 27.7% of total managed behavioral healthcare covered lives were enrolled in risk-based products as of January 1999. The Company believes that the market for risk-based products has grown and will continue to grow as payors attempt to reduce their responsibility for the cost of providing behavioral healthcare while ensuring an appropriate level of access to care. Risk-based products can generate significantly greater revenue per covered life than other non-risk product types. According to the OPEN MINDS survey, risk-based products account for approximately one-half of total managed behavioral healthcare industry revenue, but, as stated above, accounted for only approximately 27.7% of total covered lives as of January 1999. During fiscal 1999, risk-based products accounted for approximately 75.2% of the Company's behavioral managed...
Medicaid. Medicaid is a joint state and federal program to provide healthcare benefits to low income individuals, including welfare recipients. According to the Health Care Financing Administration of the United States Department of Health and Human Services ("HCFA"), federal and state Medicaid spending increased from $75.4 billion in 1990 to an estimated $159.9 billion in 1997, at an average annual rate almost twice as fast as the annual increase in overall healthcare spending. Furthermore, according to HCFA, from 1991 to 1996 the number of Medicaid beneficiaries covered under full managed contracts grew at a compound annual rate of approximately 40% per year. The Company expects that the Balanced Budget Act of 1997 (the "Budget Act") will slow the growth of Medicaid spending by accelerating the trend of state Medicaid programs toward shifting beneficiaries into managed care programs in order to control rising costs.

Despite the recent increase in managed care enrollment of Medicaid beneficiaries, Medicaid managed care enrollment as a percentage of all Medicaid beneficiaries remains small. As of June 1996, according to the National Institute for Health Care Management, only approximately 35% of all Medicaid beneficiaries were enrolled in some form of managed care program, and less than 7% were enrolled in risk-based programs. The Company expects the number of Medicaid recipients enrolled in managed behavioral healthcare programs to increase through two avenues: (i) subcontracts with HMOs and (ii) direct contracts with state agencies. As HMOs increase their penetration of the Medicaid market, the Company expects that many HMOs will continue to (or begin to) subcontract with behavioral managed healthcare companies to provide services for Medicaid beneficiaries. State agencies have also begun to contract directly with behavioral managed healthcare companies to provide behavioral healthcare services to their Medicaid beneficiaries. Iowa, Massachusetts, Nebraska, Maryland, Pennsylvania, Tennessee and Montana are examples of states that have decided to "carve out" behavioral healthcare from their overall Medicaid managed care programs and have contracted or are expected to contract directly with behavioral managed healthcare companies to provide such services. The Company expects that the Budget Act will accelerate the trend of states contracting directly with behavioral managed healthcare companies. During fiscal 1999, Medicaid programs accounted for approximately 27.3% of the Company's behavioral managed healthcare revenue and represented approximately 4.4% of covered lives as of September 30, 1999. A majority of the Company's Medicaid contracts are risk-based. See "Cautionary Statements--Dependence on Government Spending for Managed Healthcare; Possible Impact of Healthcare Reform" and "--Risk-Based Products" and "Business--Regulation--Budget Act."

COMPANY OVERVIEW

GENERAL

According to enrollment data reported in OPEN MINDS, the Company is the nation's largest provider of behavioral managed healthcare services. As of September 30, 1999, the Company had approximately 66.4 million covered lives under behavioral managed healthcare contracts and managed behavioral healthcare programs for approximately 3,500 customers. Through its current network of over 40,000 providers and 5,000 treatment facilities, the Company manages behavioral healthcare programs for HMOs, Blue Cross/Blue Shield organizations and other insurance companies, corporations, federal, state and local governmental agencies, labor unions and various state Medicaid programs. The Company believes it has the largest and most comprehensive behavioral healthcare provider network in the United States. In addition to the Company's behavioral managed healthcare segment, the Company offers specialty managed care products related to the management of certain chronic medical conditions. The Company also offers a broad continuum of human services to 6,444 individuals who receive healthcare benefits funded by state and local governmental agencies through National Mentor, Inc. ("Mentor"), its wholly-owned human services provider.

The Company's professional care managers coordinate and manage the delivery
of behavioral healthcare treatment services through the Company's network of providers, which includes psychiatrists, psychologists, licensed clinical social workers, marriage and family therapists and licensed clinical professional counselors. The treatment services provided by the Company's behavioral provider network include outpatient programs (such as counseling and therapy), intermediate care programs (such as sub-acute emergency care, intensive outpatient programs and partial hospitalization services), inpatient treatment services and alternative care services (such as residential treatment, home and community-based programs and rehabilitative and support services). The Company provides these services through: (i) risk-based products, (ii) EAPs, (iii) ASO products and (iv) products that combine features of some or all of these products. Under risk-based products, the Company arranges for the provision of a full range of behavioral healthcare services for beneficiaries of its customers' healthcare benefit plans through fee arrangements under which the Company assumes all or a portion of the responsibility for the cost of providing such services in exchange for a fixed per member per month fee. Under EAPs, the Company provides assessment services to employees and dependents of its customers, and if required, referral services to the appropriate behavioral healthcare service provider. Under ASO products, the Company provides services such as utilization review, claims administration and provider network management. The Company does not assume the responsibility for the cost of providing healthcare services pursuant to its ASO products.

The Company conducts operations in three business segments: (i) behavioral managed healthcare, (ii) human services and (iii) specialty managed healthcare. The following describes the Company's three business segments:

BEHAVIORAL MANAGED HEALTHCARE. The behavioral managed healthcare segment is the Company's primary operating segment. The Company's behavioral managed healthcare operations are organized around three customer segments: (i) the Health Plan Division, focusing on the needs of health insurance plans and HMO's and their members; (ii) the Workplace Division, focusing on self-insured employers and labor unions and their employees and dependants; and (iii) the Public Sector Division, focusing on the needs of public purchasers of behavioral healthcare services and their constituents.

HUMAN SERVICES. The Company's human services business provided specialty home-based behavioral healthcare services through Mentor, to approximately 6,444 individuals in 181 programs in 22 states as of September 30, 1999. Mentor was founded in 1983 and was acquired by the Company in January 1995. Mentor's services include specialty home-based behavioral healthcare services, which feature individualized home and community-based health and human services delivered in highly structured and professionally monitored family environments or "mentor" homes. The mentor homes serve clients with chronic behavioral disorders and disabilities requiring long-term care, including children and adolescents with behavioral problems, individuals with mental retardation or developmental disabilities, and individuals with neurological impairment or other medical and behavioral frailties. Mentor also provides various residential and day services for individuals with acquired brain injuries and for individuals with mental retardation and developmental disabilities.

SPECIALTY MANAGED HEALTHCARE. The Company's specialty managed healthcare business provides specialty risk-based products and administrative services to a variety of health insurance companies and other customers, including Prudential, Cigna and HIP of New York and Florida. The specialty managed healthcare operations focus on the needs of health plans to manage their specialty care networks and disease management programs in areas such as diabetes, asthma, oncology and cardiology.
INCREASE ENROLLMENT IN BEHAVIORAL MANAGED HEALTHCARE PRODUCTS. The Company believes it has an opportunity to increase covered lives in all its behavioral managed healthcare products. The Company believes it will increase ASO and EAP covered lives with further penetration of large corporate, HMO and insurance customers. The Company also believes that it has an opportunity to increase revenues, earnings and cash flows from operations by increasing lives covered by its risk-based products in all customer segments. The Company is the industry's leading provider of risk-based products, according to data reported by OPEN MINDS, and believes that it may benefit from the continuing shift to risk-based products. According to OPEN MINDS, industry enrollment in risk-based products has grown from approximately 13.6 million in 1993 to approximately 49.0 million as of January 1999, representing a compound annual growth rate of over 25%. Despite this growth, only approximately 27.7% of total behavioral managed healthcare enrollees were in risk-based products as of January 1999. The Company believes that the market for risk-based products has grown and will continue to grow as payors attempt to reduce their cost of providing behavioral healthcare while ensuring a high quality of care and an appropriate level of access to care. The Company believes enrollment in its risk-based products will increase through growth in new covered lives and through the transition of covered lives in ASO and EAP products to higher revenue risk-based products. There are certain risks associated with increased enrollment in risk-based products. See "Cautionary Statements--Risk-Based Products."

PURSUE ADDITIONAL SPECIALTY MANAGED HEALTHCARE OPPORTUNITIES. The Company believes that significant demand exists for specialty managed healthcare products related to the management of certain chronic conditions. The Company believes its large number of covered lives, information systems infrastructure and experience in managing behavioral healthcare programs position the Company to provide customers with specialty managed healthcare products. In addition, the Company may attempt to expand its specialty managed care product offerings by pursuing strategic acquisitions. The Company may be unable to fully execute its acquisition strategy due to possible financial and liquidity concerns. See "Cautionary Statements--Leverage and Debt Service Obligations" and "Management's Discussion and Analysis of Financial Condition and Results of Operations--Outlook--Liquidity and Capital Resources."

EXPANSION OF HUMAN SERVICES GEOGRAPHIC COVERAGE AND PRODUCT MIX. The human services industry is a very fragmented, $100 billion industry that continues to be consolidated by a few competitors. The Company believes continued growth will result from its ability to increase its geographic coverage through strategic acquisitions as well as leveraging its human services product offerings on a nationwide basis. The Company may be unable to fully execute its acquisition strategy due to possible financial and liquidity concerns. See "Cautionary Statements--Leverage and Debt Service Obligations" and "Management's Discussion and Analysis of Financial Condition and Results of Operations--Outlook--Liquidity and Capital Resources."

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BEHAVIORAL MANAGED HEALTHCARE PRODUCTS AND SERVICES

GENERAL. The following table sets forth the approximate number of covered lives as of September 30, 1998 and 1999 and revenue for fiscal 1998 and 1999 for the types of behavioral managed healthcare programs offered by the Company:

<table>
<thead>
<tr>
<th>PROGRAMS</th>
<th>COVERED LIVES</th>
<th>PERCENT</th>
<th>REVENUE</th>
<th>PERCENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>(IN MILLIONS, EXCEPT PERCENTAGES)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1998</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Risk-Based Products</td>
<td>18.6</td>
<td>30.2%</td>
<td>$ 773.3</td>
<td>75.4%</td>
</tr>
<tr>
<td>EAP, ASO and other products</td>
<td>43.0</td>
<td>69.8%</td>
<td>252.9</td>
<td>24.6%</td>
</tr>
<tr>
<td>Total</td>
<td>61.6</td>
<td>100.0%</td>
<td>$1,026.2</td>
<td>100.0%</td>
</tr>
</tbody>
</table>
The number of the Company's covered lives fluctuates based on the number of the Company's customer contracts and as employee, HMO and insurance company subscriber and government program enrollee populations change from time to time.

RISK-BASED PRODUCTS. Under the Company's risk-based products, the Company typically arranges for the provision of a full range of outpatient, intermediate and inpatient treatment services to beneficiaries of its customers' healthcare benefit plans, primarily through arrangements in which the Company assumes all of the responsibility for the cost of providing such services in exchange for a per member per month fee. The Company's experience with risk-based contracts covering a large number of lives has given it a broad base of data from which to analyze utilization rates. The Company believes that this broad database permits it to estimate utilization trends and costs more accurately than many of its competitors, which allows it to bid effectively. The Company believes that its experience has also allowed it to develop effective measures for managing the cost of providing a unit of care to its covered lives. The Company has developed or acquired clinical protocols, which permit it to assist its network providers to administer effective treatment in a cost efficient manner, and claims management technology, which permits the Company to reduce the cost of processing claims. The Company's care managers are an essential element in its provision of cost-effective care. Care managers, in consultation with treating professionals, and using the Company's clinical protocols, authorize an appropriate level and intensity of services that can be delivered in a cost-efficient manner.

EMPLOYEE ASSISTANCE PROGRAMS. The Company's EAP products typically provide assessment and referral services to employees and dependents of the Company's customers in an effort to assist in the early identification and resolution of productivity problems associated with the employees who are impaired by behavioral conditions or other personal concerns. For many EAP customers, the Company also provides limited outpatient therapy (typically limited to eight or fewer sessions) to patients requiring such services. For these services, the Company typically is paid a fixed fee per member per month; however, the Company is usually not responsible for the cost of providing care beyond these services. If further services are necessary beyond limited outpatient therapy, the Company will refer the beneficiary to an appropriate provider or treatment facility.

INTEGRATED PRODUCTS. Under its integrated products, the Company typically establishes an EAP to function as the "front end" of a managed care program that provides a full range of services, including more intensive treatment services not covered by the EAP. The Company typically manages the EAP and accepts all or some of the responsibility for the cost of any additional treatment required upon referral out of the EAP, thus integrating the two products and using both the Company's care management and clinical care techniques to manage the provision of care.

ASO PRODUCTS. Under its ASO products, the Company provides services ranging from utilization review and claims administration to the arrangement for and management of a full range of patient treatment services, but does not assume any of the responsibility for the cost of providing treatment services. Services include member assistance, management reporting and claims processing in addition to utilization review and care management.
GENERAL. The following table sets forth the approximate number of covered lives as of September 30, 1998 and 1999 and revenue for fiscal 1998 and 1999 in each of the Company's market segments described below:

<table>
<thead>
<tr>
<th>MARKET</th>
<th>COVERED LIVES</th>
<th>PERCENT</th>
<th>REVENUE</th>
<th>PERCENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>(IN MILLIONS, EXCEPT PERCENTAGES)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>1998</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Workplace (Corporations and Labor Unions)</td>
<td>22.8</td>
<td>37.0%</td>
<td>$165.3</td>
<td>16.1%</td>
</tr>
<tr>
<td>Health Plans</td>
<td>35.4</td>
<td>57.5%</td>
<td>625.3</td>
<td>60.9%</td>
</tr>
<tr>
<td>Public Sector (Primarily Medicaid)</td>
<td>3.4</td>
<td>5.5%</td>
<td>235.6</td>
<td>23.0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>61.6</td>
<td>100.0%</td>
<td>$1,026.2</td>
<td>100.0%</td>
</tr>
<tr>
<td><strong>1999</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Workplace (Corporations and Labor Unions)</td>
<td>27.0</td>
<td>40.7%</td>
<td>$252.8</td>
<td>17.1%</td>
</tr>
<tr>
<td>Health Plans</td>
<td>36.5</td>
<td>54.9%</td>
<td>824.9</td>
<td>55.6%</td>
</tr>
<tr>
<td>Public Sector (Primarily Medicaid)</td>
<td>2.9</td>
<td>4.4%</td>
<td>405.5</td>
<td>27.3%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>66.4</td>
<td>100.0%</td>
<td>$1,483.2</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

CORPORATIONS AND LABOR UNIONS. Corporations and, to a lesser extent, labor unions, account for a large number of the Company's contracts to provide behavioral managed healthcare services and, in particular, EAP and integrated EAP/managed care services. The Company has structured a variety of fee arrangements with corporate customers to cover all or a portion of the responsibility of the cost of providing treatment services. In addition, the Company operates a number of programs for corporate customers on an ASO basis. Management believes the corporate market is an area of potential growth for the Company, as corporations are anticipated to increase their utilization of behavioral managed healthcare services. In an effort to increase penetration of the corporate market, the Company intends to build upon its experience in managing programs for large corporate customers (such as IBM, Federal Express and AT&T) and to market integrated programs to existing EAP customers and other prospective corporate clients.

HEALTH PLANS. The Company is a leader in the HMO market, providing behavioral managed healthcare services to HMO beneficiaries. HMO contracts are full, limited or shared risk contracts in which the Company generally accepts a fixed fee per member per month from the HMO in exchange for arranging for a full or specified range of behavioral healthcare services for a specific portion of the HMO's beneficiaries. Although certain large HMOs provide their own behavioral managed healthcare services, many HMOs "carve out" behavioral healthcare from their general healthcare services and subcontract such services to behavioral managed healthcare companies such as the Company. The Company anticipates that its business with HMOs will continue to grow. The Company is also the nation's leading provider of behavioral managed healthcare services to Blue Cross/Blue Shield organizations, serving 35 such organizations as of September 30, 1999.

PUBLIC SECTOR. The Company provides behavioral managed healthcare services to Medicaid recipients through both direct contracts with state and local governmental agencies and through subcontracts with HMOs focused on Medicaid beneficiary populations. In addition to the Medicaid population, other public entitlement programs, such as Medicare and state insurance programs for the uninsured, offer the Company areas of potential future growth. The Company expects that governmental agencies will continue to implement a significant number of managed care Medicaid programs through contracts with HMOs and that many HMOs will subcontract with behavioral managed healthcare organizations, such as the Company, for behavioral healthcare services. The Company also
expects that other states will continue the trend of "carving-out" behavioral healthcare services from their general healthcare benefit plans and contracting directly with behavioral managed healthcare companies such as the Company. See "Industry--Areas of Growth," "Cautionary Statements--Dependence on Government Spending for Managed Healthcare; Possible Impact of Healthcare Reform" and "Cautionary Statements--Regulation--Other Proposed Legislation."

BEHAVIORAL MANAGED HEALTHCARE CONTRACTS

The Company's contracts with customers typically have terms of one to three years, and in certain cases contain renewal provisions (at the customer's option) for successive terms of between one and two years (unless terminated earlier). Substantially all of these contracts are immediately terminable with cause and many are terminable without cause by the customer or the Company either upon the giving of requisite notice and the passage of a specified period of time (typically between 60 and 180 days) or upon the occurrence of other specified events. In addition, the Company's contracts with federal, state and local governmental agencies, under both direct contract and subcontract arrangements with HMOs, generally are conditioned on legislative appropriations. These contracts, notwithstanding terms to the contrary, generally can be terminated or modified by the customer if such appropriations are not made. See "Cautionary Statements--Risk Based Programs" and "Cautionary Statements--Reliance on Customer Contracts."

The specific terms of the Company's contracts are determined by whether the contracts are for risk-based, EAP, integrated or ASO products. Risk-based, EAP and ASO contracts provide for payment of a per member per month fee to the Company. The Company's billing arrangements for integrated products vary on a case by case basis.

BEHAVIORAL MANAGED HEALTHCARE NETWORK

The Company's behavioral managed healthcare and EAP treatment services are provided by a network of third-party providers. The number and type of providers in a particular area depend upon customer preference, site, geographic concentration and demographic make-up of the beneficiary population in that area. Network providers include a variety of specialized behavioral healthcare personnel, such as psychiatrists, psychologists, licensed clinical social workers, substance abuse counselors and other professionals.

As of September 30, 1999, the Company had contractual arrangements covering over 40,000 individual third-party network providers. The Company's network providers are independent contractors located throughout the local areas in which the Company's customers' beneficiary populations reside. Network providers work out of their own offices, although the Company's personnel are available to assist them with consultation and other needs. Network providers include both individual practitioners, as well as individuals who are members of group practices or other licensed centers or programs. Network providers typically execute standard contracts with the Company for which they are typically paid by the Company on a fee-for-service basis. In some cases, network providers are paid on a "case rate" basis, whereby the provider is paid a set rate for an entire course of treatment, or through other risk sharing arrangements.

As of September 30, 1999, the Company's behavioral managed healthcare network included contractual arrangements with approximately 5,000 third-party treatment facilities, including inpatient psychiatric and substance abuse hospitals, intensive outpatient facilities, partial hospitalization facilities, community health centers and other community-based facilities, rehabilitative and support facilities, and other intermediate care and alternative care facilities or programs. This variety of facilities enables the Company to offer patients a full continuum of care and to refer patients to the most appropriate facility or program within that continuum. Typically, the Company contracts with facilities on a per diem or fee-for-service basis and, in some cases, on a "case rate" or capitated basis. The contracts between the Company and inpatient and other facilities typically are for one year terms and, in some cases, are
automatically renewable at the Company's option. Facility contracts are usually terminable by the Company or the facility owner upon 30 to 120 days notice.

COMPETITION

Each segment of the Company's business is highly competitive. With respect to its managed care businesses, the Company competes with large insurance companies, HMOs, PPOs, third-party administrators ("TPAs"), independent practitioner associations ("IPAs"), multi-disciplinary medical groups and other managed care companies. Many of the Company's competitors are significantly larger and have greater financial, marketing and other resources than the Company, and some of the Company's competitors provide a broader range of services. The Company may also encounter substantial competition in the future from new market entrants. Many of the Company's customers that are managed care companies may, in the future, seek to provide behavioral managed healthcare and EAP services to their employees or subscribers directly, rather than by contracting with the Company for such services. Because of competition, the Company does not expect to be able to rely on price increases to achieve revenue growth and expects to continue experiencing pressure on direct operating margins. See "Cautionary Statements--Highly Competitive Industry."

The Company's human services operations compete with various for profit and not-for-profit entities, including, but not limited to: (i) behavioral managed healthcare companies that have started managing human services for governmental agencies; (ii) home health care organizations; (iii) proprietary nursing home companies; and (iv) proprietary human services companies. The Company believes that the most significant factors in a customer's selection of services include price, quality of services and outcomes. The pricing aspect of such services is especially important to attract public sector agencies looking to outsource public services to the private sector as demand for quality services escalates while budgeted dollars for healthcare services are reduced. The Company's management believes that it competes effectively with respect to these factors.

The Company believes it benefits from the competitive strengths described below:

INDUSTRY LEADERSHIP. The Company is the largest provider of behavioral managed healthcare services in the United States, according to enrollment data reported in OPEN MINDS. The Company believes, based on data reported in OPEN MINDS, that it also now has the number one market position in each of the major product markets in which it competes. The Company believes its position will enhance its ability to: (i) provide a consistent level of high quality service on a nationwide basis; (ii) enter into agreements with behavioral healthcare providers that allow it to control healthcare costs for its customers; and (iii) market its behavioral managed care products to large corporate, HMO and health insurance customers, which, the Company believes, increasingly prefer to be serviced by a single-source provider on a national basis. See "Cautionary Statements--Highly Competitive Industry and --Reliance on Customer Contracts" for a discussion of the risks associated with the highly competitive nature of the behavioral managed healthcare industry and the Company's reliance on contracts with payors of behavioral healthcare benefits, respectively.

BROAD PRODUCT OFFERING AND NATIONWIDE PROVIDER NETWORK. The Company offers behavioral managed care products that can be designed to meet specific customer needs, including risk-based and partial risk-based products, integrated EAPs, stand-alone EAPs and ASO products. The Company's provider network encompasses over 40,000 providers and nearly 5,000 treatment facilities in all 50 states. The Company believes that the combination of its product offerings and its provider network allows the Company to meet its customers needs for behavioral managed healthcare on a nationwide basis, and positions the Company to capture incremental revenue opportunities resulting from the continued growth of the behavioral managed healthcare industry and the continued migration of its customers from ASO and EAP products to higher revenue risk-based products. See "Cautionary Statements--Risk-Based Products" for a discussion of the risks associated with risk-based products, which are the Company's primary source of revenue.
BROAD BASE OF CUSTOMER RELATIONSHIPS. The Company believes that the breadth of its customer relationships are attributable to the Company's broad product offerings, nationwide provider network, commitment to quality care and ability to manage behavioral healthcare costs effectively. The Company's customers include: (i) Blue Cross/Blue Shield organizations; (ii) national HMOs and other large insurers, such as Aetna and Humana; (iii) large corporations, such as IBM, Federal Express and AT&T; (iv) state and local governmental agencies through commercial, Medicaid and other programs; and (v) the federal government through contracts with CHAMPUS and the U.S. Postal Service. This broad base of customer relationships provides the Company with stable and diverse sources of revenue, earnings and cash flows and an established base from which to continue to increase covered lives and revenue. See "Cautionary Statements--Reliance on Customer Contracts" for a discussion of the risks associated with the Company's reliance on certain contracts with payors of behavioral healthcare benefits.

PROVEN RISK MANAGEMENT EXPERIENCE. The Company had approximately 19.2 million covered lives under risk-based contracts at September 30, 1999, making it the nation's industry leader in at-risk behavioral managed healthcare products, based on data reported in OPEN MINDS. The Company's experience with risk-based products covering a large number of lives has given it a broad base of data from which to analyze utilization rates. The Company believes that this broad database permits it to estimate utilization trends and costs more accurately than many of its competitors, which allows it to bid effectively. The Company believes that its experience has also allowed it to develop effective measures for controlling the cost of providing a unit of care to its covered lives. Among other cost control measures, the Company has developed or acquired clinical protocols, which permit the Company to assist its network providers to administer effective treatment in a cost efficient manner, and claims management technology, which permits the Company to reduce the cost of processing claims.

INSURANCE

The Company maintains a general and professional liability insurance policy with an unaffiliated insurer. The policy is written on an "occurrence" basis, subject to a $250,000 per claim and $1.0 million annual aggregate self-insured retention, for a three-year policy period ending June 2001.

REGULATION

GENERAL. The behavioral managed healthcare industry and the provision of behavioral healthcare services are subject to extensive and evolving state and federal regulation. The Company is subject to certain state laws and regulations, including those governing: (i) the licensing of insurance companies, HMOs, PPOs, TPAs and companies engaged in utilization review and (ii) the licensing of healthcare professionals, including restrictions on business corporations from practicing, controlling or exercising excessive influence over behavioral healthcare services through the direct employment of psychiatrists or, in a few states, psychologists and other behavioral healthcare professionals. These laws and regulations vary considerably among states and the Company may be subject to different types of laws and regulations depending on the specific regulatory approach adopted by each state to regulate the managed care business and the provision of behavioral healthcare treatment services. In addition, the Company is subject to certain federal laws as a result of the role the Company assumes in connection with managing its customers' employee benefit plans. The regulatory scheme generally applicable to the Company's managed care operations is described in this section.

The Company believes its operations are structured to comply with applicable laws and regulations in all material respects and that it has received all licenses and approvals that are material to the operation of its business. However, regulation of the managed healthcare industry is evolving, with new legislative enactments and regulatory initiatives at the state and federal levels being implemented on a regular basis. Consequently, it is possible that a
LICENSURE. Certain regulatory agencies having jurisdiction over the Company possess discretionary powers when issuing or renewing licenses or granting approval of proposed actions such as mergers, a change in ownership, transfer or assignment of licenses and certain intracorporate transactions. One or multiple agencies may require as a condition of such licensure or approval that the adoption of a model NAIC regulation in the area of health plan standards, which could be adopted by individual states in whole or in part, and could result in the Company being required to meet additional or new standards in connection with its existing operations. Individual states have also recently adopted their own regulatory initiatives that subject entities such as the Company to regulation under state insurance laws. This includes, but is not limited to, requiring licensure as an insurance company or HMO and requiring adherence to specific financial solvency standards. State insurance laws and regulations may limit the ability of the Company to pay dividends, make certain investments and repay certain indebtedness. Licensure as an insurance company, HMO or similar entity could also subject the Company to regulations governing reporting and disclosure, mandated benefits, and other traditional insurance regulatory requirements. PPO regulations to which the Company may be subject may require the Company to register with a state authority and provide information concerning its operations, particularly relating to provider and payor contracting. The imposition of such requirements could increase the Company’s cost of doing business and could delay the Company’s conduct or expansion of its business in some areas. The licensure process under state insurance laws can be lengthy and, unless the applicable state regulatory agency allows the Company to continue to operate while the licensure process is ongoing, the Company could experience a material adverse effect on its operating results and financial condition while its licensure application is pending. In addition, failure by the Company to obtain and maintain required licenses typically also constitutes

establishes a minimum amount of capital necessary for a managed care organization to support its overall operations, allowing consideration for the organization's size and risk profile. The NAIC initiative also may result in the adoption of a model NAIC regulation in the area of health plan standards, which

In many states, entities that assume risk under contracts with licensed insurance companies or HMOs have not been considered by state regulators to be conducting an insurance or HMO business. As a result, the Company has not sought licensure as either an insurer or HMO in certain states. The National Association of Insurance Commissioners (the "NAIC") has undertaken a comprehensive review of the regulatory status of entities arranging for the provision of healthcare services through a network of providers that, like the Company, may assume risk for the cost and quality of healthcare services, but that are not currently licensed as an HMO or similar entity. As a result of this review, the NAIC developed a "health organizations risk-based capital" formula, designed specifically for managed care organizations, that

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an event of default under the Company's contracts with its customers. The loss of business from one or more of the Company's major customers as a result of such an event of default or otherwise could have a material adverse effect on the Company.

UTILIZATION REVIEW AND THIRD-PARTY ADMINISTRATOR ACTIVITIES. Numerous states in which the Company does business have adopted, or are expected to adopt, regulations governing entities engaging in utilization review and TPA activities. Utilization review regulations typically impose requirements with respect to the qualifications of personnel reviewing proposed treatment, timeliness and notice of the review of proposed treatment, and other matters. TPA regulations typically impose requirements regarding claims processing and payments and the handling of customer funds. Utilization review and TPA regulations may increase the Company's cost of doing business in the event that compliance requires the Company to retain additional personnel to meet the regulatory requirements and to take other required actions and make necessary filings. Although compliance with utilization review regulations has not had a material adverse effect on the Company, there can be no assurance that specific regulations adopted in the future would not have such a result, particularly since the nature, scope and specific requirements of such provisions vary considerably among states that have adopted regulations of this type.

There is a trend among states to require licensure or certification of entities performing utilization review or TPA activities; however, certain federal courts have held that such licensure requirements are preempted by the Employee Retirement Income Security Act of 1974, as amended, ("ERISA"). ERISA preempts state laws that mandate employee benefit structures or their administration, as well as those that provide alternative enforcement mechanisms. The Company believes that its TPA activities performed for its self-insured employee benefit plan customers are exempt from otherwise applicable state licensing or registration requirements based upon federal preemption under ERISA and has relied on this general principle in determining not to seek licensure for certain of its activities in many states. Existing case law is not uniform on the applicability of ERISA preemption with respect to state regulation of utilization review or TPA activities. There can be no assurance that additional licensure will not be required with respect to utilization review or TPA activities in certain states.

"ANY WILLING PROVIDER" LAWS. Several states in which the Company does business have adopted, or are expected to adopt, "any willing provider" laws. Such laws typically impose upon insurance companies, PPOs, HMOs or other types of third-party payors an obligation to contract with, or pay for the services of, any healthcare provider willing to meet the terms of the payor's contracts with similar providers.

Compliance with any willing provider laws could increase the Company's costs of assembling and administering provider networks and could, therefore, have a material adverse effect on its operations.

LICENSING OF HEALTHCARE PROFESSIONALS. The provision of behavioral healthcare treatment services by psychiatrists, psychologists and other providers is subject to state regulation with respect to the licensing of healthcare professionals. The Company believes that the healthcare professionals who provide behavioral healthcare treatment on behalf of or under contracts with the Company are in compliance with the applicable state licensing requirements and current interpretations thereof; however, there can be no assurance that changes in such state licensing requirements or interpretations thereof will not adversely affect the Company's existing operations or limit expansion. With respect to the Company's crisis intervention program, additional licensure of clinicians who provide telephonic assessment or stabilization services to individuals who are calling from out-of-state may be required if such assessment or stabilization services are deemed by regulatory agencies to be treatment provided in the state of such individual's residence. The Company believes that any such additional licensure could be obtained; however, there can be no assurance that such licensing requirements will not adversely affect the Company's existing operations or limit expansion.

PROHIBITION ON FEE SPLITTING AND CORPORATE PRACTICE OF PROFESSIONS. The laws of some states limit the ability of a business corporation to directly provide, control or exercise excessive influence over behavioral healthcare
services through the direct employment of psychiatrists, psychologists, or other behavioral healthcare professionals. In addition, the laws of some states prohibit psychiatrists, psychologists, or other healthcare professionals from splitting fees with other persons or entities. These laws and their interpretations vary from state to state and enforcement by the courts and regulatory authorities may vary from state to state and may change over time. The Company believes that its operations as currently conducted are in material compliance with the applicable laws, however, there can be no assurance that the Company's existing operations and its contractual arrangements with psychiatrists, psychologists and other healthcare professionals will not be successfully challenged under state laws prohibiting fee splitting or the practice of a profession by an unlicensed entity, or that the enforceability of such contractual arrangements will not be limited. The Company believes that it could, if necessary, restructure its operations to comply with changes in the interpretation or enforcement of such laws and regulations, and that such restructuring would not have a material adverse effect on its operations.

DIRECT CONTRACTING WITH LICENSED INSURERS. Regulators in several states in which the Company does business have adopted policies that require HMOs or, in some instances, insurance companies, to contract directly with licensed healthcare providers, entities or provider groups, such as IPAs, for the provision of treatment services, rather than with unlicensed intermediary companies. In such states, the Company's customary model of contracting directly with its customers may need to be modified so that, for example, the IPAs (rather than the Company) contract directly with the HMO or insurance company, as appropriate, for the provision of treatment services. The Company intends to work with a number of these HMO customers to restructure existing contractual arrangements, upon contract renewal or in renegotiations, so that the entity which contracts with the HMO directly is an IPA. The Company does not expect this method of contracting to have a material adverse effect on its operations.

OTHER REGULATION OF HEALTHCARE PROVIDERS. The Company's business is affected indirectly by regulations imposed upon healthcare providers. Regulations imposed upon healthcare providers include provisions relating to the conduct of, and ethical considerations involved in, the practice of psychiatry, psychology, social work and related behavioral healthcare professions and, in certain cases, the common law duty to warn others of danger or to prevent patient self-injury. Confidentiality and patient privacy requirements are particularly strict in the field of behavioral healthcare services, and additional legislative initiatives relating to confidentiality are expected. The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") included a provision that prohibits the wrongful disclosure of certain "individually identifiable health information." HIPAA requires the Secretary of the Department to adopt standards relating to the transmission of such health information by healthcare providers and healthcare plans. Although the Company believes that such regulations do not at present materially impair the Company's operations, there can be no assurance that such indirect regulation will not have a material adverse effect on the Company in the future.

REGULATION OF CUSTOMERS. Regulations imposed upon the Company's customers include, among other things, benefits mandated by statute, exclusions from coverages prohibited by statute, procedures governing the payment and processing of claims, record keeping and reporting requirements, requirements for and payment rates applicable to coverage of Medicaid and Medicare beneficiaries, provider contracting and enrollee rights, and confidentiality requirements. Although the Company believes that such regulations do not at present materially impair the Company's operations, there can be no assurance that such indirect regulation will not have a material adverse effect on the Company in the future.

ERISA. Certain of the Company's services are subject to the provisions of ERISA. ERISA governs certain aspects of the relationship between employer-sponsored healthcare benefit plans and certain providers of services to such plans through a series of complex laws and regulations that are subject to periodic interpretation by the Internal Revenue Service and the Department of Labor. In some circumstances, and under certain customer contracts, the Company may be expressly named as a "fiduciary" under ERISA, or be deemed to have assumed duties that make it an ERISA fiduciary, and thus be required to carry out its operations in a manner that complies with ERISA requirements in all material respects. Although the Company believes that it is in material compliance with the applicable ERISA requirements and that such compliance does not currently have a material adverse effect on the Company's operations, there
can be no assurance that continuing ERISA compliance efforts or any future changes to the applicable ERISA requirements will not have a material adverse effect on the Company.

OTHER PROPOSED LEGISLATION. In the last five years, legislation has periodically been introduced at the state and federal level providing for new healthcare regulatory programs and materially revising existing healthcare regulatory programs. Any such legislation, if enacted, could materially adversely affect the Company's business, financial condition or results of operations. Such legislation could include both federal and state bills affecting the Medicaid programs which may be pending in or recently passed by state legislatures and which are not yet available for review and analysis. Such legislation could also include proposals for national health insurance and other forms of federal regulation of health insurance and healthcare delivery. It is not possible at this time to predict whether any such legislation will be adopted at the federal or state level, or the nature, scope or applicability to the Company's business of any such legislation, or when any particular legislation might be implemented. No assurance can be given that any such federal or state legislation will not have a material adverse effect on the Company.

CAUTIONARY STATEMENTS

This Form 10-K includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Although the Company believes that its plans, intentions and expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such plans, intentions or expectations will be achieved. Important factors that could cause actual results to differ materially from the Company's forward-looking statements are set forth below and elsewhere in this Form 10-K. All forward-looking statements attributable to the Company or persons acting on behalf of the Company are expressly qualified in their entirety by the cautionary statements set forth below.

LEVERAGE AND DEBT SERVICE OBLIGATIONS The Company is currently highly leveraged, with indebtedness that is substantial in relation to its stockholders' equity. As of September 30, 1999, the Company's aggregate outstanding indebtedness was approximately $1.14 billion and the Company's stockholders' equity was approximately $196.7 million. The Credit Agreement and the Indenture permit the Company to incur or guarantee certain additional indebtedness, subject to certain limitations.

The Company's high degree of leverage could have important consequences to the Company, including, but not limited to, the following: (i) the Company's ability to obtain additional financing for working capital, capital expenditures, acquisitions, general corporate purposes or other purposes may be impaired in the future; (ii) a substantial portion of the Company's cash flows from operations must be dedicated to the payment of principal and interest on its indebtedness; (iii) the Company is substantially more leveraged than certain of its competitors, which might place the Company at a competitive disadvantage; (iv) the Company may be hindered in its ability to adjust rapidly to changing market conditions and (v) the Company's high degree of leverage could make it more vulnerable in the event of a downturn in general economic conditions or its business or in the event of adverse changes in the regulatory environment or other adverse circumstances applicable to the Company.

The Company's ability to repay or to refinance its indebtedness and to pay interest on its indebtedness will depend on its financial and operating performance, which, in turn, is subject to prevailing economic and competitive conditions and to certain financial, business and other factors, many of which are beyond the Company's control. These factors could include operating difficulties, increased operating costs, the actions of competitors, regulatory
developments and delays in implementing strategic projects. The Company's ability to meet its debt service and other obligations may depend in significant part on the extent to which the Company can successfully implement its business strategy. There can be no assurance that the Company will be able to implement its strategy fully or that the anticipated results of its strategy will be realized. See "Business--Business Strategy."

If the Company's cash flows and capital resources are insufficient to fund its debt service obligations, the Company may be forced to reduce or delay capital expenditures, sell assets or seek to obtain additional equity capital or to restructure its debt. There can be no assurance that the Company's cash flows and capital resources will be sufficient for payment of principal of and interest on its indebtedness in the future, or that any such alternative measures would be successful or would permit the Company to meet its scheduled debt service obligations.

In addition, because the Company's obligations under the Credit Agreement bear interest at floating rates, an increase in interest rates could adversely affect, among other things, the Company's ability to meet its debt service obligations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Outlook--Results of Operations."

RESTRICTIVE FINANCING COVENANTS The Credit Agreement and the Indenture contain a number of covenants that restrict the operations of the Company and its subsidiaries. In addition, the Credit Agreement requires the Company to comply with specified financial ratios and tests, including a minimum interest coverage ratio, a maximum leverage ratio, a minimum net worth test, a maximum senior debt ratio and a minimum "EBITDA" test (as defined in the Credit Agreement, as amended). There can be no assurance that the Company will be able to comply with such covenants, ratios and tests in the future. The Company's ability to comply with such covenants, ratios and tests may be affected by events beyond its control, including prevailing economic, financial and industry conditions. The breach of any such covenants, ratios or tests could result in a default under the Credit Agreement that would permit the lenders thereunder to declare all amounts outstanding thereunder to be immediately due and payable, together with accrued and unpaid interest, and to prevent the Company from paying principal, premium, interest or other amounts due on any or all of the Notes until the default is cured or all senior indebtedness is paid or satisfied in full. Furthermore, the commitments of the lenders under the Credit Agreement to make further extensions of credit thereunder could be terminated. If the Company were unable to repay all amounts accelerated, the lenders could proceed against the subsidiary guarantors and the collateral securing the Company's and the subsidiary guarantors' obligations pursuant to the Credit Agreement. If the indebtedness outstanding pursuant to the Credit Agreement were to be accelerated, there can be no assurance that the assets of the Company would be sufficient to repay such indebtedness and the other indebtedness of the Company. The value of the Company's common stock would be adversely affected if the Company were unable to repay such indebtedness.

RISK-BASED PRODUCTS Revenues under risk-based contracts are the primary source of the Company's revenue from its behavioral managed healthcare business. Such revenues accounted for approximately 59.6% of the Company's total revenue and approximately 75.2% of its behavioral managed healthcare revenue in fiscal 1999. Under a risk-based contract, the Company assumes all or a portion of the responsibility for the cost of providing a full or specified range of behavioral healthcare treatment services to a specified beneficiary population in exchange, generally, for a fixed fee per member per month. In order for such contracts to be profitable, the Company must accurately estimate the rate of service utilization by beneficiaries enrolled in programs managed by the Company and control the unit cost of such services. If the aggregate cost of behavioral healthcare treatment services provided to a given beneficiary population in a given period exceeds the aggregate of the per member per month fees received by the Company with respect to the beneficiary population in such period, the Company will incur a loss with respect to such beneficiary population during such period. Furthermore, the Company may be required to pay during any period amounts with respect to behavioral healthcare treatment services provided to a given beneficiary population that exceed per member per month fees received with respect to such beneficiary population during the same period. There can be no
assurance that the Company's assumptions as to service utilization rates and costs will accurately and adequately reflect actual utilization rates and costs, nor can there be any assurance that increases in behavioral healthcare costs or higher-than-anticipated utilization rates, significant aspects of which are outside the Company's control, will not cause expenses associated with such contracts to exceed the Company's revenue for such contracts. In addition, there can be no assurance that adjustments will not be required to the estimates, particularly those regarding cost of care, made in reporting historical financial results. See Note 1 to the audited consolidated financial statements of the Company included elsewhere herein. The Company expects to attempt to increase membership in its risk-based products. If the Company is successful in this regard, the Company's exposure to potential losses from its risk-based products will also be increased. Furthermore, certain of such contracts and state regulations limit the profits that may be earned by the Company on risk-based business and may require refunds if the loss experience is more favorable than that originally anticipated. Such contracts and regulations may also require the Company or certain of its subsidiaries to reserve a specified amount of cash as financial assurance that it can meet its obligations under such contracts. As of September 30, 1999, the Company had restricted cash and investments of $116.8 million pursuant to such contracts and regulations. Such amounts will not be available to the Company for general corporate purposes. Furthermore, certain state regulations restrict the ability of subsidiaries that offer risk-based products to pay dividends to the Company. Certain state regulations relating to the licensing of insurance companies may also adversely affect the Company's risk-based business. See "Regulation." Although experience varies on a contract-by-contract basis, historically, the Company's risk-based contracts have been profitable. However, the degree of profitability varies significantly from contract to contract. For example, the Company's Medicaid contracts with governmental entities generally tend to have direct profit margins that are lower than the Company's other contracts. The most significant factor affecting the profitability of risk-based contracts is the ability to control direct service costs in relation to contract pricing.

RELIANCE ON CUSTOMER CONTRACTS Approximately 79.2% of the Company's revenue in fiscal 1999 was derived from contracts with payors of behavioral healthcare benefits. The Company's behavioral managed healthcare contracts typically have terms of one to three years, and in certain cases contain renewal provisions providing for successive terms of between one and two years (unless terminated earlier). Substantially all of these contracts are immediately terminable with cause and many, including some of the Company's most significant contracts, are terminable without cause by the customer upon the provision of requisite notice and the passage of a specified period of time (typically between 60 and 180 days), or upon the occurrence of certain other specified events. The Company's ten largest behavioral managed healthcare customers accounted for approximately 57.5% of the Company's behavioral managed healthcare revenue for fiscal 1999. The Company's contract with the State of Tennessee to manage the behavioral healthcare benefits for the State's TennCare program represented approximately 14.4% of the Company's behavioral managed healthcare revenue and approximately 11.4% of the Company's consolidated revenue in fiscal 1999. The Company's managed behavioral contracts and specialty managed care contracts with Aetna, including Nylcare and Prudential, which were acquired by Aetna in July 1998 and August 1999, respectively, represented approximately 15.9% and 29.3% of the Company's behavioral managed healthcare revenue and specialty managed healthcare revenue, respectively, and approximately 15.7% of the Company's consolidated revenue in fiscal 1999. There can be no assurance that such contracts will be extended or successfully renegotiated or that the terms of any new contracts will be comparable to those of existing contracts. Loss of all of these contracts or customers would, and loss of any one of these customers could, have a material adverse effect on the Company. In addition, price competition in bidding for contracts can significantly affect the financial terms of any new or renegotiated contract.

DEPENDENCE ON GOVERNMENT SPENDING FOR MANAGED HEALTHCARE; POSSIBLE IMPACT OF HEALTHCARE REFORM A significant portion of the Company's managed care revenue is derived, directly or indirectly, from federal, state and local governmental agencies, including state Medicaid programs. Reimbursement rates vary from state
to state, are subject to periodic negotiation and may limit the Company's ability to maintain or increase rates. The Company is unable to predict the impact on the Company's operations of future regulations or legislation affecting Medicaid or Medicare programs, or the healthcare industry in general, and there can be no assurance that future regulations or legislation will not have a material adverse effect on the Company. Moreover, any reduction in government spending for such programs could also have a material adverse effect on the Company. In addition, the Company's contracts with federal, state and local governmental agencies, under both direct contract and subcontract arrangements, generally are conditioned upon financial appropriations by one or more governmental agencies, especially with respect to state Medicaid programs. These contracts generally can be terminated or modified by the customer if such appropriations are not made. Finally, some of the Company's contracts with federal, state and local governmental agencies, under both direct contract and subcontract arrangements, require the Company to perform additional services if federal, state or local laws or regulations imposed after the contract is signed so require, in exchange for additional compensation to be negotiated by the parties in good faith. Government and other third-party payors are generally seeking to impose lower reimbursement rates and to renegotiate reduced contract rates with service providers in a trend toward cost control. See "Industry--Areas of Growth" and "Business--Business Strategy."

The House of Representatives of the U.S. Congress recently passed the Norwood-Dingell bill which would (if it or similar legislation became law), among other things, place limits on health care plans methods of operations, limit employers' and health care plans' ability to define medical necessity and permit employers and health care plans to be sued in state courts for coverage determinations. It is uncertain whether the Company could recoup, through higher premiums or other measures, the increased costs of federally mandated benefits or other increased costs caused by such legislation or similar legislation. The Company cannot predict the effect of this legislation, or other legislation that may be adopted by Congress, and no assurance can be given that such legislation will not have an adverse effect on the Company.

REGULATION The managed healthcare industry and the provision of behavioral healthcare services are subject to extensive and evolving state and federal regulation. The Company is subject to certain state laws and regulations, including those governing: (i) the licensing of insurance companies, HMOs, PPOs, TPAs and companies engaged in utilization review and (ii) the licensing of healthcare professionals, including restrictions on business corporations from practicing, controlling or exercising excessive influence over behavioral healthcare services through the direct employment of psychiatrists or, in a few states, psychologists and other behavioral healthcare professionals. In addition, the Company is subject to certain federal laws as a result of the role the Company assumes in connection with managing its customers' employee benefit plans. The Company's managed care operations are also indirectly affected by regulations applicable to the establishment and operation of behavioral healthcare clinics and facilities.

In many states, entities that assume risk under contracts with licensed insurance companies or HMOs have not been considered by state regulators to be conducting an insurance or HMO business. As a result, the Company has not sought licensure as either an insurer or HMO in certain states. Regulators in some states, however, have determined that risk assuming activity by entities that are not themselves providers of care is an activity that requires some form of licensure. There can be no assurance that other states in which the Company operates will not adopt a similar view, thus requiring the Company to obtain additional licenses. Such additional licensure might require the Company to maintain minimum levels of deposits, net worth, capital, surplus or reserves, or limit the Company's ability to pay dividends, make investments or repay indebtedness. The imposition of these additional licensure requirements could increase the Company's cost of doing business or delay the Company's conduct or expansion of its business.

Regulators may impose operational restrictions on entities granted licenses to operate as insurance companies or HMOs. For example, the California Department of Corporations ("DOC") imposed certain restrictions on the Company in connection with its issuance of an approval of the Company's acquisitions of HAI and Merit, including restrictions on the ability of the California subsidiaries of HAI and Merit to fund the Company's operations in other states
and on the ability of the Company to make certain operational changes with respect to HAI and Merit California subsidiaries.

In addition, utilization review and TPA activities conducted by the Company are regulated by many states, which states impose requirements upon the Company that increase its business costs. The Company believes that its TPA activities performed for its self-insured employee benefit plan customers are exempt from otherwise applicable state licensing or registration requirements based upon federal preemption under ERISA, and has relied on this general principle in determining not to seek licensure for certain of its activities in many states. Existing case law is not uniform on the applicability of ERISA preemption with respect to state regulation of utilization review or TPA activities. There can be no assurance that additional licensure will not be required with respect to utilization review or TPA activities in certain states. See "Business--Regulation--Insurance, HMO, and PPO Activities" and "--Utilization Review and Third-Party Administrator Activities."

State regulatory agencies responsible for the administration and enforcement of the laws and regulations to which the Company's operations are subject have broad discretionary powers. A regulatory agency or a court in a state in which the Company operates could take a position under existing or future laws or regulations, or change its interpretation or enforcement practices with respect thereto, that such laws or regulations apply to the Company differently than the Company believes such laws and regulations apply or should be enforced. The resultant compliance with, or revocation of, or failure to obtain, required licenses and governmental approvals could result in significant alteration to the Company's business operations, delays in the expansion of the Company's business and lost business opportunities, any of which, under certain circumstances, could have a material adverse effect on the Company. See "Business--Regulation--General," "--Licensure," "--Insurance, HMO and PPO Activities" and "--Utilization Review and Third-Party Administrator Activities."

The laws of some states limit the ability of a business corporation to directly provide, control or exercise excessive influence over behavioral healthcare services through the direct employment of psychiatrists, psychologists, or other behavioral healthcare professionals. In addition, the laws of some states prohibit psychiatrists, psychologists, or other healthcare professionals from splitting fees with other persons or entities. These laws and their interpretations vary from state to state and enforcement by the courts and regulatory authorities may vary from state to state and may change over time. The Company believes that its operations as currently conducted are in material compliance with the applicable laws, however there can be no assurance that the Company's existing operations and its contractual arrangements with psychiatrists, psychologists and other healthcare professionals will not be successfully challenged under state laws prohibiting fee splitting or the practice of a profession by an unlicensed entity, or that the enforceability of such contractual arrangements will not be limited. The Company believes that it could, if necessary, restructure its operations to comply with changes in the interpretation or enforcement of such laws and regulations, and that such restructuring would not have a material adverse effect on its operations.

Several states in which the Company does business have adopted, or are expected to adopt, "any willing provider" laws. Such laws typically impose upon insurance companies, PPOs, HMOs or other types of third-party payors an obligation to contract with, or pay for the services of, any healthcare provider willing to meet the terms of the payor's contracts with similar providers. Compliance with any willing provider laws could increase the Company's costs of assembling and administering provider networks and could, therefore, have a material adverse effect on its operations.

HIGHLY COMPETITIVE INDUSTRY The industry in which the Company conducts its managed care businesses is highly competitive. The Company competes with large insurance companies, HMOs, PPOs, TPAs, provider groups and other managed care companies. Many of the Company's competitors are significantly larger and have greater financial, marketing and other resources than the Company, and some of the Company's competitors provide a broader range of services. The Company may also encounter substantial competition in the future from new market entrants.
Many of the Company's customers that are managed care companies may, in the future, seek to provide behavioral managed healthcare services to their employees or subscribers directly, rather than contracting with the Company for such services. See "Business--Competition."

**RISKS RELATED TO AMORTIZATION OF INTANGIBLE ASSETS** The Company's total assets at September 30, 1999 reflect intangible assets of approximately $1.27 billion. At September 30, 1999, net intangible assets were 67.3% of total assets and 643.8% of total stockholders' equity. Intangible assets include goodwill of approximately $1.11 billion, which is amortized over 25 to 40 years, and other identifiable intangible assets (primarily customer lists, provider networks and treatment protocols) of approximately $158.3 million that are amortized over 4 to 30 years. The amortization periods used by the Company may differ from those used by other entities. In addition, the Company may be required to shorten the amortization period for intangible assets in future periods based on the prospects of acquired companies. There can be no assurance that the value of such assets will ever be realized by the Company. The Company evaluates, on a regular basis, whether events and circumstances have occurred that indicate that all or a portion of the carrying value of intangible assets may no longer be recoverable, in which case a charge to earnings for impairment losses could become necessary. Any determination requiring the write-off of a significant portion of unamortized intangible assets would adversely affect the Company's results of operations. A write-off of intangible assets could become necessary if the anticipated undiscounted cash flows of an acquired company do not support the carrying value of long-lived assets, including intangible assets. At present, no evidence exists that would indicate impairment losses may be necessary in future periods.

**PROFESSIONAL LIABILITY; INSURANCE** The management and administration of the delivery of behavioral and specialty managed healthcare services, like other healthcare services, entail significant risks of liability. The Company is regularly subject to lawsuits alleging malpractice and related legal theories, some of which involve situations in which participants in the Company's behavioral programs have committed suicide. The Company is also subject to claims of professional liability for alleged negligence in performing utilization review activities, as well as for acts and omissions of independent contractors participating in the Company's third-party provider networks. The Company is subject to claims for the costs of services for which payment was denied. There can be no assurance that the Company's procedures for limiting liability have been or will be effective, or that one or more lawsuits will not have a material adverse effect on the Company in the future.

Recently, certain managed healthcare companies have been targeted as defendants in several national class action lawsuits regarding their business practices. These class action complaints include (i) inadequate disclosure of provider compensation arrangements to members, (ii) misrepresentation and omissions in advertising and health plan materials and (iii) concealment of information from health plan members used to determine what claims will be paid, procedures to determine medical necessity and procedures to determine the extent and type of coverage. The Company believes that these national class action lawsuits are part of a trend targeting the healthcare industry, particularly managed care companies. While the Company has received suits of a similar nature in the past, it has not been named as a defendant in any of these new trend of national class action lawsuits. However, there can be no assurance that the Company won't be named in such class action lawsuits or that such lawsuits won't have a material adverse effect on the Company.

The Company carries professional liability insurance, subject to certain deductibles. There can be no assurance that such insurance will be sufficient to cover any judgments, settlements or costs relating to present or future claims, suits or complaints or that, upon expiration thereof, sufficient insurance will be available on favorable terms, if at all. If the Company is unable to secure
adequate insurance in the future, or if the insurance carried by the Company is not sufficient to cover any judgments, settlements or costs relating to any present or future actions or claims, there can be no assurance that the Company will not be subject to a liability that could have a material adverse effect on the Company. See "Business-Insurance" and "Legal Proceedings."

The Company has certain potential liabilities relating to the self-insurance program it maintained with respect to its provider business prior to the Crescent Transactions. In addition, the Company continues to be subject to governmental investigations and inquiries, civil suits and other claims and assessments with respect to the provider business. See "Legal Proceedings" and Note 11 to the Company's audited historical consolidated financial statements included elsewhere herein.

EXECUTIVE OFFICERS OF THE REGISTRANT

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<tr>
<th>NAME</th>
<th>AGE</th>
<th>POSITION</th>
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<tr>
<td>Henry T. Harbin M.D................</td>
<td>52</td>
<td>President, Chief Executive Officer and Director</td>
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<tr>
<td>Mark S. Demilio....................</td>
<td>44</td>
<td>Executive Vice President and General Counsel</td>
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<tr>
<td>Clifford W. Donnelly..............</td>
<td>46</td>
<td>Executive Vice President and Chief Financial Officer</td>
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<tr>
<td>Clarissa C. Marques, Ph.D.........</td>
<td>47</td>
<td>Executive Vice President of Clinical and Quality Management</td>
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<tr>
<td>John J. Wider, Jr..................</td>
<td>52</td>
<td>President and Chief Operating Officer of Magellan Behavioral Health</td>
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HENRY T. HARBIN, M.D. became President, Chief Executive Officer and a Director of the Company on March 18, 1998. Dr. Harbin served as President and Chief Executive Officer of Green Spring from 1994 to 1998. Dr. Harbin served as Executive Vice President of the Company from 1995 until becoming President and Chief Executive Officer of the Company.

MARK S. DEMILIO became Executive Vice President and General Counsel of the Company in July 1999. Prior thereto, Mr. Demilio was with Youth Services International, Inc., a publicly traded company that managed facilities for adjudicated youth, serving as Executive Vice President Business Development and General Counsel from March 1997 and Acting Chief Financial Officer from June 1998. Mr. Demilio was a partner with Miles & Stockbridge, a Baltimore, Maryland-based law firm, from 1994 to March 1997 and served as an associate with that firm from 1989.

CLIFFORD W. DONNELLY became Executive Vice President and Chief Financial Officer of the Company in March 1999. Mr. Donnelly was Chief Financial Officer for Physicians Corporation of America ("PCA") from 1988 to September 1997 when PCA was acquired by Humana, Inc. PCA was a publicly-held company specializing in managed healthcare through HMO products and workers compensation products.

CLARISSA C. MARQUES, PH.D. has served as Executive Vice President of Clinical and Quality Management since March 1998. Dr. Marques served as Executive Vice President and Chief Clinical Officer of Green Spring during 1997 and 1998. Dr. Marques served as Senior Vice President of Green Spring from 1992 to 1997.

JOHN J. WIDER, JR. has served as President and Chief Operating Officer of
Magellan Behavioral Health ("MBH") since March 1998. Mr. Wider served as Executive Vice President and Chief Operating Officer of Green Spring from 1997 to 1998. Mr. Wider was President and General Manager for Cigna Healthcare Corporation's ("Cigna") Mid-Atlantic region from 1996 to 1997. Mr. Wider served as Area Operations Officer for Cigna during 1995 and 1996 and as Vice President of Sales of Cigna's Midwest region from 1993 to 1995.

EMPLOYEES OF THE REGISTRANT

At September 30, 1999, the Company had approximately 12,500 full-time and part-time employees. The Company believes it has satisfactory relations with its employees.

ITEM 2. PROPERTIES

GENERAL. The Company's principal executive offices are located in Columbia, Maryland; the lease for the Company's headquarters expires in 2003.

BEHAVIORAL MANAGED CARE BUSINESS. Magellan Behavioral Health ("MBH") leases its 172 offices with terms expiring between 1999 and 2008. MBH's headquarters are leased and are co-located with the principal executive offices in Columbia, Maryland.

HUMAN SERVICES BUSINESS. Mentor leases its 134 offices with terms expiring between 1999 and 2005. Mentor's headquarters are leased and are located in Boston, Massachusetts with the lease expiring in 2002.

SPECIALITY MANAGED CARE BUSINESS. Allied and Care Management Resources, Inc. lease their 5 offices with terms expiring between 1999 and 2004.

ITEM 3. LEGAL PROCEEDINGS

The management and administration of the delivery of behavioral managed healthcare services, and the direct provision of behavioral healthcare treatment services, entail significant risks of liability. From time to time, the Company is subject to various actions and claims arising from the acts or omissions of its employees, network providers or other parties. In the normal course of business, the Company receives reports relating to suicides and other serious incidents involving patients enrolled in its programs. Such incidents occasionally give rise to malpractice, professional negligence and other related actions and claims against the Company or its network providers. As the number of lives covered by the Company grows and the number of providers under contract increases, actions and claims against the Company (and, in turn, possible legal liability) predicated on malpractice, professional negligence or other related legal theories can be expected to increase. See "Cautionary Statements--Professional Liability; Insurance." Many of these actions and claims received by the Company seek substantial damages and therefore require the defendant to incur significant fees and costs related to their defense. To date, claims and actions against the Company alleging professional negligence have not resulted in material liabilities and the Company does not believe that any pending action against it will have a material adverse effect on the Company. There can be no assurance that pending or future actions or claims for professional liability (including any judgments, settlements or costs associated therewith) will not have a material adverse effect on the Company. See "--Insurance" and "Cautionary Statements--Professional Liability; Insurance."

From time to time, the Company receives notifications from and engages in discussions with various governmental agencies concerning its respective managed care businesses and operations. As a result of these contacts with regulators,
in response to governmental agency inquiries or discussions with regulators, the Company has determined to seek licensure as a single service HMO, TPA or utilization review agent in one or more jurisdictions.

On May 26, 1998, a group of eleven plaintiffs purporting to represent an uncertified class of psychiatrists, psychologists and social workers brought an action under the federal antitrust laws in the United States District Court for the District of New Jersey against nine behavioral health managed care organizations, including Merit, CMG, Green Spring and HAI (collectively, the "Defendants"). The complaint alleges that the Defendants violated Section I of the Sherman Act by engaging in a conspiracy to fix the prices at which the Defendants purchase services from mental healthcare providers such as the plaintiffs. The complaint further alleges that the Defendants engaged in a group boycott to exclude mental healthcare providers from the Defendants' networks in order to further the goals of the alleged conspiracy. The complaint also challenges the propriety of the Defendants' capitation arrangements with their respective customers, although it is unclear from the complaint whether the plaintiffs allege that the Defendants unlawfully conspired to enter into capitation arrangements with their respective customers. The complaint seeks treble damages against the Defendants in an unspecified amount and a permanent injunction prohibiting the Defendants from engaging in the alleged conduct which forms the basis of the complaint, plus costs and attorneys' fees. Upon joint motion by the Defendants, the case was transferred to the United States District Court for the Southern District of New York, the same court where a previous similar case (the "Stephens Case") was dismissed for failure to state a claim upon which relief can be granted. On March 15, 1999, the Defendants filed a joint motion to dismiss the case for substantially the same reasons as in the Stephens Case. On June 16, 1999, the court denied the motion to dismiss. The case currently is in discovery. On October 14, 1999, the Plaintiffs filed a motion seeking class certification for a class that would include approximately 200,000 providers. The court has not yet heard argument on that motion. The Company does not believe this matter will have a material adverse effect on its financial position or results of operations.

The healthcare industry is subject to numerous laws and regulations. The subjects of such laws and regulations include, but are not limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and/or allegations concerning possible violations of fraud and abuse and false claims statutes and/or regulations by healthcare providers. Entities that are found to have violated these laws and regulations may be excluded from participating in government healthcare programs, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. The Office of the Inspector General of the Department of Health and Human Services and the United States Department of Justice ("Department of Justice") and certain other governmental agencies are currently conducting inquiries and/or investigations regarding the compliance by the Company and certain of its subsidiaries and the compliance by CBHS and certain of its subsidiaries with such laws and regulations. Certain of the inquiries relate to the operations and business practices of the Psychiatric Hospital Facilities prior to the consummation of the Crescent Transactions in June 1997. The Department of Justice has indicated that its inquiries are based on its belief that the federal government has certain civil and administrative causes of action under the Civil False Claims Act, the Civil Monetary Penalties Law, other federal statutes and the common law arising from the participation in federal health benefit programs of CBHS psychiatric facilities nationwide. The Department of Justice inquiries relate to the following matters: (i) Medicare cost reports, (ii) Medicaid cost statements, (iii) supplemental applications to CHAMPUS/TRICARE based on Medicare cost reports, (iv) medical necessity of services to patients and admissions, (v) failure to provide medically necessary treatment or admissions and (vi) submission of claims to government payors for inpatient and outpatient psychiatric services. No amounts related to such
proposed causes of action have yet been specified. The Company cannot reasonably estimate the settlement amount, if any, associated with the Department of Justice inquiries. Accordingly, no reserve has been recorded related to this matter.

The Company is also subject to or party to other litigation, claims, and civil suits, relating to its operations and business practices. In the opinion of management, the Company has recorded reserves that are adequate to cover litigation, claims or assessments that have been or may be asserted against the Company, and for which the outcome is probable and reasonably estimable, arising out of such other litigation, claims and civil suits. Furthermore, management believes that the resolution of such litigation, claims and civil suits will not have a material adverse effect on the Company's financial position or results of operations; however, there can be no assurance in this regard.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. MARKET PRICE FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company has one class of common stock, $0.25 par value per share, which is listed for trading on the New York Stock Exchange (ticker symbol "MGL"). As of November 30, 1999, there were 9,354 holders of record of the Company's common stock. The following table sets forth the high and low sales prices of the Company's common stock from October 1, 1997 through the fiscal year ended September 30, 1999 as reported by the New York Stock Exchange:

<table>
<thead>
<tr>
<th>CALENDAR YEAR</th>
<th>HIGH</th>
<th>LOW</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fourth Quarter</td>
<td>31 3/4</td>
<td>20 9/16</td>
</tr>
<tr>
<td>1998</td>
<td></td>
<td></td>
</tr>
<tr>
<td>First Quarter</td>
<td>26</td>
<td>18 5/8</td>
</tr>
<tr>
<td>Second Quarter</td>
<td>28 7/16</td>
<td>24</td>
</tr>
<tr>
<td>Third Quarter</td>
<td>26</td>
<td>9 5/8</td>
</tr>
<tr>
<td>Fourth Quarter</td>
<td>10 3/4</td>
<td>6 3/8</td>
</tr>
<tr>
<td>1999</td>
<td></td>
<td></td>
</tr>
<tr>
<td>First Quarter</td>
<td>11 1/8</td>
<td>4 3/16</td>
</tr>
<tr>
<td>Second Quarter</td>
<td>10</td>
<td>3 9/16</td>
</tr>
<tr>
<td>Third Quarter</td>
<td>10 1/2</td>
<td>6 7/8</td>
</tr>
</tbody>
</table>

The Company did not declare any cash dividends during fiscal 1998 or 1999. As of November 30, 1999, the Company was prohibited from paying dividends on its common stock under the terms of the Credit Agreement, except in very limited circumstances.

ITEM 6. SELECTED FINANCIAL DATA
The following table sets forth selected historical consolidated financial information of the Company for each of the five years in the period ended September 30, 1999. On September 2, 1999, the Company's Board of Directors approved a formal plan to dispose of the businesses included in the Company's healthcare provider and healthcare franchising segments. On September 10, 1999, the Company consummated the CBHS Transactions. Accordingly, the statement of operations data has been restated to reflect the healthcare provider and healthcare franchising segments as discontinued operations. Selected consolidated financial information for the three years ended September 30, 1999 and as of September 30, 1998 and 1999, presented below, have been derived from, and should be read in conjunction with, the Company's audited consolidated financial statements and the notes thereto. Selected consolidated financial information for the two years ended September 30, 1995 and 1996 and as of September 30, 1995, 1996 and 1997 has been derived from the Company's unaudited consolidated financial statements. The selected financial data set forth below should be read in conjunction with the Company's audited consolidated financial statements and the notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere herein.

### STATEMENT OF OPERATIONS DATA:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>$56,077</td>
<td>$302,573</td>
<td>$463,872</td>
<td>$1,310,778</td>
<td>$1,871,636</td>
</tr>
<tr>
<td>Salaries, cost of care and other operating expenses</td>
<td>77,499</td>
<td>299,855</td>
<td>438,472</td>
<td>1,183,626</td>
<td>1,663,626</td>
</tr>
<tr>
<td>Equity in (earnings) loss of unconsolidated subsidiaries</td>
<td>--</td>
<td>2,005</td>
<td>5,567</td>
<td>(12,795)</td>
<td>(20,462)</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>3,644</td>
<td>14,290</td>
<td>19,683</td>
<td>49,264</td>
<td>73,531</td>
</tr>
<tr>
<td>Interest, net</td>
<td>55,405</td>
<td>48,584</td>
<td>46,438</td>
<td>76,505</td>
<td>93,752</td>
</tr>
<tr>
<td>ESGP expense</td>
<td>17,960</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Stock option expense (credit)</td>
<td>(467)</td>
<td>914</td>
<td>4,292</td>
<td>(5,623)</td>
<td>18</td>
</tr>
<tr>
<td>Managed care integration costs</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>16,962</td>
<td>6,238</td>
</tr>
<tr>
<td>Special charges, net</td>
<td>--</td>
<td>1,221</td>
<td>--</td>
<td>--</td>
<td>4,441</td>
</tr>
<tr>
<td>Income (loss) from continuing operations before income taxes, minority interest and extraordinary items</td>
<td>(97,984)</td>
<td>(64,296)</td>
<td>(50,580)</td>
<td>2,839</td>
<td>50,472</td>
</tr>
<tr>
<td>Provision for (benefit from) income taxes</td>
<td>(39,194)</td>
<td>(25,719)</td>
<td>(26,232)</td>
<td>5,544</td>
<td>27,376</td>
</tr>
<tr>
<td>Income (loss) from continuing operations before minority interest and extraordinary items</td>
<td>(58,790)</td>
<td>(38,577)</td>
<td>(23,348)</td>
<td>2,694</td>
<td>23,096</td>
</tr>
<tr>
<td>Minority interest</td>
<td>--</td>
<td>4,531</td>
<td>6,856</td>
<td>4,094</td>
<td>630</td>
</tr>
<tr>
<td>Income (loss) from continuing operations before extraordinary items</td>
<td>(58,790)</td>
<td>(43,108)</td>
<td>(37,204)</td>
<td>(6,799)</td>
<td>22,466</td>
</tr>
<tr>
<td>Discontinued operations:</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>(47,423)</td>
</tr>
<tr>
<td>Income from discontinued operations</td>
<td>15,827</td>
<td>76,491</td>
<td>41,959</td>
<td>20,531</td>
<td>29,645</td>
</tr>
<tr>
<td>Loss on disposal of discontinued operations</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>(47,423)</td>
</tr>
<tr>
<td>Income (loss) from discontinued operations</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>(47,423)</td>
</tr>
<tr>
<td>Income (loss) before extraordinary items</td>
<td>(42,963)</td>
<td>32,383</td>
<td>4,755</td>
<td>13,732</td>
<td>4,688</td>
</tr>
<tr>
<td>Extraordinary items/losses on early extinguishments of debt</td>
<td>--</td>
<td>--</td>
<td>(5,253)</td>
<td>(33,015)</td>
<td>--</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>$(42,963)</td>
<td>$32,383</td>
<td>$(498)</td>
<td>$13,732</td>
<td>$4,688</td>
</tr>
</tbody>
</table>

### INCOME (LOSS) PER COMMON SHARE--BASIC:

| Income (loss) from continuing operations | $(2.11) | $(1.39) | $(1.29) | $(0.22) | $(0.71) |
| Income (loss) from discontinued operations | 0.57 | 2.43 | 1.46 | 0.67 | (0.56) |
| Loss from extraordinary items | -- | -- | (0.18) | (1.07) | -- |
| Net income (loss) | $(1.54) | $1.04 | $(0.02) | $(0.63) | $0.15 |

### INCOME (LOSS) PER COMMON SHARE--DILUTED:

| Income (loss) from continuing operations | $(2.11) | $(1.39) | $(1.29) | $(0.22) | $(0.70) |
| Income (loss) from discontinued operations | 0.57 | 2.43 | 1.46 | 0.67 | (0.56) |
| Loss from extraordinary items | -- | -- | (0.18) | (1.07) | -- |
| Net income (loss) | $(1.54) | $1.04 | $(0.02) | $(0.63) | $0.15 |

### BALANCE SHEET DATA (END OF PERIOD):

| Current assets           | $305,575  | $338,150 | $507,038 | $399,724  | $374,927  |
| Current liabilities      | 214,162   | 274,316  | 219,376  | 454,766   | 474,268   |
| Property and equipment, net | 488,767   | 495,390  | 109,214  | 177,169   | 120,667   |
| Total assets             | 983,558   | 1,140,137| 896,868  | 1,225,646 | 1,144,308 |
| Total debt and capital lease obligations | 541,569   | 572,058  | 395,294  | 1,225,646 | 1,144,308 |
| Stockholders' equity     | 88,560    | 121,817  | 159,498  | 188,433   | 186,696   |
OVERVIEW

Prior to June 1997, the Company derived the majority of its revenue from providing behavioral healthcare services in an inpatient setting. Payments from third-party payors are the principal source of revenue for most behavioral healthcare providers. In the early 1990's, many third party payors sought to control the cost of providing care to their patients by instituting managed care programs or seeking the assistance of managed care companies. Providers participating in managed care programs agree to provide services to patients for a discount from established rates, which generally results in pricing concessions by the providers and lower margins. Additionally, managed care programs generally encourage alternatives to inpatient treatment settings and reduce utilization of inpatient services. As a result, third-party payors established managed care programs or engaged managed care companies in many areas of healthcare, including behavioral healthcare. The Company, which until June 1997, was the largest operator of psychiatric hospitals in the United States, was adversely affected by the adoption of managed care programs as the principal cost control measure of third-party payors.

Prior to the first quarter of fiscal 1996, the Company was not engaged in the behavioral managed healthcare business. During the first quarter of fiscal 1996, the Company acquired a 61% ownership interest in Green Spring Health Services, Inc. ("Green Spring"). At that time, the Company intended to become a fully integrated behavioral healthcare provider by combining the behavioral managed healthcare products offered by Green Spring with the direct treatment services offered by the Company's psychiatric hospitals. The Company believed that an entity that participated in both the managed care and the provider segments of the behavioral healthcare industry could more efficiently provide and manage behavioral healthcare for insured populations than an entity that was solely a managed care company. The Company also believed that earnings from its behavioral managed care business would offset, in part, the negative impact on the financial performance of its psychiatric hospitals caused by managed care. Green Spring was the Company's first significant involvement in behavioral managed healthcare. During the second quarter of fiscal 1998, the minority stockholders of Green Spring converted their 39% ownership interest in Green Spring into an aggregate of 2,831,516 shares of Magellan common stock.

Subsequent to the Company's acquisition of Green Spring, the growth of the behavioral managed healthcare industry accelerated. Under the Company's majority ownership, Green Spring increased its base of covered lives from 12.0 million at the end of calendar year 1995 to 21.1 million at the end of calendar year 1997, a compound annual growth rate of over 32%. While growth in the industry was accelerating, the behavioral managed healthcare industry also began to consolidate. The Company concluded that this consolidation presented an opportunity for it to increase its participation in the behavioral managed healthcare industry, which the Company believed offered growth and earnings prospects superior to those of the psychiatric hospital industry. Therefore, the Company decided to sell its domestic psychiatric facilities to obtain capital for expansion of its behavioral managed healthcare business.

On June 17, 1997, the Company consummated the Crescent Transactions which provided the Company with approximately $200 million of net cash proceeds, after debt repayment, for use in implementing its business strategy to increase its participation in the managed healthcare industry. The Company used the net cash proceeds of approximately $200 million, after debt repayment, to finance the acquisitions of NAI and Allied in December 1997. The Company further implemented its business strategy through the acquisition of Merit in February 1998.
On September 10, 1999, the Company consummated the CBHS Transactions. The CBHS Transactions, together with the formal plan of disposal authorized by the Company's Board of Directors on September 2, 1999, represents the disposal of the Company's healthcare provider and healthcare franchising business segments under APB 30. APB 30 requires that the results of continuing operations be reported separately from those of discontinued operations for all periods presented and that any gain or loss from disposal of a segment of a business be reported in conjunction with the related results of discontinued operations. Accordingly, the Company has restated its results of operations for all prior periods. The Company recorded an after-tax loss on disposal of its healthcare provider and healthcare franchising business segments of approximately $47.4 million (primarily non-cash), in fiscal 1999.

The Company currently operates through three principal business segments which are engaged in:

- **THE BEHAVIORAL MANAGED HEALTHCARE BUSINESS.** The Company's MAGELLAN BEHAVIORAL HEALTH division coordinates and manages the delivery of behavioral healthcare treatment services through its network of providers, which includes psychiatrists, psychologists and other medical professionals. The treatment services provided through these provider networks include outpatient programs (such as counseling or therapy), intermediate care programs (such as intensive outpatient programs and partial hospitalization services), inpatient treatment and alternative care services (such as residential treatment and home or community-based programs). The Company provides these services primarily through: (i) risk-based products, where the Company assumes all or a portion of the responsibility for the cost of providing treatment services in exchange for a fixed per member per month fee, (ii) ASO products, where the Company provides services such as utilization review, claims administration or provider network management, (iii) EAPs and (iv) products which combine features of some or all of the Company's risk-based, ASO, or EAP products.

- **THE HUMAN SERVICES BUSINESS.** The Company provides various human services through Mentor. These human services include specialty home-based healthcare services provided through "mentor" homes as well as residential and day treatment services for individuals with acquired brain injuries and for individuals with mental retardation and developmental disabilities.

- **THE SPECIALTY MANAGED HEALTHCARE BUSINESS.** The Company's MAGELLAN SPECIALTY HEALTH division provides specialty risk-based and ASO services to a variety of health insurance companies and other customers.

At September 30, 1999, the Company's MAGELLAN BEHAVIORAL HEALTH division, managed the behavioral healthcare benefits of approximately 66.4 million individuals; Mentor, which provided community-based services to 6,444 individuals; and the Company's MAGELLAN SPECIALTY HEALTH division, which was formed primarily through acquisitions completed in fiscal 1997 (Care Management Resources, Inc.) and fiscal 1998 (Allied) managed specialty benefits for approximately 3.5 million members of health plans.

**RESULTS OF OPERATIONS**

The following tables summarize, for the periods indicated, operating results by continuing business segment (in thousands).
<table>
<thead>
<tr>
<th>FISCAL 1997</th>
<th>BEHAVIORAL</th>
<th>SPECIALTY</th>
<th>CORPORATE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>MANAGED</td>
<td>HUMAN</td>
<td>MANAGED</td>
</tr>
<tr>
<td>Net revenue</td>
<td>$375,541</td>
<td>$88,331</td>
<td>$ --</td>
</tr>
<tr>
<td>Salaries, cost of care and other operating expenses</td>
<td>332,955</td>
<td>77,636</td>
<td>2,303</td>
</tr>
<tr>
<td>Equity in loss of unconsolidated subsidiaries</td>
<td>5,567</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Segment Profit(1)</td>
<td>$ 37,019</td>
<td>$10,695</td>
<td>$(2,303)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FISCAL 1998</th>
<th>BEHAVIORAL</th>
<th>SPECIALTY</th>
<th>CORPORATE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>MANAGED</td>
<td>HUMAN</td>
<td>MANAGED</td>
</tr>
<tr>
<td>Net revenue</td>
<td>$1,026,243</td>
<td>$141,032</td>
<td>$143,503</td>
</tr>
<tr>
<td>Salaries, cost of care and other operating expenses</td>
<td>901,846</td>
<td>125,539</td>
<td>140,375</td>
</tr>
<tr>
<td>Equity in earnings of unconsolidated subsidiaries</td>
<td>(12,795)</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Segment Profit(1)</td>
<td>$ 137,192</td>
<td>$ 15,493</td>
<td>$ 3,128</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FISCAL 1999</th>
<th>BEHAVIORAL</th>
<th>SPECIALTY</th>
<th>CORPORATE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>MANAGED</td>
<td>HUMAN</td>
<td>MANAGED</td>
</tr>
<tr>
<td>Net revenue</td>
<td>$1,483,202</td>
<td>$191,277</td>
<td>$197,157</td>
</tr>
<tr>
<td>Salaries, cost of care and other operating expenses</td>
<td>1,285,391</td>
<td>169,549</td>
<td>194,747</td>
</tr>
<tr>
<td>Equity in earnings of unconsolidated subsidiaries</td>
<td>(20,442)</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Segment Profit(1)</td>
<td>$ 218,253</td>
<td>$ 21,728</td>
<td>$ 2,410</td>
</tr>
</tbody>
</table>

(1) Segment Profit is the measure of profitability used by management to assess the operating performance of each business segment. See Note 13, "Business Segment Information", to the Company's audited consolidated financial statements appearing elsewhere herein.

FISCAL 1998 COMPARED TO FISCAL 1999
BEHAVIORAL MANAGED HEALTHCARE. Revenue increased 44.5% or $457.0 million, to $1.48 billion for fiscal 1999, from $1.03 billion in fiscal 1998. Salaries, cost of care and other operating expenses increased 42.5%, or $383.5 million, to $1.29 billion for fiscal 1999, from $901.8 million in fiscal 1998. Equity in earnings of unconsolidated subsidiaries increased $7.6 million, to $20.4 million for fiscal 1999, from $12.8 million for fiscal 1998. The increases resulted primarily from (i) the HAI and Merit acquisitions in fiscal 1998, (ii) increased enrollment related to existing customers, (iii) expanded services and lives under management with certain public sector customers, (iv) new business development and (v) increases in retroactive customer settlements, offset by reductions in general and administrative costs as a result of the integration of Green Spring, HAI and Merit and the termination of one public sector contract (Montana Medicaid) in fiscal 1999. Total covered lives increased 7.8% or 4.8 million to 66.4 million at September 30, 1999 from 61.6 million at September 30, 1998. The Company frequently records retroactive customer settlements, which may be favorable or unfavorable, under its commercial behavioral managed healthcare contracts. Revenue and Segment Profit for fiscal 1999 reflect approximately $9.8 million of such favorable settlements compared to favorable settlements of $1.8 million during fiscal 1998. The Company recorded $3.7 million of favorable retroactive customer settlements in the fourth quarter of fiscal 1999.

HUMAN SERVICES. Revenue increased 35.7%, or $50.3 million, to $191.3 million for fiscal 1999, from $141.0 million in fiscal 1998. Salaries, cost of care and other operating expenses increased 35.1%, or $44.0 million, to $169.5 million for fiscal 1999 from $125.5 million in fiscal 1998. The increases were attributable to acquisitions consummated in fiscal 1998 and fiscal 1999 and internal growth, offset by reductions in revenue and Segment Profit at one acquired business in fiscal 1999 as a result of rate and placement reductions from a state agency. Total placements increased 9.5% to 6,444 at September 30, 1999, compared to 5,883 at September 30, 1998.

SPECIALTY MANAGED HEALTHCARE. Revenue increased 37.4%, or $53.7 million, to $197.2 million for fiscal 1999, compared to $143.5 million in the same period in fiscal 1998. Salaries, cost of care and other operating expenses increased 38.7%, or $54.3 million, to $194.7 million for fiscal 1999, compared to $140.4 million in fiscal 1998. The increase in revenue and salaries, cost of care and other operating expenses was primarily related to the Allied acquisition in fiscal 1998 and a shift toward more risk-based business in fiscal 1999 offset by the loss of a significant customer at the end of fiscal 1998 and increased administrative spending in fiscal 1999 to support future internal growth.

CORPORATE OVERHEAD AND OTHER. Salaries and other operating expenses decreased 12.1%, or $1.9 million, primarily as a result of ongoing integration of corporate administrative functions with business unit administrative functions.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization increased 49.1%, or $24.2 million, to $73.5 million for fiscal 1999, from $49.3 million in fiscal 1998. The increase was primarily attributed to (i) the acquisition of HAI, Allied and Merit in fiscal 1998, (ii) depreciation related to recent capital expenditures and (iii) amortization related to the Aetna Payment (as defined) made in fiscal 1999.

INTEREST, NET. Interest expense, net, increased 22.6%, or $17.3 million, to $93.8 million for fiscal 1999, from $76.5 million in fiscal 1998. The increase was primarily the result of interest expense incurred on borrowings used to fund the Merit acquisition and related transactions in fiscal 1998.
OTHER ITEMS. Stock option expense for fiscal 1999 was not material compared to a credit of $5.6 million in fiscal 1998 primarily due to fluctuations in the market price of the Company's stock in fiscal 1998.

The Company recorded managed care integration costs of $6.2 million for fiscal 1999, compared to $17.0 million in fiscal 1998. For a more complete discussion of managed care integration costs, see Note 9, "Managed Care Integration Plan and Costs and Special Charges" to the Company's audited consolidated financial statements set forth elsewhere herein.

The Company recorded special charges of $4.4 million during fiscal 1999 related primarily to the loss on disposal of an office building, executive severance and costs associated with moving the Company's corporate headquarters from Atlanta, Georgia to Columbia, Maryland.

The Company's effective income tax rate was 54.2% for fiscal 1999. The effective income tax rate exceeds statutory rates due primarily to non-deductible goodwill amortization resulting from the Merit acquisition of $18.0 million for fiscal 1999.

Minority interest decreased $3.5 million, to $0.6 million during fiscal 1999 primarily as a result of the Green Spring minority stockholder conversion in fiscal 1999.

Income from discontinued operations, net of tax, increased 44.4% or $9.1 million to $29.6 million for fiscal 1999 compared to $20.5 million for fiscal 1998. Income from the healthcare provider segment increased 171.1%, or $20.7 million to $32.8 million for fiscal 1999 compared to $12.1 million for fiscal 1998. The increase is primarily attributable to (i) the net effect of the Company's sale of its three European Hospitals in April 1999, which included a gain on sale of $14.4 million, net of tax, (ii) increases in income of $8.8 million, net of tax, from cost report settlements related primarily to the resolution of Medicare cost report matters in the fourth quarter of fiscal 1999 associated with the Company's sale of the Psychiatric Hospital Facilities, and (iii) increases in income of $4.8 million, net of tax, related to adjustments to accounts receivable collection fee reserves recorded in connection with the Crescent Transactions, offset by reductions in adjustments to income of $2.5 million, net of tax, related to updated actuarial estimates of malpractice claims. Income from the healthcare franchising segment decreased $11.6 million, net of tax, to a loss of $3.2 million, net of tax, for fiscal 1999 compared to income of $8.4 million, net of tax, for the same period in 1998. The decrease was primarily attributable to the declining operating performance of CBHS, which resulted in the Company recording and collecting no franchise fees from CBHS in fiscal 1999. The Company recorded a loss on disposal of discontinued operations of approximately $47.4 million, net of tax, during fiscal 1999 as a result of the CBHS Transactions. See Note 3, "Discontinued Operations" to the Company's audited consolidated financial statements set forth elsewhere herein.

The Company recorded an extraordinary loss on early extinguishment of debt of approximately $33.0 million, net of tax, during fiscal 1998, related primarily to refinancing the Company's long-term debt in connection with the Merit acquisition.
BEHAVIORAL MANAGED HEALTHCARE. Revenue increased 173.3%, or $650.7 million, to $1,026.2 million for fiscal 1998 from $375.5 million in fiscal 1997. Salaries, cost of care and other operating expenses increased 170.8%, or $568.8 million, to $901.8 million for fiscal 1998 from $333.0 million in fiscal 1997. Equity in earnings of unconsolidated subsidiaries increased $18.4 million to $12.8 million in fiscal 1998 compared to a loss of $5.6 million in fiscal 1997. The increases resulted primarily from the acquisitions of HAI and Merit in fiscal 1998 and internal growth at Green Spring. Revenue and Segment Profit increased as a result of acquisitions, the award of several new contracts in fiscal 1997 and 1998 and significant improvements in negotiated rates and terms of the TennCare contract in fiscal 1998.

HUMAN SERVICES. Revenue increased 59.7%, or $52.7 million, to $141.0 million for fiscal 1998 from $88.3 million in fiscal 1997. Salaries, cost of care and other operating expenses increased 61.7%, or $47.9 million, to $125.5 million in fiscal 1998 from $77.6 million in fiscal 1997. The increases were attributable to seven acquisitions consummated in fiscal 1998 and internal growth. Placements in Mentor homes increased 19.6% in fiscal 1998.

SPECIALTY MANAGED HEALTHCARE. Revenue was $143.5 million in fiscal 1998 compared to $0 in fiscal 1997. Salaries, cost of care and other operating expenses were $140.4 million in fiscal 1998 compared to $2.3 million in fiscal 1997. The increase in revenues and salaries, cost of care and other operating expenses were primarily related to the Allied acquisition. Fiscal 1997 salaries, cost of care and other operating expenses represent start-up costs related to the Company's initial involvement in the specialty managed care business.

CORPORATE OVERHEAD AND OTHER. Salaries and other operating expenses decreased 38.0%, or $9.7 million, due primarily to the transfer of personnel and overhead to CBHS and the healthcare franchising segment in fiscal 1997 as a result of the Crescent Transactions.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization increased 150.3%, or $29.6 million, to $49.3 million in fiscal 1998 from $19.7 million fiscal 1997. The increase was primarily attributable to increases in depreciation and amortization resulting from the HAI, Allied and Merit acquisitions.

INTEREST, NET. Interest expense, net, increased 64.9% or $30.1 million to $76.5 million in fiscal 1998 from $46.4 million in fiscal 1997. The increase was primarily the result of interest expense incurred on borrowings used to fund the Merit acquisition and related transactions offset by lower interest expense due to lower average borrowings and higher interest income from cash received in the Crescent Transactions through December 5, 1997.

OTHER ITEMS. Stock option expense for fiscal 1998 decreased $9.9 million compared to fiscal 1997 primarily due to fluctuations in the market price of the Company's common stock.

The Company recorded managed care integration costs of $17.0 million for fiscal 1998. See Note 9, "Managed Care Integration Plan and Costs, and Special Charges" to the Company's audited consolidated financial statements set forth elsewhere herein.

The Company's effective income tax rate was 195.3% for fiscal 1998 primarily
due to non-deductible goodwill amortization of approximately $11.0 million resulting from the Merit acquisition in fiscal 1998.


Income from discontinued operations, net of tax, decreased 51.2%, or $21.5 million to $20.5 million in fiscal 1998 from $42.0 million in fiscal 1997. Income from the healthcare provider segment decreased 65.9% or $23.4 million to $12.1 million in fiscal 1998 from $35.5 million in fiscal 1997. The decrease resulted primarily from (i) the effect of the Crescent Transactions which included a $35.9 million loss in 1997, net of tax, (ii) decreases in income of $12.3 million from settlements and adjustments related to reimbursement issues ("Cost Report Settlements"), net of tax, (iii) favorable adjustments to fiscal 1997 income of $3.8 million related to accounts receivable retained by the Company that were generated by the hospitals operated by CBHS, net of tax, and (iv) decreases in adjustments to income of $2.0 million related to updated actuarial estimates of malpractice claim reserves, net of tax. Income from the healthcare franchising segment increased 29.2%, or $1.9 million, to $8.4 million in fiscal 1998 compared to $6.5 million in fiscal 1997. The increase resulted primarily from the effect of the Crescent Transactions offset by declining operating performance of CBHS in fiscal 1998. See Note 3, "Discontinued Operations", to the Company's audited consolidated financial statements included elsewhere herein.

The Company recorded extraordinary losses on early extinguishments of debt, net of tax, of $5.3 million and $33.0 million during fiscal 1997 and 1998, respectively, related primarily to the termination of its then existing credit agreements in fiscal 1997 and 1998 and the extinguishment of the long-term debt related to the Merit acquisition in fiscal 1998. See Note 5, "Long-Term Debt, Capital Lease Obligations and Operating Leases," to the Company's audited consolidated financial statements set forth elsewhere herein.

OUTLOOK--RESULTS OF OPERATIONS

BEHAVIORAL MANAGED HEALTHCARE RESULTS OF OPERATIONS. The Company's behavioral managed healthcare Segment Profit is subject to significant fluctuations on a quarterly basis. These fluctuations may result from: (i) changes in utilization levels by enrolled members of the Company's risk-based contracts, including seasonal utilization patterns; (ii) performance-based contractual adjustments to revenue, reflecting utilization results or other performance measures; (iii) retroactive contractual adjustments under commercial contracts and CHAMPUS contracts; (iv) retrospective membership adjustments; (v) timing of implementation of new contracts and enrollment changes; (vi) pricing adjustments upon long-term contract renewals and (vii) changes in estimates regarding medical costs and incurred but not yet reported medical claims.

The Company's contract with the State of Tennessee to manage the behavioral healthcare benefits for the State's TennCare program ("TennCare Contract") represented approximately 14.4% of the Company's behavioral managed healthcare revenue and approximately 11.4% of the Company's consolidated revenue in fiscal 1999. The TennCare Contract contains provisions that limit the Company's profit, subject to the carryforward of losses incurred in prior periods. The Company's profit under the TennCare Contract benefited from the carryforward of losses incurred in prior periods during fiscal 1999. The Company's Segment Profit under the TennCare Contract is expected to be up to $10 million lower in fiscal 2000 than fiscal 1999 as result of these contract provisions.
The Company performs provider network, care management and medical review services for Independence Blue Cross ("IBC"), a health insurance company, under a contract that was entered into on July 7, 1994, with terms of up to five years. The Company is in the process of renegotiating the terms of its contract with IBC. Based on preliminary discussions with IBC, the Company expects to renew the IBC contract on a long-term basis. However, there can be no assurance that the Company will be able to renew the IBC contract at existing pricing levels.

INTEREST RATE RISK. The Company had $512.9 million of total debt outstanding under the Credit Agreement at September 30, 1999. Debt under the Credit Agreement bears interest at variable rates. Historically, the Company's has elected the interest rate option under the Credit Agreement that is an adjusted London inter-bank offer rate ("LIBOR") plus a borrowing margin. See Note 5, "Long-Term Debt, Capital Lease Obligations and Operating Leases", to the Company's audited consolidated financial statements appearing elsewhere herein. Based on September 30, 1999 borrowing levels, a 25 basis point increase in interest rates would cost the Company approximately $1.3 million per year in additional interest expense. LIBOR-based Eurodollar borrowing rates have increased since January 1999. One month and six month LIBOR-based Eurodollar rates increased by approximately 45 basis points and 100 basis points, respectively, between January 1999 and September 1999 and may continue to increase during fiscal 2000. The Company's earnings could be adversely affected by further increases in interest rates.

TPG INVESTMENT. On December 15, 1999, the Company consummated the TPG Investment. See Note 15, "Subsequent Event" to the Company's audited consolidated financial statements set forth elsewhere herein. The TPG Investment will reduce fiscal 2000 diluted income from continuing operations per common share.

HISTORICAL LIQUIDITY AND CAPITAL RESOURCES--FISCAL 1997-1999

OPERATING ACTIVITIES. The Company's net cash provided by (used in) operating activities was $73.6 million, $(4.2) million and $41.9 million for fiscal 1997, 1998 and 1999, respectively. The increase in cash provided by operating activities in fiscal 1999 compared to fiscal 1998 was primarily the result of reduction in income taxes paid, net of refunds received, of $10.8 million, and increases in cash flows from operations as a result of the HAI and Merit acquisitions, offset by reductions in franchise fees collected from CBHS of $40.6 million, changes in reserve for unpaid claims of $11.0 million and increases in interest paid of $6.9 million. The decrease in cash provided by operating activities in fiscal 1998 compared to fiscal 1997 was primarily the result of: (i) higher interest payments ($54.4 million and $95.2 million in fiscal 1997 and 1998, respectively,) as a result of the Merit acquisition; (ii) reduced cash flows from the provider business, net of franchise fees received and (iii) the funding of liabilities related to the Merit acquisition.

INVESTING ACTIVITIES. The Company utilized $33.3 million, $44.2 million and $48.1 million in funds during fiscal 1997, 1998 and 1999, respectively, for capital expenditures. The increases were the result of the Company's transition to the managed care business from the provider business.
primarily equity investments in CBHS and Premier (as defined) and hospital acquisitions in fiscal 1997, managed care acquisitions and human services acquisitions in fiscal 1998 and contingent consideration paid related to managed care acquisitions in fiscal 1999.

The Company received distributions from unconsolidated subsidiaries of $11.4 million and $21.2 million in fiscal 1998 and 1999, respectively. Distributions received from Choice (as defined) were $11.4 million and $13.0 million in fiscal 1998 and 1999, respectively, with the remaining distributions being received from the Provider JVs in fiscal 1999.

The Company received proceeds from the sale of assets of $398.7 million, $11.9 million and $54.2 million in fiscal 1997, 1998 and 1999, respectively. The sales proceeds were generated primarily from (i) the Crescent Transactions in fiscal 1997, (ii) the sale of hospital real estate related to closed hospitals retained by the Company and (iii) the sale of the European Hospitals in fiscal 1999.

FINANCING ACTIVITIES. The Company borrowed approximately $203.6 million, $1.2 billion and $76.8 million during fiscal 1997, 1998 and 1999, respectively. The fiscal 1997 borrowings primarily funded the repayment of variable rate secured notes and other long-term debt (including the refinancing of a previous revolving credit agreement), acquisitions and working capital needs. The fiscal 1998 borrowings primarily funded the Merit acquisition and related long-term debt refinancing with the remaining amounts representing borrowings under the Revolving Facility for short-term capital needs. The fiscal 1999 borrowings were primarily draws under the Revolving Facility for short-term capital needs.

The Company issued approximately 2.6 million warrants, in aggregate, to Crescent and COI for $25.0 million in cash as part of the Crescent Transactions during fiscal 1997.

On November 1, 1996, the Company announced that its board of directors had approved the repurchase of an additional 3.0 million shares of common stock from time to time subject to the terms of the Company's then current credit agreements. During fiscal 1998, the Company repurchased approximately 0.7 million shares of its common stock for approximately $14.4 million.

As of September 30, 1999, the Company had approximately $112.4 million of availability under the Revolving Facility, excluding approximately $17.6 million of availability reserved for certain letters of credit. The Company was in compliance with all debt covenants as of September 30, 1999.

OUTLOOK--LIQUIDITY AND CAPITAL RESOURCES

DEBT SERVICE OBLIGATIONS. The interest payments on the Company's $625.0 million 9% Series A Senior Subordinated Notes due 2008 and interest and
principal payments on indebtedness outstanding pursuant to the Company's $700.0 million Credit Agreement represent significant liquidity requirements for the Company. Borrowings under the Credit Agreement bear interest at floating rates and require interest payments on varying dates depending on the interest rate option selected by the Company. As of September 30, 1999, borrowings pursuant to the Credit Agreement included $492.9 million under the Term Loan Facility and up to $150.0 million under the Revolving Facility. The Company had $20.0 million of borrowings and $17.6 million of letters of credit outstanding under the Revolving Facility at September 30, 1999. As of September 30, 1999, the Company is required to repay the principal amount of borrowings outstanding under the Term Loan Facility and the principal amount of the Notes in the years and amounts set forth in the following table (in millions):

<table>
<thead>
<tr>
<th>FISCAL YEAR</th>
<th>PRINCIPAL AMOUNT</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>$ 30.1</td>
</tr>
<tr>
<td>2001</td>
<td>36.2</td>
</tr>
<tr>
<td>2002</td>
<td>45.9</td>
</tr>
<tr>
<td>2003</td>
<td>85.5</td>
</tr>
<tr>
<td>2004</td>
<td>145.6</td>
</tr>
<tr>
<td>2005</td>
<td>122.5</td>
</tr>
<tr>
<td>2006</td>
<td>27.1</td>
</tr>
<tr>
<td>2007</td>
<td>--</td>
</tr>
<tr>
<td>2008</td>
<td>625.0</td>
</tr>
</tbody>
</table>

In addition, any amounts outstanding under the Revolving Facility mature in February 2004.

POTENTIAL PURCHASE PRICE ADJUSTMENTS. In December 1997, the Company purchased HAI from Aetna for approximately $122.1 million, excluding transaction costs. In addition, the Company incurred the obligation to make contingent payments to Aetna which may total up to $60.0 million annually over the five-year period subsequent to closing. The Company is obligated to make contingent payments under two separate calculations as follows: In respect of each Contract Year (as defined), the Company may be required to pay to Aetna the "Tranche 1 Payments" (as defined) and the "Tranche 2 Payments" (as defined). "Contract Year" means each of the twelve-month periods ending on the last day of December in 1998, 1999, 2000, 2001, and 2002.

Upon the expiration of each Contract Year, the Tranche 1 Payment shall vest with respect to such Contract Year in an amount equal to the product of (i) the Tranche 1 Cumulative Incremental Members (as defined) for such Contract Year and (ii) the Tranche 1 Multiplier (as defined) for such Contract Year. The vested amount of Tranche 1 Payment shall be zero with respect to any Contract Year in which the Tranche 1 Cumulative Incremental Members is a negative number. Furthermore, in the event that the number of Tranche 1 Cumulative Incremental Members with respect to any Contract Year is a negative number due to a decrease in the number of Tranche 1 Cumulative Incremental Members for such Contract Year (as compared to the immediately preceding Contract Year), Aetna will forfeit the right to receive a certain portion (which may be none or all) of the vested and unpaid amounts of the Tranche 1 Payment relating to preceding Contract Years.

"Tranche 1 Cumulative Incremental Members" means, with respect to any Contract Year, (i) the number of Equivalent Members (as defined) serviced by the Company during such Contract Year for Tranche 1 Members, minus (ii)(A) for each Contract Year other than the initial Contract Year, the number of Equivalent Members serviced by the Company for Tranche 1 Members during the immediately preceding Contract Year or (B) for the initial Contract Year, the number of Tranche 1 Members as of September 30, 1997, subject to certain upward...
adjustments. There were 3,761,253 Tranche 1 Members for the initial Contract Year, prior to such upward adjustments. "Tranche 1 Members" are members of managed behavioral healthcare plans for whom the Company provides services in any of specified categories of products or services. "Equivalent Members" for any Contract Year equals the aggregate Member Months for which the Company provides services to a designated category or categories of members during the applicable Contract Year divided by 12. "Member Months" means, for each member, the number of months for which the Company provides services and is compensated. The "Tranche 1 Multiplier" is $80, $50, $40, $25, and $20 for the Contract Years 1998, 1999, 2000, 2001, and 2002, respectively.

For each Contract Year, the Company is obligated to pay to Aetna the lesser of (i) the vested portion of the Tranche 1 Payment for such Contract Year and the vested and unpaid amount relating to prior Contract Years as of the end of the immediately preceding Contract Year and (ii) $25.0 million. To the extent that the vested and unpaid portion of the Tranche 1 Payment exceeds $25.0 million, the Tranche 1 Payment remitted to Aetna shall be deemed to have been paid first from any vested but unpaid amounts from previous Contract Years in order from the earliest Contract Year for which vested amounts remain unpaid to the most recent Contract Year at the time of such calculation. Except with respect to the Contract Year ending in 2002, any vested but unpaid portion of the Tranche 1 Payment shall be available for payment to Aetna in future Contract Years, subject to certain exceptions. All vested but unpaid amounts of Tranche 1 Payments shall expire following the payment of the Tranche 1 Payment in respect to the Contract Year ending in 2002, subject to certain exceptions. In no event shall the aggregate Tranche 1 Payments to Aetna exceed $125.0 million.

Upon the expiration of each Contract Year, the Tranche 2 payment shall be an amount equal to the lesser of: (a) (i) the product of (A) the Tranche 2 Cumulative Members (as defined) for such Contract Year and (B) the Tranche 2 Multiplier (as defined) applicable to such number of Tranche 2 Cumulative Members, minus (ii) the aggregate of the Tranche 2 Payments paid to Aetna for all previous Contract Years and (b) $35.0 million. The amount shall be zero with respect to any Contract Year in which the Tranche 2 Cumulative Members is a negative number.

"Tranche 2 Cumulative Members" means, with respect to any Contract Year, (i) the equivalent Members serviced by the Company during such Contract Year for Tranche 2 Members, minus (ii) the Tranche 2 Members as of September 30, 1997, subject to certain upward adjustments. There were 936,391 Tranche 2 Members prior to such upward adjustments. "Tranche 2 Members" means Members for whom the Company provides products or services in the HMO category. The "Tranche 2 Multiplier" with respect to each Contract Year is $65 in the event that the Tranche 2 Cumulative Members are less than 2,100,000 and $70 if more than or equal to 2,100,000.

For each Contract Year, the Company shall pay to Aetna the amount of Tranche 2 Payment payable for such Contract Year. All rights to receive Tranche 2 Payment shall expire following the payment of the Tranche 2 Payment in respect to the Contract Year ending in 2002, subject to certain exceptions. Notwithstanding anything herein to the contrary, in no event shall the aggregate Tranche 2 Payment to Aetna exceed $175.0 million, subject to certain exceptions.

The Company paid $60.0 million to Aetna on March 26, 1999 for both the full Tranche 1 Payment and the full Tranche 2 Payment for the Contract Year ended December 31, 1998. Also, based upon the most recent membership enrollment data related to the Contract Year to end December 31, 1999 ("Contract Year 2"), the Company believes beyond a reasonable doubt that it will be required to make both the full Tranche 1 Payment and the full Tranche 2 Payment ($60.0 million in aggregate) related to Contract Year 2. Accordingly, the Company recorded $120.0 million of goodwill and other intangible assets related to the purchase of HAI during fiscal 1999. The Contract Year 2 liability of $60.0 million is included in "Deferred credits and other long-term liabilities" in the Company's consolidated balance sheet as of September 30, 1999. The Company intends to borrow under the Revolving Facility to meet this obligation, which is expected to be paid during the second quarter of fiscal 2000.

In December, 1997 the Company purchased Allied for $70.0 million, excluding transaction costs. The purchase price the Company originally paid for Allied...
consisted of a $50.0 million payment to the former owners of Allied and a $20.0 million deposit into an interest-bearing escrow account and was subject to increase or decrease based on the operating performance of Allied during the three years following the closing. The Company was required to pay up to $60.0 million, of which $20.0 million would have been distributed from the escrow account, during the three years following the closing of the Allied acquisition if Allied's performance exceeded certain earnings targets.

During the quarter ended December 31, 1998, the Company and the former owners of Allied amended the Allied purchase agreement (the "Allied Amendments"). The Allied Amendments resulted in the following changes to the original terms of the Allied purchase agreement:

- The original $20.0 million placed in escrow by the Company at the consummation of the Allied acquisition, plus accrued interest, was repaid to the Company.

- The Company paid the former owners of Allied $4.5 million of additional consideration, which was recorded as goodwill.

- The Company capped future obligations with respect to additional contingent payments for the purchase of Allied at $3.0 million. The earnings targets which must be met by Allied for this amount to be paid were increased.

By virtue of acquiring Merit, the Company may be required to make certain payments to the former shareholders of CMG Health, Inc. ("CMG") a managed behavioral healthcare company that was acquired by Merit in September, 1997. Such contingent payments are subject to an aggregate maximum of $23.5 million. The Company has initiated legal proceedings against certain former owners of CMG with respect to representations made by such former owners in conjunction with Merit's acquisition of CMG. Whether any contingent payments will be made to the former shareholders of CMG and the amount and timing of contingent payments, if any, may be subject to the outcome of these proceedings.

REVOLVING FACILITY AND LIQUIDITY. The Revolving Facility provides the Company with revolving loans and letters of credit in an aggregate principal amount at any time not to exceed $150.0 million. At September 30, 1999, the Company had approximately $112.4 million of availability under the Revolving Facility. The Company estimates that it will spend approximately $45.0 million for capital expenditures in fiscal 2000. The majority of the Company's anticipated capital expenditures relate to management information systems and related equipment. The Company believes that the cash flows generated from its operations, together with amounts available for borrowing under the Revolving Facility, should be sufficient to fund its debt service requirements, anticipated capital expenditures, contingent payments, if any, with respect to HAI and CMG, and other investing and financing activities for the foreseeable future. The Company expects to have significant liquidity needs during the first and second fiscal quarters of fiscal 2000 including, but not limited to, (i) CHAMPUS settlement payments of $38.1 million (first fiscal quarter), (ii) 1999 short-term incentive plan payments of approximately $12.0 million (second fiscal quarter), (iii) semi-annual interest payments on the Notes of $28.1 million (second fiscal quarter) and (iv) contingent consideration payable to Aetna of to $60.0 million (second fiscal quarter). The Company expects its borrowing capacity under the Revolving Facility to decline to approximately $30.0 million to $40.0 million by March 31, 2000 depending primarily on (i) the timing and amount of contingent consideration paid related to HAI and CMG (if any), (ii) operating and cash flow performance of the Company in fiscal 2000, (iii) capital resources needed to pursue certain new risk-based managed care business and (iv) the timing and amount of acquisition-related spending. If the Company's borrowing capacity under the Revolving Facility is expected to fall below the levels described above, management intends to delay or forego certain investing activities, including capital expenditures and acquisitions, and possibly forego certain new business opportunities. The Company's future
operating performance and ability to service or refinance the Notes or to extend or refinance the indebtedness outstanding pursuant to the Credit Agreement will be subject to future economic conditions and to financial, business, regulatory and other factors, many of which are beyond the Company's control.

RESTRICTIVE FINANCING COVENANTS. The Credit Agreement imposes restrictions on the Company's ability to make capital expenditures, and both the Credit Agreement and the Indenture limit the Company's ability to incur additional indebtedness. Such restrictions, together with the highly leveraged financial condition of the Company, may limit the Company's ability to respond to market opportunities. The covenants contained in the Credit Agreement also, among other things, restrict the ability of the Company to dispose of assets; repay other indebtedness; amend other debt instruments (including the Indenture); pay dividends; create liens on assets; enter into sale and leaseback transactions; make investments, loans or advances; redeem or repurchase common stock and make acquisitions.

STRATEGIC ALTERNATIVES TO REDUCE LONG-TERM DEBT AND IMPROVE LIQUIDITY. The Company's sale of the European Hospitals in April 1999 was one of the steps in the Company's exit from the healthcare provider and healthcare franchising businesses in order to reduce long-term debt and improve liquidity. The Company is currently involved in discussions with various parties to divest certain other non-core businesses. There can be no assurance that the Company will be able to divest any businesses or that the divestiture of such businesses would result in significant reductions of long-term debt or improvements in liquidity.

On December 15, 1999, the Company received approximately $54.0 million of net proceeds (after transaction costs) upon issuance of Series A Preferred Stock to TPG. Approximately 50% of the net proceeds received from the issuance of the Series A Preferred Stock was used to reduce debt outstanding under the Term Loan Facility with the remaining 50% of the proceeds being used for general corporate purposes. The Company is also reviewing additional strategic alternatives to improve its capital structure and liquidity. There can be no assurance that the Company will be able to consummate any transaction that will improve its capital structure and/or liquidity.

NET OPERATING LOSS CARRYFORWARDS. During June 1999, the Company received an assessment from the Internal Revenue Service (the "IRS Assessment") related to its federal income tax returns for the fiscal years ended September 30, 1992 and 1993. The IRS Assessment disallowed approximately $162 million of deductions that relate primarily to interest expense in fiscal 1992. The Company filed an appeal of the IRS Assessment during September 1999.

The Company had previously recorded a valuation allowance for the full amount of the $162 million of deductions disallowed in the IRS Assessment. The IRS Assessment is not expected to result in a material cash payment for income taxes related to prior years; however, the Company's federal income tax net operating loss carryforwards would be reduced if the Company's appeal is unsuccessful.

RECENT ACCOUNTING PRONOUNCEMENTS

In April 1998, the AICPA issued Statement of Position 98-5, "Reporting on the Costs of Start-up Activities" ("SOP 98-5"). SOP 98-5 requires all nongovernmental entities to expense costs of start-up activities as those costs are incurred. Start-up costs, as defined by SOP 98-5, include pre-operating costs, pre-opening costs and organization costs.
SOP 98-5 becomes effective for financial statements for fiscal years beginning after December 15, 1998. At adoption, a company must record a cumulative effect of a change in accounting principle to write off any unamortized start-up costs remaining on the balance sheet when SOP 98-5 is adopted. Prior year financial statements cannot be restated. The Company adopted SOP 98-5 effective October 1, 1998. The Company's adoption of SOP 98-5 had no impact on its financial position or results of operations.

Emerging Issues Task Force Issue 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but a Minority Shareholder or Shareholders Have Certain Approval or Veto Rights" ("EITF 96-16") supplements the guidance contained in AICPA Accounting Research Bulletin 51, "Consolidated Financial Statements", and in Statement of Financial Accounting Standards No. 94, "Consolidation of All Majority-Owned Subsidiaries" ("ARB 51/FAS 94"), about the conditions under which the Company's consolidated financial statements should include the financial position, results of operations and cash flows of subsidiaries which are less than wholly-owned along with those of the Company and its subsidiaries.

In general, ARB 51/FAS 94 requires consolidation of all majority-owned subsidiaries except those for which control is temporary or does not rest with the majority owner. Under the ARB 51/FAS 94 approach, instances of control not resting with the majority owner were generally regarded to arise from such events as the legal reorganization or bankruptcy of the majority-owned subsidiary. EITF 96-16 expands the definition of instances in which control does not rest with the majority owner to include those where significant approval or veto rights, other than those which are merely protective of the minority shareholder's interest, are held by the minority shareholder or shareholders ("Substantive Participating Rights"). Substantive Participating Rights include, but are not limited to: (i) selecting, terminating and setting the compensation of management responsible for implementing the majority-owned subsidiary's policies and procedures and (ii) establishing operating and capital decisions of the majority-owned subsidiary, including budgets, in the ordinary course of business.

The provisions of EITF 96-16 apply to new investment agreements made after July 24, 1997, and to existing agreements which are modified after such date. The Company has made no new investments, and has modified no existing investments, to which the provisions of EITF 96-16 would have applied.

In addition, the transition provisions of EITF 96-16 must be applied to majority-owned subsidiaries previously consolidated under ARB 51/FAS 94 for which the underlying agreements have not been modified in financial statements issued for years ending after December 15, 1998 (fiscal 1999 for the Company). The adoption of the transition provisions of EITF 96-16 on October 1, 1998 had the following effect on the Company's consolidated financial position:

<table>
<thead>
<tr>
<th></th>
<th>OCTOBER 1, 1998</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase (decrease) in:</td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$(21,092)</td>
</tr>
<tr>
<td>Other current assets</td>
<td>(9,538)</td>
</tr>
<tr>
<td>Long-term assets</td>
<td>(30,049)</td>
</tr>
<tr>
<td>Investment in unconsolidated</td>
<td></td>
</tr>
<tr>
<td>subsidiaries</td>
<td>26,498</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$(34,181)</td>
</tr>
<tr>
<td>Current liabilities</td>
<td></td>
</tr>
<tr>
<td>Minority interest</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$(10,381)</td>
</tr>
<tr>
<td></td>
<td>(23,800)</td>
</tr>
</tbody>
</table>
POTENTIAL IMPACT OF YEAR 2000 COMPUTER ISSUES

OVERVIEW. The year 2000 computer problem is the inability of computer systems which store dates by using the last two digits of the year (i.e. "98" for "1998") to reliably recognize that dates after December 31, 1999 are later than, and not before, 1999. For instance, the date January 1, 2000, may be mistakenly interpreted as January 1, 1900, in calculations involving dates on systems which are non-year 2000 compliant.

The Company relies on information technology ("IT") systems and other systems and facilities such as telephones, building access control systems and heating and ventilation equipment ("Embedded Systems") to conduct its business. These systems are potentially vulnerable to year 2000 problems due to their use of the date information.

The Company also has business relationships with customers and healthcare providers and other critical vendors who are themselves reliant on IT and Embedded Systems to conduct their businesses.

STATE OF READINESS. The Company's IT systems are largely decentralized, with each major operating unit having its own standards for systems which include both purchased and internally-developed software. The Company's IT hardware infrastructure is built mainly around mid-range computers and IBM PC-compatible servers and desktop systems.

The Company's principal means of ensuring year 2000 readiness for purchased software has been the replacement, upgrade or repair of non-compliant systems. This replacement process would have been undertaken for business reasons irrespective of the year 2000 problem; however, it would, more than likely, have been implemented over a longer period of time. The Company's internally-developed software was either designed to be year 2000 ready from inception or have been modified to be year 2000 ready and has gone through an independent verification and validation process. The Company believes its mission critical systems have been remediated to a state of year 2000 readiness.

To successfully prepare for the Year 2000, a Program Management Office "(PMO)" was established by the Company. The PMO's responsibility is to provide oversight to the year 2000 project, develop plans, policies and procedures, manage risk, as well as perform independent verification and validation for the Company's year 2000 readiness.

Each of the Company's major operating units has a Chief Information Officer who is responsible for ensuring that all year 2000 issues are addressed and mitigated before any computational problems related to dates after December 31, 1999, occur.

The Company's plan for IT systems consists of several phases, primarily:

(i) Inventory--identifying all IT systems and the magnitude of year 2000 readiness risk of each according to its potential business impact;
(ii) Date assessment--identifying IT systems that use date functions and assessing them for year 2000 functionality;
(iii) Remediation--reprogramming, replacing or upgrading where necessary, inventoried items to ensure they are year 2000 ready; and
(iv) Testing and certification--testing the code modifications and new inventory with other associated systems, including extensive date testing and performing quality assurance testing to ensure successful operation in the post-1999 environment.

The Company has completed the inventory and assessment phases for substantially all of its IT systems. The Company has completed the remediation, testing and certification of substantially all of its IT systems.

The Company leases most of the office space in which its reliance on Embedded Systems presents a potential problem and has been working with the respective lessors to identify any potential year 2000 problems related to these Embedded Systems. Responses concerning year 2000 readiness have been received and assessed from all facilities considered mission critical. Risk has been determined for each facility and follow-up activities continue to ensure that facilities remain a low risk for year 2000.

The Company believes that its year 2000 projects have been substantially completed.

EXTERNAL RELATIONSHIPS. The Company also faces the risk that one or more of its critical suppliers or customers ("External Relationships") will not be able to interact with the Company due to the third party's inability to resolve its own year 2000 issues, including those associated with its own External Relationships. The Company has completed its inventory of External Relationships and risk rated each External Relationship based upon the potential business impact, available alternatives and cost of substitution. The Company determined the overall year 2000 readiness of its External Relationships. In the case of significant customers and mission critical suppliers such as banks, telecommunications providers and other utilities and IT vendors, the Company has been engaged in discussions with the third parties and has, in many cases, obtained detailed information as to those parties' year 2000 plans and state of readiness.

YEAR 2000 COSTS. Total costs incurred solely for remediation of potential year 2000 problems were approximately $4.3 million in fiscal 1999. A large majority of these costs were incremental expenses that will not recur in calendar 2000 or thereafter. The Company expenses these costs as incurred and funds these costs through operating cash flows. In addition, the Company estimates that it has accelerated approximately $5.5 million of capital expenditures that would have been budgeted for future periods into fiscal 1999 to ensure year 2000 readiness for outdated systems.

Year 2000 readiness is critical to the Company. The Company has redeployed some resources from non-critical system enhancements to address year 2000 issues. Due to the importance of IT systems to the Company's business, management has deferred non-critical systems enhancements to become year 2000 ready. The Company does not expect these redeployments and deferrals to have a material impact on the Company's financial condition or results of operations.

RISKS AND CONTINGENCY/RECOVERY PLANNING. If the Company's year 2000 issues were unresolved, the most reasonably likely worst case scenario would include, among other possibilities, the inability to accurately and timely authorize and process benefits and claims, accurately bill customers, assess claims exposure, determine liquidity requirements, report accurate data to management, stockholders, customers, regulators and others, cause business interruptions or shutdowns, financial losses, reputational harm, loss of significant customers,
increased scrutiny by regulators and litigation related to year 2000 issues. The Company is attempting to limit the potential impact of the year 2000 by monitoring the progress of its own year 2000 project and those of its critical External Relationships and by developing contingency/recovery plans. The Company cannot guarantee that it will be able to resolve all of its year 2000 issues. Any critical unresolved year 2000 issues at the Company or its External Relationships, however, could have a material adverse effect on the Company's results of operations, liquidity or financial condition.

The Company has developed, or is developing, contingency/recovery plans aimed at ensuring the continuity of critical business functions before and after December 31, 1999. As part of that process, the Company has substantially completed the development of manual work alternatives to automated processes which should both ensure business continuity and provide a ready source of input to affected systems when they are returned to an operational status. These manual alternatives presume, however, that basic infrastructure such as electrical power and telephone service, as well as purchased systems which are advertised to be year 2000 ready by their manufacturers (primarily personal computers and productivity software) will remain unaffected by the year 2000 problem. Contingency planning activities will continue through calendar year-end. Activities consist of, but are not limited to, plan verification of all key corporate functions, establishment of response teams and associated "war rooms", testing of call centers telephone re-routing strategy and rehearsal for year-end transition.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has significant interest rate risk related to its variable rate debt outstanding under the Credit Agreement. See "Cautionary Statements--Leverage and Debt Service Obligations," "Management's Discussion and Analysis of Financial Condition and Results of Operations--Outlook--Results of Operations and Outlook--Liquidity and Capital Resources" and Note 5, "Long-Term Debt, Capital Lease Obligations and Operating Leases" to the Company's audited consolidated financial statements set forth elsewhere herein.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Information with respect to this item is contained in the Company's audited consolidated financial statements and financial statement schedule indicated in the Index on Page F-1 of this Annual Report on Form 10-K and is incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information with respect to the Company's executive officers is contained under "Item 1. Business--Executive Officers of the Registrant." Pursuant to General Instruction G(3) to Form 10-K, the information required by this item with respect to directors and compliance with Section 16(a) of the Exchange Act has been omitted inasmuch as the Company files with the Securities and Exchange Commission a definitive proxy statement not later than 120 days subsequent to the end of its fiscal year. Such information is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION
Pursuant to General Instruction G(3) to Form 10-K, the information required with respect to this item has been omitted inasmuch as the Company files with the Securities and Exchange Commission a definitive proxy statement not later than 120 days subsequent to the end of its fiscal year. Such information is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Pursuant to General Instruction G(3) to Form 10-K, the information required with respect to this item has been omitted inasmuch as the Company files with the Securities and Exchange Commission a definitive proxy statement not later than 120 days subsequent to the end of its fiscal year. Such information is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Pursuant to General Instruction G(3) to Form 10-K, the information required with respect to this item has been omitted inasmuch as the Company files with the Securities and Exchange Commission a definitive proxy statement not later than 120 days subsequent to the end of its fiscal year. Such information is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(A) DOCUMENTS FILED AS PART OF THE REPORT:

1. FINANCIAL STATEMENTS

Information with respect to this item is contained on Pages F-1 to F-51 of this Annual Report on Form 10-K.

2. FINANCIAL STATEMENT SCHEDULE

Information with respect to this item is contained on page S-1 of this Annual Report on Form 10-K.

3. EXHIBITS

<table>
<thead>
<tr>
<th>EXHIBIT NO.</th>
<th>DESCRIPTION OF EXHIBIT</th>
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<tr>
<td>2(a)</td>
<td>Stock Purchase Agreement, dated November 14, 1995, among Blue Cross and Blue Shield of New Jersey, Inc. Health Care Service Corporation, Independence Blue Cross, Medical Service Association of Pennsylvania, Pierce County Medical Bureau, Inc., Veritus, Inc., Green Spring Health Services, Inc. and the Company, which was filed as Exhibit 10(e) to the Company's Quarterly Report on Form 10-Q for the Quarterly period ended December 31, 1995, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>2(b)</td>
<td>GPA Stock Exchange Agreement, dated November 14, 1995, between Green Spring Health Services, Inc. and the Company, which was filed as Exhibit 10(f) to the Company's Quarterly Report on Form 10-Q for the Quarterly period ended December 31, 1995, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>2(c)</td>
<td>Real Estate Purchase and Sale Agreement, dated January 29, 1997, between the Company and Crescent Real Estate Equities Limited Partnership, which was filed as Exhibit 2(a) to the Company's current report on Form 8-K filed on April 23, 1997, and is incorporated herein by reference.</td>
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<tr>
<td>EXHIBIT NO.</td>
<td>DESCRIPTION OF EXHIBIT</td>
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<tr>
<td>2(d)</td>
<td>Amendment No. 1, dated February 28, 1997, to the Real Estate Purchase and Sale Agreement, dated January 29, 1997, between the Company and Crescent Real Estate Equities Limited Partnership, which was filed as Exhibit 2(b) to the Company's current report on Form 8-K filed on April 23, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>2(e)</td>
<td>Amendment No. 2, dated May 29, 1997, to the Real Estate Purchase and Sale Agreement, dated January 29, 1997, between the Company and Crescent Real Estate Equities Limited Partnership, which was filed as Exhibit 2(c) to the Company's current report on Form 8-K, which was filed on June 30, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>2(f)</td>
<td>Contribution Agreement, dated June 16, 1997, between the Company and Crescent Operating, Inc., which was filed as Exhibit 2(d) to the Company's current report on Form 8-K which was filed on June 30, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>2(g)</td>
<td>Stock Purchase Agreement, dated August 5, 1997, between the Company and Aetna Insurance Company of Connecticut, which was filed as Exhibit 2(e) to the Company's current report on Form 8-K, which was filed on December 17, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>2(h)</td>
<td>Master Service Agreement, dated August 5, 1997, between the Company, Aetna U.S. Healthcare, Inc. and Human Affairs International, Incorporated, which was filed as Exhibit 2(f) to the Company's current report on Form 8-K, which was filed on December 17, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>2(i)</td>
<td>First Amendment to Stock Purchase Agreement, dated December 4, 1997, between the Company and Aetna Insurance Company of Connecticut, which was filed as Exhibit 2(g) to the Company's current report on Form 8-K, which was filed on December 17, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>2(j)</td>
<td>First Amendment to Master Services Agreement, dated December 4, 1997, between the Company, Aetna U.S. Healthcare, Inc. and Human Affairs International, Incorporated, which was filed as Exhibit 2(h) to the Company's current report on Form 8-K, which was filed on December 17, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>2(k)</td>
<td>Asset Purchase Agreement, dated October 16, 1997, among the Company; Allied Health Group, Inc.; Sky Management Co.; Florida Specialty Network, LTD; Surgical Associates of South Florida, Inc.; Surginet, Inc.; Jacob Nudel, M.D.; David Russin, M.D. and Lawrence Schimmel, M.D., which was filed as Exhibit 2(i) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>2(l)</td>
<td>First Amendment to Asset Purchase Agreement, dated December 5, 1997, among the Company; Allied Health Group, Inc.; Sky Management, Inc.; Sky Management Co.; Florida Specialty Network, LTD; Surgical Associates of South Florida, Inc.; Surginet, Inc.; Jacob Nudel, M.D.; David Russin M.D.; and Lawrence Schimmel, M.D., which was filed as Exhibit 2(j) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1997, and is incorporated herein by reference.</td>
</tr>
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</table>
| 2(m)        | Second Amendment to Asset Purchase Agreement, dated November 18, 1998, among the Company; Allied Health Group, Inc.; Sky Management, Inc.; Sky Management Co.; Florida Specialty Network, LTD; Surgical Associates of South Florida, Inc.; Surginet, Inc.; Jacob Nudel, M.D.; David Russin M.D.; and Lawrence Schimmel, M.D., which was filed as Exhibit 2(k) to
the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1998 and is incorporated herein by reference.

2(n) Third Amendment to Asset Purchase agreement, dated December 31, 1998, among the Company; Allied Health Group, Inc.; Gut Management, Inc.; Sky Management Co.; Florida Specialty Network, LTD; Surgical Associates of South Florida, Inc.; Surginet, Inc.; Jacob Nudel, M.D.; David Russein, M.D.; and Lawrence Schimmel, M.D., which was filed as Exhibit 2(b) to the Company's Quarterly on Form 10-Q for the quarterly period ended December 31, 1998 and is incorporated herein by reference.

2(o) Agreement and Plan of Merger, dated October 24, 1997, among the Company, Merit Behavioral Care Corporation and MBC Merger Corporation which was filed as Exhibit 2(g) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1997, and is incorporated herein by reference.

2(p) Share Purchase Agreement, dated April 2, 1999, by and among the Company, Charter Medical International, S.A., Inc. (a wholly owned subsidiary of the Company), Investment AB Bure, and CMEL Holding Limited (a wholly owned subsidiary of Investment AB Bure), filed as Exhibit 2(a) to the Company's current report on Form 8-K, which was filed on April 12, 1999, and is incorporated herein by reference.

2(q) Stock Purchase Agreement, dated April 2, 1999, by and among the Company, Charter Medical International S.A., Inc. (a wholly owned subsidiary of the Company), Investment AB Bure and Grodrunden 515 AB (a wholly owned subsidiary of Investment AB Bure), filed as Exhibit 2(b) to the Company's current report on Form 8-K, which was filed on April 12, 1999, and is incorporated herein by reference.

2(r) First Amendment to Share Purchase Agreement, dated April 8, 1999, by and among the Company, Charter Medical International S.A., Inc. (a wholly owned subsidiary of the Company), Investment AB Bure, and CMEL Holding Limited (a wholly owned subsidiary of Investment AB Bure), filed as Exhibit 2(c) to the Company's current report on Form 8-K, which was filed on April 12, 1999, and is incorporated herein by reference.

2(s) First Amendment to Stock Purchase Agreement, dated April 8, 1999, among the Company, Charter Medical International S.A., Inc. (a wholly owned subsidiary of the Company), Investment AB Bure, and CMEL Holding Limited (a wholly owned subsidiary of Investment AB Bure), filed as Exhibit 2(d) to the Company's current report on Form 8-K, which was filed on April 12, 1999, and is incorporated herein by reference.

2(t) Letter Agreement dated August 10, 1999 by and among the Company, Charter Behavioral Health Systems, LLC, Crescent Real Estate Equities Limited Partnership and Crescent Operating, Inc., which was filed as Exhibit 2(a) to the Company's current report on Form 8-K, which was filed on September 24, 1999 and is incorporated herein by reference.

3(a) Restated Certificate of Incorporation of the Company, as filed in Delaware on October 16, 1992, which was filed as Exhibit 3(a) to the Company's Annual Report on Form 10-K for the year ended September 30, 1992, and is incorporated herein by reference.

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<tr>
<td>3(b)</td>
<td>Bylaws of the Company.</td>
</tr>
<tr>
<td>3(c)</td>
<td>Certificate of Ownership and Merger merging Magellan Health Services, Inc. (a Delaware corporation) into Charter Medical Corporation (a Delaware corporation), as filed in Delaware</td>
</tr>
</tbody>
</table>
on December 21, 1995, which was filed as Exhibit 3(c) to the Company's Annual Report on Form 10-K for the year ended September 30, 1995, and is incorporated herein by reference.

4(a) Stockholders' Agreement, dated December 13, 1995, among Green Spring Health Services, Inc., Blue Cross and Blue Shield of New Jersey, Inc., Health Care Service Corporation, Independence Blue Cross, Pierce County Medical Bureau, Inc. and the Company, which was filed as Exhibit 4(d) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1995, and is incorporated herein by reference.

4(b) First Amendment to Stockholders' Agreement, dated February 28, 1997, among Green Spring Health Services, Inc, Blue Cross and Blue Shield of New Jersey, Inc., Health Care Service Corporation, Independence Blue Cross, Pierce County Medical Bureau, Inc. and the Company, which was filed as Exhibit 4(af) to the Company's Annual Report on Form 10-K for the year ended September 30, 1997, and is incorporated herein by reference.

4(c) Exchange Agreement, dated December 13, 1995, among Blue Cross and Blue Shield of New Jersey, Inc., Health Care Service Corporation, Independence Blue Cross, Pierce County Medical Bureau, Inc. and the Company, which was filed as Exhibit 4(e) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1995, and is incorporated herein by reference.

4(d) Stock and Warrant Purchase Agreement, dated December 22, 1995, between the Company and Richard E. Rainwater, which was filed as Exhibit 4(f) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1995, and is incorporated herein by reference.

4(e) Amendment No. 1 to Stock and Warrant Purchase Agreement, dated January 25, 1996, between the Company and Rainwater-Magellan Holdings, L.P., which was filed as Exhibit 4.7 to the Company's Registration Statement on Form S-3 dated February 26, 1996, and is incorporated herein by reference.

4(f) Warrant Purchase Agreement, dated January 29, 1997, between the Company and Crescent Real Estate Equities Limited Partnership which was filed as Exhibit 4(a) to the Company's current report on Form 8-K, which was filed on April 23, 1997, and is incorporated herein by reference.

4(g) Amendment No. 1, dated June 17, 1997, to the Warrant Purchase Agreement, dated January 29, 1997, between the Company and Crescent Real Estate Equities Limited Partnership, which was filed as Exhibit 4(b) to the Company's current report on Form 8-K, which was filed on June 30, 1997, and is incorporated herein by reference.

4(h) Indenture, dated as of February 12, 1998, between the Company and Marine Midland Bank, as Trustee, relating to the 9% Senior Subordinated Notes due February 15, 2008 of the Company, which was filed as Exhibit 4(a) to the Company's Current Report on Form 8-K, which was filed April 3, 1998, and is incorporated herein by reference.

4(i) Purchase Agreement, dated February 5, 1998, between the Company and Chase Securities Inc., which was filed as Exhibit 4(b) to the Company's Current Report on Form 8-K, which was filed April 3, 1998, and is incorporated herein by reference.

4(j) Exchange and Registration Rights Agreement, dated February 12, 1998, between the Company and Chase Securities Inc., which was filed as Exhibit 4(c) to the Company's Current Report on Form 8-K, which was filed on April 3, 1998, and is incorporated herein by reference.
4(k) Credit Agreement, dated February 12, 1998, among the Company, certain of the Company's subsidiaries listed therein and The Chase Manhattan Bank, as administrative agent, which was filed as Exhibit 4(d) to the Company's Current Report on Form 8-K, which was filed April 3, 1998, and is incorporated herein by reference.

4(l) Amendment No. 1, dated as of September 30, 1998, to the Credit Agreement, dated as of February 12, 1998, among the Company, certain of the Company's subsidiaries listed therein and The Chase Manhattan Bank, as administrative agent, which was filed as Exhibit 4(e) to the Company's Registration Statement Form S-4 (no. 333-49335), which was filed on October 5, 1998, and is incorporated herein by reference.

4(m) Amendment No. 2, dated as of April 30, 1999, to the Credit Agreement dated as of February 12, 1998, among the Company certain of the Company's subsidiaries listed therein and the Chase Manhattan Bank, as administrative agent which was filed as Exhibit 4(a) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1999 and is incorporated herein by reference.

4(n) Amendment No. 3, dated as of July 29, 1999, to the Credit Agreement dated as of February 12, 1998, among the Company's subsidiaries listed therein and the Chase Manhattan Bank, as administrative agent.

4(o) Amendment No. 4, dated as of September 8, 1999, to the Credit Agreement dated as of February 12, 1998, among the Company's subsidiaries listed therein and the Chase Manhattan Bank, as administrative agent.

4(p) Investment Agreement dated as of July 19, 1999, between the Company and TPG Magellan LLC together with the following exhibits: (i) form of Certificate of Designations of Series A Cumulative Convertible Preferred Stock; (ii) form of Certificate of Designation of Series B Cumulative Convertible Preferred Stock; (iii) form of Certificate of Designations of Series C Junior Participating Preferred Stock; and (iv) form of Escrow Agreement by and among The Company, TPG Magellan LLC and SunTrust Bank, Atlanta, as escrow agent, filed as Exhibit 4.1 to the Company's current report on Form 8-K, which was filed on July 21, 1999, and is incorporated herein by reference.

4(q) Registration Rights Agreement, dated as of July 19, 1999, between the Company and TPG Magellan LLC, filed as Exhibit 4.2 to the Company's current report on Form 8-K, which was filed on July 21, 1999, and is incorporated herein by reference.

4(r) Amended and Restated Investment Agreement, dated December 14, 1999, between the Company and TPG Magellan LLC together with the following exhibits: (i) form of Certificate of Designations of Series A Cumulative Convertible Preferred Stock; (ii) form of Certificate of Designation of Series B Cumulative Convertible Preferred Stock; (iii) form of Certificate of Designations of Series C Junior Participating Preferred Stock.

*10(a) 1992 Stock Option Plan of the Company, as amended, which was filed as Exhibit 10(c) to the Company's Annual Report on Form 10-K for the year ended September 30, 1994, and is incorporated herein by reference.

*10(b) 1992 Directors' Stock Option Plan of the Company, as amended, which was filed as Exhibit 10(d) to the Company's Annual Report on Form 10-K for the year ended September 30, 1994, and is incorporated herein by reference.

*10(c) 1994 Stock Option Plan of the Company, as amended, which was filed as Exhibit 10(e) to the Company's Annual Report on Form 10-K for the year ended September 30, 1994, and is incorporated herein by reference.

*10(d) Directors' Unit Award Plan of the Company, which was filed as Exhibit 10(i) to the Company's Registration Statement on Form S-4 (No. 33-53701) filed May 18, 1994, and is incorporated herein by reference.
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<tr>
<td>*10(e)</td>
<td>1996 Stock Option Plan of the Company, which was filed as Exhibit 10(a) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1996 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(f)</td>
<td>1996 Directors' Stock Option Plan of the Company, which was filed as Exhibit 10(b) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1996 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(g)</td>
<td>1997 Stock Option Plan of the Company, which was filed as Exhibit 10(i) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(h)</td>
<td>Amendment to the Company's 1992 Directors' Stock Option Plan, which was filed as Exhibit 10(d) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(i)</td>
<td>Amendment to the Company's Directors' 1996 Directors Stock Option Plan, which was filed as Exhibit 10(e) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(j)</td>
<td>Amendment to the Company's 1994 Stock Option Plan, which was filed as Exhibit 10(f) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(k)</td>
<td>Amendment to the Company's 1996 Stock Option Plan, which was filed as Exhibit 10(g) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(l)</td>
<td>Amendment to the Company's 1997 Stock Option Plan, which was filed as Exhibit 10(h) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(m)</td>
<td>Amended 1998 Stock Option Plan of the Company, which was filed as Exhibit 10(i) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(n)</td>
<td>Third Amendment to the Company's 1998 Stock Option Plan, which was filed as Exhibit 10(j) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(o)</td>
<td>Employment Agreement, dated March 31, 1995, between the Company and Craig L. McKnight, Executive Vice President and Chief Financial Officer, which was filed as Exhibit 10(l) to the Company's Annual Report on Form 10-K for the year ended September 30, 1995, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(p)</td>
<td>Letter Agreement, dated November 9, 1993, between Green Spring Health Services, Inc. and Henry T. Harbin, M.D., Executive Vice President of the Company and President and Chief Executive Officer of Green Spring Health Services, Inc., which was filed as Exhibit 10(c) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1995 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(q)</td>
<td>Letter Agreement, dated September 19, 1994 between Green Spring Health Services, Inc. and Henry T. Harbin, M.D., Executive Vice President of the Company and President and Chief Executive Officer of Green Spring Health Services, Inc., which was filed as Exhibit 10(d) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1995 and is incorporated herein by reference.</td>
</tr>
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</table>
| *10(r) | Employment Agreement dated February 28, 1996, between Green Spring Health Services, Inc. and Henry T. Harbin, M.D., Executive Vice President of the Company and President and Chief Executive Officer of Green Spring Health Services,
Inc., which was filed as Exhibit 10(t) to the Company's Annual Report on Form 10-K for the year ended September 30, 1996, and is incorporated herein by reference.

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<td>*10(s)</td>
<td>Compensation Agreement dated September 30, 1996, between Magellan Health Services, Inc. and Henry T. Harbin, M.D., Executive Vice President of the Company and President and Chief Executive Officer of Green Spring Health Services, Inc., which was filed as Exhibit 10(u) to the Company's Annual Report on Form 10-K for the year ended September 30, 1996, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(t)</td>
<td>Written description of the Green Spring Health Services, Inc. Annual Incentive Plan for the period ended September 30, 1998, which was filed as Exhibit 10(s) to the Company's Annual Report on Form 10-K for the year ended September 30, 1998 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(u)</td>
<td>Magellan Corporate Short-Term Incentive Plan for the fiscal year ended September 30, 1999, which was filed as Exhibit 10(a) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(v)</td>
<td>Magellan Behavioral Health Short-Term Incentive Plan for the fiscal year ended September 30, 1999, which was filed as Exhibit 10(b) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(w)</td>
<td>Letter Agreement, dated March 2, 1999, between the Company and Clifford W. Donnelly, Executive Vice President of the Company.</td>
</tr>
<tr>
<td>*10(x)</td>
<td>Letter Agreement, dated June 4, 1999, between the Company and Mark S. Demilio, Executive Vice President of the Company.</td>
</tr>
<tr>
<td>10(y)</td>
<td>Master Lease Agreement, dated June 16, 1997, between Crescent Real Estate Funding VII, L.P., as Landlord, and Charter Behavioral Health Systems, LLC, as Tenant, which was filed as Exhibit 99(b) to the Company's current report on Form 8-K, which was filed on June 30, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>10(z)</td>
<td>Master Franchise Agreement, dated June 17, 1997, between the Company and Charter Behavioral Health Systems, LLC, which was filed as Exhibit 99(c) to the Company's current report on Form 8-K, which was filed on June 30, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>10(aa)</td>
<td>Form of Franchise Agreement, dated June 17, 1997, between the Company, as Franchisor, and Franchise Owners, which was filed as Exhibit 99(d) to the Company's current report on Form 8-K, which was filed on June 30, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>10(ab)</td>
<td>Subordination Agreement, dated June 16, 1997, between the Company, Charter Behavioral Health Systems, LLC and Crescent Real Estate Equities Limited Partnership, which was filed as Exhibit 99(e) to the Company's current report on Form 8-K, which was filed on June 30, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>10(ac)</td>
<td>Operating Agreement of Charter Behavioral Health Systems, LLC, dated June 16, 1997, between the Company and Crescent Operating, Inc., which was filed as Exhibit 99(f) to the Company's current report on Form 8-K, which was filed on June 30, 1997, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>10(ad)</td>
<td>Warrant Purchase Agreement, dated June 16, 1997, between the Company and Crescent Operating, Inc., which was filed as Exhibit 99(g) to the Company's current report on Form 8-K, which was filed on June 30, 1997, and is incorporated herein by reference.</td>
</tr>
</tbody>
</table>
*10(ae) 1998 Stock Option Plan of the Company which was filed as Exhibit (ay) to the Company's Registration Statement on Form S-4, which was filed on April 3, 1998, and is incorporated herein by reference.

<table>
<thead>
<tr>
<th>EXHIBIT NO.</th>
<th>DESCRIPTION OF EXHIBIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>*10(af)</td>
<td>Letter Agreement, dated May 7, 1997, between Green Spring Health Services, Inc. and John J. Wider, Jr., Executive Vice President and Chief Operating Officer of Green Spring Health Services, Inc., which was filed as Exhibit 10 (az) to the Company's Registration Statement on Form S-4, which was filed on April 3, 1998, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(ag)</td>
<td>Employment Agreement, dated December 9, 1998, between Magellan Behavioral Health, Inc. and John Wider, President and Chief Operating Officer of Magellan Behavioral Health, Inc., which was filed as Exhibit 10 to the Company's Form 10-Q for the quarterly period ended December 31, 1998 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(ah)</td>
<td>Employment Agreement, dated March 12, 1997, between Green Spring Health Services, Inc. and Clarissa C. Marques, Chief Clinical Officer of Green Spring Health Services, Inc., which was filed as Exhibit 10 (ba) to the Company's Registration Statement on Form S-4, which was filed on April 3, 1998, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(ai)</td>
<td>Letter Agreement, dated February 2, 1995, between Green Spring Health Services, Inc. and Clarissa C. Marques, Senior Vice President of Green Spring Health Services, Inc., which was filed as Exhibit 10 (bb) to the Company's Registration Statement on Form S-4, which was filed on April 3, 1998, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(aj)</td>
<td>Employment Agreement, dated February 11, 1999, between the Company and Clarissa C. Marques, Ph.D., Executive Vice President of the Company, which was filed as Exhibit 10(c) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>*10(ak)</td>
<td>Employment Agreement, dated June 25, 1998, between the Company and Henry T. Harbin, M.D., President, Chief Executive Officer of the Company, which was filed as exhibit 10(a) to the Company's quarterly report on Form 10-Q for the quarterly period ended June 30, 1998 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>10(al)</td>
<td>Offer to Purchase and Consent Solicitation Statement, dated January 12, 1998, by the Company for all of its 11 1/4% Series A Senior Subordinated Notes due 2008, which was filed as Exhibit 10(ad) to the Company's Registration Statement on Form S-4, which was filed on April 3, 1998, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>10(alm)</td>
<td>Offer to Purchase and Consent Solicitation Statement, dated January 12, 1998, by Merit Behavioral Care Corporation for all of its 11 1/2% Senior Subordinated Notes due 2005, which was filed as Exhibit 10(ad) to the Company's Registration Statement on Form S-4, which was filed on April 3, 1998, and is incorporated herein by reference.</td>
</tr>
<tr>
<td>10(an)</td>
<td>Agreement and Plan of Merger by and among Merit Behavioral Care Corporation, Merit Merger Corp., and CMG Health, Inc. dated as of July 14, 1997, which was filed as Exhibit 10(ah) to the Company's Annual Report on Form 10-K for the year ended September 30, 1998 and is incorporated herein by reference.</td>
</tr>
<tr>
<td>21</td>
<td>List of subsidiaries of the Company.</td>
</tr>
<tr>
<td>23</td>
<td>Consent of Arthur Andersen LLP.</td>
</tr>
</tbody>
</table>
* Constitutes a management contract or compensatory plan arrangement.

(B) REPORTS ON FORM 8-K:

The Company filed the following current reports on Form 8-K with the Securities and Exchange Commission during the quarter ended September 30, 1999.

<table>
<thead>
<tr>
<th>DATE OF REPORT</th>
<th>ITEM REPORTED AND DESCRIPTION</th>
<th>FINANCIAL STATEMENT FILED</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 19, 1999</td>
<td>Item 5. Other Events--TPG Investment</td>
<td>No</td>
</tr>
<tr>
<td>September 24, 1999</td>
<td>Item 2. Disposition of Assets--CBHS Transactions</td>
<td>Yes(1)</td>
</tr>
</tbody>
</table>


(C) EXHIBITS REQUIRED BY ITEM 601 OF REGULATION S-K:

Exhibits required to be filed by the Company pursuant to Item 601 of Regulation S-K are contained in a separate volume.

(D) FINANCIAL STATEMENT AND SCHEDULES REQUIRED BY REGULATION S-X:

Information with respect to this item is contained on page S-1 of this Annual Report on Form 10-K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

MAGELLAN HEALTH SERVICES, INC.  
(Registrant)

Date: December 23, 1999

/S/ CLIFFORD W. DONNELLY

Clifford W. Donnelly  
Executive Vice President and  
Chief Financial Officer

Date: December 23, 1999

/S/ THOMAS C. HOFMEISTER
Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<table>
<thead>
<tr>
<th>SIGNATURE</th>
<th>TITLE</th>
<th>DATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>/s/ HENRY T. HARBIN</td>
<td>President, Chief Executive Officer and Director</td>
<td>December 23, 1999</td>
</tr>
<tr>
<td>/s/ DAVID BONDERMAN</td>
<td>Director</td>
<td>December 23, 1999</td>
</tr>
<tr>
<td>/s/ JONATHAN J. COSLET</td>
<td>Director</td>
<td>December 23, 1999</td>
</tr>
<tr>
<td>/s/ G. FRED DIBONA, JR.</td>
<td>Director</td>
<td>December 23, 1999</td>
</tr>
<tr>
<td>/s/ ANDRE C. DIMITRIADIS</td>
<td>Director</td>
<td>December 23, 1999</td>
</tr>
<tr>
<td>/s/ A.D. FRAZIER, JR.</td>
<td>Director</td>
<td>December 23, 1999</td>
</tr>
<tr>
<td>/s/ GERALD L. MCMANIS</td>
<td>Director</td>
<td>December 23, 1999</td>
</tr>
<tr>
<td>/s/ DANIEL S. MESSINA</td>
<td>Director</td>
<td>December 23, 1999</td>
</tr>
<tr>
<td>/s/ ROBERT W. MILLER</td>
<td>Chairman of the Board of Directors</td>
<td>December 23, 1999</td>
</tr>
<tr>
<td>/s/ DARLA D. MOORE</td>
<td>Director</td>
<td>December 23, 1999</td>
</tr>
<tr>
<td>/s/ JEFFREY A. SONNENFIELD</td>
<td>Director</td>
<td>December 23, 1999</td>
</tr>
<tr>
<td>/s/ JAMES B. WILLIAMS</td>
<td>Director</td>
<td>December 23, 1999</td>
</tr>
</tbody>
</table>
The following consolidated financial statements of the registrant and its subsidiaries are submitted herewith in response to Item 8 and Item 14(a):1:

PAGE
--------

MAGELLAN HEALTH SERVICES, INC.
Audited Consolidated Financial Statements

Report of independent public accountants............... F-2
Consolidated balance sheets as of September 30, 1998 and 1999................................................... F-3
Consolidated statements of operations for the fiscal years ended September 30, 1997, 1998 and 1999........ F-4
Consolidated statements of changes in stockholders' equity for the fiscal years ended September 30, 1997, 1998 and 1999........................................... F-5
Consolidated statements of cash flows for the fiscal years ended September 30, 1997, 1998 and 1999........ F-6
Notes to consolidated financial statements.............. F-7

The following financial statement schedule of the registrant and its subsidiaries is submitted herewith in response to Item 14(a):2:

PAGE
-------

Schedule II--Valuation and qualifying accounts.......... S-1

Financial statements in response to Item 14 (d)(1):

CHOICE BEHAVIORAL HEALTH PARTNERSHIP

The audited consolidated financial statements of Choice Behavioral Health Partnership ("Choice") will be filed in an amendment to this Form 10-K no later than March 30, 2000. Choice's fiscal year end is December 31, 1999.

F-1

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of Magellan Health Services, Inc:

We have audited the accompanying consolidated balance sheets of Magellan Health Services, Inc. (a Delaware corporation) and subsidiaries as of September 30, 1998 and 1999, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three 

years in the period ended September 30, 1999. These consolidated financial statements and the schedule referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Magellan Health Services, Inc. and subsidiaries as of September 30, 1998 and 1999 and the results of their operations and their cash flows for each of the three years in the period ended September 30, 1999 in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule listed in the index to financial statements is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, fairly states, in all material respects, the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSEN LLP

Baltimore, Maryland
November 30, 1999 (except with respect to the matter discussed in Note 15, as to which the date is December 15, 1999)

F-2

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Current Assets</td>
<td>399,724</td>
<td>374,927</td>
</tr>
</tbody>
</table>

**ASSETS**

Current Assets:

- Cash, including cash equivalents of $14,185 at September 30, 1998 and $10,147 at September 30, 1999 at cost, which approximates market value: $ 92,050 $ 37,440
- Accounts receivable, less allowance for doubtful accounts of $34,867 at September 30, 1998 and $28,437 at September 30, 1999: 174,846 198,646
- Restricted cash and investments: 89,212 116,824
- Refundable income taxes: 4,939 3,452
- Other current assets: 38,677 18,565
- Total Current Assets: 399,724 374,927
Assets restricted for settlement of unpaid claims and other long-term liabilities........................... 37,910 --

Property and equipment, net.................................................... 177,169 120,667

Deferred income taxes..................................................... 98,184 91,657
Investments in unconsolidated subsidiaries.......................... 11,066 18,396
Other long-term assets..................................................... 35,415 9,599

Goodwill, net of accumulated amortization of $32,785 at September 30, 1998 and $60,869 at September 30, 1999........................................ 992,431 1,108,086

Other intangible assets, net of accumulated amortization of $12,343 at September 30, 1998 and $26,457 at September 30, 1999........... 165,189 158,283

----------   ----------

$1,917,088   $1,881,615

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:
Accounts payable................................................... $ 42,873 $ 44,425
Accrued liabilities.................................................. 193,530 209,796
Medical claims payable............................................. 195,330 189,928
Current maturities of long-term debt and capital lease obligations........................................ 23,033 30,119

Total Current Liabilities............................................ 454,766 474,268

Long-term debt and capital lease obligations.................. 1,202,613 1,114,189
Reserve for unpaid claims........................................... 30,280 --
Deferred credits and other long-term liabilities........... 14,011 92,948
Minority interest.................................................... 26,985 3,514

Commitments and Contingencies

Stockholders' Equity:
Preferred stock, without par value
Authorized--10,000 shares
Issued and outstanding--none......................................... -- --

Common stock, par value $.25 per share
Authorized--80,000 shares
Issued and outstanding--33,898 shares at September 30, 1998 and 34,268 shares at September 30, 1999........... 8,476 8,566

Other Stockholders' Equity:
Additional paid-in capital............................................. 349,651 352,030
Accumulated deficit................................................... (149,238) (144,550)
Warrants outstanding.................................................. 25,050 25,050
Common stock in treasury, 2,289 shares at September 30, 1998 and September 30, 1999.............................. (44,309) (44,309)
Cumulative foreign currency adjustments included in other comprehensive income............................... (1,197) (91)

Total Stockholders' Equity............................................. 188,433 196,696

----------   ----------   ----------   ----------

$1,917,088   $1,881,615

The accompanying Notes to Consolidated Financial Statements are an integral part of these balance sheets.

F-3

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

FISCAL YEAR ENDED SEPTEMBER 30,

1997  1998  1999

Net revenue.............................................................. $463,872 $1,310,778 $1,871,636

----------   ----------   ----------
Costs and expenses:

<table>
<thead>
<tr>
<th>Description</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries, cost of care and other operating expenses............................</td>
<td>438,472</td>
<td>1,183,626</td>
<td>1,663,626</td>
</tr>
<tr>
<td>Equity in (earnings) losses of unconsolidated subsidiaries ....................</td>
<td>5,567</td>
<td>(12,795)</td>
<td>(20,442)</td>
</tr>
<tr>
<td>Depreciation and amortization .........</td>
<td>19,683</td>
<td>49,264</td>
<td>73,531</td>
</tr>
<tr>
<td>Interest, net..........................</td>
<td>46,438</td>
<td>76,505</td>
<td>93,752</td>
</tr>
<tr>
<td>Stock option expense (credit) ........................................</td>
<td>4,292</td>
<td>(5,623)</td>
<td>18</td>
</tr>
<tr>
<td>Managed care integration costs ...........................................</td>
<td>--</td>
<td>16,962</td>
<td>6,238</td>
</tr>
<tr>
<td>Special charges .......................................................</td>
<td>--</td>
<td>--</td>
<td>4,441</td>
</tr>
</tbody>
</table>

---

<table>
<thead>
<tr>
<th>Description</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income (loss) from continuing operations before income taxes, minority interest and extraordinary items</td>
<td>(50,580)</td>
<td>2,839</td>
<td>50,472</td>
</tr>
<tr>
<td>Provision for (benefit from) income taxes ...................................</td>
<td>(20,232)</td>
<td>5,544</td>
<td>27,376</td>
</tr>
<tr>
<td>Income (loss) from continuing operations before minority interest and extraordinary items</td>
<td>(30,348)</td>
<td>(2,705)</td>
<td>23,096</td>
</tr>
<tr>
<td>Minority interest ........................................................</td>
<td>6,856</td>
<td>4,094</td>
<td>630</td>
</tr>
<tr>
<td>Income (loss) from continuing operations before extraordinary items ........</td>
<td>(37,204)</td>
<td>(6,799)</td>
<td>22,466</td>
</tr>
</tbody>
</table>

Discontinued operations:

<table>
<thead>
<tr>
<th>Description</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from discontinued operations ..............................................</td>
<td>41,959</td>
<td>20,531</td>
<td>29,645</td>
</tr>
<tr>
<td>Loss on disposal of discontinued operations, net of income tax benefit of $31,616</td>
<td>--</td>
<td>--</td>
<td>(47,423)</td>
</tr>
</tbody>
</table>

---

<table>
<thead>
<tr>
<th>Description</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income before extraordinary items ................................................</td>
<td>4,755</td>
<td>13,732</td>
<td>4,688</td>
</tr>
<tr>
<td>Extraordinary items--net losses on early extinguishments of debt (net of income tax benefit of $3,503 in 1997 and $22,010 in 1998)</td>
<td>(5,253)</td>
<td>(33,015)</td>
<td>--</td>
</tr>
<tr>
<td>Net income (loss) ........................................................................</td>
<td>(498)</td>
<td>(19,283)</td>
<td>4,688</td>
</tr>
<tr>
<td>Other comprehensive income (loss) ..............................................</td>
<td>(683)</td>
<td>675</td>
<td>1,106</td>
</tr>
<tr>
<td>Comprehensive income (loss) .......................................................</td>
<td>(1,181)</td>
<td>(18,608)</td>
<td>5,794</td>
</tr>
</tbody>
</table>

Weighted average number of common shares

<table>
<thead>
<tr>
<th>Description</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>outstanding--basic ........................................................................</td>
<td>28,781</td>
<td>30,784</td>
<td>31,758</td>
</tr>
</tbody>
</table>

Weighted average number of common shares

<table>
<thead>
<tr>
<th>Description</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>outstanding--diluted ........................................................................</td>
<td>28,781</td>
<td>30,784</td>
<td>31,916</td>
</tr>
</tbody>
</table>

Income (loss) per common share--basic:

<table>
<thead>
<tr>
<th>Description</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income (loss) from continuing operations before extraordinary items ........</td>
<td>(1.29)</td>
<td>(0.22)</td>
<td>0.71</td>
</tr>
<tr>
<td>Income (loss) from discontinued operations .........................................</td>
<td>1.46</td>
<td>0.67</td>
<td>(0.56)</td>
</tr>
<tr>
<td>Extraordinary losses on early extinguishments of debt ................................</td>
<td>(0.18)</td>
<td>(1.07)</td>
<td>--</td>
</tr>
<tr>
<td>Net income (loss) ............................................................................</td>
<td>(0.02)</td>
<td>(0.63)</td>
<td>0.15</td>
</tr>
</tbody>
</table>

Income (loss) per common share--diluted:

<table>
<thead>
<tr>
<th>Description</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income (loss) from continuing operations before extraordinary items ........</td>
<td>(1.29)</td>
<td>(0.22)</td>
<td>0.70</td>
</tr>
<tr>
<td>Income (loss) from discontinued operations .........................................</td>
<td>1.46</td>
<td>0.67</td>
<td>(0.56)</td>
</tr>
<tr>
<td>Extraordinary losses on early extinguishments of debt ................................</td>
<td>(0.18)</td>
<td>(1.07)</td>
<td>--</td>
</tr>
<tr>
<td>Net income (loss) ............................................................................</td>
<td>(0.02)</td>
<td>(0.63)</td>
<td>0.15</td>
</tr>
</tbody>
</table>

(1) Net of income tax provision of $27,973, $13,687 and $19,763, for fiscal 1997, 1998 and 1999, respectively.
FISCAL YEAR ENDED SEPTEMBER 30,

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Common Stock:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance, beginning of period</td>
<td>$8,252</td>
<td>$8,361</td>
<td>$8,476</td>
</tr>
<tr>
<td>Exercise of options and warrants</td>
<td>109</td>
<td>115</td>
<td>90</td>
</tr>
<tr>
<td>Balance, end of period</td>
<td>$8,361</td>
<td>$8,476</td>
<td>$8,566</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Additional paid-in capital:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance, beginning of period</td>
<td>327,681</td>
<td>340,645</td>
<td>349,651</td>
</tr>
<tr>
<td>Stock option expense (credit)</td>
<td>4,292</td>
<td>(5,623)</td>
<td>4,688</td>
</tr>
<tr>
<td>Exercise of options and warrants</td>
<td>8,156</td>
<td>3,867</td>
<td>2,542</td>
</tr>
<tr>
<td>Green Spring Minority Stockholder Conversion</td>
<td>--</td>
<td>10,722</td>
<td>--</td>
</tr>
<tr>
<td>Other</td>
<td>516</td>
<td>40</td>
<td>(181)</td>
</tr>
<tr>
<td>Balance, end of period</td>
<td>340,645</td>
<td>349,651</td>
<td>352,030</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Accumulated deficit:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance, beginning of period</td>
<td>(129,457)</td>
<td>(129,955)</td>
<td>(149,238)</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>(498)</td>
<td>(19,283)</td>
<td>4,688</td>
</tr>
<tr>
<td>Balance, end of period</td>
<td>(129,955)</td>
<td>(149,238)</td>
<td>(144,550)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Warrants outstanding:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance, beginning of period</td>
<td>54</td>
<td>25,050</td>
<td>25,050</td>
</tr>
<tr>
<td>Exercise of warrants</td>
<td>(4)</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Issuance of warrants to Crescent and COI</td>
<td>25,000</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Balance, end of period</td>
<td>25,050</td>
<td>25,050</td>
<td>25,050</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Common stock in treasury:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance, beginning of period</td>
<td>(82,731)</td>
<td>(82,731)</td>
<td>(44,309)</td>
</tr>
<tr>
<td>Purchases of treasury stock</td>
<td>--</td>
<td>(14,352)</td>
<td>--</td>
</tr>
<tr>
<td>Green Spring Minority Stockholder Conversion</td>
<td>--</td>
<td>52,774</td>
<td>--</td>
</tr>
<tr>
<td>Balance, end of period</td>
<td>(82,731)</td>
<td>(44,309)</td>
<td>(44,309)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cumulative foreign currency adjustments included in other comprehensive income:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance, beginning of period</td>
<td>(1,189)</td>
<td>(1,872)</td>
<td>(1,197)</td>
</tr>
<tr>
<td>Components of other comprehensive income (loss):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrealized foreign currency translation gain (loss) (net of reclassification adjustment related to sale of European Hospitals of $1,678 in 1999)</td>
<td>(1,138)</td>
<td>1,125</td>
<td>(230)</td>
</tr>
<tr>
<td>Sale of European Hospitals</td>
<td>--</td>
<td>--</td>
<td>2,074</td>
</tr>
<tr>
<td>Provision for (benefit from) income taxes</td>
<td>(1,138)</td>
<td>1,125</td>
<td>1,844</td>
</tr>
<tr>
<td>Other comprehensive income (loss)</td>
<td>(683)</td>
<td>675</td>
<td>1,106</td>
</tr>
<tr>
<td>Balance, end of period</td>
<td>(1,872)</td>
<td>(1,197)</td>
<td>(91)</td>
</tr>
<tr>
<td>Total Stockholders' Equity</td>
<td>$159,498</td>
<td>$188,433</td>
<td>$196,696</td>
</tr>
</tbody>
</table>

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.
# MAGELLA HEALTH SERVICES, INC. SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

**(IN THOUSANDS)**

<table>
<thead>
<tr>
<th>FISCAL YEAR ENDED SEPTEMBER 30,</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1997</td>
<td>1998</td>
<td>1999</td>
</tr>
<tr>
<td>Cash Flows From Operating Activities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>$(498)</td>
<td>$(19,283)</td>
<td>$4,688</td>
</tr>
<tr>
<td>Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loss (gain) on sale of assets</td>
<td>54,121</td>
<td>(3,001)</td>
<td>23,623</td>
</tr>
<tr>
<td>Loss on CBHS Transactions</td>
<td>--</td>
<td>--</td>
<td>79,039</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>19,683</td>
<td>49,264</td>
<td>73,531</td>
</tr>
<tr>
<td>Impairment of long-lived assets</td>
<td>--</td>
<td>2,507</td>
<td>--</td>
</tr>
<tr>
<td>Other non-cash portion of special charges and discontinued operations</td>
<td>33,300</td>
<td>37,499</td>
<td>(422)</td>
</tr>
<tr>
<td>Equity in (earnings) losses of unconsolidated subsidiaries</td>
<td>5,567</td>
<td>(12,795)</td>
<td>20,442</td>
</tr>
<tr>
<td>Stock option expense (credit)</td>
<td>4,292</td>
<td>(5,623)</td>
<td>3,843</td>
</tr>
<tr>
<td>Non-cash interest expense</td>
<td>33,300</td>
<td>(3,001)</td>
<td>23,623</td>
</tr>
<tr>
<td>Extraordinary losses on early extinguishments of debt</td>
<td>5,567</td>
<td>(12,795)</td>
<td>20,442</td>
</tr>
<tr>
<td>Cash flows from changes in assets and liabilities, net of effects from sales and acquisitions of businesses:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts receivable, net</td>
<td>60,675</td>
<td>(1,585)</td>
<td>(21,321)</td>
</tr>
<tr>
<td>Restricted cash and investments</td>
<td>--</td>
<td>(21,782)</td>
<td>(22,130)</td>
</tr>
<tr>
<td>Other current assets</td>
<td>4,708</td>
<td>(3,010)</td>
<td>6,182</td>
</tr>
<tr>
<td>Other long-term assets</td>
<td>2,411</td>
<td>4,955</td>
<td>2,577</td>
</tr>
<tr>
<td>Medical claims payable</td>
<td>(68,715)</td>
<td>(50,082)</td>
<td>(20,842)</td>
</tr>
<tr>
<td>Medical claims payable</td>
<td>8,056</td>
<td>6,358</td>
<td>(22,202)</td>
</tr>
<tr>
<td>Income taxes payable and deferred income taxes</td>
<td>(14,669)</td>
<td>(14,489)</td>
<td>14,143</td>
</tr>
<tr>
<td>Reserve for unpaid claims</td>
<td>(26,553)</td>
<td>(19,177)</td>
<td>30,196</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>(23,038)</td>
<td>(9,290)</td>
<td>17,224</td>
</tr>
<tr>
<td>Minority interest, net of dividends paid</td>
<td>9,633</td>
<td>(929)</td>
<td>3,142</td>
</tr>
<tr>
<td>Other</td>
<td>(1,018)</td>
<td>(1,701)</td>
<td>(1,333)</td>
</tr>
<tr>
<td>Total adjustments</td>
<td>74,097</td>
<td>15,079</td>
<td>37,188</td>
</tr>
<tr>
<td>Net cash provided by (used in) operating activities</td>
<td>73,599</td>
<td>(4,204)</td>
<td>41,876</td>
</tr>
<tr>
<td>Cash Flows From Investing Activities:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>(33,348)</td>
<td>(44,213)</td>
<td>(48,119)</td>
</tr>
<tr>
<td>Acquisitions and investments in businesses, net of cash acquired</td>
<td>(50,876)</td>
<td>(1,046,436)</td>
<td>(69,457)</td>
</tr>
<tr>
<td>Conversion of joint ventures from consolidation to equity method</td>
<td>--</td>
<td>--</td>
<td>(21,092)</td>
</tr>
<tr>
<td>Distributions received from unconsolidated subsidiaries</td>
<td>--</td>
<td>11,441</td>
<td>21,970</td>
</tr>
<tr>
<td>Decrease in assets restricted for settlement of unpaid claims and other long-term liabilities</td>
<td>17,209</td>
<td>51,006</td>
<td>42,570</td>
</tr>
<tr>
<td>Proceeds from sale of assets</td>
<td>398,695</td>
<td>11,875</td>
<td>54,196</td>
</tr>
<tr>
<td>Net cash provided by (used in) investing activities</td>
<td>331,680</td>
<td>(1,016,327)</td>
<td>(19,932)</td>
</tr>
<tr>
<td>Cash Flows From Financing Activities:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payments on debt and capital lease obligations</td>
<td>(390,254)</td>
<td>(438,633)</td>
<td>(156,004)</td>
</tr>
<tr>
<td>Proceeds from issuance of debt, net of issuance costs</td>
<td>203,643</td>
<td>1,188,706</td>
<td>76,818</td>
</tr>
<tr>
<td>Proceeds from exercise of stock options and warrants</td>
<td>8,265</td>
<td>3,982</td>
<td>2,632</td>
</tr>
<tr>
<td>Proceeds from issuance of warrants</td>
<td>25,000</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Purchases of treasury stock</td>
<td>--</td>
<td>(14,352)</td>
<td>--</td>
</tr>
<tr>
<td>Net cash provided by (used in) financing activities</td>
<td>(153,346)</td>
<td>739,703</td>
<td>(76,554)</td>
</tr>
</tbody>
</table>
Net increase (decrease) in cash and cash equivalents........    251,933          (280,828)         (54,610)
Cash and cash equivalents at beginning of period............    120,945           372,878           92,050
---------       -----------       ----------
Cash and cash equivalents at end of period..................  $ 372,878       $    92,050       $   37,440
=========       ===========       ===========

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 1999

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The consolidated financial statements of Magellan Health Services, Inc., a Delaware corporation, ("Magellan" or the "Company") include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company's primary business segment, as of September 30, 1999, was its behavioral managed healthcare business. The Company operates in two other business segments, which are described in further detail in Note 13, "Business Segment Information."

On September 2, 1999, the Company's Board of Directors approved a formal plan to dispose of the businesses and interests that comprise the Company's healthcare provider and healthcare franchising business segments (the "Disposal Plan"). The results of operations of the healthcare provider and healthcare franchising business segments have been reported in the accompanying financial statements as discontinued operations for all periods presented.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

MANAGED CARE REVENUE

Managed care revenue is recognized over the applicable coverage period on a per member basis for covered members and as earned and estimable for performance-based revenues. Deferred revenue is recorded when premium payments are received in advance of the applicable coverage period.

ADVERTISING COSTS

The production costs of advertising are expensed as incurred. The Company does not consider any of its advertising costs to be direct-response and, accordingly, does not capitalize such costs. Advertising costs consist primarily of radio and television air time, which is amortized as utilized, and printed media services. Advertising expense for continuing operations was approximately $0.7 million, $2.4 million and $2.4 million for the fiscal years ended September 30, 1997, 1998 and 1999, respectively. Advertising expense for discontinued operations was approximately $18.5 million, $2.3 million and $0.2 million for the years ended September 30, 1997, 1998, and 1999, respectively.
The Company records interest expense net of interest income. Interest income for the fiscal years ended September 30, 1997, 1998, and 1999 was approximately $9.0 million, $10.8 million and $10.4 million, respectively.

Cash equivalents are short-term, highly liquid interest-bearing investments with a maturity of three months or less when purchased, consisting primarily of money market instruments.

 Restricted cash and investments at September 30, 1998 and 1999 include approximately $89.2 million and $116.8 million, respectively that is held for the payment of claims under the terms of certain behavioral managed care contracts and for regulatory purposes related to the payment of claims in certain jurisdictions.

Accounts receivable subject the Company to a concentration of credit risk with third party payors that include health insurance companies, managed healthcare organizations, healthcare providers and governmental entities. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific payors, historical trends and other information. Management believes the allowance for doubtful accounts is adequate to provide for normal credit losses.

Assets restricted for the settlement of unpaid claims and other long-term liabilities include investments which are carried at fair market value. Transfer of such investments from the Company's insurance subsidiaries to Magellan or any of its other subsidiaries is subject to approval by certain regulatory authorities. As of September 30, 1998 and 1999, assets restricted for settlement of unpaid claims and other long-term liabilities were approximately $37.9 million and $0, respectively. On July 2, 1999, the Company transferred its remaining unpaid claims portfolio to a third party insurer for approximately $22.3 million. This transfer was funded from assets restricted for the settlement of unpaid claims.

The investments can be classified into three categories: (i) held to maturity; (ii) available for sale; and (iii) trading. Unrealized holding gains or losses are recorded for trading and available for sale securities. The Company's investments are classified as available for sale. The unrealized gain or loss on investments available for sale was not material at September 30, 1997, 1998 and 1999.
Property and equipment are stated at cost, except for assets that have been impaired, for which the carrying amount is reduced to estimated fair value. Expenditures for renewals and improvements are charged to the property accounts. Replacements and maintenance and repairs that do not improve or extend the life of the respective assets are expensed as incurred. Internal-use software is capitalized in accordance with AICPA Statement of Position 98-1. Amortization of capital lease assets is included in depreciation expense. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets, which is generally ten to forty years for buildings and improvements, three to ten years for equipment and three to five years for capitalized internal-use software. Depreciation expense for continuing operations was $9.6 million, $18.6 million and $30.0 million for the fiscal years ended September 30, 1997, 1998 and 1999, respectively. Depreciation expense for discontinued operations was $24.5 million, $5.4 million and $2.3 million for the fiscal years ended September 30, 1997, 1998 and 1999, respectively.

Property and equipment, net, consisted of the following at September 30, 1998 and 1999 (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>September 30, 1998</th>
<th>September 30, 1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>$11,607</td>
<td>$114</td>
</tr>
<tr>
<td>Buildings and improvements</td>
<td>78,886</td>
<td>12,079</td>
</tr>
<tr>
<td>Equipment</td>
<td>112,422</td>
<td>119,518</td>
</tr>
<tr>
<td>Capitalized internal-use software</td>
<td>33,923</td>
<td>55,648</td>
</tr>
<tr>
<td></td>
<td>236,838</td>
<td>187,359</td>
</tr>
<tr>
<td>Accumulated depreciation</td>
<td>(60,100)</td>
<td>(66,692)</td>
</tr>
<tr>
<td></td>
<td>176,738</td>
<td>120,667</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>431</td>
<td>--</td>
</tr>
<tr>
<td>Property and equipment, net</td>
<td>$177,169</td>
<td>$120,667</td>
</tr>
</tbody>
</table>

INTANGIBLE ASSETS

Intangible assets are composed principally of (i) goodwill, (ii) customer lists and relationships and (iii) deferred financing costs. Goodwill represents the excess of the cost of businesses acquired over the fair value of the net identifiable assets at the date of acquisition and is amortized using the straight-line method over 25 to 40 years. Customer lists and relationships and other intangible assets are amortized using the straight-line method over their estimated useful lives of 4 to 30 years. Deferred financing costs are amortized over the terms of the underlying agreements.
The Company continually monitors events and changes in circumstances which could indicate that carrying amounts of intangible assets may not be recoverable. When events or changes in circumstances are present that indicate the carrying amount of intangible assets may not be recoverable, the Company assesses the recoverability of intangible assets by determining whether the carrying value of such intangible assets will be recovered through the future cash flows expected from the use of the asset and its eventual disposition. Impairment losses from continuing operations of approximately $2.4 million were recorded in fiscal 1998 as a result of the Integration Plan (see Note 9), including property and equipment.

MEDICAL CLAIMS PAYABLE

Medical claims payable represent the liability for healthcare claims reported but not yet paid and claims incurred but not yet reported ("IBNR") related to the Company's managed healthcare businesses. The IBNR portion of medical claims payable is estimated based upon authorized healthcare services, past claim payment experience for member groups, adjudication decisions, enrollment data, utilization statistics and other factors. Although considerable variability is inherent in such estimates, management believes the liability for medical claims payable is adequate. Medical claims payable balances are continually monitored and reviewed. Changes in assumptions for care costs caused by changes in actual experience could cause these estimates to change in the near term.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 1999

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FOREIGN CURRENCY

Changes in the cumulative translation of foreign currency assets and liabilities are presented as a separate component of stockholders' equity. Gains and losses resulting from foreign currency transactions, which were not material, are included in operations as incurred.

NET INCOME (LOSS) PER COMMON SHARE

Net income (loss) per common share is computed based on the weighted average number of shares of common stock and common stock equivalents outstanding during the period.

The Exchange Option (as defined), was classified as a potentially dilutive security for fiscal 1997 and 1998 for the purpose of computing diluted income per common share. The Exchange Option (as defined) was anti-dilutive for fiscal 1997 and 1998 and, therefore, was excluded from the diluted income per common share calculations. The Exchange Option (as defined) was exercised in January 1998.

STOCK-BASED COMPENSATION

In October 1995, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," ("FAS 123") which became effective for fiscal years beginning after December 15, 1995 (fiscal 1997 for the Company). FAS 123 established new financial accounting and reporting standards for stock-based compensation plans. Entities are allowed to measure compensation cost for stock-based compensation under FAS 123 or APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Entities electing to remain with the accounting in APB 25 are required to make pro forma disclosures of net income and income per common share as if the provisions of FAS 123 had been applied. The Company has adopted
FAS 123 on a pro forma disclosure basis. The Company continues to account for stock-based compensation under APB 25. See Note 6, "Stockholders' Equity".

RECENT ACCOUNTING PRONOUNCEMENTS

In April 1998, the AICPA issued Statement of Position 98-5, "Reporting on the Costs of Start-up Activities" ("SOP 98-5"). SOP 98-5 requires all nongovernmental entities to expense costs of start-up activities as those costs are incurred. Start-up costs, as defined by SOP 98-5, include pre-operating costs, pre-opening costs and organizational costs. SOP 98-5 became effective for financial statements for fiscal years beginning after December 15, 1998. At adoption, a company must record a cumulative effect of a change in accounting principle to write off any unamortized start-up costs remaining on the balance sheet when SOP 98-5 is adopted. Prior year financial statements cannot be restated. The Company adopted SOP 98-5 on October 1, 1998. The adoption of SOP 98-5 did not have any impact on the Company's financial position or results of operations.

Emerging Issues Task Force Issue 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights" ("EITF 96-16") supplements the guidance contained in AICPA Accounting Research Bulletin 51, "Consolidated Financial Statements", and in Statement of Financial Accounting Standards No. 94, "Consolidation of All Majority-Owned Subsidiaries" ("ARB 51/FAS 94"), about the conditions under which the Company's consolidated financial statements should include the financial position, results of operations and cash flows of subsidiaries which are less than wholly-owned along with those of the Company's wholly-owned subsidiaries.

In general, ARB 51/FAS 94 requires consolidation of all majority-owned subsidiaries except those for which control is temporary or does not rest with the majority owner. Under the ARB 51/FAS 94 approach, instances of control not resting with the majority owner were generally regarded to arise from such events as the legal reorganization or bankruptcy of the majority-owned subsidiary. EITF 96-16 expands the definition of instances in which control does not rest with the majority owner to include those where significant approval or veto rights, other than those which are merely protective of the minority shareholder's interest, are held by the minority shareholder or shareholders ("Substantive Participating Rights"). Substantive Participating Rights include, but are not limited to: i) selecting, terminating and setting the compensation of management responsible for implementing the majority-owned subsidiary's policies and procedures, and ii) establishing operating and capital decisions of the majority-owned subsidiary, including budgets, in the ordinary course of business.

The provisions of EITF 96-16 apply to new investment agreements made after July 24, 1997, and to existing investment agreements which are modified after this date. The Company has made no new investments, and has modified no existing investments, to which the provisions of EITF 96-16 would have applied.

In addition, the provisions of EITF 96-16 must be applied to majority-owned subsidiaries previously consolidated under ARB 51/FAS 94 for which the underlying agreements have not been modified in financial statements issued for years ending after December 15, 1998 (fiscal 1999 for the Company). The adoption of the provisions of EITF 96-16 on October 1, 1998, had the following effects on the Company's consolidated financial position:
INCREASE (DECREASE) IN:

- Cash and cash equivalents: $(21,092)
- Other current assets: (9,538)
- Long-term assets: (30,049)
- Investment in unconsolidated subsidiaries: 26,498

Total Assets: $(34,181)

Current liabilities: $(10,381)
Minority interest: (23,800)

Total Liabilities: $(34,181)

RECLASSIFICATIONS

Certain reclassifications have been made to fiscal 1997 and 1998 amounts to conform to fiscal 1999 presentation.

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 1999

2. ACQUISITIONS AND JOINT VENTURES

ACQUISITIONS

MERIT ACQUISITION. On February 12, 1998, the Company consummated the acquisition of Merit Behavioral Care Corporation ("Merit") for cash consideration of approximately $448.9 million plus the repayment of Merit's debt. Merit manages behavioral healthcare programs across all segments of the healthcare industry, including HMOs, Blue Cross/Blue Shield organizations and other insurance companies, corporations and labor unions, federal, state and local governmental agencies and various state Medicaid programs. The Company accounted for the Merit acquisition using the purchase method of accounting. On September 12, 1997, Merit completed the acquisition of CMG Health, Inc. ("CMG"). CMG was also a national behavioral managed healthcare company. Merit paid approximately $48.7 million in cash and issued approximately 739,000 shares of Merit common stock as consideration for CMG. The former owners of CMG may be entitled to additional consideration, depending on the performance of three CMG customer contracts. Such contingent payments are subject to an aggregate maximum of $23.5 million. No contingent consideration will be payable to the former shareholders of CMG based on the performance of two of the three CMG customer contracts at September 30, 1999. The Company may still be required to pay contingent consideration to the former shareholders of CMG depending on the financial performance of CHOICE Behavioral Health Partnership ("Choice"). Choice is a joint venture with Value Options, Inc. that services a contract with CHAMPUS (as defined). The Company and Value Options, Inc. each own 50% of Choice. The payment of contingent consideration, if any, to the former shareholders of CMG, depends on the financial performance of Choice from October 1, 1996 to June 30, 1997, which is subject to a CHAMPUS Adjustment (as defined) the Company expects to receive in fiscal 2000. The Company has initiated legal proceedings against certain former owners of CMG with respect to representations made by such former owners in conjunction with Merit's acquisition of CMG. Whether any contingent payments will be made to the former...
shareholders of CMG and the amount and timing of contingent payments, if any, may be subject to the outcome of these proceedings.

In connection with the acquisition of Merit, the Company (i) terminated its existing credit agreement; (ii) repaid all loans outstanding pursuant to Merit's existing credit agreement; (iii) completed a tender offer for its 11.25% Series A Senior Subordinated Notes due 2004 (the "Old Notes"); (iv) completed a tender offer for Merit's 11.50% Senior Subordinated notes due 2005 (the "Merit Outstanding Notes"); (v) entered into a new senior secured bank credit agreement (the "Credit Agreement") providing for a revolving credit facility (the "Revolving Facility") and a term loan facility (the "Term Loan Facility") of up to $700 million; and (vi) issued $625 million in 9.0% Senior Subordinated Notes due 2008 (the "Notes").

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 1999

2. ACQUISITIONS AND JOINT VENTURES (CONTINUED)

The following table sets forth the sources and uses of funds for the Merit acquisition and related transactions (the "Transactions") at closing (in thousands):

<table>
<thead>
<tr>
<th>SOURCES:</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents..........</td>
<td>59,290</td>
</tr>
<tr>
<td>Credit Agreement:</td>
<td></td>
</tr>
<tr>
<td>Revolving Facility (1)</td>
<td>20,000</td>
</tr>
<tr>
<td>Term Loan Facility</td>
<td>550,000</td>
</tr>
<tr>
<td>The Notes</td>
<td>625,000</td>
</tr>
<tr>
<td>Total sources</td>
<td>1,254,290</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>USES:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash paid to Merit Shareholders</td>
<td>448,867</td>
</tr>
<tr>
<td>Repayment of Merit existing credit agreement (2)</td>
<td>196,357</td>
</tr>
<tr>
<td>Purchase of the Old Notes (3)</td>
<td>432,102</td>
</tr>
<tr>
<td>Purchase of Merit Outstanding Notes (4)</td>
<td>121,651</td>
</tr>
<tr>
<td>Transaction costs (5)</td>
<td>55,313</td>
</tr>
<tr>
<td>Total uses</td>
<td>1,254,290</td>
</tr>
</tbody>
</table>

(1) The Revolving Facility provides for borrowings of up to $150.0 million.

(2) Includes principal amount of $193.7 million and accrued interest of $2.7 million.

(3) Includes principal amount of $375.0 million, tender premium of $43.4 million and accrued interest of $13.7 million.

(4) Includes principal amount of $100.0 million, tender premium of $18.8 million and accrued interest of $2.8 million.
Transaction costs include, among other things, expenses associated with the debt tender offers, the Notes offering, the Merit acquisition and the Credit Agreement.

HAI ACQUISITION. On December 4, 1997, the Company consummated the purchase of Human Affairs International, Incorporated ("HAI"), formerly a unit of Aetna, Inc. ("Aetna"), for approximately $122.1 million, which the Company funded from cash on hand. HAI manages behavioral healthcare programs, primarily through EAPs and other behavioral managed healthcare plans. The Company may be required to make additional contingent payments of up to $60.0 million annually to Aetna over the five year period subsequent to closing. The amount and timing of the payments will be contingent upon net increases in the number of HAI's covered lives in specified products. The Company accounted for the HAI acquisition using the purchase method of accounting.

The Company may be required to make additional contingent payments of up to $300 million to Aetna (the "Contingent Payments") over the five-year period (each year a "Contract Year") subsequent to closing. The amount and timing of the Contingent Payments will depend upon HAI's receipt of additional covered lives as computed, under two separate calculations. Under the first calculation, the Company may be required to pay up to $25.0 million per year for each of five years following the acquisition based on the net annual growth in the number of lives covered in specified HAI products. Under the second calculation,

The Company may be required to pay up to $35.0 million per Contract Year, based on the net cumulative increase in lives covered by certain other HAI products.

The Company is obligated to make contingent payments under two separate calculations (as previously described) as follows: In respect of each Contract Year, the Company may be required to pay to Aetna the "Tranche 1 Payments" (as defined) and the "Tranche 2 Payments" (as defined).

Upon the expiration of each Contract Year, the Tranche 1 Payment shall vest with respect to such Contract Year in an amount equal to the product of (i) the Tranche 1 Cumulative Incremental Members (as defined) for such Contract Year and (ii) the Tranche 1 Multiplier (as defined) for such Contract Year. The vested amount of Tranche 1 Payment shall be zero with respect to any Contract Year in which the Tranche 1 Cumulative Incremental Members is a negative number. Furthermore, in the event that the number of Tranche 1 Cumulative Incremental Members with respect to any Contract Year is a negative number due to a decrease in the number of Tranche 1 Cumulative Incremental Members for such Contract Year (as compared to the immediately preceding Contract Year), Aetna will forfeit the right to receive a certain portion (which may be none or all) of the vested and unpaid amounts of the Tranche 1 Payment relating to preceding Contract Years.

"Tranche 1 Cumulative Incremental Members" means, with respect to any Contract Year, (i) the number of Equivalent Members (as defined) serviced by the Company during such Contract Year for Tranche 1 Members, minus (ii) (A) for each Contract Year other than the Initial Contract Year, the number of Equivalent Members serviced by the Company for Tranche 1 Members during the immediately preceding Contract Year or (B) for the Initial Contract Year, the number of Tranche 1 Members as of September 30, 1997, subject to certain upward adjustments. There were 3,761,253 Tranche 1 Members for the initial Contract
Year, prior to such upward adjustments. "Tranche 1 Members" are members of managed behavioral healthcare plans for whom the Company provides services in any of specified categories of products or services. "Equivalent Members" for any Contract Year equals the aggregate Member Months for which the Company provides services to a designated category or categories of members during the applicable Contract Year divided by 12. "Member Months" means, for each member, the number of months for which the Company provides services and is compensated. The "Tranche 1 Multiplier" is $80, $50, $40, $25, and $20 for the Contract Years 1998, 1999, 2000, 2001, and 2002, respectively.

For each Contract Year, the Company is obligated to pay to Aetna the lesser of (i) the vested portion of the Tranche 1 Payment for such Contract Year and the vested and unpaid amount relating to prior Contract Years as of the end of the immediately preceding Contract Year and (ii) $25.0 million. To the extent that the vested and unpaid portion of the Tranche 1 Payment exceeds $25.0 million, the Tranche 1 Payment remitted to Aetna shall be deemed to have been paid first from any vested but unpaid amounts from previous Contract Years in order from the earliest Contract Year for which vested amounts remain unpaid to the most recent Contract Year at the time of such calculation. Except with respect to the Contract Year ending in 2002, any vested but unpaid portion of the Tranche 1 Payment shall be available for payment to Aetna in future Contract Years, subject to certain exceptions. All vested but unpaid amounts of Tranche 1 Payments shall expire following the payment of the Tranche 1 Payment in respect to the Contract Year ending in 2002, subject to certain exceptions. In no event shall the aggregate Tranche 1 Payments to Aetna exceed $125.0 million.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 1999

2. ACQUISITIONS AND JOINT VENTURES (CONTINUED)

Upon the expiration of each Contract Year, the Tranche 2 Payment shall be an amount equal to the lesser of: (a)(i) the product of (A) the Tranche 2 Cumulative Members (as defined) for such Contract Year and (B) the Tranche 2 Multiplier (as defined) applicable to such number of Tranche 2 Cumulative Members, minus (ii) the aggregate of the Tranche 2 Payments paid to Aetna for all previous Contract Years and (b) $35.0 million. The amount shall be zero with respect to any Contract Year in which the Tranche 2 Cumulative Members is a negative number.

"Tranche 2 Cumulative Members" means, with respect to any Contract Year; (i) the Equivalent Members serviced by the Company during such Contract Year for Tranche 2 Members, minus (ii) the Tranche 2 Members as of September 30, 1997, subject to certain upward adjustments. There were 936,391 Tranche 2 Members prior to such upward adjustments. "Tranche 2 Members" means Members for whom the Company provides products or services in the HMO category. The "Tranche 2 Multiplier" with respect to each Contract Year is $85 in the event that the Tranche 2 Cumulative Members are less than 2,100,000, and $70 if more than or equal to 2,100,000.

For each Contract Year, the Company shall pay to Aetna the amount of Tranche 2 Payment payable for such Contract Year. All rights to receive Tranche 2 Payment shall expire following the payment of the Tranche 2 Payment in respect to the Contract Year ending in 2002, subject to certain exceptions. Notwithstanding anything herein to the contrary, in no event shall the aggregate Tranche 2 payment to Aetna exceed $175.0 million, subject to certain exceptions.

The Company paid $60.0 million to Aetna on March 26, 1999 for both the full Tranche 1 Payment and the full Tranche 2 Payment for the Contract Year ended December 31, 1998. Also, based upon the most recent membership enrollment data related to the Contract Year to end December 31, 1999 ("Contract Year 2"), the Company believes beyond a reasonable doubt that it will be required to make both the full Tranche 1 Payment and the full Tranche 2 Payment ($60.0 million in aggregate) related to Contract Year 2. Accordingly, the Company recorded $120.0 million of goodwill and other intangible assets related to the purchase of HAI during fiscal 1999. The Contract Year 2 liability of $60.0 million is included in "Deferred credits and other long-term liabilities" in the Company's
consolidated balance sheet as of September 30, 1999. The Company intends to borrow under the Revolving Facility to meet this obligation, which is expected to be paid during the second quarter of fiscal 2000.

The Company would record additional contingent consideration payable, if any, as goodwill and identifiable intangible assets.

ALLIED ACQUISITION. On December 5, 1997, the Company purchased the assets of Allied Health Group, Inc. and certain affiliates ("Allied"). Allied provides specialty managed care services, including risk-based products and administrative services to a variety of insurance companies and other customers. Allied has over 80 physician networks across the eastern United States. Allied's networks include physicians specializing in cardiology, oncology and diabetes. The Company paid approximately $70.0 million for Allied, with cash on hand, of which $50.0 million was paid to the seller at closing with the remaining $20.0 million placed in escrow. The Company accounted for the Allied acquisition using the purchase method of accounting. The escrowed amount was payable in one-third increments if Allied achieved specified earnings targets during each of the three years following the closing. Additionally, the purchase price could have been increased during the three year period by up to $40.0 million if Allied's performance exceeded specified earnings targets.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 1999

2. ACQUISITIONS AND JOINT VENTURES (CONTINUED)

During the quarter ended December 31, 1998, the Company and the former owners of Allied amended the Allied purchase agreement (the "Allied Amendments"). The Allied Amendments resulted in the following changes to the original terms of the Allied purchase agreement:

- The original $20.0 million placed in escrow by the Company at the consummation of the Allied acquisition, plus accrued interest, was repaid to the Company. This $20.0 million was included in the $70.0 million originally paid for Allied.

- The Company paid the former owners of Allied $4.5 million additional consideration which was recorded as goodwill.

- The Company capped future obligations with respect to additional contingent payments for the purchase of Allied at $3.0 million. The earnings targets which must be met by Allied for this amount to be paid were increased.

The Company would record contingent consideration payable, if any, as additional goodwill.

The following unaudited pro forma information for the fiscal years ended September 30, 1998 and 1999 has been prepared assuming the Allied acquisition, HAI acquisition, Merit acquisition, the Transactions, the Green Spring Minority Stockholder Conversion (as defined), the Europe Sale (as defined) and the CBHS Transactions (as defined), were consummated on October 1, 1997. The unaudited pro forma information does not purport to be indicative of the results that would have actually been obtained had such transactions been consummated on October 1, 1997 or which may be attained in future periods (in thousands, except per share data):
<table>
<thead>
<tr>
<th></th>
<th>SEPTEMBER 30, 1998</th>
<th>SEPTEMBER 30, 1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>$1,609,770</td>
<td>$1,871,636</td>
</tr>
<tr>
<td>Income (loss) from continuing operations before extraordinary item</td>
<td>(1,152)</td>
<td>28,924</td>
</tr>
<tr>
<td>Income (loss) per common share--basic:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from continuing operations before extraordinary item</td>
<td>(0.04)</td>
<td>0.91</td>
</tr>
<tr>
<td>Income (loss) per common share--diluted:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from continuing operations before extraordinary item</td>
<td>(0.04)</td>
<td>0.91</td>
</tr>
</tbody>
</table>

(1) Excludes expected unrealized cost savings related to the Integration Plan (as defined) and managed care integration costs (See Note 9).

(2) Excludes the extraordinary losses on early extinguishment of debt for the year ended September 30, 1998, that were directly attributable to the consummation of the Transactions.

HUMAN SERVICES ACQUISITIONS During fiscal 1998 and 1999, the Company acquired eight businesses, in aggregate, in its human services segment for an initial aggregate purchase price of approximately $60 million (collectively, the "Human Services Acquisitions"). The Human Services Acquisitions were accounted for using the purchase method of accounting. The Human Services Acquisitions provide various residential and day services for individuals with acquired brain injuries and for individuals with mental retardation and developmental disabilities.

GREEN SPING ACQUISITION. On December 13, 1995, the Company acquired a 51% ownership interest in Green Spring Health Services, Inc. ("Green Spring") for approximately $68.9 million in cash, the issuance of 215,458 shares of common stock valued at approximately $4.3 million and the contribution of Group Practice Affiliates, Inc. ("GPA"), a wholly-owned subsidiary of the Company, which became a wholly-owned subsidiary of Green Spring. In addition, the minority stockholders of Green Spring were issued an option agreement whereby they could exchange their interests in Green Spring for an equivalent of the Company's common stock or subordinated notes (the "Exchange Option"). On December 20, 1995, the Company acquired an additional 10% ownership interest in Green Spring for approximately $16.7 million in cash as a result of an exercise by a minority stockholder of its Exchange Option. In January 1998, the minority stockholders of Green Spring converted their collective 39% interest in Green Spring into an aggregate of 2,831,516 shares of the Company's common stock through exercise of the Exchange Option (the "Green Spring Minority Stockholder Conversion"). As a result of the Green Spring Minority Stockholder Conversion, the Company owns 100% of Green Spring. The Company issued shares from treasury to effect the Green Spring Minority Stockholder Conversion and accounted for it as a purchase of minority interest at a fair value of consideration paid of approximately $63.5 million.
The Company recorded the investments in Green Spring using the purchase method of accounting. Green Spring's results of operations have been included in the Company's consolidated financial statements since the acquisition date, less minority interest through January, 1998, at which time the Company became the sole owner of Green Spring.

At each reporting date through January 1998, the Company assessed the fair value of the Exchange Option in relation to the redemption price available to the minority stockholders. In any period that the fair value of the Exchange Option was determined to be less than the redemption price, the difference would have been recognized as an adjustment to minority interest. No losses were recorded in fiscal 1997 and 1998 as a result of changes in the fair value of the Exchange Option.

JOINT VENTURES

Through its acquisition of Merit, the Company became a 50% partner with Value Options, Inc. in Choice, a managed behavioral healthcare company. Choice derives all of its revenues from a contract with the Civilian Health and Medical Program of the Uniformed Services ("CHAMPUS"), and with TriCare, the successor to CHAMPUS. The Company accounts for its investment in Choice using the equity method.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

SEPTEMBER 30, 1999

2. ACQUISITIONS AND JOINT VENTURES (CONTINUED)

A summary of unaudited financial information for the Company's investment in Choice is as follows (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>SEPTEMBER 30, 1998</th>
<th>SEPTEMBER 30, 1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td>$22,974</td>
<td>$19,572</td>
</tr>
<tr>
<td>Property and equipment, net</td>
<td>345</td>
<td>228</td>
</tr>
<tr>
<td>Total assets</td>
<td>$23,319</td>
<td>$19,800</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>$16,829</td>
<td>$12,673</td>
</tr>
<tr>
<td>Partners' capital</td>
<td>6,490</td>
<td>7,127</td>
</tr>
<tr>
<td>Total liabilities and partners’ capital</td>
<td>$23,319</td>
<td>$19,800</td>
</tr>
<tr>
<td>Magellan investment in Choice</td>
<td>$ 3,245</td>
<td>$ 3,563</td>
</tr>
</tbody>
</table>

FOR THE 231 DAYS ENDED SEPTEMBER 30, 1998 FISCAL YEAR ENDED SEPTEMBER 30, 1999

<table>
<thead>
<tr>
<th></th>
<th>SEPTEMBER 30, 1998</th>
<th>SEPTEMBER 30, 1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net revenue</td>
<td>$38,676</td>
<td>$54,880</td>
</tr>
</tbody>
</table>
The Company owns a 50% interest in Premier Behavioral Systems of Tennessee, LLC ("Premier"). Premier was formed to manage behavioral healthcare benefits for the State of Tennessee's TennCare program. The Company accounts for its investment in Premier using the equity method. The Company's investment in Premier at September 30, 1998 and 1999 was $5.8 million and $12.2 million, respectively. The Company's equity in income (loss) of Premier for fiscal 1997, 1998 and 1999 was $(5.6) million, $4.7 million and $6.3 million, respectively.

3. DISCONTINUED OPERATIONS

GENERAL

On September 10, 1999, the Company consummated the transfer of assets and other interests pursuant to a Letter Agreement dated August 10, 1999 with Crescent Real Estate Equities ("Crescent"), Crescent Operating, Inc. ("COI") and Charter Behavioral Health Systems, LLC ("CBHS") that effects the Company's exit from its healthcare provider and healthcare franchising businesses (the "CBHS Transactions"). The terms of the CBHS Transactions are summarized as follows:

HEALTHCARE PROVIDER INTERESTS

- The Company redeemed 80% of its CBHS common interest and all of its CBHS preferred interest, leaving it with a 10% non-voting common interest in CBHS.

- The Company agreed to transfer to CBHS its interests in five of its six hospital-based joint ventures ("Provider JVs") and related real estate as soon as practicable.

- The Company transferred to CBHS the right to receive approximately $7.1 million from Crescent for the sale of two psychiatric hospitals that were acquired by the Company (and leased to CBHS) in connection with CBHS' acquisition of certain businesses from Ramsay Healthcare, Inc. in fiscal 1998.

- The Company forgave receivables due from CBHS of approximately $3.3 million for payments received by CBHS for patient services prior to the formation of CBHS on June 17, 1997. The receivables related primarily to patient stays that "straddled" the formation date of CBHS.

- The Company will pay $2.0 million to CBHS in 12 equal monthly installments
beginning on the first anniversary of the closing date.

- CBHS will indemnify the Company for 20% of up to the first $50 million (i.e., $10 million) for expenses, liabilities and settlements related to government investigations for events that occurred prior to June 17, 1997 (the "CBHS Indemnification"). CBHS will be required to pay the Company a maximum of $500,000 per year under the CBHS Indemnification.

- Crescent, COI, CBHS and Magellan have provided each other with mutual releases of claims among all of the parties with respect to the original transactions that effected the formation of CBHS and the operation of CBHS since June 17, 1997 with certain specified exceptions.

- The Company transferred certain other real estate and interests related to the healthcare provider business to CBHS.

HEALTHCARE FRANCHISING INTERESTS

- The Company transferred its healthcare franchising interests to CBHS, which included Charter Advantage, LLC, the Charter call center operation, the Charter name and related intellectual property. The Company has been released from performing any further franchise services or incurring future franchising expenses.

- The Company forgave prepaid call center management fees of approximately $2.7 million.

- The Company forgave unpaid franchise fees of approximately $115 million.

The CBHS Transactions, together with the formal plan of disposal authorized by the Company's Board of Directors on September 2, 1999, represents the disposal of the Company's healthcare provider and healthcare franchising business segments under Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations--Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" ("APB 30"). APB 30 requires that the results of continuing operations be reported separately from those of discontinued operations for all periods presented and that any gain or loss from disposal of a segment of a business be reported in conjunction with the related results of discontinued operations. Accordingly, the Company has restated its results of operations for all prior periods. The Company recorded an after-tax loss on disposal of its healthcare provider and healthcare franchising business segments of approximately $47.4 million, (primarily non-cash) in the fourth quarter of fiscal 1999. The Company expects to transfer the Provider JVs and related real estate to CBHS and to sell its remaining joint venture interest and related real estate by no later than August 31, 2000.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

SEPTEMBER 30, 1999

3. DISCONTINUED OPERATIONS (CONTINUED)

The summarized results of the operations of the healthcare provider and healthcare franchising segments are as follows (in thousands):
<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>HEALTHCARE PROVIDER</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net revenue(1)</td>
<td>$729,652</td>
<td>$133,256</td>
<td>$74,860</td>
</tr>
<tr>
<td>Salaries, cost of care and other operating expenses</td>
<td>582,609</td>
<td>106,760</td>
<td>53,952</td>
</tr>
<tr>
<td>Equity in earnings of unconsolidated subsidiaries</td>
<td>--</td>
<td>--</td>
<td>(2,901)</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>25,018</td>
<td>5,266</td>
<td>2,141</td>
</tr>
<tr>
<td>Interest income(2)</td>
<td>(1,060)</td>
<td>(1,130)</td>
<td>(76)</td>
</tr>
<tr>
<td>Special charges(income), net</td>
<td>60,225</td>
<td>135</td>
<td>(33,046)</td>
</tr>
<tr>
<td>Other expenses(3)</td>
<td>27,390</td>
<td>10,093</td>
<td>21,907</td>
</tr>
<tr>
<td>Net income</td>
<td>$35,470</td>
<td>$12,132</td>
<td>$32,883</td>
</tr>
</tbody>
</table>

| **HEALTHCARE FRANCHISING** |           |           |           |
| Net revenue               | $22,739   | $55,625   | $563      |
| Salaries, cost of care and other operating expenses | 3,643 | 9,072 | 5,623 |
| Equity in loss of CBHS     | 8,122     | 31,878    | --        |
| Depreciation and amortization | 160 | 355 | 337 |
| Special charges            | --        | 323       | --        |
| Other expenses(3)          | 4,325     | 5,598     | (2,159)   |
| Net income (loss)          | $6,489    | $8,399    | $(3,238)  |

| **DISCONTINUED OPERATIONS--COMBINED** |           |           |           |
| Net revenue(1)               | $752,391  | $188,881  | $75,423   |
| Salaries, cost of care and other operating expenses | 586,252 | 115,832 | 59,575 |
| Equity in (earnings) losses of unconsolidated subsidiaries | 8,122 | 31,878 | (2,901) |
| Depreciation and amortization | 25,178 | 5,621 | 2,478 |
| Interest income(2)          | (1,060)   | (1,130)   | (76)      |
| Special charges(income), net | 60,225 | 458 | (33,046) |
| Other expenses(3)           | 31,715    | 15,691    | 19,748    |
| Net income                  | $41,959   | $20,531   | $29,645   |

---

(1) Includes $27.4 million, $7.0 million and $21.6 million in fiscal 1997, 1998 and 1999, respectively, related to the settlement and adjustment of reimbursement issues related to prior periods ("Cost Report Settlements").

(2) Interest expense has not been allocated to discontinued operations.

(3) Includes income taxes and minority interest.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 1999

3. DISCONTINUED OPERATIONS (CONTINUED)
The summary of the loss on disposal of discontinued operations is as follows (in thousands):

Basis in Provider JV's......................... $ 44,598
Basis in Real Estate transferred to CBHS........ 13,969
Basis in Franchise and other operations........ 7,285
Working capital forgiveness.................... 5,565
Transaction costs and legal fees............. 7,622
---
Loss before income taxes.................... 79,039
Income tax benefit.......................... 31,616
---
$ 47,423
---

Remaining assets and liabilities of the provider business at September 30, 1999 include, among other things, (i) net amounts receivable for Cost Report Settlements of $16.2 million, (ii) hospital-based real estate of $7.0 million, (iii) long-term debt of $6.4 million related to the hospital-based real estate and (iv) reserve for discontinued operations of $11.4 million. The Company is also subject to inquiries and investigations from governmental agencies related to its operating and business practices prior to consummation of the Crescent Transactions (as defined) on June 17, 1997. See Note 11.

The following table provides a rollforward of liabilities resulting from the CBHS Transactions (in thousands):

<table>
<thead>
<tr>
<th>TYPE OF COST</th>
<th>1998</th>
<th>ADDITIONS</th>
<th>PAYMENTS</th>
<th>OTHER</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction costs and legal fees.........</td>
<td>$ --</td>
<td>$ 7,622</td>
<td>$(69)</td>
<td>$ --</td>
<td>$ 7,553</td>
</tr>
<tr>
<td>Provider JV working capital...............</td>
<td>--</td>
<td>2,931</td>
<td>--</td>
<td>185</td>
<td>3,116</td>
</tr>
<tr>
<td>Other.....................................</td>
<td>--</td>
<td>755</td>
<td>--</td>
<td>--</td>
<td>755</td>
</tr>
<tr>
<td>---</td>
<td>$ --</td>
<td>$11,308</td>
<td>$(69)</td>
<td>$185</td>
<td>$11,424</td>
</tr>
<tr>
<td>---</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

CRESCENT TRANSACTIONS

On June 17, 1997, the Company consummated a series of transactions including the sale of substantially all of its domestic hospital real estate and related personal property (the "Psychiatric Hospital Facilities") to Crescent and the sale of certain related assets to CBHS. In addition, CBHS was formed as a joint venture to operate the domestic portion of the Company's provider business segment. CBHS was initially owned equally by Magellan and COI. The Company accounted for its 50% investment in CBHS under the equity method of accounting. The Company received approximately $417.2 million in cash (before costs estimated to be $16.0 million) and warrants in COI for the purchase of 2.5% of COI's common stock at $18.32, which are exercisable over 12 years. The Company also issued 1,283,311 warrants each to Crescent and COI (the "Crescent Warrants") for the purchase of Magellan common stock at an exercise price of $30 per share.
3. DISCONTINUED OPERATIONS (CONTINUED)

In related agreements, (i) Crescent leased the hospital real estate and related assets to CBHS for initial annual rent beginning at approximately $41.7 million with a 5% annual escalation clause compounded annually (the "Facilities Lease") and (ii) CBHS was to pay Magellan approximately $78.3 million in annual franchise fees, subject to increase, for the use of assets retained by Magellan and for support in certain areas. The franchise fees to be paid by CBHS to the Company were subordinated to the lease obligations in favor of Crescent. The assets retained by Magellan included, but were not limited to, the "CHARTER" name, intellectual property, protocols and procedures, clinical quality management, operating processes and the "1-800-CHARTER" telephone call center. Magellan provided CBHS ongoing support in areas including advertising and marketing assistance, risk management services, outcomes monitoring, and consultation on matters relating to reimbursement, government relations, clinical strategies, regulatory matters, strategic planning and business development.

The Company initially used approximately $200 million of the proceeds from the Crescent Transactions to reduce its long-term debt, including borrowings under its then existing credit agreement. In December 1997, the Company used the remaining proceeds from the Crescent Transactions to acquire additional managed healthcare businesses. See Note 2, "Acquisitions and Joint Ventures."

The Company recorded a loss before income taxes of approximately $59.9 million in fiscal 1997 as a result of the Crescent Transactions, which consisted of the following (in thousands):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable collection fees</td>
<td>$21,400</td>
</tr>
<tr>
<td>Impairment losses on intangible assets</td>
<td>14,408</td>
</tr>
<tr>
<td>Exit costs and construction obligation</td>
<td>12,549</td>
</tr>
<tr>
<td>Loss on the sale of property and equipment</td>
<td>11,511</td>
</tr>
<tr>
<td></td>
<td>-------</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$59,868</strong></td>
</tr>
</tbody>
</table>

Accounts receivable collection fees represent the reduction in the net realizable value of accounts receivable for estimated collection fees on retained hospital-based receivables for CBHS pursuant to a contractual obligation with CBHS, whereby CBHS received a fee equal to 5% of collections for the first 120 days after consummation of the Crescent Transactions and estimated bad debt agency fees of 40% for receivables collected subsequent to 120 days after the consummation of the Crescent Transactions. The Company reduced the accounts receivable collection fees reserve by $8.1 million during the fourth quarter of fiscal 1999 as substantially all hospital-based receivables subject to the collection fees had been collected at September 30, 1999.

INVESTMENT IN CBHS

The Company owned a 50% voting interest and 10% non-voting interest in CBHS as of September 30, 1998 and 1999 respectively. The Company became a 50% owner of CBHS upon consummation of the Crescent Transactions and reduced its ownership interest to 10% as a result of the CBHS Transactions. The Company accounted for
its investment in CBHS using the equity method through September 10, 1999. The Company's 10% investment in CBHS is valued at $0 at September 30, 1999.

HOSPITAL-BASED JOINT VENTURES. The Company was an owner in six and five hospital-based joint ventures at September 30, 1998 and 1999, respectively. The Company sold its interest in the Chicago, IL joint venture to the minority owner in September 1999. Generally, each member of the joint venture leased and/or contributed certain assets in each respective market to the joint venture with the Company becoming the managing member.

On October 1, 1998, the Provider JVs, excluding Westwood/Pembroke, were converted from consolidation to the equity method of accounting due to the Company's implementation of the transition guidance set forth in EITF 96-16. See Note 1, "Recent Accounting Pronouncements". A summary of the Provider JVs is as follows:

<table>
<thead>
<tr>
<th>MARKET</th>
<th>DATE</th>
<th>PERCENTAGE</th>
<th>MINORITY OWNER/S</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chicago, IL (sold September 1999)</td>
<td>June 1994</td>
<td>75%</td>
<td>Naperville Health Ventures</td>
</tr>
<tr>
<td>Boston, MA</td>
<td>February 1995</td>
<td>97.5%</td>
<td>Westwood/Pembroke Corp., Psychiatric Associates of Norfolk County, Inc.</td>
</tr>
<tr>
<td>Albuquerque, NM</td>
<td>May 1995</td>
<td>67%</td>
<td>Columbia/HCA Healthcare Corporation</td>
</tr>
<tr>
<td>Raleigh, NC</td>
<td>June 1995</td>
<td>50%</td>
<td>Columbia/HCA Healthcare Corporation</td>
</tr>
<tr>
<td>Lafayette, LA</td>
<td>October 1995</td>
<td>50%</td>
<td>Columbia/HCA Healthcare Corporation</td>
</tr>
<tr>
<td>Anchorage, AK</td>
<td>August 1996</td>
<td>57%</td>
<td>Columbia/HCA Healthcare Corporation</td>
</tr>
</tbody>
</table>

The Provider JVs have been managed by CBHS for a fee equivalent to the Company's portion of their earnings since June 17, 1997. The net proceeds from the sale of the Chicago, IL joint venture were transferred to CBHS in September 1999.

SPECIAL CHARGES (INCOME)

GENERAL

The following table summarizes special charges (income) recorded during the three years in the period ended September 30, 1999 in the Company's healthcare provider and healthcare franchising businesses (in thousands):

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

SEPTEMBER 30, 1999

3. DISCONTINUED OPERATIONS (CONTINUED)
FISCAL YEAR ENDED
SEPTEMBER 30,
-------------------------------

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Facility closures</td>
<td>$4,201</td>
<td>$ --</td>
<td>$ --</td>
</tr>
<tr>
<td>Gains on the sale of psychiatric hospitals, net.</td>
<td>$(5,388)</td>
<td>$(3,000)</td>
<td>$(24,974)</td>
</tr>
<tr>
<td>Loss on Crescent Transactions</td>
<td>59,868</td>
<td>--</td>
<td>(8,072)</td>
</tr>
<tr>
<td>Termination of CBHS sale transaction</td>
<td>--</td>
<td>3,458</td>
<td>--</td>
</tr>
<tr>
<td>Other</td>
<td>1,544</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>---------------------------------------------</td>
<td>-----------</td>
<td>-----------</td>
<td>-----------</td>
</tr>
<tr>
<td></td>
<td>$60,225</td>
<td>$ 458</td>
<td>$(33,046)</td>
</tr>
</tbody>
</table>

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

SEPTEMBER 30, 1999

3. DISCONTINUED OPERATIONS (CONTINUED)

FACILITY CLOSURES

During fiscal 1997, the Company consolidated, closed or sold three psychiatric facilities and its one general hospital (the "Closed Facilities"), respectively, exclusive of the Crescent Transactions. The three psychiatric facilities closed in fiscal 1997 were sold as part of the Crescent Transactions.

The Company recorded charges of approximately $4.2 million related to facility closures in fiscal 1997:

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>Severance and related benefits</td>
<td>$2,976</td>
</tr>
<tr>
<td>Contract terminations and other</td>
<td>1,225</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>-----------</td>
</tr>
<tr>
<td></td>
<td>$4,201</td>
</tr>
</tbody>
</table>

Approximately 700 employees were terminated at the facilities closed in 1997. The recorded amounts have been paid as of September 30, 1998.

GAINS ON SALE OF PSYCHIATRIC FACILITIES, NET AND OTHER

During fiscal 1997, 1998 and 1999, the Company recorded gains of approximately $5.4 million, $3.0 million and $1.1 million, respectively, related to the sales of psychiatric hospitals and other real estate. The Company also recorded a charge of approximately $1.5 million during fiscal 1997 for costs incurred related primarily to the expiration of its agreement to sell its three
European Hospitals.

EUROPEAN PSYCHIATRIC HOSPITALS. On April 9, 1999, the Company sold its European psychiatric provider operations to Investment AB Bure of Sweden for approximately $57.0 million (before transaction costs of approximately $2.5 million) (the "Europe Sale"). The Europe Sale resulted in a non-recurring gain of approximately $23.9 million before provision for income taxes which is included in gain of sale of psychiatric hospitals.

The Company used approximately $38.2 million of the net proceeds from the Europe Sale to make mandatory unscheduled principal payments on indebtedness outstanding under the Term Loan Facility (as defined). The remaining proceeds were used to reduce borrowings outstanding under the Revolving Facility (as defined).

TERMINATION OF CBHS SALE TRANSACTION

On March 3, 1998, the Company and certain of its wholly owned subsidiaries entered into definitive agreements with COI and CBHS pursuant to which the Company would have, among other things, sold the Company's franchise operations, certain domestic provider operations and certain other assets and operations. On August 19, 1998, the Company announced that it had terminated discussions with COI for the sale of its interest in CBHS.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 1999

3. DISCONTINUED OPERATIONS (CONTINUED)

In connection with the termination of the CBHS sale transaction, the Company recorded a charge of approximately $3.5 million as follows (in thousands):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (in thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Severance(1)</td>
<td>$ 488</td>
</tr>
<tr>
<td>Lease termination(1)</td>
<td>1,067</td>
</tr>
<tr>
<td>Impairment of long-lived assets</td>
<td>153</td>
</tr>
<tr>
<td>Transaction costs and other</td>
<td>1,750</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$3,458</strong></td>
</tr>
</tbody>
</table>

(1) Relates to staffing reductions and lease terminations incurred in the Company's franchising and outcomes monitoring subsidiaries.

4. BENEFIT PLANS

The Company currently has a defined contribution retirement plan (the "401(k) Plan"), which is in the form of an amendment and restatement of the Green Spring 401(k) Plan. Certain other 401(k) plans and assets, including the Magellan 401(k) Plan, were merged into the Green Spring Plan effective January 1, 1999. Employee participants can elect to voluntarily contribute up to 15% of their compensation to the 401(k) Plan. The Company makes contributions to the 401(k) Plan based on employee compensation and contributions. Additionally, the Company makes a discretionary contribution of 2% of each eligible employee's compensation. The Company matches 50% of each employee's contribution up to 3% of their compensation. The Company recognized $3.0 million of expense for the
year ended September 30, 1999 for the matching contribution to the 401(k) Plan.

The Company maintained a defined contribution plan (the "Magellan 401-K Plan"). Participants could contribute up to 15% of their compensation to the Magellan 401-K Plan. The Company made discretionary contributions of 2% of each employee's compensation and matched 50% of each employee's contribution up to 3% of their compensation. During the fiscal years ended September 30, 1997, 1998 and 1999, the Company made contributions of approximately $5.7 million, $3.2 million and $1.2 million respectively, to the Magellan 401-K Plan.

Green Spring maintained a defined contribution plan (the "Green Spring 401-K Plan"). Employee participants could elect to voluntarily contribute up to 6% or 12% of their compensation, depending upon each employee's compensation level, to the Green Spring 401-K Plan. Green Spring matched up to 3% of each employee's compensation. Employees vested in employer contributions over five years. During the fiscal years ended September 30, 1997, 1998 and 1999 the Company contributed approximately $1.3 million, $1.2 million and $2.9 million, respectively, to the Green Spring 401-K Plan.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

SEPTEMBER 30, 1999

5. LONG-TERM DEBT, CAPITAL LEASE OBLIGATIONS AND OPERATING LEASES

Information with regard to the Company's long-term debt and capital lease obligations at September 30, 1998 and 1999 is as follows (in thousands):

<table>
<thead>
<tr>
<th>Credit Agreement</th>
<th>SEPTEMBER 30, 1998</th>
<th>SEPTEMBER 30, 1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revolving Facility (7.63% at September 30, 1999) due through 2004</td>
<td>$40,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Term Loan Facility (7.75% to 8.25% at September 30, 1999) due through 2006</td>
<td>550,000</td>
<td>492,873</td>
</tr>
<tr>
<td>9.0% Senior Subordinated Notes due 2008</td>
<td>625,000</td>
<td>625,000</td>
</tr>
<tr>
<td>11.5% other notes payable through 2005</td>
<td>4,198</td>
<td>35</td>
</tr>
<tr>
<td>3.8% capital lease obligations due through 2014</td>
<td>6,448</td>
<td>6,400</td>
</tr>
<tr>
<td>Less amounts due within one year</td>
<td>23,033</td>
<td>30,119</td>
</tr>
<tr>
<td>$1,202,613</td>
<td>$1,114,189</td>
<td></td>
</tr>
</tbody>
</table>

The aggregate scheduled maturities of long-term debt and capital lease obligations during the five fiscal years subsequent to September 30, 1999 are as follows (in thousands): 2000--$30,119; 2001--$36,161; 2002--$45,922; 2003--$85,523 and 2004--$145,560.
The Notes, which are carried at cost, had a fair value of approximately $534 million at both September 30, 1998 and 1999, based on market quotes. The Company's remaining debt is also carried at cost, which approximates fair market value.

The Company recognized a net extraordinary loss from the early extinguishment of debt of approximately $33.0 million, net of income tax benefit, during fiscal 1998, to write off unamortized deferred financing costs related to terminating the previous credit agreement and extinguishing the Old Notes, to record the tender premium and related costs of extinguishing the Old Notes and to record the gain on extinguishment of the Company's 7.5% Swiss bonds. The Credit Agreement provides for a Term Loan Facility in an original aggregate principal amount of $550 million, consisting of an approximately $183.3 million Tranche A Term Loan (the "Tranche A Term Loan"), an approximately $183.3 million Tranche B Term Loan (the "Tranche B Term Loan") and an approximately $183.3 million Tranche C Term Loan (the "Tranche C Term Loan"), and a Revolving Facility providing for revolving loans to the Company and the "Subsidiary Borrowers" (as defined therein) and the issuance of letters of credit for the account of the Company and the Subsidiary Borrowers in an aggregate principal amount (including the aggregate stated amount of letters of credit) of $150.0 million. Letters of credit outstanding were $17.6 million at September 30, 1999.

The Tranche A Term Loan and the Revolving Facility mature on February 12, 2004. The Tranche B Term Loan matures on February 12, 2005 and the Tranche C Term Loan matures on February 12, 2006. The Tranche A Term Loan amortizes in installments in each fiscal year in amounts equal to $26.0 million in 2000, $32.1 million in 2001, $41.8 million in 2002, $44.6 million in 2003 and $10.5 million in 2004. The Tranche B Term Loan amortizes in installments in amounts equal to $2.0 million in each of 2000 through 2002, $38.9 million in 2003, $96.2 million in 2004 and $27.7 million in 2005. The Tranche C Term Loan amortizes in installments in each fiscal year in amounts equal to $2.0 million in 2000 through 2003, $38.9 million in 2004, $94.8 million in 2005 and $27.1 million in 2006. In addition, the Credit Facilities are subject to mandatory prepayment and reductions (to be applied first to the Term Loan Facility) in an amount equal to (a) 75% of the net proceeds of certain offerings of equity securities by the Company or any of its subsidiaries, (b) 100% of the net proceeds of certain debt issues of the Company or any of its subsidiaries, (c) 75% of the Company's excess cash flow, as defined, and (d) 100% of the net proceeds of certain asset sales or other dispositions of property of the Company and its subsidiaries, in each case subject to certain limited exceptions.

The Credit Agreement contains a number of covenants that, among other things restrict the ability of the Company and its subsidiaries to dispose of assets, incur additional indebtedness, incur or guarantee obligations, prepay other indebtedness or amend other debt instruments (including the indenture for the Notes (the "Indenture")), pay dividends, create liens on assets, make investments, make loans or advances, redeem or repurchase common stock, make acquisitions, engage in mergers or consolidations, change the business conducted by the Company and its subsidiaries and make capital expenditures. In addition, the Credit Agreement requires the Company to comply with specified financial ratios and tests, including minimum coverage ratios, maximum leverage ratios,
maximum senior debt ratios and minimum "EBITDA" (as defined in the Credit Agreement) and minimum net worth tests. As of September 30, 1999, the Company was in compliance with its debt covenants.

At the Company's election, the interest rates per annum applicable to the loans under the Credit Agreement are a fluctuating rate of interest measured by reference to either (a) an adjusted London inter-bank offer rate ("LIBOR") plus a borrowing margin or (b) an alternate base rate ("ABR") (equal to the higher of the Chase Manhattan Bank's published prime rate or the Federal Funds effective rate plus 1/2 of 1%) plus a borrowing margin. The borrowing margins applicable to the Tranche A Term Loan and loans under the Revolving Facility are currently 1.25% for ABR loans and 2.25% for LIBOR loans, and are subject to reduction if the Company's financial results satisfy certain leverage tests. The borrowing margins applicable to the Tranche B Term Loan and the Tranche C Term Loan are 1.50% and 1.75%, respectively, for ABR loans and 2.50% and 2.75%, respectively, for LIBOR loans, and are not subject to reduction. Amounts outstanding under the credit facilities not paid when due bear interest at a default rate equal to 2.00% above the rates otherwise applicable to each of the loans under the Term Loan Facility and the Revolving Facility.

The obligations of the Company and the Subsidiary Borrowers under the Credit Agreement are unconditionally and irrevocably guaranteed by, subject to certain exceptions, each wholly owned domestic subsidiary and, subject to certain exceptions, each foreign subsidiary of the Company. In addition, the Revolving Facility, the Term Loan Facility and the guarantees are secured by security interests in and pledges of or liens on substantially all the material tangible and intangible assets of the guarantors, subject to certain exceptions.

The Notes are general unsecured senior subordinated obligations of the Company. The Notes are limited in aggregate principal amount to $625.0 million and will mature on February 15, 2008. Interest on the Notes accrues at the rate of 9.0% per annum and is payable semi-annually on each February 15 and August 15, commencing on August 15, 1998. The Notes were originally issued as unregistered securities and later exchanged for securities which were registered with the Securities and Exchange Commission. Due to a delay in the registration of the Notes to be exchanged, the Company was required to increase the interest rate on the Notes by 100 basis points per annum for the period from July 13, 1998 through November 9, 1998, the date of issuance of the Notes to be exchanged.

The Notes are redeemable at the option of the Company. The Notes may be redeemed at the option of the Company, in whole or in part, at the redemption prices (expressed as a percentage of the principal amount) set forth below, plus accrued and unpaid interest, during the twelve-month period beginning on February 15 of the years indicated below:

<table>
<thead>
<tr>
<th>YEAR</th>
<th>REDemption PRICES</th>
</tr>
</thead>
<tbody>
<tr>
<td>----</td>
<td>---------------</td>
</tr>
<tr>
<td>2008</td>
<td>100%</td>
</tr>
</tbody>
</table>
In addition, at any time and from time to time prior to February 15, 2001, the Company may, at its option, redeem up to 35% of the original aggregate principal amount of the Notes at a redemption price (expressed as a percentage of the principal amount) of 109%, plus accrued and unpaid interest with the net cash proceeds of one or more equity offerings; provided that at least 65% of the original aggregate principal amount of Notes remains outstanding immediately after the occurrence of such redemption and that such redemption occurs within 60 days of the date of the closing of any such equity offering.

The Indenture limits, among other things: (i) the incurrence of additional indebtedness by the Company and its restricted subsidiaries; (ii) the payment of dividends on, and redemption or repurchase of, capital stock of the Company and its restricted subsidiaries and the redemption of certain subordinated obligations of the Company; (iii) certain other restricted payments, including investments; (iv) sales of assets; (v) certain transactions with affiliates; (vi) the creation of liens; and (vii) consolidations, mergers and transfers of all or substantially all the Company's assets. The Indenture also prohibits certain restrictions on distributions from restricted subsidiaries. However, all such limitations and prohibitions are subject to certain qualifications and exceptions.

The Company recorded extraordinary losses of approximately $5.3 million, net of tax, during fiscal 1997 to write off unamortized deferred financing costs related to its previous credit agreement and for costs related to paying off its then existing variable rate secured notes.

The Company leases certain of its operating facilities. The leases, which expire at various dates through 2008, generally require the Company to pay all maintenance, property and tax insurance costs.

At September 30, 1999, aggregate amounts of future minimum payments under operating leases were as follows: 2000--$34.5 million; 2001--$30.8 million; 2002--$26.7 million; 2003--$19.7 million; 2004--$11.1 million; subsequent to 2004--$15.2 million.

Rent expense for continuing operations was $10.3 million, $27.8 million and $39.9 million, respectively for the years ended September 30, 1997, 1998 and 1999. Rent expense for discontinued operations was $8.9 million, $2.8 million and $1.7 million, respectively for the fiscal years ended September 30, 1997, 1998 and 1999.

6. STOCKHOLDERS' EQUITY

Pursuant to the Company's Restated Certificate of Incorporation, the Company is authorized to issue 80 million shares of common stock, $.25 par value per share, and 10 million shares of preferred stock, without par value. No shares of preferred stock have been issued as of September 30, 1999.
COMMON STOCK

The Company is prohibited from paying dividends on its common stock under the terms of the Indenture and the Credit Agreement except under very limited circumstances.

1992 STOCK OPTION PLAN

The 1992 Stock Option Plan provided for the issuance of approximately 3.4 million options to purchase shares of common stock. A summary of changes in options outstanding and other related information is as follows:

<table>
<thead>
<tr>
<th>FISCAL YEAR ENDED SEPTEMBER 30,</th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance, beginning of period....</td>
<td>368,990</td>
<td>368,990</td>
<td>6,000</td>
</tr>
<tr>
<td>Canceled.........................</td>
<td>--</td>
<td>--</td>
<td>(6,000)</td>
</tr>
<tr>
<td>Exercised.........................</td>
<td>--</td>
<td>(362,990)</td>
<td>--</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>------</td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td>Balance, end of period...........</td>
<td>368,990</td>
<td>6,000</td>
<td>--</td>
</tr>
<tr>
<td>Option prices, end of period.....</td>
<td>$4.36-$22.75</td>
<td>$22.75</td>
<td>$--</td>
</tr>
<tr>
<td>Price range of exercised options..</td>
<td>--</td>
<td>$4.36</td>
<td>$--</td>
</tr>
<tr>
<td>Average exercise price............</td>
<td>--</td>
<td>$4.36</td>
<td>$--</td>
</tr>
</tbody>
</table>

The exercise price of certain options would have been reduced upon termination of employment of a certain optionee without cause. The Company recorded compensation expense for the difference between the exercise price of these options and the fair value of the Company's common stock until the measurement date was known. Such compensation expense was included in stock option expense (credit) in the Company's statements of operations until such options were exercised in August 1998.

1994 STOCK OPTION PLAN

The 1994 Stock Option Plan (the "1994 Plan") provided for the issuance of approximately 1.3 million options to purchase shares of common stock. Officers and key employees of the Company are eligible to participate. The options have an exercise price which approximates fair market value of the Common Stock at the date of grant. A summary of changes in options outstanding and other related information is as follows:
FISCAL YEAR ENDED SEPTEMBER 30,
-----------------------------------------
<table>
<thead>
<tr>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance, beginning of period...</td>
<td>948,669</td>
<td>1,028,494</td>
</tr>
<tr>
<td>Granted......................</td>
<td>341,166</td>
<td>--</td>
</tr>
<tr>
<td>Canceled....................</td>
<td>(87,498)</td>
<td>(298,276)</td>
</tr>
<tr>
<td>Exercised...................</td>
<td>(173,843)</td>
<td>(49,001)</td>
</tr>
<tr>
<td>Balance, end of period......</td>
<td>1,028,494</td>
<td>681,217</td>
</tr>
<tr>
<td>Option prices, end of period..</td>
<td>$15.687-$27.718</td>
<td>$15.687-$27.718</td>
</tr>
<tr>
<td>Average exercise price........</td>
<td>$22.20</td>
<td>$19.903</td>
</tr>
</tbody>
</table>

Options granted under the 1994 Plan are exercisable to the extent vested. An option vests at the rate of 33 1/3% of the shares covered by the option on each of the first three anniversary dates of the grant of the option if the optionee is an employee of the Company on such dates. Options must be exercised no later than ten years after the date of grant. As of September 30, 1999, 94.3% of the options outstanding were vested.

1996 STOCK OPTION PLAN

The 1996 Stock Option Plan (the "1996 Plan") provides for the issuance of 1.75 million options to purchase shares of the Company's common stock. Options must be granted on or before December 31, 1999. Officers and key employees of the Company are eligible to participate. The options have an exercise price which approximates fair market value of the common stock at the date of grant. A summary of changes in options outstanding and other related information is as follows:

FISCAL YEAR ENDED SEPTEMBER 30
-----------------------------------------
<table>
<thead>
<tr>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance, beginning of period...</td>
<td>1,298,500</td>
<td>1,411,292</td>
</tr>
<tr>
<td>Granted......................</td>
<td>310,667</td>
<td>50,000</td>
</tr>
<tr>
<td>Canceled....................</td>
<td>(96,125)</td>
<td>(42,000)</td>
</tr>
<tr>
<td>Exercised...................</td>
<td>(101,750)</td>
<td>(178,375)</td>
</tr>
<tr>
<td>Balance, end of period......</td>
<td>1,411,292</td>
<td>1,240,917</td>
</tr>
<tr>
<td>Option prices, end of period..</td>
<td>$15.75-$30.875</td>
<td>$15.75-$30.875</td>
</tr>
<tr>
<td>Average exercise price........</td>
<td>$22.20</td>
<td>$19.903</td>
</tr>
</tbody>
</table>

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTMBER 30, 1999
6. STOCKHOLDERS' EQUITY (CONTINUED)

Options granted under the 1996 Plan are exercisable to the extent vested. An option vests at the rate of 25% of the shares covered by the option on each of the four anniversary dates of the grant of the option if the optionee is an employee of the Company on such dates. Options must be exercised no later than November 30, 2005.

The 1996 Plan provides that the options granted thereunder, upon the occurrence of certain events, vest and become fully exercisable upon the "sale, lease, transfer of other disposition... of all or substantially all" of the Company's assets. Based upon a review of relevant Delaware case law, the Company believes that substantial uncertainty existed regarding whether the Crescent Transactions, which are described in Note 3, constituted a "sale ... of all or substantially all" of the Company's assets. Accordingly, the Company's Board of Directors determined it should treat the Crescent Transactions as such an event in order to eliminate the risk of a dispute. Options outstanding under the 1996 Plan immediately vested upon closing the Crescent Transactions. As of September 30, 1999, 62.5% of the options outstanding under the 1996 Plan were vested.

1997 STOCK OPTION PLAN

The 1997 Stock Option Plan (the "1997 Plan") provides for the issuance of 1.5 million options to purchase shares of the Company's common stock. Options must be granted on or before December 31, 2000. Officers and key employees of the Company are eligible to participate. The options have an exercise price which approximates fair market value of the common stock at the date of grant. A summary of changes in options outstanding and other related information is as follows:

<table>
<thead>
<tr>
<th>FISCAL YEAR ENDED SEPTEMBER 30,</th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance, beginning of period...</td>
<td>--</td>
<td>988,333</td>
<td>732,278</td>
</tr>
<tr>
<td>Granted...</td>
<td>988,333</td>
<td>396,000</td>
<td>801,500</td>
</tr>
<tr>
<td>Canceled...</td>
<td>--</td>
<td>(652,055)</td>
<td>(167,873)</td>
</tr>
<tr>
<td>Balance, end of period...</td>
<td>988,333</td>
<td>732,278</td>
<td>$1,365,905</td>
</tr>
<tr>
<td>Option prices, end of period...</td>
<td>$24.375-$31.00</td>
<td>$22.328-$31.063</td>
<td>$4.188-$24.375</td>
</tr>
</tbody>
</table>

Options granted under the 1997 Plan are exercisable to the extent vested. An option vests at the rate of 33 1/3% of the shares covered by the option on each of the three anniversary dates of the grant of the option if the optionee is an employee of the Company on such dates. Options must be exercised no later than February 28, 2007. As of September 30, 1999, 34.3% of the options outstanding under the 1997 Plan were vested. Certain of the options granted under the 1997 stock option plan were granted prior to the stockholder approval date. The measurement date for purposes of measuring compensation expense for such grants under the 1997 Plan was the date of stockholder approval, which resulted in compensation expense of approximately $0.5 million and $0.2 million in fiscal 1997 and 1998, respectively.

1998 STOCK OPTION PLAN

The 1998 Stock Option Plan (the "1998 Plan") provides for the issuance of
1.0 million options to purchase shares of the Company's common stock. Options must be granted on or before December 31,

FISCAL YEAR ENDED SEPTEMBER 30, 1998

<table>
<thead>
<tr>
<th>Options</th>
<th>Exercise Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>$14.56-$22.875</td>
<td>$4.188-$8.406</td>
</tr>
</tbody>
</table>

Options granted under the 1998 Plan are exercisable to the extent vested. An option vests over the period specified in each stock option grant. Options must be exercised no later than December 31, 2008. As of September 30, 1999, 21.6% of the options outstanding under the 1998 Plan were vested.

1997 EMPLOYEE STOCK PURCHASE PLAN

The 1997 Employee Stock Purchase Plan (the "1997 ESPP") covers 600,000 shares of common stock that can be purchased by eligible employees of the Company. The 1997 ESPP offering periods will have a term not less than three months and not more than 12 months. The first offering period under the 1997 ESPP began January 1, 1997 and the last offering period will end on or before December 31, 1999. The option price of each offering period will be the lesser of (i) 85% of the fair value of a share of common stock on the first day of the offering period or (ii) 85% of the fair value of a share of common stock on the last day of the offering period.

A summary of the 1997 ESPP is as follows:

<table>
<thead>
<tr>
<th>Offering Period</th>
<th>Begun</th>
<th>Ended</th>
<th>Options Exercised</th>
<th>Exercise Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>January 2, 1997</td>
<td>June 30, 1997</td>
<td>73,410</td>
<td>$19.125</td>
</tr>
<tr>
<td>2</td>
<td>August 1, 1997</td>
<td>December 31, 1997</td>
<td>26,774</td>
<td>$19.125</td>
</tr>
<tr>
<td>Date Range</td>
<td>Option Price</td>
<td>Number of Options</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------------</td>
<td>--------------</td>
<td>-------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>January 1, 1998</td>
<td>June 30, 1998</td>
<td>43,800</td>
<td></td>
<td></td>
</tr>
<tr>
<td>July 1, 1998</td>
<td>December 31, 1998</td>
<td>163,234</td>
<td></td>
<td></td>
</tr>
<tr>
<td>January 1, 1999</td>
<td>June 30, 1999</td>
<td>152,570</td>
<td></td>
<td></td>
</tr>
<tr>
<td>July 1, 1999</td>
<td>December 31, 1999</td>
<td>--</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The number of options granted and the option price for the sixth offering period will be determined on December 31, 1999 when the option price is known.

### 1992 DIRECTORS' STOCK OPTION PLAN AND DIRECTORS' UNIT AWARD PLAN

The 1992 Directors' Stock Option Plan (the "1992 Directors Plan") provides for the grant of options to non-employee members of the Company's Board of Directors to purchase up to 175,000 shares of the Company's common stock, subject to adjustments to reflect certain changes in capitalization. The options have an exercise price which approximates the fair market value of the common stock on the date of grant. During fiscal 1997, 1998 and 1999, no options were granted. As of September 30, 1999, 75,000 options were outstanding at $8.406. No options were exercised during fiscal 1997, 1998 or 1999.

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### 1996 DIRECTORS' STOCK OPTION PLAN

The 1996 Directors' Stock Option Plan (the "1996 Directors Plan") provides for the grant of options to non-employee members of the Company's Board of Directors to purchase up to 250,000 shares of the Company's common stock, subject to adjustments to reflect certain changes in capitalization. The options have an exercise price which approximates the fair market value of a share of the common stock on the date of grant. During fiscal 1997, 25,000 options were granted at an exercise price of $30.812. During fiscal 1998, 50,000 options were granted at an exercise prices ranging from $20.25 to $22.4375. During fiscal 1999, no options were granted. As of September 30, 1999, 150,000 options were...
outstanding at $8.406. No options were exercised during fiscal 1997, 1998 or 1999.

Options granted can be exercised from the date of vesting until November 30, 2005. No options can be granted after December 31, 1999. Options vest at the rate of 25% of the shares covered on each of the four anniversary dates of the grant of the option if the optionee continues to serve as a non-employee director on such dates. Options vest in full in certain instances of termination. As of September 30, 1999, 62.5% of the options outstanding were vested.

STOCK OPTION REPRICING

On November 17, 1998, the Company's Board of Directors approved the repricing of stock options outstanding under the Company's existing stock option plans (the "Stock Option Repricing"). Each holder of 10,000 or more stock options that was eligible to participate in the Stock Option Repricing was required to forfeit a percentage of outstanding stock options as follows:

- Directors, including the Chief Executive Officer................................. 40%
- Named Executive Officers.................................................... 30%
- Other holders of 50,000 or more stock options............................... 25%
- Other holders of 10,000-49,999 stock options.................................. 15%

The Stock Option Repricing was consummated on December 8, 1998 based on the fair value of the Company's common stock on such date. Approximately 2.0 million outstanding stock options were repriced to $8.406 and approximately 0.7 million outstanding stock options were cancelled as a result of the Stock Option Repricing. Each participant in the Stock Option Repricing was precluded from exercising repriced stock options until June 8, 1999.

A summary of the Stock Option Repricing by stock option plan is as follows (in thousands):

<table>
<thead>
<tr>
<th>OPTIONS REPRICED</th>
<th>OPTIONS CANCELLED</th>
</tr>
</thead>
</table>
RIGHTS PLAN

The Company adopted a share purchase rights plan in fiscal 1992 (the "Rights Plan"). Pursuant to the Rights Plan, each share of common stock also represents one share purchase right (collectively, the "Rights"). The Rights trade automatically with the underlying shares of common stock. Upon becoming exercisable, but prior to the occurrence of certain events, each Right initially entitles its holder to buy one share of common stock from the Company at an exercise price of $60.00. The Rights will be distributed and become exercisable only if a person or group acquires, or announces its intention to acquire, common stock exceeding certain levels, as specified in the Rights Plan. Upon the occurrence of such events, the exercise price of each Right reduces to one-half of the then current market price. The Rights also give the holder certain rights in an acquiring company's common stock. The Company is entitled to redeem the Rights at a price of $.01 per Right at any time prior to the distribution of the Rights. The Rights have no voting power until exercised.

COMMON STOCK WARRANTS

The Company issued 114,690 warrants in fiscal 1992 which expire on June 30, 2002 (the "2002 Warrants") to purchase one share each of the Company's common stock. The 2002 Warrants have an exercise price of $5.24 per share. During fiscal 1997 and 1998, 1,397 and 1,553 were issued, respectively, upon the exercise of 2002 Warrants. At September 30, 1999, 18,920 of the 2002 Warrants were outstanding.

The Company also has 146,791 warrants outstanding with an exercise price of $38.70 per share which expire on September 1, 2006.

Crescent and COI each have the right to purchase 1,283,311 shares of common stock (2,566,622 shares in aggregate; collectively the "Crescent Warrants") at a warrant exercise price of $30.00 per share.
Crescent's and COI's rights with respect to the Crescent Warrants are not contingent on or subject to the satisfaction or completion of any obligation that Crescent or COI may have to CBHS, or that CBHS may have to the Company, or by any subordination of fees otherwise payable to the Company by CBHS.

The Crescent Warrants contain provisions relating to adjustments in the number of shares covered by the Crescent Warrants and the warrant exercise price in the event of stock splits, stock dividends, mergers, reorganizations and similar transactions.

The Crescent Warrants were recorded at $25.0 million upon issuance, which was their approximate fair value upon execution of the Warrant Purchase Agreement in January 1997.

TREASURY STOCK TRANSACTIONS

During fiscal 1998, the Company repurchased an aggregate of 696,600 shares of its common stock in the open market for approximately $14.4 million. Those transactions were funded with cash on hand.

In January 1998, the Company issued an aggregate of 2,831,516 shares of treasury stock to the then existing minority stockholders of Green Spring to effect the Green Spring Minority Stockholder Conversion. See Note 2, "Acquisitions and Joint Ventures."

INCOME (LOSS) PER COMMON SHARE

The Company adopted Statement of Financial Accounting Standards No. 128, "Earnings per Share" ("FAS 128"), effective October 1, 1997. Income per common share for fiscal 1997 has been restated to conform to FAS 128 as required. The effect of adopting FAS 128 was not material.

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 1999

6. STOCKHOLDERS' EQUITY (CONTINUED)

The following table presents the components of weighted average common shares outstanding--diluted:
<table>
<thead>
<tr>
<th>Year</th>
<th>Weighted Average Common Shares Outstanding--Basic</th>
<th>Common Stock Equivalents--Stock Options</th>
<th>Common Stock Equivalents--Warrants</th>
<th>Weighted Average Common Shares Outstanding--Diluted</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>28,781</td>
<td>--</td>
<td>--</td>
<td>28,781</td>
</tr>
<tr>
<td>1998</td>
<td>30,784</td>
<td>--</td>
<td>--</td>
<td>30,784</td>
</tr>
<tr>
<td>1999</td>
<td>31,758</td>
<td>151</td>
<td>7</td>
<td>31,916</td>
</tr>
</tbody>
</table>

Options to purchase approximately 3,004,650 shares of common stock at $8.19 - $31.00 per share were outstanding during fiscal 1999 but were not included in the computation of diluted EPS because the options exercise price was greater than the average market price of the common shares. Approximately 2,851,960 of these options, which expire between fiscal 2004 and 2009, were still outstanding at September 30, 1999.

Warrants to purchase approximately 4,713,000 shares of common stock at $26.15 to $38.70 per share were outstanding during fiscal 1999 but were not included in the computation of diluted EPS because the warrants exercise price was greater than the average market price of the common shares. The warrants, which expire between fiscal 2000 and 2009, were still outstanding at September 30, 1999.

The Company owned a 61% equity interest in Green Spring Health Services, Inc. ("Green Spring") during the periods presented above. The four minority stockholders of Green Spring had the options to exchange their ownership interests in Green Spring for 2,831,516 shares of the Company's common stock or $65.1 million of subordinated notes. The Exchange Option was considered a potentially dilutive security from the point in time the Company acquired Green Spring in December 1995 for the purpose of computing diluted income per common share. The Exchange Option was anti-dilutive for all periods presented and, therefore, was excluded from the respective diluted income per common share calculations.

Each of the minority stockholders of Green Spring exercised the Exchange Option in January 1998, which resulted in the issuance of 2,831,516 shares of the Company's common stock. See Note 2--"Acquisitions and Joint Ventures--Green Spring."

On December 15, 1999, the Company consummated the TPG investment (as defined). See Note 15, - "Subsequent Event."

Common stock equivalents of approximately 693,000 and 414,000 were excluded from the diluted income per common share calculation for the years ended September 30, 1997 and 1998, respectively, due to their anti-dilutive nature as a result of the Company's loss from continuing operations before extraordinary items for such periods.

STOCK-BASED COMPENSATION

Effective October 1, 1996, the Company adopted the disclosure requirements of FAS 123. FAS 123 requires disclosure of pro forma net income and pro forma net income per share as if the fair value-based method of accounting for stock options had been applied in measuring compensation cost for stock-based
6. STOCKHOLDERS' EQUITY (CONTINUED)

awards granted in fiscal 1996, 1997, 1998 and 1999. Pro forma amounts are not representative of the effects of stock-based awards on future pro forma net income and pro forma net income per share because those pro forma amounts exclude the pro forma compensation expense related to unvested stock options granted before fiscal 1996.

Reported and pro forma net income and net income per share amounts are set forth below (in thousands, except per share data):

<table>
<thead>
<tr>
<th></th>
<th>FISCAL YEAR ENDED</th>
<th>SEPTEMBER 30,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1997</td>
<td>1998</td>
</tr>
<tr>
<td>Reported:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from continuing operations before extraordinary items</td>
<td>$(37,204)</td>
<td>$(6,799)</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>(498)</td>
<td>(19,283)</td>
</tr>
<tr>
<td>Income (loss) per common share--basic:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from continuing operations before extraordinary items</td>
<td>(1.29)</td>
<td>(0.22)</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>(0.02)</td>
<td>(0.63)</td>
</tr>
<tr>
<td>Income (loss) per common share--diluted:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from continuing operations before extraordinary items</td>
<td>(1.29)</td>
<td>(0.22)</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>(0.02)</td>
<td>(0.63)</td>
</tr>
</tbody>
</table>

Pro Forma:

<table>
<thead>
<tr>
<th></th>
<th>FISCAL YEAR ENDED</th>
<th>SEPTEMBER 30,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1997</td>
<td>1998</td>
</tr>
<tr>
<td>Income (loss) from continuing operations before extraordinary items</td>
<td>$(45,680)</td>
<td>$(10,744)</td>
</tr>
<tr>
<td>Net loss..................</td>
<td>(8,974)</td>
<td>(23,228)</td>
</tr>
<tr>
<td>Income (loss) per common share--basic:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from continuing operations before extraordinary items</td>
<td>(1.59)</td>
<td>(0.35)</td>
</tr>
<tr>
<td>Net loss..................</td>
<td>(0.31)</td>
<td>(0.75)</td>
</tr>
<tr>
<td>Income (loss) per common share--diluted:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from continuing operations before extraordinary items</td>
<td>(1.59)</td>
<td>(0.35)</td>
</tr>
<tr>
<td>Net loss..................</td>
<td>(0.31)</td>
<td>(0.75)</td>
</tr>
</tbody>
</table>

The fair values of the stock options and ESPP options granted were estimated on the date of their grant using the Black-Scholes option pricing model based on the following weighted average assumptions:

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk-free interest rate</td>
<td>6.0%</td>
<td>4.5%</td>
<td>5.8%</td>
</tr>
<tr>
<td>Expected life</td>
<td>5.5 years</td>
<td>4 years</td>
<td>3.8 years</td>
</tr>
</tbody>
</table>
6. STOCKHOLDERS’ EQUITY (CONTINUED)

The weighted average fair value of options granted during fiscal 1997, 1998 and 1999 was $9.67, $9.53 and $2.21, respectively.

Stock option activity for all plans for 1997, 1998 and 1999 was as follows:

<table>
<thead>
<tr>
<th>Fiscal Year Ended September 30,</th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Weighted Average Exercise Options</td>
<td>Weighted Average Exercise Options</td>
<td>Weighted Average Exercise Options</td>
</tr>
<tr>
<td></td>
<td>Price</td>
<td></td>
<td>Price</td>
</tr>
<tr>
<td>Balance, beginning of period...</td>
<td>2,916,159</td>
<td>$17.92</td>
<td>4,122,109</td>
</tr>
<tr>
<td>Granted.........................</td>
<td>1,665,166</td>
<td>24.24</td>
<td>1,386,500</td>
</tr>
<tr>
<td>Canceled........................</td>
<td>(183,623)</td>
<td>20.84</td>
<td>(1,082,331)</td>
</tr>
<tr>
<td>Exercised.......................</td>
<td>(275,593)</td>
<td>20.26</td>
<td>(590,366)</td>
</tr>
<tr>
<td>Exercisable, end of period.....</td>
<td>2,419,711</td>
<td>17.65</td>
<td>2,375,919</td>
</tr>
</tbody>
</table>

Stock options outstanding on September 30, 1999:

<table>
<thead>
<tr>
<th>Options Outstanding</th>
<th>Weighted Average Range of Exercise Price</th>
<th>Options Remaining Contractual Life (Years)</th>
<th>Weighted Average Exercise Price</th>
<th>Options Exercisable</th>
<th>Weighted Average Exercise Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>$4.188 - $8.188</td>
<td>1,576,921</td>
<td>7.37</td>
<td>$5.628</td>
<td>52,843</td>
<td>$7.313</td>
</tr>
<tr>
<td>$8.406</td>
<td>1,865,739</td>
<td>6.89</td>
<td>8.406</td>
<td>1,223,973</td>
<td>8.406</td>
</tr>
<tr>
<td></td>
<td>4,406,882</td>
<td>6.89</td>
<td>10.149</td>
<td>2,190,538</td>
<td>13.739</td>
</tr>
</tbody>
</table>

Expected volatility........................... 30% 50% 50%
Expected dividend yield....................... 0% 0% 0%
7. INCOME TAXES

The provision for income taxes consisted of the following (in thousands):

<table>
<thead>
<tr>
<th>FISCAL YEAR ENDED SEPTEMBER 30,</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
</tr>
<tr>
<td>------</td>
</tr>
<tr>
<td>Income taxes currently payable:</td>
</tr>
<tr>
<td>Federal</td>
</tr>
<tr>
<td>State</td>
</tr>
<tr>
<td>Foreign</td>
</tr>
<tr>
<td>Deferred income taxes:</td>
</tr>
<tr>
<td>Federal</td>
</tr>
<tr>
<td>State</td>
</tr>
<tr>
<td>Foreign</td>
</tr>
<tr>
<td>--------</td>
</tr>
<tr>
<td>$(20,232)</td>
</tr>
<tr>
<td>=======</td>
</tr>
</tbody>
</table>

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

SEPTEMBER 30, 1999

7. INCOME TAXES (CONTINUED)

A reconciliation of the Company's income tax provision (benefit) to that computed by applying the statutory federal income tax rate is as follows (in thousands):

<table>
<thead>
<tr>
<th>FISCAL YEAR ENDED SEPTEMBER 30,</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
</tr>
<tr>
<td>------</td>
</tr>
<tr>
<td>Income tax provision (benefit) at federal statutory income tax rate</td>
</tr>
<tr>
<td>State income taxes, net of federal income tax benefit</td>
</tr>
<tr>
<td>Merit goodwill amortization</td>
</tr>
<tr>
<td>Other--net</td>
</tr>
<tr>
<td>Income tax provision (benefit)</td>
</tr>
<tr>
<td>=======</td>
</tr>
</tbody>
</table>

As of September 30, 1999, the Company has estimated tax net operating loss ("NOL") carryforwards of approximately $512 million available to reduce future federal taxable income. These NOL carryforwards expire in 2006 through 2018 and are subject to examination by the Internal Revenue Service. In addition, the Company also has estimated tax NOL carryforwards of approximately $125 million available to reduce the federal taxable income of Merit and its subsidiaries. These NOL carryforwards expire in 2009 through 2018 and are subject to examination by the Internal Revenue Service. Further, these NOL carryforwards are subject to limitations on the taxable income of Merit and its subsidiaries.
The Company has recorded a valuation allowance against the portion of the total NOL deferred tax asset and certain other deferred tax assets, that in management's opinion, are not likely to be recovered.

Components of the net deferred income tax (assets) liabilities at September 30, 1998 and 1999 are as follows (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>SEPTEMBER 30,</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1998</td>
<td>1999</td>
</tr>
<tr>
<td><strong>Deferred tax liabilities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property and depreciation</td>
<td>$ 8,670</td>
<td>$ 2,060</td>
</tr>
<tr>
<td>Long-term debt and interest</td>
<td>20,388</td>
<td>19,735</td>
</tr>
<tr>
<td>ESOP</td>
<td>12,777</td>
<td>12,968</td>
</tr>
<tr>
<td>Intangibles</td>
<td>12,777</td>
<td>12,968</td>
</tr>
<tr>
<td>Other</td>
<td>9,556</td>
<td>15,209</td>
</tr>
<tr>
<td><strong>Total deferred tax liabilities</strong></td>
<td>51,391</td>
<td>61,304</td>
</tr>
<tr>
<td><strong>Deferred tax assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intangible Assets</td>
<td>(8,992)</td>
<td>--</td>
</tr>
<tr>
<td>Operating loss carryforwards</td>
<td>(250,512)</td>
<td>(254,696)</td>
</tr>
<tr>
<td>Self-insurance reserves</td>
<td>(9,534)</td>
<td>(2,220)</td>
</tr>
<tr>
<td>Restructuring costs</td>
<td>(4,071)</td>
<td>(9,552)</td>
</tr>
<tr>
<td>Other</td>
<td>(40,359)</td>
<td>(51,953)</td>
</tr>
<tr>
<td><strong>Total deferred tax assets</strong></td>
<td>(313,468)</td>
<td>(318,421)</td>
</tr>
<tr>
<td><strong>Valuation allowance</strong></td>
<td>163,893</td>
<td>165,460</td>
</tr>
<tr>
<td><strong>Deferred tax assets after valuation allowance</strong></td>
<td>(149,575)</td>
<td>(152,961)</td>
</tr>
<tr>
<td><strong>Net deferred tax assets</strong></td>
<td>$ 98,184</td>
<td>$ 91,657</td>
</tr>
</tbody>
</table>

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

SEPTEMBER 30, 1999

7. INCOME TAXES (CONTINUED)

During June 1999, the Company received an assessment from the Internal Revenue Service (the "IRS Assessment") related to its federal income tax returns for the fiscal years ended September 30, 1992 and 1993. The IRS Assessment disallowed approximately $162 million of deductions that relate primarily to interest expense in fiscal 1992. The Company filed an appeal of the IRS Assessment during September 1999.

The Company had previously recorded a valuation allowance for the full amount of the $162 million of deductions disallowed in the IRS Assessment. The IRS Assessment is not expected to result in a material cash payment for income taxes related to prior years; however, the Company's federal income tax net operating loss carryforwards would be reduced if the Company's appeal is unsuccessful.
The Internal Revenue Service is currently examining Merit and CMG's income tax returns for pre-acquisition periods. In management's opinion, adequate provisions have been made for any adjustments which may result from these examinations, including a potential reduction in the amount of NOL carryforwards. The Company believes the examinations could result in a reduction in NOL carryforwards available to offset future taxable income.

8. ACCRUED LIABILITIES

Accrued liabilities consist of the following (in thousands):

<table>
<thead>
<tr>
<th>SEPTMBER 30,</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1998</td>
<td>1999</td>
</tr>
<tr>
<td>Salaries, wages and other benefits</td>
<td>$ 23,893</td>
<td>$ 22,318</td>
</tr>
<tr>
<td>CHAMPUS Adjustments</td>
<td>25,484</td>
<td>51,784</td>
</tr>
<tr>
<td>Due to Providers</td>
<td>17,576</td>
<td>35,918</td>
</tr>
<tr>
<td>Other</td>
<td>126,577</td>
<td>99,776</td>
</tr>
<tr>
<td>$193,530</td>
<td>$209,796</td>
<td></td>
</tr>
</tbody>
</table>

9. MANAGED CARE INTEGRATION PLAN AND COSTS AND SPECIAL CHARGES

INTEGRATION PLAN

The Company integrated three behavioral managed care organizations ("BMCOs"), Green Spring, HAI and Merit, as a result of acquisitions consummated in fiscal 1996 (Green Spring) and fiscal 1998 (HAI and Merit). The Company also integrated two specialty managed care organizations, Allied and Care Management Resources, Inc. ("CMR"). During fiscal 1998, management committed the Company to a plan to combine and integrate the operations of its BMCOs and specialty managed care organizations (the "Integration Plan") that resulted in the elimination of duplicative functions and standardized business practices and information technology platforms.

The Integration Plan resulted in the elimination of approximately 1,000 positions during fiscal 1998 and fiscal 1999. Approximately 510 employees were involuntarily terminated pursuant to the Integration Plan.

The employee groups of the BMCOs that were primarily affected include executive management, finance, human resources, information systems and legal personnel at the various BMCOs corporate headquarters and regional offices and credentialing, claims processing, contracting and marketing personnel at various operating locations.

The Integration Plan has resulted in the closure and identified closure of
approximately 20 leased facilities at the BMCOs, Allied and CMR during fiscal 1998 and 1999.

The Company initially recorded approximately $21.3 million of liabilities related to the Integration Plan, of which $12.4 million was recorded as part of the Merit purchase price allocation and $8.9 million was recorded in the statement of operations under "Managed care integration costs" in fiscal 1998.

During fiscal 1999, the Company recorded adjustments of approximately $(0.3) million, net, to such liabilities, of which $(0.8) million was recorded as part of the Merit purchase price allocation and $0.5 million was recorded in the statement of operations under "Managed care integration costs." The Company may record additional adjustments to such liabilities during the future periods depending on its ability to sublease closed offices and upon determination of the final amount of the Company's severance obligations.

The following table provides a rollforward of liabilities resulting from the Integration Plan (in thousands):

<table>
<thead>
<tr>
<th>TYPE OF COST</th>
<th>SEPTEMBER 30, 1997</th>
<th>ADDITIONS</th>
<th>PAYMENTS</th>
<th>SEPTEMBER 30, 1998</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$</td>
<td>$13,009</td>
<td>$(6,819)</td>
<td>$ 6,190</td>
</tr>
<tr>
<td>Employee termination benefits</td>
<td>--</td>
<td>8,008</td>
<td>(533)</td>
<td>7,475</td>
</tr>
<tr>
<td>Facility closing costs</td>
<td>--</td>
<td>244</td>
<td>(75)</td>
<td>169</td>
</tr>
<tr>
<td>Other</td>
<td>--</td>
<td>244</td>
<td>(75)</td>
<td>169</td>
</tr>
<tr>
<td></td>
<td>$</td>
<td>$21,261</td>
<td>$(7,427)</td>
<td>$13,834</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TYPE OF COST</th>
<th>SEPTEMBER 30, 1998</th>
<th>ADJUSTMENTS</th>
<th>PAYMENTS</th>
<th>SEPTEMBER 30, 1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee termination benefits</td>
<td>$ 6,190</td>
<td>$ 1,959</td>
<td>$(7,380)</td>
<td>$ 769</td>
</tr>
<tr>
<td>Facility closing costs</td>
<td>7,475</td>
<td>(2,071)</td>
<td>(2,310)</td>
<td>3,094</td>
</tr>
<tr>
<td>Other</td>
<td>169</td>
<td>(169)</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td></td>
<td>$13,834</td>
<td>$(281)</td>
<td>$(9,690)</td>
<td>$3,863</td>
</tr>
</tbody>
</table>

OTHER INTEGRATION COSTS

The Integration Plan resulted in additional incremental costs that were expensed as incurred in accordance with Emerging Issues Task Force Consensus 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)" that are not described above and certain other charges. Other integration costs include, but are not limited to, outside consultants, costs to relocate closed office contents and long-lived assets.
impairments. Other integration costs are reflected in the statement of operations under "Managed care integration costs".

During fiscal 1998, the Company incurred approximately $8.1 million, in other integration costs, including long-lived asset impairments of approximately $2.4 million, and outside consulting costs of approximately $4.1 million. The asset impairments relate primarily to identifiable intangible assets and leasehold improvements that no longer have value and have been written off as a result of the Integration Plan.

During fiscal 1999, the Company incurred approximately $5.7 million in other integration costs, primarily for outside consulting costs and employee and office relocation costs.

SPECIAL CHARGES. During fiscal 1999, the Company recorded special charges of approximately $4.4 million related primarily to the loss on disposal of an office building, executive severance and relocation of its corporate headquarters from Atlanta, Georgia to Columbia, Maryland.

10. SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information is as follows (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income taxes paid, net of refunds received</td>
<td>$18,406</td>
<td>$11,116</td>
<td>$347</td>
</tr>
<tr>
<td>Interest paid, net of amounts capitalized</td>
<td>54,378</td>
<td>95,153</td>
<td>102,094</td>
</tr>
</tbody>
</table>
| Non-cash Transactions:
  Initial capital contribution to CBHS, primarily property and equipment, less assumed liabilities | 5,281   | --     | --     |
  Common Stock in Treasury issued in connection with the purchase of the remaining 39% interest in Green Spring Health Services, Inc. | --     | 63,496 | --     |

11. COMMITMENTS AND CONTINGENCIES

The Company is self-insured for a portion of its general and professional liability risks. The reserves for self-insured general and professional liability losses, including loss adjustment expenses, were included in reserve for unpaid claims in the Company's balance sheet and were based on actuarial estimates that were discounted at an average rate of 6% to their present value based on the Company's historical claims experience adjusted for current industry trends. These reserves related primarily to the professional liability risks of the Company's healthcare provider segment prior to the Crescent Transactions. The undiscounted amount of the reserve for unpaid claims at
On August 1, 1996, the United States Department of Justice, Civil Division, filed an Amended Complaint in a civil QUI TAM action initiated in November 1994 against the Company and its Orlando South hospital subsidiary ("Charter Orlando") by two former employees. The First Amended Complaint alleges that Charter Orlando violated the federal False Claims Act (the "Act") in billing for inpatient treatment provided to elderly patients. The Court granted the Company's motion to dismiss the government's First Amended Complaint yet granted the government leave to amend its First Amended Complaint. The government filed
a Second Amended Complaint on December 12, 1996 which, similar to the First Amended Complaint, alleges that the Company and its subsidiary violated the Act in billing for the treatment of geriatric patients. Like the First Amended Complaint, the Second Amended Complaint was based on disputed clinical and factual issues which the Company believes do not constitute a violation of the Act. On the Company's motion, the Court ordered the parties to participate in mediation of the matter. As a result of the mediation, the parties reached a settlement. Pursuant to the settlement, the Company paid approximately $4.8 million in August 1998. Furthermore, Charter Orlando (operated by CBHS) did not seek reimbursement for services provided to patients covered under the Medicare program for a period of up to fifteen months. The Company reimbursed CBHS for the resulting loss of revenues through September 30, 1999.

On May 26, 1998, a group of eleven plaintiffs purporting to represent an uncertified class of psychiatrists, psychologists and social workers brought an action (the "Holstein Case") under the federal antitrust laws in the United States District Court for the District of New Jersey against nine behavioral health managed care organizations, including Merit, CMG, Green Spring and HAI (collectively, the "Defendants"). The complaint alleges that the Defendants violated Section I of the Sherman Act by engaging in a conspiracy to fix the prices at which the Defendants purchase services from mental healthcare providers such as the plaintiffs. The complaint further alleges that the Defendants engaged in a group boycott to exclude mental healthcare providers from the Defendants' networks in order to further the goals of the alleged conspiracy. The complaint also challenges the propriety of the Defendants' capitation arrangements with their respective customers, although it is unclear from the complaint whether the plaintiffs allege that the Defendants unlawfully conspired to enter into capitation arrangements with their respective customers. The complaint seeks treble damages against the Defendants in an unspecified amount and a permanent injunction prohibiting the Defendants from engaging in the alleged conduct which forms the basis of the complaint, plus costs and attorneys' fees. Upon joint motion by the Defendants, the case was transferred to the United States District Court for the Southern District of New York, the same court where a previous similar case (the "Stephens Case") was dismissed for failure to state a claim upon which relief can be granted. On March 15, 1999, the Defendants filed a joint motion to dismiss the case for substantially the same reasons as in the Stephens Case. On June 16, 1999, the court denied the motion to dismiss. The case currently is in discovery. On October 14, 1999, the Plaintiffs filed a motion seeking class certification for a class of approximately 200,000 providers. The court has not yet heard argument on that motion. The Company does not believe this matter will have a material adverse effect on its financial position or results of operations.

The Company is also subject to or party to other litigation, claims, and civil suits, relating to its operations and business practices. Certain of the Company's managed care litigation matters involve class action lawsuits, including the Holstein Case, in which the Company has been named as a defendant. Besides the Holstein Case, the Company has certain other class action lawsuits which allege (i) the Company inappropriately denied and/or failed to authorize benefits for mental health treatment under insurance policies with a customer of the Company and (ii) the Company was party to employee malpractice and professional negligence regarding a specific mental health illness. In the opinion of management, the Company has recorded reserves that are adequate to cover litigation, claims or assessments that have been or may be asserted against the Company, and for which the outcome is probable and reasonably estimable, arising out of such other litigation, claims and civil
suits. Furthermore, management believes that the resolution of such litigation, claims and civil suits will not have a material adverse effect on the Company's financial position or results of operations; however, there can be no assurance in this regard.

The Company provides mental health and substance abuse services, as a subcontractor, to beneficiaries of CHAMPUS. The fixed monthly amounts that the Company receives for medical costs under CHAMPUS contracts are subject to retroactive adjustment ("CHAMPUS Adjustments") based upon actual healthcare utilization during the period known as the "data collection period". The Company has recorded reserves of approximately $25.5 million and $51.8 million as of September 30, 1998 and 1999, respectively for CHAMPUS Adjustments. During the first quarter of fiscal 2000, the Company reached a settlement agreement with a contractor under one of its CHAMPUS contracts whereby the Company agreed to pay approximately $38.1 million to the contractor during the quarter ended December 31, 1999. The Company and the contractor under this CHAMPUS contract are in the process of appealing the department of defense's retroactive adjustment. While management believes that the present reserve for CHAMPUS Adjustments is reasonable, ultimate settlement resulting from the adjustment and available appeal process may vary from the amount provided.

12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Gerald L. McManis, a director of the Company, is the President of McManis Associates, Inc. ("MAI"), a healthcare development and management consulting firm. During fiscal 1997, 1998 and 1999, MAI provided consulting services to the Company with respect to the development of strategic plans and a review of the Company's business processes. The Company incurred approximately $865,000 and $85,000 in fees for such services and related expenses during fiscal 1997 and 1998, respectively.

G. Fred DiBona, Jr., a director of the Company, is a Director and the President and Chief Executive Officer of Independence Blue Cross ("IBC"), a health insurance company.

IBC owned 16.67% of Green Spring prior to December 13, 1995. On December 13, 1995, IBC sold 4.42% of its ownership interest in Green Spring to the Company for $5,376,000 in cash. IBC had a cost basis of $3,288,000 in the 4.42% ownership interest sold to the Company. The Exchange Option described previously gave IBC the right to exchange its ownership interest in Green Spring for a maximum of 889,456 shares of Common Stock or $20,460,000 in subordinated notes through December 13, 1998. IBC exercised its Exchange Option in January 29, 1998 for Magellan Common Stock valued at approximately $17.9 million.

IBC and its affiliated entities contract with the Company for provider network, care management and medical review services pursuant to contractual relationships entered into on July 7, 1994 with terms of up to five years. The Company's contract with IBC is in the process of being renegotiated. During fiscal 1997, 1998 and 1999, IBC and its affiliated entities made payments to Green Spring of approximately $48.0 million, $54.7 million and $71.3 million and owed Green Spring approximately $13.5 million and $1.3 million at September 30, 1998 and 1999, respectively. The Company recorded revenue of approximately $47.4 million, $54.6 million and $59.1 million from IBC during fiscal 1997, 1998 and 1999, respectively.
On July 7, 1994, IBC sold a subsidiary to Green Spring in exchange for a $15 million promissory note. As of September 30, 1999, such promissory note had been repaid.

Darla D. Moore, a director of the Company since February 1996, is the spouse of Richard E. Rainwater, Chairman of the Board of Crescent and one of the largest stockholders of the Company (13.0% beneficial ownership as of September 30, 1999). Because of her relationship to Mr. Rainwater, Ms. Moore did not participate in any Board action taken with respect to the Crescent Transactions.

Daniel S. Messina, a director of the Company, is the Chief Financial Officer of Aetna U.S. Healthcare, a subsidiary of Aetna. Mr. Messina became a director of the Company in December 1997. On December 4, 1997, the Company consummated the purchase of HAI, formerly a unit of Aetna, for approximately $122.1 million plus contingent consideration.

The Company may be required to make additional contingent payments of up to $60.0 million annually to Aetna over the five-year period subsequent to closing. The amount and timing of the payments will be contingent upon net increases in the HAI's covered lives in specified products. The Company paid $60.0 million to Aetna for both the full Tranche 1 Payment and the full Tranche 2 Payment for the Contract Year ended December 31, 1998, on March 26, 1999. The consideration paid for HAI was determined through arm's length negotiations that considered, among other factors, the historical and projected income of HAI. The consideration paid by the Company was determined by the Board with the advice of management and the Company's investment bankers.

Aetna and its affiliated entities contract with the Company for various behavioral and specialty managed care services pursuant to contractual relationships, the most material of which is the Master Service Agreement, which was entered into on December 4, 1997. During fiscal 1998 and 1999, Aetna and its affiliated entities paid the Company approximately $72.3 million and $296.4 million, respectively for such services. As of September 30, 1998 and 1999, Aetna and its affiliated entities owed the Company approximately $0.8 million and $24.4 million, respectively. The Company recorded revenue of approximately $69.2 million and $293.1 million, respectively from Aetna during fiscal 1998 and 1999.

13. BUSINESS SEGMENT INFORMATION

The Company operates through three reportable business segments engaging in (i) the behavioral managed healthcare business, (ii) the human services business and (iii) the specialty managed healthcare business. The behavioral managed healthcare segment provides behavioral managed care services to health plans, insurance companies, corporations, labor unions and various governmental agencies. The human services segment provides therapeutic foster care services and residential and day services to individuals with acquired brain injuries and for individuals with mental retardation and developmental disabilities. The specialty managed healthcare segment provides managed care services to health plans and insurance companies for chronic medical conditions and other specialty services.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance of its segments based on profit or loss from continuing operations before depreciation, amortization, interest, net, stock option expense (credit),
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

SEPTEMBER 30, 1999

13. BUSINESS SEGMENT INFORMATION (CONTINUED)

managed care integration costs, special charges, net, income taxes and minority interest ("Segment Profit"). Intersegment sales and transfers are not significant.

The Company's reportable segments are strategic business units that offer different services. They are managed separately because each business has (i) different marketing strategies due to differences in types of customers and (ii) different capital resource needs.

The following tables summarize, for the periods indicated, operating results and other financial information, by business segment (in thousands):

<table>
<thead>
<tr>
<th>BEHAVIORAL HEALTHCARE</th>
<th>HUMAN SERVICES</th>
<th>SPECIALTY MANAGED HEALTHCARE</th>
<th>CORPORATE OVERHEAD AND OTHER</th>
<th>CONSOLIDATED</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net revenue</td>
<td>$375,541</td>
<td>$88,331</td>
<td>--</td>
<td>$463,872</td>
</tr>
<tr>
<td>Segment profit (loss)</td>
<td>37,019</td>
<td>10,695</td>
<td>(2,303)</td>
<td>19,833</td>
</tr>
<tr>
<td>Equity in loss of unconsolidated subsidiaries</td>
<td>(5,567)</td>
<td>--</td>
<td>--</td>
<td>(5,567)</td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>9,548</td>
<td>1,880</td>
<td>567</td>
<td>33,348</td>
</tr>
<tr>
<td>1998</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net revenue</td>
<td>$1,026,243</td>
<td>$141,032</td>
<td>$143,503</td>
<td>$1,310,778</td>
</tr>
<tr>
<td>Segment profit (loss)</td>
<td>137,192</td>
<td>15,493</td>
<td>3,128</td>
<td>139,947</td>
</tr>
<tr>
<td>Equity in earnings of unconsolidated subsidiaries</td>
<td>12,795</td>
<td>--</td>
<td>--</td>
<td>12,795</td>
</tr>
<tr>
<td>Investment in unconsolidated subsidiaries</td>
<td>10,125</td>
<td>--</td>
<td>941</td>
<td>11,066</td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>27,535</td>
<td>8,391</td>
<td>3,937</td>
<td>44,213</td>
</tr>
<tr>
<td>Total assets</td>
<td>1,356,259</td>
<td>119,356</td>
<td>78,062</td>
<td>1,917,088</td>
</tr>
<tr>
<td>1999</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net revenue</td>
<td>$1,483,202</td>
<td>$191,277</td>
<td>$197,157</td>
<td>$1,871,636</td>
</tr>
<tr>
<td>Segment profit (loss)</td>
<td>218,253</td>
<td>21,728</td>
<td>2,410</td>
<td>228,452</td>
</tr>
<tr>
<td>Equity in earnings of unconsolidated subsidiaries</td>
<td>20,442</td>
<td>--</td>
<td>--</td>
<td>20,442</td>
</tr>
<tr>
<td>Investment in unconsolidated subsidiaries</td>
<td>18,396</td>
<td>--</td>
<td>--</td>
<td>18,396</td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>37,487</td>
<td>5,779</td>
<td>4,129</td>
<td>48,119</td>
</tr>
<tr>
<td>Total assets</td>
<td>1,472,539</td>
<td>127,348</td>
<td>88,535</td>
<td>1,881,615</td>
</tr>
</tbody>
</table>

The following tables reconcile segment profit to consolidated income from continuing operations before provision for income taxes, minority interest and extraordinary items:

1997

| Segment profit                        | $19,833 |
| Depreciation and amortization         | (19,683) |
| Interest, net                         | (46,428) |
| Stock option expense                  | (4,292)  |
| Loss from continuing operations before provision for income taxes, minority interest and extraordinary items | $(50,580) |
13. BUSINESS SEGMENT INFORMATION (CONTINUED)

1998

Segment profit .............................................. $139,947
Depreciation and amortization ............................... (49,264)
Interest, net ............................................... (76,505)
Stock option credit ......................................... 5,623
Managed care integration costs .............................. (16,962)

Income from continuing operations before provision for
income taxes, minority interest and extraordinary
items ................................................................. $  2,839

1999

Segment Profit .............................................. $228,452
Depreciation and amortization ............................... (73,531)
Interest, net ............................................... (93,752)
Stock option (expense) credit ................................ (18)
Managed care integration costs .............................. (6,238)
Special charges .............................................. (4,441)

Income from continuing operations before provision for
income taxes, minority interest and extraordinary item... $ 50,472

Revenue generated and long-lived assets located in foreign countries are not
material. Revenues from one customer of the Company's behavioral managed
healthcare segment represented 11.4% of the Company's consolidated revenues for
fiscal 1999. Revenues from one customer served by both the Company's behavioral
managed healthcare segment and specialty managed healthcare segment represented
15.7% of the Company's consolidated revenues for fiscal 1999.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Revenue</td>
<td>$443,331</td>
<td>$479,703</td>
<td>$463,421</td>
<td>$485,181</td>
</tr>
<tr>
<td><strong>Cost and expenses:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries, cost of care and other operating expenses</td>
<td>392,313</td>
<td>429,602</td>
<td>412,315</td>
<td>429,396</td>
</tr>
<tr>
<td>Equity in earnings of unconsolidated subsidiaries</td>
<td>(3,783)</td>
<td>(6,262)</td>
<td>(8,196)</td>
<td>(2,201)</td>
</tr>
<tr>
<td>Segment Profit</td>
<td>54,801</td>
<td>56,363</td>
<td>59,302</td>
<td>57,986</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>17,513</td>
<td>18,129</td>
<td>19,801</td>
<td>22,739</td>
</tr>
<tr>
<td>Interest, net</td>
<td>24,122</td>
<td>24,229</td>
<td>22,662</td>
<td>22,739</td>
</tr>
<tr>
<td>Stock option expense</td>
<td>12</td>
<td>6</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Managed care integration costs</td>
<td>1,750</td>
<td>2,119</td>
<td>522</td>
<td>1,847</td>
</tr>
<tr>
<td>Special charges, net</td>
<td>1,084</td>
<td>2,252</td>
<td>--</td>
<td>1,105</td>
</tr>
<tr>
<td><strong>Total Cost and Expenses</strong></td>
<td>44,481</td>
<td>46,735</td>
<td>42,985</td>
<td>43,779</td>
</tr>
<tr>
<td><strong>Income from continuing operations before income taxes and minority interest</strong></td>
<td>10,320</td>
<td>9,628</td>
<td>16,317</td>
<td>14,207</td>
</tr>
<tr>
<td>Provision for income taxes</td>
<td>5,915</td>
<td>5,658</td>
<td>8,323</td>
<td>7,480</td>
</tr>
<tr>
<td><strong>Income from continuing operations before minority interest</strong></td>
<td>16,235</td>
<td>15,276</td>
<td>24,637</td>
<td>21,687</td>
</tr>
<tr>
<td>Minority interest</td>
<td>4,405</td>
<td>3,970</td>
<td>7,994</td>
<td>6,727</td>
</tr>
<tr>
<td><strong>Income from continuing operations</strong></td>
<td>3,995</td>
<td>4,004</td>
<td>7,805</td>
<td>6,662</td>
</tr>
<tr>
<td>Discontinued operations:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (loss) from discontinued operations</td>
<td>186</td>
<td>(47)</td>
<td>13,694</td>
<td>15,812</td>
</tr>
<tr>
<td>Loss on disposal of discontinued operations</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>(47,423)</td>
</tr>
<tr>
<td><strong>Net income (loss)</strong></td>
<td>$4,181</td>
<td>$3,957</td>
<td>$21,499</td>
<td>$(24,949)</td>
</tr>
<tr>
<td><strong>Income (loss) per common share -- basic:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from continuing operations</td>
<td>$0.13</td>
<td>$0.13</td>
<td>$0.25</td>
<td>$0.21</td>
</tr>
<tr>
<td>Income (loss) from discontinued operations</td>
<td>$0.01</td>
<td>--</td>
<td>$0.43</td>
<td>$(0.99)</td>
</tr>
<tr>
<td><strong>Net income (loss)</strong></td>
<td>$0.13</td>
<td>$0.12</td>
<td>$0.68</td>
<td>$(0.78)</td>
</tr>
<tr>
<td><strong>Income (loss) per common share -- diluted:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from continuing operations</td>
<td>$0.13</td>
<td>$0.13</td>
<td>$0.24</td>
<td>$0.21</td>
</tr>
<tr>
<td>Income (loss) from discontinued operations</td>
<td>$0.01</td>
<td>--</td>
<td>$0.43</td>
<td>$(0.98)</td>
</tr>
<tr>
<td><strong>Net income (loss)</strong></td>
<td>$0.13</td>
<td>$0.12</td>
<td>$0.67</td>
<td>$(0.77)</td>
</tr>
</tbody>
</table>
1998

Net Revenue................................. $159,632 $321,256 $415,863 $414,027

Cost and expenses:
Salaries, cost of care and other operating expenses.......................................... 146,078 294,513 375,943 367,092
Equity in (earnings) losses of unconsolidated subsidiaries.................................. 634 (1,200) (6,750) (5,479)
Segment Profit........................................... 12,920 27,943 46,670 52,414
Depreciation and amortization....................... 5,568 11,489 16,326 15,881
Interest, net....................................... 7,685 17,799 24,693 26,328
Stock option expense (credit).......................... (3,959) 420 12 (2,096)
Managed care integration costs...................... -- 11,074 1,240 4,648

Segment Profit...................................... 9,294 40,782 42,271 44,761

Income (loss) from continuing operations before income taxes, minority interest and extraordinary items.... 3,626 (12,839) 4,399 7,653
Provision for (benefit from) income items............. 1,451 (4,278) 3,361 5,010
Minority interest..................................... 2,374 618 1,095 7

Income (loss) from continuing operations before extraordinary items............................... (199) (9,179) (57) 2,636
Discontinued operations:
Income (loss) from discontinued operations........... 7,827 6,887 7,467 (1,650)
Extraordinary item -- net loss on early extinguishments of debt.................................. -- (13,015) -- --

Net income (loss)..................................... 7,628 $(35,307) 7,410 $ 986

Income (loss) per common share -- basic:
Income (loss) from operations before extraordinary items........................................... $ (0.01) $ (0.30) $ -- $ 0.08
Income (loss) from discontinued operations........... $ 0.27 $ 0.22 $ 0.24 $ (0.05)
Extraordinary losses on early extinguishments of debt............................................. $ -- $ (1.06) $ -- $ --
Net income (loss)..................................... $ 0.26 $ (1.14) $ 0.24 $ 0.03

Income (loss) per common share -- diluted:
Income (loss) from continuing operations before extraordinary items............................... $ (0.01) $ (0.30) $ -- $ 0.08
Income (loss) from discontinued operations........... $ 0.27 $ 0.22 $ 0.24 $ (0.05)
Extraordinary losses on early extinguishments of debt............................................. $ -- $ (1.06) $ -- $ --
Net income (loss)..................................... $ 0.26 $ (1.14) $ 0.24 $ 0.03

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MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 1999

15. SUBSEQUENT EVENT
On July 19, 1999, the Company entered into a definitive agreement to issue approximately $75.4 million of cumulative convertible preferred stock to TPG Magellan, LLC, an affiliate of the investment firm Texas Pacific Group ("TPG") (the "TPG Investment"). On December 15, 1999, the Company and TPG amended and restated the definitive agreement and consummated the TPG Investment.

Pursuant to the amended and restated definitive agreement, TPG purchased approximately $59.1 million of the Company's Series A Cumulative Convertible Preferred Stock (the "Series A Preferred Stock") and an Option (the "Option") to purchase an additional approximately $21.0 million of Series A Preferred Stock. Net proceeds from issuance of Series A Preferred Stock were $54.0 million. Approximately 50% of the net proceeds received from the issuance of the Series A Preferred Stock was used to reduce debt outstanding under the Term Loan Facility with the remaining 50% of the proceeds being used for general corporate purposes. The Series A Preferred Stock carries a dividend of 6.5% per annum, payable in quarterly installments in cash or common stock, subject to certain conditions. Dividends not paid in cash or common stock will accumulate. The Series A Preferred Stock is convertible at any time by the holder into approximately 6.3 million shares of the Company's common stock at a conversion price of $9.375 per share and carries "as converted" voting rights. The Company may, under certain circumstances, require the holders of the Series A Preferred Stock to convert such stock into common stock. The Series A Preferred Stock, plus accrued and unpaid dividends thereon, must be redeemed by the Company on December 15, 2009. The Options will expire unless exercised by June 15, 2002. TPG may exercise the Options in whole or in part. The Company may, under certain circumstances, require TPG to exercise the Options. The terms of the shares of Series A Preferred Stock issuable pursuant to the Options are identical to the terms of the shares of Series A Preferred Stock issued to TPG at the closing of the TPG Investment.

TPG has three representatives on the Company's twelve-member Board of Directors.

The issuance of common stock in respect of accrued and unpaid dividend obligations on the Series A Preferred Stock and the issuance of common stock underlying the Options are subject to approval by the Company's stockholders. The Company intends to seek such stockholder approval no later than the next annual meeting of its stockholders, which is expected to be held in February 2000.

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SCHEDULE II--VALUATION AND QUALIFYING ACCOUNTS--MAGELLAN

(IN THOUSANDS)

<table>
<thead>
<tr>
<th>CLASSIFICATION</th>
<th>BEGINNING</th>
<th>CHARGED TO</th>
<th>CHARGED TO</th>
<th>END OF</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>OF PERIOD</td>
<td>COSTS AND</td>
<td>OTHER</td>
<td>PERIOD</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ACCOUNTS--</td>
<td>DEDUCTIONS--</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>EXPENSES</td>
<td>OF PERIOD</td>
<td></td>
</tr>
<tr>
<td>Fiscal year ended September 30, 1997:</td>
<td>$50,548</td>
<td>$46,211 (D)</td>
<td>$19,373(A)</td>
<td>$40,311</td>
</tr>
<tr>
<td>Allowance for doubtful accounts............</td>
<td>$21,400</td>
<td>$5,164 (F)</td>
<td>$2,943(G)</td>
<td>$34,867</td>
</tr>
<tr>
<td>Fiscal year ended September 30, 1998:</td>
<td>$40,311</td>
<td>$4,977 (D)</td>
<td>$15,031(A)</td>
<td>$34,867</td>
</tr>
<tr>
<td>Allowance for doubtful accounts............</td>
<td></td>
<td>$4,376(C)</td>
<td>$4,376(C)</td>
<td>$29,828</td>
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</tbody>
</table>


### Fiscal year ended September 30, 1999:

<table>
<thead>
<tr>
<th>Allowance for doubtful accounts</th>
<th>$34,867</th>
<th>$3,277 (D)</th>
<th>$2,362 (A)</th>
<th>$1,280 (B)</th>
<th>$28,437</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>(8,072) (E)</td>
<td>604 (C)</td>
<td>672 (F)</td>
<td>2,649 (H)</td>
</tr>
<tr>
<td></td>
<td>$34,867</td>
<td>$14,795</td>
<td>$3,946</td>
<td>$6,001</td>
<td>$28,437</td>
</tr>
</tbody>
</table>

---

(A) Recoveries of accounts receivable previously written off.

(B) Accounts written off.

(C) Allowance for doubtful accounts (net) assumed or disposed of in acquisitions or dispositions.

(D) Bad debt expense.

(E) Accounts receivable collection fees included in loss on Crescent Transactions.

(F) Accounts receivable collection fees payable to CBHS and outside vendors.

(G) Amounts reclassified to contractual allowances.

(H) Conversion of Provider JVs from consolidation to equity method.

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BYLAWS
OF
MAGELLAN HEALTH SERVICES, INC.

ARTICLE I.
OFFICES

SECTION 1. REGISTERED OFFICE. The registered office shall be in the
SECTION 2. OTHER OFFICES. The corporation may also have offices at such other places both within and without the State of Delaware as the board of directors may from time to time determine or the business of the corporation may require.

ARTICLE II.

MEETINGS OF STOCKHOLDERS

SECTION 1. PLACE OF MEETINGS. All meetings of the stockholders for the election of directors shall be held in the City of Atlanta, State of Georgia, at such place as may be fixed from time to time by the Board of Directors, or at such other place either within or without the State of Delaware as shall be designated from time to time by the Board of Directors and stated in the notice of the meeting. Meetings of stockholders for any other purpose may be held at such time and place, within or without the State of Delaware, as shall be stated in the notice of the meeting or in a duly executed waiver of notice thereof.

SECTION 2. DATE OF MEETINGS. Annual meetings of stockholders shall be held on a date and at a time as shall be designated from time to time by the Board of Directors and stated in the notice of the meeting, at which the stockholders shall elect members of the Board of Directors and transact such other business as may properly be brought before the meeting. Election of directors need not be by written ballot.

SECTION 3. NOTICE OF MEETINGS. Written notice of the annual meeting stating the place, date and hour of the meeting shall be given to each stockholder entitled to vote at such meeting not less than ten nor more than sixty days before the date of the meeting.

SECTION 4. LIST OF STOCKHOLDERS. The officer who has charge of the stock ledger of the corporation shall prepare and make, or cause to be prepared and made, at least ten days before every meeting of stockholders, a complete list of the stockholders entitled to vote at the meeting, arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten 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 list shall also be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present.

SECTION 5. SPECIAL MEETINGS. Special meetings of the stockholders, for any purpose or purposes, unless otherwise prescribed by statute or by the certificate of incorporation, may be called only by the affirmative vote of a majority of the Board of Directors.

SECTION 6. NOTICE OF SPECIAL MEETINGS. Written notice of a special meeting stating the place, date and hour of the meeting and the purpose or purposes for which the meeting is called, shall be given not less than ten nor more than sixty days before the date of the meeting, to each stockholder entitled to vote at such meeting.

SECTION 7. LIMITATIONS ON SPECIAL MEETINGS. Business transacted at any special meeting of stockholders shall be limited to the purposes stated in the notice.

SECTION 8. QUORUM AND ADJOURNMENT. The holders of a majority of the shares of all classes of stock issued and outstanding and entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum at all meetings of the stockholders for the transaction of business, except as otherwise provided by statute or by the certificate of incorporation. If, however, such quorum shall not be present or represented at any meeting of the stockholders, the stockholders entitled to vote thereat, present in person or represented by proxy, shall have power to adjourn the meeting from time to time,
without notice other than announcement at the meeting, until a quorum shall be present or represented. At such adjourned meeting at which a quorum shall be present or represented any business may be transacted which might have been transacted at the meeting as originally notified. If the adjournment is for more than thirty days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

SECTION 9. STOCKHOLDER ACTION. Except as provided in Section 3 of Article III of these Bylaws, or unless the question is one upon which, by express provision of statute or the certificate of incorporation, a different vote is required, in which case such express provision shall govern and control the decision of such question: (1) in all matters other than the election of directors, the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the subject matter shall be the act of the stockholders; (2) directors shall be elected by a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of directors; and (3) in voting on such questions, every stockholder of record who is entitled to vote shall be entitled to one vote for each share of stock held by him on the record date for such meeting.

SECTION 10. VOTING RIGHTS. Except as otherwise provided by law or by the certificate of incorporation, the holders of shares of all classes of stock shall have the right to vote, in person or by proxy, together on all matters to come before a meeting of the stockholders.

SECTION 11. PROXIES AND VOTING RIGHTS. No proxy shall be voted on after three years from its date, unless the proxy provides for a longer period. A duly executed proxy shall be irrevocable if it states that it is irrevocable and if, and only as long as, it is coupled with an interest sufficient in law to support an irrevocable power. A proxy may be made irrevocable regardless of whether the interest with which it is coupled is an interest in the stock itself or an interest in the corporation generally. In the event that any proxy shall designate two or more persons to act as proxies, a majority of such persons present at the meeting, or if only one be present that one, shall have all of the powers conferred by the proxy upon all of the persons so designated unless the proxy shall otherwise provide.

SECTION 12. ACTION BY CONSENT. The stockholders may not take any actions required to be taken at an annual or special meeting of the stockholders, or any actions which may be taken at an annual meeting or special meeting of the stockholders, by written consent in lieu of a meeting.

SECTION 13. INSPECTOR OF ELECTIONS. The Board of Directors, in advance of any meeting of the stockholders of the Corporation, shall appoint one or more inspectors of elections to act at such meeting, and any adjournment thereof. In case any person who has been designated as an inspector of elections fails to appear or act, the vacancy may be filled by an alternate appointed by the Board, in advance of the meeting, or at the meeting by the person presiding thereat. An inspector, before entering upon discharge of his duties, shall take and sign an oath faithfully to execute the duties of inspector with strict impartiality and according to the best of his ability. The inspector or inspectors so appointed shall perform the duties required by Section 231 of the Delaware General Corporation Law.

SECTION 14. PRESIDING OFFICER. The Chairman of the Board of Directors, or in his absence the President, shall serve as Chairman of every stockholders' meeting unless some other person is elected to serve as Chairman by a majority vote of the voting power of the shares represented at the meeting. The Chairman shall appoint the Secretary of the corporation, or in his absence an Assistant Secretary, as Secretary of every stockholders' meeting and such other persons as he deems required to assist with the meeting.

ARTICLE III.

DIRECTORS

SECTION 1. NUMBER, ELECTION AND TERM OF OFFICE. The number of directors which shall constitute the whole Board shall be that number that is designated in the Certificate of Incorporation of the Corporation. A change in the number
of directors shall only occur by an affirmative vote of at least seventy-five percent (75%) of the issued and outstanding shares of the corporation entitled to vote thereon cast at a meeting of the stockholders called for such purpose. The Board of Directors shall be divided into three classes, as nearly equal in numbers as the then total number of directors constituting the whole Board permits, with the term of office of one class expiring each year. The directors shall be elected at the annual meeting of the stockholders, except as provided in Sections 2 and 3 of this Article, and each director elected shall hold office until his successor is elected and qualifies. Directors need not be stockholders or a resident of the State of Delaware.

SECTION 2. VACANCIES. Any vacancies in the Board of Directors for any reason, and any newly created directorships resulting from any increase in the authorized number of directors, may be filled by a majority of the directors then in office, though less than a quorum, or by a sole remaining director, and the directors so chosen shall hold office until the next election of the respective class or classes for which such directors shall have been chosen and until their successors are duly elected and shall qualify, unless sooner displaced. If there are no directors in office, then an election of directors may be held in the manner provided by statute.

SECTION 3. REMOVAL. Notwithstanding any other provision of these Bylaws (and notwithstanding the fact that some lesser percentage may be specified by law), any director or the entire Board of Directors of the corporation may be removed from office at any time, but only (i) for cause by the affirmative vote of the holders of a majority of the issued and outstanding shares of the capital stock of the corporation entitled to vote thereon cast at a meeting of the stockholders called for that purpose, or (ii) without cause by the affirmative vote of the holders of at least seventy-five percent (75%) of the issued and outstanding shares of capital stock of the corporation entitled to vote thereon cast at a meeting of the stockholders called for that purpose.

SECTION 4. POWERS OF DIRECTORS. The business of the corporation shall be managed by its Board of Directors which may exercise all such powers of the corporation and do all such lawful acts and things as are not by statute or by the certificate of incorporation or by these Bylaws directed or required to be exercised or done by the stockholders.

SECTION 5. PLACE OF MEETINGS. The Board of Directors of the corporation may hold meetings, both regular and special, either within or without the State of Delaware. The Board of Directors shall appoint from its members a Chairman of the Board of Directors who shall preside at all meetings of the stockholders and the Board of Directors. In the absence of the Chairman of the Board of Directors from a meeting of the Board of Directors, the Board of Directors shall appoint from its members, by a majority vote of all directors constituting a quorum, another director who shall preside at such meeting. The Chairman of the Board of Directors may but need not be an officer of or employed in an executive or any other capacity by the corporation.

SECTION 6. TIME OF MEETINGS. A meeting of the Board of Directors shall be held immediately following the annual meeting of stockholders at the same place as such annual meeting or, in the alternative, at such time and place as shall be fixed by the vote of the stockholders at the annual meeting. No notice of such meeting shall be necessary, provided a quorum shall be present. In the event such meeting is not held at the time and place determined under the preceding sentence, the meeting may be held at such time and place as shall be specified in a notice given as hereinbefore provided for special meetings of the Board of Directors, or as shall be specified in a written waiver signed by all of the directors.

SECTION 7. REGULAR MEETINGS. Regular meetings of the Board of Directors may be held without notice at such time and at such place as shall from time to time be determined by the Board of Directors.

SECTION 8. SPECIAL MEETINGS. Special meetings of the Board of Directors may be called by the Chairman of the Board of Directors, the President, or a majority of the directors then in office
(a) by written notice mailed to each director first class postage prepaid, not later than the fifth day before the meeting, or (b) by either written or oral notice given personally or by telephone or other means of electronic communication, in which case the meeting may be held as soon after such notice is given as a quorum shall be assembled at the place of the meeting or by telephone conference call, unless another time shall be specified in the notice.

SECTION 9. QUORUM. At all meetings of the Board of Directors, a majority of the directors then in office shall constitute a quorum for the transaction of business and the act of a majority of the directors present at any meeting at which there is a quorum shall be the act of the Board of Directors, except as may be otherwise specifically provided by statute, by the certificate of incorporation or by these Bylaws. If a quorum shall not be present at any meeting of the Board of Directors, the directors present thereat may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present.

SECTION 10. ACTION BY CONSENT. Unless otherwise restricted by the certificate of incorporation or these Bylaws, any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting, if all members of the Board or committee, as the case may be, consent thereto in writing, and the writing or writings are filed with the minutes of proceedings of the Board or committee.

SECTION 11. TELEPHONE CONFERENCE CALL. Unless otherwise restricted by the Certificate of Incorporation or these Bylaws, members of the board of directors, or any committee designated by the board of directors, may participate in a meeting of the board of directors, or any committee, by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and such participation in a meeting shall constitute presence in person at the meeting.

SECTION 12. EXECUTIVE AND OTHER COMMITTEES. The Board of Directors may, by resolution adopted by a majority of the whole Board of Directors, appoint three or more of its members to constitute an Executive Committee which to the extent provided by the Board of Directors shall have and exercise all of the authority of the Board of Directors, except as otherwise provided by law, in the management of the business and affairs of the corporation, and may authorize the seal of the corporation to be affixed to all papers which may require it. All action taken by the Executive Committee shall be reported to the Board of Directors at its first meeting thereafter. The Board of Directors may also from time to time by resolution passed by a majority of the whole Board appoint other committees, consisting of one or more members, from among its members; and such committee or committees shall have such powers and duties as the Board of Directors may from time to time prescribe. Unless otherwise provided by the Board of Directors, a majority of the members of any committee appointed by the Board of Directors pursuant to this Section 12 shall constitute a quorum at any meeting thereof and the act of a majority of the members present at a meeting at which a quorum is present shall be the act of such committee. Action may be taken by any such committee without a meeting by a writing as provided in Section 10 of this Article III. Any such committee shall, subject to any rules prescribed by the Board of Directors, prescribe its own rules for calling, giving notice of and holding meetings and its method of procedure at such meetings and shall keep a written record of all action taken by it.

SECTION 13. MINUTES OF COMMITTEE MEETINGS. Each committee shall keep regular minutes of its meetings and periodically report the same to the Board of Directors.

SECTION 14. COMPENSATION. The directors may be paid their expenses, if any, of attendance at each meeting of the Board of Directors and may be paid a fixed sum for attendance at each meeting of the Board of Directors or a stated salary as director or a combination thereof. No such payment shall preclude any director from serving the corporation in any other capacity and receiving compensation therefor. Members of special or standing committees may be allowed like compensation for attending committee meetings.

ARTICLE IV.

NOTICES
SECTION 1. PROCEDURE. Whenever, under the provisions of the statutes or of the certificate of incorporation or of these Bylaws, notice is required to be given to any director or stockholder, it shall not be construed to mean personal notice, but such notice may be given in writing, by mail, addressed to such director or stockholder, at his address as it appears on the records of the corporation, with postage thereon prepaid, and such notice shall be deemed to be given at the time when the same shall be deposited in the United States mail. Notice to directors may also be given as provided in Section 8 of Article III.

SECTION 2. WAIVER AND CONSENT. Whenever any notice is required to be given under the provisions of the statutes or of the certificate of incorporation or of these Bylaws, a waiver thereof in writing, signed by the person or persons entitled to said notice, whether before or after the time stated therein, shall be deemed equivalent thereto. Notice of all stockholders' meetings, whether annual or special, shall be given in writing and may be given by the Chairman of the Board of Directors or the Secretary (or in case of their refusal, by the person or persons entitled to call meetings under the provisions of these Bylaws). The notice shall state the general nature of the business to be transacted at the meeting and the place, day and hour thereof. If such notice is mailed or telegraphed, it shall be deemed to have been given when deposited in the United States mail or with a telegraph office for transmission, as the case may be. If any meeting is adjourned to another time or place, no notice as to such adjourned meeting or of the business to be transacted thereat need be given other than by announcement at the meeting at which such adjournment is given, except as otherwise expressly provided in Section 8 of Article II.

ARTICLE V.
OFFICERS

SECTION 1. GENERAL. The officers of the corporation shall be chosen by the Board of Directors and shall be a President, a Vice President, a Secretary and a Treasurer. The Board of Directors may also choose additional Vice Presidents, and one or more Assistant Secretaries and Assistant Treasurers.

SECTION 2. ELECTION OF OFFICERS. The Board of Directors at its first meeting after each annual meeting of stockholders shall choose a President, one or more Vice Presidents, a Secretary and a Treasurer, or shall continue the incumbents in office.

SECTION 3. ADDITIONAL OFFICERS. The Board of Directors may appoint such other officers and agents as it shall deem necessary who shall hold their offices for such terms and shall exercise such powers and perform such duties as shall be determined from time to time by the Board of Directors.

SECTION 4. COMPENSATION. The salaries of all officers and agents of the corporation shall be fixed by the Board of Directors or by a duly authorized committee.

SECTION 5. TENURE. Each officer of the Corporation shall hold office until the earliest to occur of (a) his successor is elected and qualifies, (b) death or retirement of such officer, (c) resignation of such officer or (d) removal of such officer in the manner provided by these bylaws. Any officer elected or appointed by the Board of Directors may be removed at any time by the affirmative vote of a majority of the Board of Directors or, in the case of all officers except the President, by the President. Any vacancy occurring in any office of the Corporation and all newly created officer positions shall be filled by the Board of Directors.

SECTION 6. PRESIDENT - POWERS AND DUTIES. The President shall be and perform the duties and responsibilities of the Chief Executive Officer of the corporation and as such shall have general supervision and control over all the affairs of the corporation, its officers and employees. The President may, but need not, be designated the Chief Operating Officer of the corporation. The President shall report to the Board of Directors regarding the affairs of the corporation and shall have such other duties and powers as may be assigned to or vested in him from time to time by the Board of Directors or by the Executive Committee and as prescribed by these Bylaws.

SECTION 7. PRESIDENT - EXECUTION OF DOCUMENTS. The President shall
execute bonds, mortgages and other contracts requiring a seal, under the seal of
the corporation, except where required or permitted by law to be otherwise
signed and executed and except where the signing and execution thereof shall be
delegated by the Board of Directors or the Executive Committee to some other
officer or agent of the corporation.

SECTION 8. VICE PRESIDENTS - POWERS AND DUTIES. The Vice President, or
if there shall be more than one the Vice Presidents, shall perform such duties
and have such powers as the Board of Directors may from time to time prescribe.

SECTION 9. SECRETARY - POWERS AND DUTIES. The Secretary shall attend
all meetings of the Board of Directors and all meetings of the stockholders and
record or cause to be recorded all the proceedings of the meetings of the
corporation and of the Board of Directors in a book to be kept for that purpose
and shall perform like duties for the standing committees when required. He
shall give, or cause to be given, notice of all meetings of the stockholders and
special meetings of the Board of Directors, and shall perform such other duties
as may be prescribed by the Board of Directors or Chairman of the Board of
Directors, under whose supervision he shall be. He shall have custody of the
corporate seal of the corporation, and he, or an Assistant Secretary, shall have
authority to affix the same to any instrument requiring it; when so affixed, it
can be attested by his signature or by

the signature of such Assistant Secretary. The Board of Directors may give
general authority to any other officer to affix the seal of the corporation and
to attest the affixing by his signature.

SECTION 10. ASSISTANT SECRETARY. The Assistant Secretary, or if there
be more than one the Assistant Secretaries in the order determined by the Board
of Directors, shall, in the absence or disability of the Secretary, perform the
duties and exercise the powers of the Secretary and shall perform such other
duties and have such other powers as the Board of Directors may from time to
time prescribe.

SECTION 11. TREASURER - POWERS AND DUTIES. The Treasurer shall have
custody of the corporate funds and securities, shall together with the
Controller keep full and accurate accounts of receipts and disbursements in
books belonging to the corporation and shall deposit all moneys and other
valuable effects in the name and to the credit of the corporation in such
depositories as may be designated by the Board of Directors.

SECTION 12. TREASURER - DISBURSEMENTS AND ACCOUNTING. The Treasurer and
Controller shall disburse the funds of the corporation as may be ordered by the
Board of Directors, and shall render to the Board of Directors, at its regular
meetings, or when the Board of Directors so requires, an account of the
financial condition of the corporation.

SECTION 13. ASSISTANT TREASURER. The Assistant Treasurer, or if there
shall be more than one the Assistant Treasurers in the order determined by the Board
of Directors, shall, in the absence or disability of the Treasurer, perform the
duties and exercise the powers of the Treasurer and shall perform such other
duties and have such other powers as the Board of Directors may from
time to time prescribe. Any one or more of the duties of the Treasurer may be
delegated by the Board of Directors to the Controller, an Assistant Treasurer or
any other officer of the corporation.

SECTION 14. BONDS. If required by the Board of Directors, any officer
shall give the corporation a bond in such sum and with such surety or sureties
as shall be satisfactory to the Board of Directors for the faithful performance
of the duties of his office and for the restoration to the corporation, in case
of his death, resignation, retirement or removal from office, of all books,
papers, vouchers, money and other property of whatever kind in his possession or
under his control belonging to the corporation.

ARTICLE VI.

CERTIFICATES FOR SHARES OF STOCK

SECTION 1. RIGHTS TO CERTIFICATE. Every holder of stock in the
corporation shall be entitled to have a certificate, signed by, or in the name
of the corporation, by the Chairman of the Board of Directors, the President or
A Vice President and the Treasurer or an Assistant Treasurer, or the Secretary or an Assistant Secretary of the corporation, certifying the number of shares of capital stock of the corporation owned by him in the corporation.

SECTION 2. CLASSES OF STOCK - RIGHTS. If the corporation shall be authorized to issue more than one class of stock, or more than one series of any class, the powers, designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights shall be set forth in full or summarized on the face or back of the certificate which the corporation shall issue to represent such class or series of stock, a statement that the corporation will furnish without charge to each stockholder who so requests, the powers, designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights.

SECTION 3. OFFICERS' SIGNATURES. Where a certificate is signed (1) by a transfer agent or an assistant transfer agent or (2) a registrar, the signature of any such officer may be facsimile. In case any officer or officers who have signed, or whose facsimile signature or signatures have been used on, any such certificate or certificates shall cease to be such officer or officers of the corporation, whether because of death, resignation or otherwise, before such certificate or certificates have been delivered by the corporation, such certificate or certificates may nevertheless be adopted by the corporation and be issued and delivered as though the person or persons who signed such certificate or certificates or whose facsimile signature or signatures have been used thereon had not ceased to be such officer or officers of the corporation.

SECTION 4. LOST CERTIFICATES. The Board of Directors may direct a new certificate or certificates to be issued in place of any certificate or certificates theretofore issued by the corporation alleged to have been lost or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate of stock to be lost or destroyed. When authorizing such issue of a new certificate or certificates, the Board of Directors may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost or destroyed certificate or certificates, or his legal representative, to advertise the same in such manner as it shall require and/or to give the corporation a bond in such sum as it may direct as indemnity against any claim that may be made against the corporation with respect to the certificate alleged to have been lost or destroyed.

SECTION 5. TRANSFERS OF STOCK. Upon surrender to the corporation or the transfer agent of the corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignment or authority to transfer, in each case with signatures guaranteed, it shall be the duty of the corporation to issue a new certificate to the person entitled thereto, cancel the old certificate and record the transaction upon its books.

SECTION 6. FIXING OF RECORD DATE. The Board of Directors shall fix in advance a date, not less than ten nor more than sixty days preceding the date of any meeting of stockholders, or the date for the payment of any dividend, or the date for the allotment of rights, or the date when any change or conversion or exchange of capital stock shall go into effect, or a date in connection with obtaining a consent, as a record date for the determination of the stockholders entitled to notice of, and to vote at, any such meeting, and any adjournment thereof, or entitled to receive payment of any such dividend, or to any such allotment of rights, or to exercise the rights in respect of any such change, conversion or exchange of capital stock, or to give such consent, and in such case such stockholders as shall be stockholders of record on the date so fixed shall be entitled to such notice of, and to vote
at, such meeting and any adjournment thereof, or to receive payment of such
dividend, or to receive such allotment of rights, or to exercise such rights, or
to give such consent, as the case may be, notwithstanding any transfer of any
stock on the books of the corporation after any such record date fixed as
aforesaid.

SECTION 7. REGISTERED STOCKHOLDERS. The corporation shall be entitled
to recognize the exclusive right of a person registered on its books as the
owner of shares to receive dividends, and to vote as such owner, and to hold
liable for calls and assessments a person registered on its books as the owner
of shares, and shall not be bound to recognize any equitable or other claim to
or interest in such share or shares on the part of any other person, whether or
not it shall have express or other notice thereof, except as otherwise provided
by the laws of Delaware.

ARTICLE VII.
INDEMNIFICATION

SECTION 1. ACTIONS NOT BY OR IN THE RIGHT OF THE CORPORATION. The
corporation shall indemnify any person who was or is a party or is threatened to
be made a party to any threatened, pending or completed action, suit or
proceeding, whether civil, criminal, administrative or investigative (other than
an action by or in the right of the corporation) by reason of the fact that he
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, employee or
agent of another corporation, partnership, joint venture, trust or other
enterprise, against expenses (including attorneys' fees), judgments, fines and
amounts paid in settlement actually and reasonably incurred by him in connection
with such action, suit or proceeding if he acted in good faith and in a manner
he reasonably believed to be in or not opposed to the best interests of the
corporation, and, with respect to any criminal action or proceeding, had no
reasonable cause to believe his conduct was unlawful. The termination of any
action, suit or proceeding by judgment, order, settlement, conviction, or upon a
plea of NOLO CONTENDERE or its equivalent, shall not, of itself, create a
presumption that the person did not act in good faith and in a manner which he
reasonably believed to be in or not opposed to the best interests of the
corporation, and, with respect to any criminal action or proceeding, had
reasonable cause to believe that his conduct was unlawful.

SECTION 2. ACTIONS BY OR IN THE RIGHT OF THE CORPORATION. The
corporation shall indemnify any person who was or is a party or is threatened to
be made a party to any threatened, pending or completed action or suit by or in
the right of the corporation to procure a judgment in its favor by reason of the
fact that he is or was a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other
enterprise, against expenses (including attorneys' fees) actually and
reasonably incurred by him in connection with the defense or settlement of such
action or suit if he acted in good faith and in a manner he reasonably believed
to be in or not opposed to the best interests of the corporation and except that
no indemnification shall be made in respect of any claim, issue or matter as to
which such person shall have been adjudged to be liable to the corporation
unless and only to the extent that the Court of Chancery or the court in which
such action or suit was brought shall determine upon application that, despite
the adjudication of liability

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but in view of all the circumstances of the case, such person is fairly and
reasonably entitled to indemnity for such expenses which the Court of Chancery
or such other court shall deem proper.

SECTION 3. INDEMNIFICATION WHERE DIRECTOR OR OFFICER SUCCESSFULLY
DEFENDS ACTION. To the extent that a director, officer or employee of the
corporation has been successful on the merits or otherwise in defense of any
action, suit or proceeding referred to in Sections 1 and 2 of this Article VII,
or in defense of any claim, issue or matter therein, he shall be indemnified
against expenses (including attorneys' fees) actually and reasonably incurred by
him in connection therewith.

SECTION 4. DETERMINATIONS REQUIRED PRIOR TO INDEMNIFICATION. Except as
provided in Section 3 of this Article VII and except as may be ordered by a
court, any indemnification under Sections 1 and 2 of this Article VII shall be made by the corporation only as authorized in the specific case upon a determination that indemnification of the director, officer or employee is proper in the circumstances because he has met the applicable standard of conduct set forth in Sections 1 and 2 of this Article VII, as the case may be. Such determination shall be made (1) by a majority vote of the directors who were not parties to such action, suit or proceeding, even though less than a quorum; or (2) if there are no such directors, or if such directors so direct, by independent legal counsel in a written opinion; or (3) by the stockholders.

SECTION 5. ADVANCES. Expenses (including attorney's fees) incurred by an officer or director in defending any civil, criminal, administrative, or investigative action, suit or proceeding shall be paid by the corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of the director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the corporation as authorized in this Article. Such expenses (including attorney's fees) incurred by other employees may be so paid upon such terms and conditions, if any, as the Board of Directors deems appropriate.

SECTION 6. GENERAL. The indemnification and advancement of expenses provided by or granted pursuant to these Bylaws shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be or shall become entitled under any agreement, vote of stockholders or disinterested directors or otherwise, both as to actions in an official capacity and as to actions in another capacity while holding such office.

SECTION 7. INSURANCE. The corporation may purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against such liabilities under the certificate of incorporation, the provisions of these Bylaws or under the provisions of the General Corporation Law of the State of Delaware.

SECTION 8. THE CORPORATION. For purposes of this Article VII, references to "the corporation" shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had the power and authority to indemnify its directors, officers and employees, so that any person who is or was a director, officer or employee of such constituent corporation, or is or was serving at the request of such corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against such liabilities under the certificate of incorporation, the provisions of these Bylaws or under the provisions of the General Corporation Law of the State of Delaware.

SECTION 9. EMPLOYEE BENEFIT PLANS. For purposes of this Article VII, references to "other enterprises" shall include employee benefit plans; the reference to "fines" shall include any excise taxes assessed on a person with respect to an employee benefit plan; and references to "serving at the request of the corporation" shall include any service as a director, officer, employee or agent of the corporation which imposes duties on, or involves services by, such director, officer or employee with respect to an employee benefit plan, its participants or beneficiaries; and a person who acted in good faith and in a manner he reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan shall be deemed to have acted in a manner "not opposed to the best interests of the corporation" as referred to in this Article VII.

SECTION 10. CONTINUATION. The indemnification and advancement of expenses provided by, or granted pursuant to, these Bylaws shall continue as to a person who has ceased to be a director, officer or employee and shall inure to the benefit of the heirs, executors and administrators of such a person.
SECTION 11. FUTURE AMENDMENTS. In the event of any amendment or addition to Section 145 of the General Corporation Law of the State of Delaware or the addition of any other section of such law with regard to indemnification, the corporation shall indemnify to the fullest extent authorized or permitted by such then-existing General Corporation Law of the State of Delaware, as amended, any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (including an action by or in the right of the corporation), by reason of the fact that he 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, employee or agent of another corporation, partnership, joint venture, trust, or other enterprise against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding.

ARTICLE VIII.

GENERAL PROVISIONS

SECTION 1. DIVIDENDS. Dividends upon the capital stock of the corporation, subject to the provisions of the certificate of incorporation, if any, may be declared by the Board of Directors at any regular or special meeting, pursuant to law. Dividends may be paid in cash, in property, or in shares of the capital stock, subject to the provisions of the certificate of incorporation.

SECTION 2. RESERVES. Before payment of any dividend, there may be set aside out of any funds of the corporation available for dividends such sum or sums as the Board of Directors from time to time, in their absolute discretion, think proper as a reserve or reserves to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the corporation, or for such other purpose as the Board of Directors shall think conducive to the interest of the corporation, and the Board of Directors may modify or abolish any such reserve in the manner in which it was created.

SECTION 3. ANNUAL STATEMENT. The Board of Directors shall present at each annual meeting, and at any special meeting, of the stockholders when called for by vote of the stockholders a concise statement of the business and condition of the corporation.

SECTION 4. CHECKS. All checks or demands for money and notes of the corporation shall be signed by such officer or officers or such other person or persons as the Board of Directors may from time to time designate.

SECTION 5. FISCAL YEAR. The fiscal year of the corporation shall be determined by the Board of Directors, and shall be from October 1 through September 30, unless otherwise determined by the Board of Directors.

SECTION 6. SEAL. The corporate seal shall be in the form prescribed by the Board of Directors. The seal may be used by causing it or a facsimile thereof to be impressed or affixed or reproduced or otherwise.

SECTION 7. MISCELLANEOUS. Unless otherwise ordered by the Board of Directors, the President, any Vice President, the Secretary, any Assistant Secretary or the Treasurer in person or by proxy appointed by any of them shall have full power and authority on behalf of the corporation to vote, act and consent with respect to any shares of stock issued by other corporations which the corporation may own or as to which the corporation has the right to vote, act or consent.

ARTICLE IX.

AMENDMENTS

These Bylaws may be altered or repealed at any regular meeting of the stockholders or of the Board of Directors or at any special meeting of the stockholders or of the Board of Directors if such notice of such alteration or
repeal be contained in the notice of such special meeting. No Bylaw adopted by vote of the stockholders shall be subject to amendment by the Board of Directors if such Bylaw so provides. Notwithstanding the foregoing, neither Sections 5 nor 12 of Article II may be amended, altered, changed or repealed except by the affirmative vote of the holders of at least seventy-five percent (75%) of the issued and outstanding shares of capital stock of the Corporation entitled to vote thereon cast at a meeting of the stockholders called for that purpose.
AMENDMENT No. 3 entered into as of July 29, 1999 (this "AMENDMENT"), to the Credit Agreement dated as of February 12, 1998 (as amended, supplemented or otherwise modified from time to time, the "CREDIT AGREEMENT"), among Magellan Health Services, Inc., a Delaware corporation (the "PARENT BORROWER"); Charter Behavioral Health System of New Mexico, Inc., a New Mexico corporation; Merit Behavioral Care Corporation, a Delaware corporation; each other wholly owned domestic subsidiary of the Parent Borrower that becomes a "Subsidiary Borrower" pursuant to Section 2.23 of the Credit Agreement (each, a "SUBSIDIARY BORROWER" and, collectively, the "SUBSIDIARY BORROWERS" (such term is used herein as modified in Article I of the Credit Agreement); the Parent Borrower and the Subsidiary Borrowers are collectively referred to herein as the "BORROWERS"); the Lenders (as defined in Article I of the Credit Agreement); The Chase Manhattan Bank, a New York banking corporation, as administrative agent (in such capacity, the "ADMINISTRATIVE AGENT") for the Lenders, as collateral agent (in such capacity the "COLLATERAL AGENT") for the Lenders and as an issuing bank (in such capacity, an "ISSUING BANK"); First Union National Bank, a national banking corporation, as syndication agent (in such capacity, the "SYNDICATION AGENT") for the Lenders and as an issuing bank (in such capacity, an "ISSUING BANK"); and Credit Lyonnais New York Branch, a licensed branch of a bank organized and existing under the laws of the Republic of France, as documentation agent (in such capacity, the "DOCUMENTATION AGENT") for the Lenders and as an issuing bank (in such capacity, an "ISSUING BANK") and, together with The Chase Manhattan Bank and First Union National Bank, each in its capacity as an issuing bank, the "ISSUING BANKS").

A. The Lenders and the Issuing Banks have extended credit to the Borrowers, and have agreed to extend credit to the Borrowers, in each case pursuant to the terms and subject to the conditions set forth in the Credit Agreement.

B. In relation to each CBHS Joint Venture (as defined in the Credit Agreement, as amended by this Amendment), the Parent Borrower and the subsidiary of the Parent Borrower that is a party to such CBHS Joint Venture (the "JV Party") have entered into a Services Agreement (as defined in the Credit Agreement, as amended by this Amendment) with CBHS or one of its subsidiaries, under which CBHS or the relevant subsidiary has agreed to provide certain services in respect of such CBHS Joint Venture. Under Section 3.1(b) of each Services Agreement with respect to a CBHS Joint Venture, the Parent Borrower and the JV Party have agreed to retain certain net proceeds from a CBHS Joint Venture Sale (as defined in the Credit Agreement, as amended by this Amendment) to be used for certain purposes specified in such Services Agreement.

C. The Parent Borrower intends to effect the GPA Sale (as defined in the Credit Agreement, as amended by this Amendment) for aggregate consideration at least equal to the fair market value of the assets sold (as determined in good faith by a Responsible Officer of the Parent Borrower), in accordance with the terms of the purchase agreement in form and substance reasonably satisfactory to the
Administrative Agent to be entered into to effect the GPA Sale.

D. The Parent Borrower intends to effect the Specified Equity Issuances (as defined in the Credit Agreement, as amended by this Amendment), and has requested that it be able to pay dividends on the capital stock issued pursuant to the Specified Equity Issuances, and redeem, repurchase or otherwise make payments in respect of such capital stock, in certain circumstances.

E. The Borrowers have requested that the requisite Lenders amend certain provisions of the Credit Agreement in connection with the transactions described in the preceding paragraphs B, C and D, and the requisite Lenders are willing so to amend such provisions of the Credit Agreement, on the terms and subject to the conditions set forth in this Amendment.

F. Capitalized terms used but not defined herein have the meanings assigned to them in the Credit Agreement.

Accordingly, in consideration of the mutual agreements herein contained and other good and valuable consideration, the sufficiency and receipt of which are hereby acknowledged, the parties hereto agree as follows:

SECTION 1. AMENDMENTS TO SECTION 1.01. (a) The definition of the term "Change in Control" in Section 1.01 of the Credit Agreement is hereby amended by adding the word "(A)" immediately after the words "defined in" in the tenth line of such definition and by adding the following text at the end of such definition before the ":"

", or (B) the terms of any capital stock issued pursuant to any Specified Equity Issuance. Without limiting the foregoing, a Change in Control shall be deemed to have occurred if a majority of the persons holding seats on the board of directors of the Parent Borrower were nominated, appointed or elected (a) by, or at the direction of, the holders of the capital stock issued pursuant to any Specified Equity Issuance or (b) pursuant to the rights contained in the terms of any Specified Equity Issuance or in any agreement entered into in connection with, or relating to, any Specified Equity Issuance."

(b) (i) The definition of the term "Permitted Stock Repurchase" in Section 1.01 of the Credit Agreement is hereby deleted in its entirety and replaced with the following new definition:

""PERMITTED STOCK REPURCHASES OR DIVIDENDS" shall mean (a) any repurchase by the Parent Borrower of shares of its common stock, (b) any repurchase by

the Parent Borrower of any stock option held by any director, officer or employee, and any amount paid by the Parent Borrower in respect of the cancelation or termination of any stock option, (c) any repurchase or redemption by the Parent Borrower of shares of non-voting capital stock issued by the Parent Borrower as part of a Specified Equity Issuance, the payment of accumulated and unpaid dividends and arrearages on such shares of non-voting capital stock to the extent that such dividends and arrearages become due and payable at the time of a repurchase or redemption permitted by this clause (c), or any payment made by the Parent Borrower in connection with the sale by the holder(s) of non-voting capital stock issued by the Parent Borrower as part of a Specified Equity Issuance, in each case (i) after March 5, 2002, (ii) only in the circumstances and to the extent required by the terms and conditions of the relevant Specified Equity Issuance and (iii) solely in accordance with the terms and conditions of the relevant Specified Equity Issuance, (d) any payment of a cash dividend on any capital stock issued pursuant to any Specified Equity Issuance or (e) any payment of dividends on any capital stock issued pursuant to any Specified Equity Issuance (i) in the form of (A) additional shares of such capital stock (or of other capital stock of the Parent Borrower issued pursuant to a Specified Equity Issuance or otherwise on terms that are not
less favorable to the Lenders than the terms of such capital stock) or (B) shares of common stock of the Parent Borrower (such common stock to have the same terms as the common stock issued by the Parent Borrower as of the date hereof or terms that are not less favorable to the Lenders than the terms of such common stock) and (ii) in accordance with the terms of such capital stock issued pursuant to such Specified Equity Issuance, in each case, so long as (A) after giving effect to such repurchase, redemption, cancelation, termination or payment, (1) the Parent Borrower shall be in compliance, on a PRO FORMA basis, with all covenants set forth in this Agreement, including then the effective covenants contained in Sections 6.10, 6.11, 6.12, 6.13 and 6.14, which shall be recomputed as at the last day of the most recently ended fiscal quarter (for which financial information has been delivered pursuant to Section 5.04) of the Parent Borrower as if such repurchase, redemption, cancelation, termination or payment had occurred on the first day of each relevant period for testing such compliance, and (2) on the date of such repurchase, redemption, cancelation, termination or payment and immediately after giving effect thereto, no Default or Event of Default shall exist, (B) the aggregate cash amount expended by the Parent Borrower in connection with all Permitted Stock Repurchases or Dividends shall not exceed during the term of this Agreement (x) in the case of all repurchases, redemptions and payments permitted by clause (c) of this definition, the sum of (I) the lesser of $18,500,000 and the aggregate cash consideration received by the Parent Borrower in respect of the issuance of non-voting capital stock as part of a Specified Equity Issuance to Persons other than the Preemptive Rights Holders, (II) the aggregate cash consideration received by the Parent Borrower in respect of the issuance of non-voting capital stock as part of a Specified Equity Issuance to the Preemptive Rights Holders solely pursuant to the exercise of their preemptive rights under the Preemptive Rights Agreement in respect of capital stock being issued to other Persons as a Specified Equity Issuance, (III) the aggregate cash consideration received by the Parent Borrower in respect of any Equity Issuance described in the first proviso to Section 2.13(d) and (IV) $10,000,000 less the aggregate amount that has been expended pursuant to clause (a), (b), (d) or (e) above (any payment made pursuant to this clause (IV) being an "additional payment") and (y) in the case of all other Permitted Stock Repurchases or Dividends as described in clauses (a), (b), (d) or (e) above, $10,000,000 less the aggregate amount that has been expended on additional payments and (C) after giving effect to any such repurchase, redemption, cancelation, termination or payment, the aggregate amount of cash and cash equivalents on the Parent Borrower's consolidated balance sheet PLUS the remaining available balance of the Total Revolving Credit Commitment shall be at least equal to (x) in the case of Permitted Stock Repurchases or Dividends as described in clauses (a), (b), (d) or (e) above, $50,000,000 or (y) in the case of Permitted Stock Repurchases or Dividends as described in clause (c) above, $20,000,000. Notwithstanding anything to the contrary set forth in this definition, the issuance by the Parent Borrower of (a) common stock of the Parent Borrower (such common stock to have the same terms as the common stock issued by the Parent Borrower as of the date hereof or terms that are not less favorable to the Lenders than the terms of such common stock) or (b) non-redeemable participating preferred stock of the Parent Borrower (such preferred stock to be issued pursuant to the terms of a Specified Equity Issuance or on terms that are not less favorable to the Lenders than those provided in such Specified Equity Issuance), in each case in respect of accumulated and unpaid dividends and arrearages on capital stock issued pursuant to a Specified Equity Issuance when such capital stock is being converted to common stock or
non-redeemable participating preferred stock of the Parent Borrower in accordance with the terms and conditions of the relevant Specified Equity Issuance, shall, to the extent that such common stock or non-redeemable participating preferred stock dividends are required under the terms and conditions of the relevant Specified Equity Issuance, constitute Permitted Stock Repurchases or Dividends."

(ii) Each reference to the term "Permitted Stock Repurchase" in the Credit Agreement is hereby replaced with the term "Permitted Stock Repurchases or Dividends".

(c) Section 1.01 of the Credit Agreement is hereby amended to add the defined term "GPA Sale" in the appropriate alphabetical order, to read in its entirety as follows:

"GPA SALE" shall mean the sale by the Parent Borrower and/or the relevant Subsidiaries, for aggregate consideration at least equal to the fair market value of the assets sold (as determined in good faith by a Responsible Officer of the Parent Borrower, taking into account when such consideration is payable), of (a) all the capital stock and/or all or substantially all the assets of Group Practice Affiliates, Inc., a Delaware corporation, and/or one or more of the subsidiaries of Group Practice Affiliates, Inc. and (b) any and all ancillary, similar or related assets to the businesses being so sold, all in accordance with the terms of a purchase agreement or agreements (in related transactions) in form and substance reasonably satisfactory to the Administrative Agent, PROVIDED that such GPA Sale shall be deemed to be an Asset Sale with Net Cash Proceeds in an amount equal to the greater of (a) $15,000,000 or (b) the Net Cash Proceeds received by the Parent Borrower and/or such relevant Subsidiaries in connection with such GPA Sale."

(d) Section 1.01 of the Credit Agreement is hereby amended to add the defined term "CBHS Joint Ventures" in the appropriate alphabetical order, to read in its entirety as follows:

"CBHS JOINT VENTURES" shall mean the partnerships and limited liability companies constituted under the agreements referred to in the following clauses (a) through (f), in each case as the same may be amended, supplemented and restated from time to time: (a) the Amended and Restated Limited Partnership Agreement dated as of May 31, 1995, under which Charter Behavioral Health System of New Mexico, Inc. and New Mexico Psychiatric Company formed Charter Heights Behavioral Health System Limited Partnership, (b) the Operating Agreement dated as of September 30, 1995, under which Charter Behavioral Health System of Lafayette, Inc. and Louisiana Psychiatric Company, Inc. formed The Charter Cypress Behavioral Health System, L.L.C., (c) the Operating Agreement dated as of June 30, 1995, under which Charter Northridge Behavioral Health System, Inc. and Wake Psychiatric Hospital, Inc. formed Holly Hill/Charter Behavioral Health System, L.L.C., (d) the Operating Agreement dated as of August 6, 1996, under which Charter Behavioral Health Systems, Inc. (now Magellan CBHS Holdings, Inc.) and Columbia North Alaska Healthcare, Inc. formed Charter North Star Behavioral Health System, L.L.C., (e) the Joint Venture Agreement dated as of November 1, 1988, under which Naperville Health Ventures (assignor of Edward Hospital Ventures) and P.I.A. Naperville, Inc. (assignor of Charter Linden Oaks Behavioral Health System, Inc.) formed Naperville Psychiatric Ventures and (f) the Agreement of Limited Partnership dated as of February 28, 1995, under which Charter Behavioral Health System of Massachusetts, Inc., Westwood/Pembroke Corporation and
(e) Section 1.01 of the Credit Agreement is hereby amended to add the defined term "CBHS Joint Venture Sale" in the appropriate alphabetical order, to read in its entirety as follows:

"CBHS JOINT VENTURE SALE" shall mean, in respect of any CBHS Joint Venture, the sale by the Parent Borrower or the Subsidiary that holds an interest in such CBHS Joint Venture, or owns a hospital property that is solely used by such CBHS Joint Venture (the "hospital"), of (a) all of its interest in such CBHS Joint Venture, (b) the hospital solely used by such CBHS Joint Venture or (c) in the case of a Subsidiary the only material asset of which is an ownership interest in such CBHS Joint Venture or the hospital, all the capital stock of that Subsidiary, for aggregate cash consideration at least equal to the fair market value of the assets sold (as determined in good faith by a Responsible Officer of the Parent Borrower, taking into account when such consideration is payable).

(f) Section 1.01 of the Credit Agreement is hereby amended to add the defined term "Preemptive Rights Agreement" in the appropriate alphabetical order, to read in its entirety as follows:

"Preemptive Rights Agreement" shall mean that certain Stock and Warrant Purchase Agreement dated as of December 22, 1995, between the Parent Borrower (formerly Charter Medical Corporation) and Richard E. Rainwater, as assigned and amended.

(g) Section 1.01 of the Credit Agreement is hereby amended to add the defined term "Preemptive Rights Holders" in the appropriate alphabetical order, to read in its entirety as follows:

"Preemptive Rights Holders" shall mean, collectively, the holders of the preemptive rights to buy capital stock of the Parent Borrower pursuant to the Preemptive Rights Agreement.

(h) Section 1.01 of the Credit Agreement is hereby amended to add the defined term "Services Agreement" in the appropriate alphabetical order, to read in its entirety as follows:

"SERVICES AGREEMENT" shall mean, in respect of each CBHS Joint Venture, the services agreement dated as of June 16, 1997, entered into among the Parent Borrower, the Subsidiary that holds an interest in such CBHS Joint Venture and CBHS or one of its subsidiaries.

(i) Section 1.01 of the Credit Agreement is hereby amended to add the defined term "Specified Equity Issuance" in the appropriate alphabetical order, to read in its entirety as follows:

"SPECIFIED EQUITY ISSUANCE" shall mean (a) any Equity Issuance by the Parent Borrower of capital stock on or before March 31, 2000, PROVIDED that (i) the Parent Borrower designates in writing to the Administrative Agent at the time of such Equity Issuance that such Equity Issuance is a "Specified Equity Issuance" for the purposes of this Agreement, (ii) the material terms of such Equity Issuance have been approved by the Required Lenders and (iii) the aggregate stated value or liquidation preference of all such capital stock so issued pursuant to this clause (a) shall not exceed the sum of (i) $76,000,000 and (ii) the aggregate cash consideration received by the Parent Borrower from the issuance of capital stock of the Parent Borrower to the Preemptive Rights Holders solely pursuant to the exercise of
their preemptive rights under the Preemptive Rights Agreement in respect of capital stock being issued to other Persons as a Specified Equity Issuance, and (b) any payment of dividends by the Parent Borrower referred to in clause (e) of the definition of the term "Permitted Stock Repurchases or Dividends."

SECTION 2. AMENDMENT TO SECTION 2.13(a). The Lenders hereby amend Section 2.13(a) of the Credit Agreement by adding the text "(i)" after the text "shall be required" in the fifth line of that Section and by adding the following text at the end of that Section:

"or (ii) in respect of any CBHS Joint Venture Sale to the extent, but only to the extent, that the Parent Borrower or any Subsidiary is required to make available for reinvestment for the benefit of CBHS or any of its subsidiaries an amount equal to all or a portion of the Net Cash Proceeds received from such CBHS Joint Venture Sale (A) in respect of all of the CBHS Joint Ventures, pursuant to Section 3.1(b) of the Services Agreement relating to such CBHS Joint Venture or (B) in respect of the CBHS Joint Ventures described in clauses (a) and (d) of the definition of the term "CBHS Joint Venture", as may be required or necessary (as reasonably determined by the Parent Borrower and to the reasonable satisfaction of the Administrative Agent) in order for the Parent Borrower or any Subsidiary to satisfy or obtain a release of its obligations pursuant to Section 6.11(b) of the Services Agreement or the organizational documents of the CBHS Joint Venture (as in effect on July 19, 1999) as a result of such CBHS Joint Venture Sale."

SECTION 3. AMENDMENT TO SECTION 2.13(d). The Lenders hereby amend Section 2.13(d) of the Credit Agreement by deleting the existing text of Section 2.13(d) in its entirety and replacing it with the following new text:

(d) In the event that any Borrower or any Guarantor shall receive Net Cash Proceeds from an Equity Issuance, the Borrowers shall, substantially simultaneously with (and in any event not later than the third Business Day next following) the receipt of such Net Cash Proceeds, prepay outstanding Loans in accordance with Section 2.13(e) by an amount equal to (i) 50% of such Net Cash Proceeds if such Equity Issuance was a Specified Equity Issuance of non-voting capital stock that has been approved by the shareholders of the Parent Borrower, (ii) 100% of such Net Cash Proceeds if such Equity Issuance was a Specified Equity Issuance of non-voting capital stock that has not been approved by the shareholders of the Parent Borrower, (iii) 50% of such Net Cash Proceeds if such Equity Issuance was a Specified Equity Issuance other than a Specified Equity Issuance described in paragraphs (i) and (ii) of this Section 2.13(d), and (iv) 75% of the Net Cash Proceeds from any other Equity Issuance; PROVIDED, HOWEVER, that no such prepayment shall be required in connection with any Equity Issuance in respect of which the Parent Borrower advises the Administrative Agent prior to date of that Equity Issuance that the Net Cash Proceeds of such Equity Issuance are intended to be used, and are used, by the Parent Borrower solely for the purpose of effecting a repurchase or redemption, or making a payment, permitted by clause (c) or (d) (but, in the case of clause (d), only with respect to dividends on non-voting capital stock issued pursuant to a Specified Equity Issuance) of the definition of the term "Permitted Stock Repurchases or Dividends", and PROVIDED FURTHER, that no such prepayment shall be required until the September 30 that is immediately after such issuance if the applicable Net Cash Proceeds plus all other Net Cash Proceeds that have yet to be applied in accordance with this Section 2.13(d) are less than $5,000,000.

SECTION 4. AMENDMENT TO SECTION 6.05. The Lenders hereby amend Section 6.05 of the Credit Agreement by adding the text "(other than the GPA Sale and each CBHS Joint Venture Sale)" after the text "Asset Sale" in the third line of that Section.
SECTION 5. AMENDMENT TO SECTION 6.08(a). The Lenders hereby amend Section 6.08(a) of the Credit Agreement by adding the following proviso to the end of that Section:

"provided, however, that any amendment of the charter or bylaws of the Parent Borrower reasonably determined by the Parent Borrower, and accepted by the Administrative Agent in its reasonable judgment, to be necessary to give effect to the terms of the Specified Equity Issuances shall not be prohibited by this Section 6.08."

SECTION 6. REPRESENTATIONS AND WARRANTIES. Each Borrower represents and warrants to the Administrative Agent and to each of the Lenders that:

(a) This Amendment has been duly authorized, executed and delivered by it and constitutes a legal, valid and binding obligation of each Loan Party party hereto, enforceable against such Loan Party in accordance with its terms.

(b) After giving effect to this Amendment, the representations and warranties set forth in Article III of the Credit Agreement are true and correct in all material respects on and as of the date hereof with the same effect as if made on and as of the date hereof, except to the extent such representations and warranties expressly relate to an earlier date.

(c) On the date hereof and immediately after giving effect to this Amendment, no Event of Default or Default has occurred and is continuing.

SECTION 7. AMENDMENT FEE. In consideration of the agreements of the Lenders contained in this Amendment, the Parent Borrower agrees to pay to the Administrative Agent, for the account of each Lender that delivers an executed counterpart of this Amendment prior to 5:00 p.m., New York City time, on July 29, 1999, an amendment fee (the "AMENDMENT FEE") in an amount equal to 0.10% of the sum of such Lender's outstanding Term Loans and Revolving Credit Commitment as of such date.

SECTION 8. CONDITIONS TO EFFECTIVENESS. This Amendment shall become effective as of the date first above written when (a) the Administrative Agent shall have received (i) counterparts of this Amendment that, when taken together, bear the signatures of the Borrowers and the Lenders required by the Credit Agreement and (ii) the Amendment Fees and (b) all fees and expenses required to be paid or reimbursed by the Borrowers pursuant hereto or to the Credit Agreement shall have been paid or reimbursed, as applicable.

SECTION 9. CREDIT AGREEMENT. Except as specifically amended hereby, the Credit Agreement shall continue in full force and effect in accordance with the provisions thereof as in existence on the date hereof. After the date hereof, any reference to the Credit Agreement shall mean the Credit Agreement as amended hereby. This Amendment shall be a Loan Document for all purposes.

SECTION 10. APPLICABLE LAW. THIS AMENDMENT SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF NEW YORK.

SECTION 11. COUNTERPARTS. This Amendment may be executed in two or more counterparts, each of which shall constitute an original but all of which taken together shall constitute but one agreement. Delivery of an executed signature page to this Amendment by facsimile transmission shall be effective as delivery of a manually signed counterpart of this Amendment.

SECTION 12. EXPENSES. The Parent Borrower agrees to reimburse the Administrative Agent for its out-of-pocket expenses in connection with this Amendment, including the reasonable fees, charges and disbursements of Cravath, Swaine & Moore, counsel for the Administrative Agent.
SECTION 13. APPROVAL OF TERMS OF SPECIFIED EQUITY ISSUANCE. By its execution hereof, each Lender shall have given its approval to the Specified Equity Issuances described in the letter from the Parent Borrower to the Administrative Agent dated July 19, 1999.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed by their respective authorized officers as of the day and year first written above.

MAGELLAN HEALTH SERVICES, INC.,
by
Name:
Title:

CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC.,
by
Name:
Title:

MERIT BEHAVIORAL CARE CORPORATION,
by
Name:
Title:

THE CHASE MANHATTAN BANK, individually and as Administrative Agent, Collateral Agent and an Issuing Bank,
by
Name:
Title:

FIRST UNION NATIONAL BANK, individually and as Syndication Agent and an Issuing Bank,
by
Name:
Title:

CREDIT LYONNAIS NEW YORK BRANCH, individually and as Documentation Agent and an Issuing Bank,
by
Name:
Title:

To Approve the Amendment:
by
Name:
EXECUTION COPY

AMENDMENT No. 4 entered into as of September 8, 1999 (this "AMENDMENT"), to the Credit Agreement dated as of February 12, 1998 (as amended, supplemented or otherwise modified from time to time, the "CREDIT AGREEMENT"), among Magellan Health Services, Inc., a Delaware corporation (the "PARENT BORROWER"); Charter Behavioral Health System of New Mexico, Inc., a New Mexico corporation; Merit Behavioral Care Corporation, a Delaware corporation; each other wholly owned domestic subsidiary of the Parent Borrower that becomes a "Subsidiary Borrower" pursuant to Section 2.23 of the Credit Agreement (each, a "SUBSIDIARY BORROWER" and, collectively, the "SUBSIDIARY BORROWERS" (such term is used herein as modified in Article I of the Credit Agreement); the Parent Borrower and the Subsidiary Borrowers are collectively referred to herein as the "BORROWERS"); the Lenders (as defined in Article I of the Credit Agreement); The Chase Manhattan Bank, a New York banking corporation, as administrative agent (in such capacity, the "ADMINISTRATIVE AGENT") for the Lenders, as collateral agent (in such capacity, the "COLLATERAL AGENT") for the Lenders and as an issuing bank (in such capacity, an "ISSUING BANK"); First Union National Bank, a national banking corporation, as syndication agent (in such capacity, the "SYNDICATION AGENT") for the Lenders and as an issuing bank (in such capacity, an "ISSUING BANK"); and Credit Lyonnais New York Branch, a licensed branch of a bank organized and existing under the laws of the Republic of France, as documentation agent (in such capacity, the "DOCUMENTATION AGENT") for the Lenders and as an issuing bank (in such capacity, an "ISSUING BANK" and, together with The Chase Manhattan Bank and First Union National Bank, each in its capacity as an issuing bank, the "ISSUING BANKS").

A. The Lenders and the Issuing Banks have extended credit to the Borrowers, and have agreed to extend credit to the Borrowers, in each case pursuant to the terms and subject to the conditions set forth in the Credit Agreement.

B. The Parent Borrower has advised the Lenders that it and the Subsidiaries intend to reduce their ownership interest in, and restructure their relationships with, CBHS and its subsidiaries and that, accordingly, they intend to effect the CBHS-Magellan Transactions.

C. The Borrowers have requested that the Required Lenders amend certain provisions of the Credit Agreement in connection with the transactions described in the preceding paragraph B, and the Required Lenders are willing so to amend such provisions of the Credit Agreement, on the terms and subject to the conditions set forth in this Amendment.

D. Capitalized terms used but not defined herein have the meanings assigned

to them in the Credit Agreement (as amended hereby).

Accordingly, in consideration of the mutual agreements herein contained and other good and valuable consideration, the sufficiency and receipt of which are hereby acknowledged, the parties hereto agree as follows:

SECTION 1. AMENDMENTS TO SECTION 1.01. (a) Section 1.01 of the Credit Agreement is hereby amended to add the defined term "CBHS-Magellan Letter
"CBHS-MAGELLAN LETTER AGREEMENT" shall mean the Letter Agreement dated August 10, 1999, among CBHS, Crescent, Crescent Affiliate and the Parent Borrower, as the same may be amended or waived from time to time, PROVIDED that any such amendments or waivers are either (a) not adverse to the Lenders in any material respect or (b) have been approved in writing by the Required Lenders."

(b) Section 1.01 of the Credit Agreement is hereby amended to add the defined term "CBHS-Magellan Transaction Agreements" in the appropriate alphabetical order, to read in its entirety as follows:

"CBHS-MAGELLAN TRANSACTION AGREEMENTS" shall mean the agreements, to be entered into pursuant to the CBHS-Magellan Letter Agreement, among CBHS, Crescent, Crescent Affiliate and the Parent Borrower (and their respective relevant subsidiaries) as more particularly described on Schedule 1 hereto, together with such other agreements among such parties as may be necessary or appropriate to effect the transactions contemplated by the CBHS-Magellan Letter Agreement, all such agreements to contain terms and conditions consistent with, and necessary to effect, the CBHS-Magellan Transactions, and as such CBHS-Magellan Transaction Agreements may be supplemented, amended or waived from time to time, PROVIDED that any such supplements, amendments or waivers are either (a) not adverse to the Lenders in any material respect or (b) have been approved in writing by the Required Lenders."

(c) Section 1.01 of the Credit Agreement is hereby amended by deleting the definition of the term "Permitted CBHS Sale" in its entirety and restating it to read as follows:

"PERMITTED CBHS SALE" shall mean the redemption by CBHS in accordance with the CBHS-Magellan Transaction Agreements and the Operating Agreement of (a) a 40% common membership interest in CBHS that is owned, directly or indirectly, by the Parent Borrower and (b) all the preferred membership interests in CBHS that are owned, directly or indirectly, by the Parent Borrower, in each case held pursuant to the Operating Agreement."

(d) Section 1.01 of the Credit Agreement is hereby amended to add the defined term "Charter Heights JV" in the appropriate alphabetical order, to read in its entirety as follows:

"CHARTER HEIGHTS JV" means the CBHS Joint Venture described in clause (a) of the definition of that term."

(e) Section 1.01 of the Credit Agreement is hereby amended to add the defined term "Permitted CBHS-Magellan Transfers" in the appropriate alphabetical order, to read in its entirety as follows:

"PERMITTED CBHS-MAGELLAN TRANSFERS" shall mean the sales, transfers and other dispositions to CBHS and its subsidiaries of the assets set forth on Schedule 6.05 on the basis set out in the CBHS-Magellan Letter Agreement and in accordance with the terms and conditions of the CBHS-Magellan Transaction Agreements."

(f) Section 1.01 of the Credit Agreement is hereby amended to add the defined term "CBHS-Magellan Transactions" in the appropriate alphabetic order, to read in its entirety as follows:

"CBHS-MAGELLAN TRANSACTIONS" shall mean the Permitted CBHS Sale, the Permitted CBHS-Magellan Transfers, and the other releases, indemnifications, assumptions and forgiveness of
liabilities, and other transactions, contemplated by the CBHS-Magellan Letter Agreement."

(g) Section 1.01 of the Credit Agreement is hereby amended to delete the text "any Permitted CBHS Sale" in clause (b)(vi) of the definition of "Consolidated EBITDA" and replace it with the text "the CBHS-Magellan Transactions".

(h) Section 1.01 of the Credit Agreement is hereby amended by adding a new clause (b)(v) to the definition of the term "Consolidated Net Income" to read in its entirety as follows:

", (v) the gain, income, loss or charge (including the establishment of any reserves reasonably determined by the Parent Borrower) attributable to any (a) write-downs, write-offs or charges in such period in respect of the Parent Borrower's investment in any CBHS Joint Venture as a result of any CBHS Joint Venture Sale or otherwise in connection with the Parent Borrower's exit from the healthcare provider and healthcare franchising businesses or (b) reversal or other reduction in such period of any write-downs, write-offs or charges referred to in clause (v)(a), PROVIDED that the amount of all such losses or charges referenced in this clause (v) shall not exceed in the aggregate for all periods, on an after tax basis, $48,000,000 minus the amount of any reversal or other reduction of any loss or charge referred to in this clause (v)."

(i) Section 1.01 of the Credit Agreement is hereby amended by adding a new clause (b)(vi) to the definition of the term "Consolidated Net Income" (as amended hereby) to read in its entirety as follows:

"and (vi) the gain, income, loss or charge (including the establishment of any reserves reasonably determined by the Parent Borrower and without duplicating any gain, income, loss or charge that has already been recognized pursuant to clause (v)) in such period attributable to any (a) write-downs, write-offs, losses or charges in such period as a result of the CBHS-Magellan Transactions or (b) reversal or other reduction in such period of any write-downs, write-offs, losses or charges referred to in clause (vi)(a), PROVIDED that the amount of all such losses or charges referenced in this clause (vi) shall not exceed in the aggregate for all periods, on an after tax basis, $48,000,000 minus the sum of (x) the amount of any reversal or other reduction of any loss or charge referred to in this clause (vi) and (y) the aggregate amount of the loss or charge excluded from the determination of Consolidated Net Income pursuant to clause (v)(a) hereof."

(j) Section 1.01 of the Credit Agreement is hereby amended by adding to the definition of the term "Excess Cash Flow" as follows:

"(i) adding the text "(excluding the amount of any decrease in Consolidated Working Capital arising solely from (x) an Asset Sale or (y) the deconsolidation of certain joint ventures on October 1, 1998, as previously disclosed in the Parent Borrower's Annual Report on Form 10-K that was publicly filed with respect to the fiscal year ended September 30, 1998)" to clause (a)(iii) of the definition of that term, after the text "during such fiscal year"; and

(ii) adding the text "the CBHS-Magellan Transactions," to clause (b)(iii) of the definition of that term, after the text "in respect of" in that clause.

(k) Section 1.01 of the Credit Agreement is hereby amended by deleting all the text after the text "100,000,000" in clause (e)(ii) of the definition of the term "Permitted Acquisitions".
Section 1.01 of the Credit Agreement is hereby amended by deleting the text "(including as a result of any material impairment of the Parent Borrower's rights or benefits under the Franchise Agreement)" from the definition of the term "Material Adverse Effect".

SECTION 2. AMENDMENT TO SECTION 2.13(a): The Lenders hereby amend Section 2.13(a) of the Credit Agreement by adding the following new clause (iii) at the end of that Section:

"or (iii) in respect of a sale or transfer of any of the CBHS Joint Ventures described in clauses (b), (c), (d), (e) and (f) of the definition of that term, as contemplated by the CBHS-Magellan Transactions, to the extent the Net Cash Proceeds received from such sale or transfer are required to be paid to CBHS or its subsidiaries pursuant to the terms of the CBHS-Magellan Transaction Agreements."

SECTION 3. AMENDMENTS TO SECTION 6.01. The Lenders hereby amend Section 6.01 by adding the following new paragraph (cc) after the existing paragraph (c):

"(cc) the unsecured obligations of the Parent Borrower to pay to CBHS and its subsidiaries an aggregate amount not to exceed $2,000,000 under the CBHS-Magellan Transaction Agreements, as more particularly described in paragraph III.a.9 of Addendum A to the CBHS-Magellan Letter Agreement."

SECTION 4. AMENDMENTS TO SECTION 6.05. (a) The Lenders hereby amend Section 6.05 of the Credit Agreement by deleting the text "(other than the GPA Sale and each CBHS Joint Venture Sale)" after the text "Asset Sale" in the third line of that Section and replacing it with "(other than the GPA Sale, each CBHS Joint Venture Sale, the Permitted CBHS Sale and each Permitted CBHS-Magellan Transfer)".

(b) The Lenders hereby amend Section 6.05(c) of the Credit Agreement by deleting it in its entirety.

SECTION 5. AMENDMENT TO SECTION 6.06(b). The Lenders hereby amend Section 6.06(b) of the Credit Agreement to add the following new paragraph "(H)" in the appropriate alphabetical order to read in its entirety as follows:

"(H) imposed in respect of Charter Medical of Puerto Rico, Inc. or Charter Behavioral Health of Puerto Rico, Inc. pursuant to the CBHS-Magellan Transaction Agreements in connection with the transactions described in clause 4 of Schedule 6.05 hereto."

SECTION 6. AMENDMENT TO SECTION 6.14: The Lenders hereby amend Section 6.14 of the Credit Agreement by adding the following proviso to the end of that Section:

"(collectively, the "Required Minimum Consolidated Net Worth"), PROVIDED that (a) in the event of any write-downs, write-offs or charges in respect of the Parent Borrower's investments in any CBHS Joint Venture as a result of any CBHS Joint Venture Sale or otherwise in connection with the Parent Borrower's exit from the healthcare provider and healthcare franchising businesses, the amount of the Required Minimum Consolidated Net Worth shall be reduced by an amount equal to
the reduction in stockholders' equity of the Parent Borrower and the Subsidiaries, as determined in accordance with GAAP, resulting from such write-downs, write-offs or charges (including the establishment of any reserves reasonably determined by the Parent Borrower and excluding any such reduction in stockholders' equity that is attributable to any such write-downs, write-offs or charges that are reversed or reduced for any reason), and PROVIDED FURTHER that such reduction shall not exceed, on an after tax basis, $48,000,000 minus the amount of any reduction in stockholders' equity that is attributable to any such write-downs, write-offs or charges that are reversed or reduced for any reason."

SECTION 7. AMENDMENT TO SECTION 6.14: The Lenders hereby amend Section 6.14 of the Credit Agreement by adding the following proviso to the end of that Section (as amended hereby):

", and (b) in the event of the CBHS-Magellan Transactions, the amount of the Required Minimum Consolidated Net Worth shall be further reduced (but without duplicating any reduction that has already been made pursuant to clause (a)) by an amount equal to the reduction in stockholders' equity of the Parent Borrower and the Subsidiaries, as determined in accordance with GAAP, resulting from any losses or charges arising from such CBHS-Magellan Transactions (including the establishment of any reserves reasonably determined by the Parent Borrower and excluding any such reduction in stockholders' equity that is attributable to any such losses or charges that are reversed or reduced for any reason), and provided further that such reduction shall not exceed, on an after tax basis, $48,000,000 minus the sum of (x) the amount of any reduction in stockholders' equity that is attributable to any losses or charges arising from such CBHS-Magellan Transactions that are reversed or reduced for any reason and (y) the reduction in the Required Minimum Consolidated Net Worth pursuant to clause (a)."

SECTION 8. AMENDMENT TO SCHEDULE 1.01(d): The Lenders hereby amend Schedule 1.01(d) by deleting it in its entirety and replacing it with a new Schedule 1.01(d) in the form of Schedule 3 hereto.

SECTION 9. ADDITION OF SCHEDULE 6.05. The Lenders hereby amend the Credit Agreement by adding a new Schedule 6.05 in the form of Schedule 2 hereto.

SECTION 10. TIMING OF TRANSACTIONS. The Lenders agree that, for all purposes in the Credit Agreement, the Permitted CBHS Sale shall be deemed to occur prior to all the other CBHS-Magellan Transactions.

SECTION 11. REPRESENTATIONS AND WARRANTIES. Each Borrower represents and warrants to the Administrative Agent and to each of the Lenders that:

(a) This Amendment has been duly authorized, executed and delivered by it and constitutes a legal, valid and binding obligation of each Loan Party hereto, enforceable against such Loan Party party in accordance with its terms.

(b) After giving effect to this Amendment, the representations and warranties set forth in Article III of the Credit Agreement are true and correct in all material respects on and as of the date hereof with the same effect as if made on and as of the date hereof, except to the extent such representations and warranties expressly relate to an earlier date.

(c) On the date hereof and immediately after giving effect to this Amendment, no Event of Default or Default has occurred and is continuing.

SECTION 12. AMENDMENT FEE. In consideration of the agreements
of the Lenders contained in this Amendment, the Parent Borrower agrees to pay to
the Administrative Agent, for the account of each Lender that delivers an
executed counterpart of this Amendment prior to 12:00 noon, New York City time,
on September 8, 1999, an amendment fee (the "AMENDMENT FEE") in an amount equal
to 0.05% of the sum of such Lender's outstanding Term Loans and Revolving Credit
Commitment as of such date.

SECTION 13. CONDITIONS TO EFFECTIVENESS. This Amendment shall
become effective as of the date first above written when (a) the Administrative
Agent shall have received (i) counterparts of this Amendment that, when taken
together, bear the signatures of the Borrowers and the Required Lenders and (ii)
the Amendment Fees and (b) all fees and expenses required to be paid or
reimbursed by the Borrowers pursuant hereto or to the Credit Agreement shall
have been paid or reimbursed, as applicable, PROVIDED that the amendments
contained in this Amendment, other than the amendments in Section 1(h), Section
1(j)(i), Section 1(l), Section 6 and Section 8, shall not become effective
unless and until the closing of the Permitted CBHS Sale, and the closing of the
other CBHS-Magellan Transactions that are to close on the same day as the
Permitted CBHS Sale, have occurred under the CBHS-Magellan Transaction
Agreements (without any amendment or waiver that is adverse to the Lenders in
any material respect that has not been agreed to by the Required Lenders).

SECTION 14. CREDIT AGREEMENT. Except as specifically amended
hereby, the Credit Agreement shall continue in full force and effect in
accordance with the provisions thereof as in existence on the date hereof. After
the date hereof, any reference to the Credit Agreement shall mean the Credit
Agreement as amended hereby. This Amendment shall be a Loan Document for all
purposes.

SECTION 15. APPLICABLE LAW. THIS AMENDMENT SHALL BE GOVERNED
BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF NEW YORK.

SECTION 16. COUNTERPARTS. This Amendment may be executed in
two or more counterparts, each of which shall constitute an original but all of
which when taken together shall constitute but one agreement. Delivery of an
executed signature page to this Amendment by facsimile transmission shall be
effective as delivery of a manually signed counterpart of this Amendment.

SECTION 17. EXPENSES. The Parent Borrower agrees to reimburse
the Administrative Agent for its out-of-pocket expenses in connection with this
Amendment, including the reasonable fees, charges and disbursements of Cravath,
Swaine & Moore, counsel for the Administrative Agent.

SECTION 18. APPROVAL OF TERMS OF CBHS-MAGELLIAN LETTER
AGREEMENT. By its execution hereof, each Lender shall have given its approval to
the terms and conditions of the CBHS-Magellan Letter Agreement.

IN WITNESS WHEREOF, the parties hereto have caused this
Amendment to be duly executed by their respective authorized officers as of the
day and year first written above.

MAGELLAN HEALTH SERVICES, INC.,

by

Name:
Title:

THE CHASE MANHATTAN BANK,
individually and as Administrative
Agent, Collateral Agent and an
Issuing Bank,

by
FIRST UNION NATIONAL BANK,
individually and as Syndication Agent and an Issuing Bank,

by

Name: 
Title: 

CREDIT LYONNAIS NEW YORK BRANCH, individually and as Documentation Agent and an Issuing Bank,

by

Name: 
Title: 

# Exhibit 4(r)

**AMENDED AND RESTATED INVESTMENT AGREEMENT**

dated as of December 14, 1999

between

TPG MAGELLAN LLC

and

MAGELLAN HEALTH SERVICES, INC.

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MISCELLANEOUS
THIS AMENDED AND RESTATED INVESTMENT AGREEMENT (the "AGREEMENT"), dated as of December 14, 1999, by and between TPG Magellan LLC, a Delaware limited liability company (the "INVESTOR"), and Magellan Health Services, Inc., a Delaware corporation (the "COMPANY").

W I T N E S S E T H:

WHEREAS, each of the Investor and the Company is a party to that certain Investment Agreement, dated as of July 19, 1999 (as amended by Amendment Number One, the "INVESTMENT AGREEMENT"), as amended by Amendment Number One to Investment Agreement, dated as of September 30, 1999 ("AMENDMENT NUMBER ONE"), by and between the Investor and the Company;

WHEREAS, each of the Investor and the Company desires to amend and restate the Investment Agreement as hereinafter set forth;

WHEREAS, each of the Company and the Investor has determined to enter into this Agreement pursuant to which (i) the Investor has agreed to purchase from the Company, and the Company has agreed to issue and sell to the Investor, 59,063 shares of the Company's Series A Cumulative Convertible Preferred Stock, without par value (the "SERIES A PREFERRED STOCK"), having the rights, preferences, privileges and restrictions set forth in the Form of Certificate of Designations attached hereto as Exhibit A (the "SERIES A CERTIFICATE OF DESIGNATIONS"), each share convertible at the option of the holder at any time following the Initial Closing into shares (the "SERIES A CONVERSION SHARES") of common stock, par value $0.25 per share (the "COMMON
STOCK”), of the Company, and (ii) the Company has agreed, subject to the satisfaction of certain conditions, to grant to the Investor an option to purchase an additional 21,000 shares of Series A Preferred Stock (the “OPTION”), which option is exercisable by the Investor as set forth herein and which option the Company can compel the Investor to exercise under certain circumstances as set forth herein;

WHEREAS, in certain circumstances set forth in the Series A Certificate of Designations, the Company may be required, in lieu of payment in cash of accrued and unpaid dividends on the Series A Preferred Stock upon conversion of the Series A Preferred Stock, to deliver shares of Series B Cumulative Convertible Preferred Stock, without par value (the "SERIES B PREFERRED STOCK," and together with the Series A Preferred Stock, the "SENIOR PREFERRED STOCK"), having the rights, preferences, privileges and restrictions set forth in the Form of Certificate of Designations attached hereto as Exhibit B (the "SERIES B CERTIFICATE OF DESIGNATIONS," and together with the Series A Certificate of Designations, the "SENIOR CERTIFICATES OF DESIGNATIONS"), each share convertible at the option of the holder at any time (A) prior to the Series B Shareholder Approval (as defined herein), into shares of the Company's Series C Junior Participating Preferred Stock, par value $0.01 per share (the "Junior Preferred Stock"), having the rights, preferences, privileges and restrictions set forth in the Form of Certificate of Designations attached hereto as Exhibit C (the "JUNIOR CERTIFICATE OF DESIGNATIONS," and together with the Senior Certificates of Designations, the "CERTIFICATES OF DESIGNATIONS"), or (B) following the Series B Shareholder Approval, shares of Common Stock (such shares of Common Stock, together with the Series A Conversion Shares, the "CONVERSION SHARES");

WHEREAS, the Series A Preferred Stock is exchangeable under certain circumstances at the option of the Company into Series A Junior Subordinated Convertible Debentures Due 2009 of the Company (the "SERIES A DEBENTURES"), having the terms and conditions provided for in Section 7.05 hereof, and the Series B Preferred Stock is exchangeable under certain circumstances at the option of the Company into Series B Junior Subordinated Convertible Debentures Due 2009 of the Company (the "SERIES B DEBENTURES," and together with the Series A Debentures, the "DEBENTURES"), having the terms and conditions provided for in Section 7.05 hereof; and

WHEREAS, the Company and the Investor desire to make certain representations, warranties, covenants and agreements in connection with the transactions contemplated herein;

NOW, THEREFORE, in consideration of the premises and the mutual representations, warranties, covenants and agreements contained herein, the parties hereto agree as follows:

ARTICLE I
DEFINITIONS; AMENDMENT AND RESTATEMENT

Section 1.01. DEFINITIONS. As used in this Agreement, the following terms shall have the meanings set forth below:

"ACCEPTANCE NOTICE" has the meaning set forth in Section 8.05(b) hereof.

"AFFILIATE" has the meaning set forth in Rule 12b-2 under the Exchange Act as in effect on the date hereof. The term "Affiliated" has a correlative meaning. Notwithstanding the foregoing, for all purposes hereof, the Investor, and each Person controlled by, controlling or under common control with the Investor (each, a "TPG PERSON"), shall not be deemed an "Affiliate" of any Designated Purchaser Person (as defined below), and no Designated Purchaser, and no Person controlled by, controlling or under common control with such Designated Purchaser (each, a "DESIGNATED PURCHASER PERSON"), shall be deemed an "Affiliate" of any TPG Person or any other Designated Purchaser Person, in any such case solely as a consequence of this Agreement or the transactions contemplated hereby.

"AGREEMENT" has the meaning set forth in the preamble hereto.

"ALTERNATIVE TRANSACTION" means any (A) direct or indirect
acquisition or purchase of any Equity Securities of the Company or any of its Significant Subsidiaries or any tender offer or exchange offer, that if consummated would result in any Person (other than the Investor or any of its Affiliates or, solely as a result of an assignment by the Investor pursuant to Section 11.09(b) hereof, a Designated Purchaser or any of its Affiliates) Beneficially Owning 10% or more of any class of Equity Securities of the Company or Equity Securities of any of its Significant Subsidiaries, (B) Control Transaction, liquidation, dissolution or similar transaction involving the Company or any of its Significant Subsidiaries (other than such a transaction involving a Significant Subsidiary that does not involve the transfer of, or the transfer of control of, all or a substantial portion of the assets of the Company and its Subsidiaries, taken as a whole), or (C) other transaction the consummation of which would prevent the consummation of the transactions contemplated hereby or would delay the Initial Closing Date to a date later than the date set forth in Section 10.01(a) hereof; PROVIDED, HOWEVER, that, notwithstanding the foregoing, (i) no transaction expressly permitted pursuant to Section 7.02 hereof, (ii) no transaction set forth in the Proposed Asset Sale Letter concluded on terms not materially worse to the Company than those terms set forth in the Proposed Asset Sale Letter and (iii) no exercise of the Rainwater-Magellan Warrant or Rainwater Pre-emptive Rights shall constitute an Alternative Transaction.

"ALTERNATIVE TRANSACTION FEE" means $2,828,437.

"AMENDMENT NUMBER ONE" has the meaning set forth in the recitals hereto.

"APPLICABLE INSURANCE DEPARTMENT" has the meaning set forth in Section 3.07(c).

"BALANCE SHEET" has the meaning set forth in Section 3.08 hereof.

"BANK APPROVAL" means the approval of the Required Lenders (as such term is defined in the Credit Agreement) of the Company's issuance of the Option and of the terms thereof and of any amendments to the Credit Agreement required to permit the issuance of the Option and the exercise thereof.

"BANK APPROVAL DATE" means the effective date of the Bank Approval.

"BENEFICIALLY OWN" with respect to any securities means having "beneficial ownership" of such securities (as determined pursuant to Rule 13d-3 under the Exchange Act as in effect on the date hereof, except that a Person shall be deemed to Beneficially Own all such securities that such Person has the right to acquire whether such right is exercisable immediately or after the passage of time). The terms "Beneficial Ownership" and "Beneficial Owner" have correlative meanings. Notwithstanding the foregoing, for all purposes hereof, (i) no TPG Person shall be deemed to Beneficially Own any securities that are held by any Designated Purchaser Person, and no Designated Purchaser Person shall be deemed to Beneficially Own any securities that are held by any TPG Person or any other Designated Purchaser Person, in any such case solely as a consequence of this Agreement or the transactions contemplated hereby, and (ii) no member of the Investor Group shall be deemed to Beneficially Own any Option Shares or securities issuable upon conversion or exchange of the Option Shares unless and until the Option is exercised.

"BIDDING PROCESS" has the meaning set forth in Section 6.01(b) hereof.

"BOARD APPROVAL" means the approval of the Board of Directors of the Company's issuance of the Option and of the terms thereof.

"BOARD APPROVAL DATE" means the effective date of the Board Approval.

"BOARD OF DIRECTORS" means the board of directors of the Company.
"BUSINESS DAY" means any day, other than a Saturday, Sunday or a day on which banking institutions in the State of New York are authorized or obligated by law or executive order to close.

"BYLAWS" means the Bylaws of the Company, as amended from time to time.

"CAPITAL FUNDING REQUIREMENTS DISCLOSURE" has the meaning set forth in Section 3.07(d) hereof.

"CERTIFICATE OF DESIGNATIONS" has the meaning set forth in the recitals hereto.

"CERTIFICATE OF INCORPORATION" means the Restated Certificate of Incorporation of the Company, as amended from time to time.

"CHANGE OF CONTROL" has the meaning set forth in the Series A Certificate of Designations.

"CHARTER" means Charter Behavioral Health Systems, LLC.

"CLAIM" has the meaning set forth in Section 11.04(c) hereof.

"CLASS I" means the class of directors of the Board of Directors with a term expiring at the annual meeting of stockholders of the Company in 2000 and every third annual meeting thereafter.

"CLASS II" means the class of directors of the Board of Directors with a term expiring at the annual meeting of stockholders of the Company in 2001 and every third annual meeting thereafter.

"CLASS III" means the class of directors of the Board of Directors with a term expiring at the annual meeting of stockholders of the Company in 2002 and every third annual meeting thereafter.

"CLOSING PRICE" means, with respect to a share of Common Stock on any Trading Day, the last reported sale price on that day or, in case no such reported sale takes place on such day, the average of the last reported bid and asked prices, regular way, on that day, in either case, as reported in the consolidated transaction reporting system with respect to securities listed on the NYSE or, if the shares of Common Stock are not listed on the NYSE, as reported in the principal consolidated transaction reporting system with respect to securities listed on the principal national securities exchange on which the shares of Common Stock are listed or, if the shares of Common Stock are not listed on the NYSE and not listed on any national securities exchange, the last quoted price on such other nationally recognized quotation system then in use.

"CODE" means the Internal Revenue Code of 1986, as amended, and all regulations promulgated thereunder, as in effect from time to time.

"COMMISSION" means the U.S. Securities and Exchange Commission.

"COMMON STOCK" has the meaning set forth in the recitals hereto.

"COMPANY" has the meaning set forth in the preamble hereto.

"COMPANY DOCUMENTS" means each document, instrument or certificate, other than the Transaction Agreements, to be executed and delivered by the Company in connection with the consummation of the transactions contemplated by this Agreement, including, without limitation, the Certificates of Designations.

"COMPANY REPRESENTATION AND WARRANTY LETTER" means a letter from the Company to the Investor, dated the Option Closing Date, substantially in the form of Exhibit G hereto.
"COMPANY WARRANTS" means the 2002 Warrants, the 2006 Warrants, the Crescent Warrants and the Rainwater-Magellan Warrant, as such terms are defined in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1998, as amended through the date hereof.

"CONTROL TRANSACTION" means any transaction (other than a transaction set forth on Schedule 1.01(A) hereof) that involves a (i) merger, consolidation, recapitalization (involving a business combination) or similar business combination transaction involving the Company or a Significant Subsidiary of the Company (other than such a transaction involving a Significant Subsidiary that does not involve the transfer of, or the transfer of control of, all or a substantial portion of the assets of the Company and its Subsidiaries, taken as a whole), (ii) sale of all or substantially all of the assets of the Company and its Subsidiaries taken as a whole, or (iii) sale or issuance of Voting Securities of the Company to a Person or Group or an acquisition of Equity Securities of the Company by a Person or Group which, following the completion of such sale, issuance or acquisition, will Beneficially Own Voting Securities of the Company representing a majority of the Voting Power of the Voting Securities of the Company; PROVIDED, HOWEVER, that, notwithstanding the foregoing, (i) no transaction expressly permitted pursuant to Section 7.02 hereof, (ii) no transaction set forth in the Proposed Asset Sale Letter concluded on terms not materially worse to the Company than those terms set forth in the Proposed Asset Sale Letter and (iii) no exercise of the Rainwater-Magellan Warrant or Rainwater Pre-emptive Rights shall constitute a Control Transaction.

"CONVERSION PRICE" has the meaning set forth in the Series A Certificate of Designations.

"CONVERSION SHARES" has the meaning set forth in the recitals hereeto. For the purposes of determining the percentage of Conversion Shares that is Beneficially Owned by the Investor, any Designated Purchaser or any of their respective Affiliates, such calculation shall be made assuming all conditions precedent to receipt of Conversion Shares in respect of the then-outstanding shares of Senior Preferred Stock have occurred or been satisfied, including, without limitation, receipt by the Company of the necessary Shareholder Approvals, and conversion of such Senior Preferred Stock in accordance with the terms thereof.

"COVERED SECURITIES" has the meaning set forth in Section 8.05(b) hereof.

"CREDIT AGREEMENT" means the Credit Agreement, dated as of February 12, 1998, among the Company, the banks and other financial institutions named therein, and The Chase Manhattan Bank, as Administrative Agent, together with all other documents entered into under or in connection with the Credit Agreement, in each case, as the same may be amended, restated, supplemented, extended, renewed or increased from time to time, replaced, substituted, refunded or refinanced or otherwise modified from time to time, in whole or in part, and any successive replacements, substitutions, refundings or refinancings.

"DEBENTURES" has the meaning set forth in the recitals hereto.

"DERIVATIVE SECURITIES" means any subscriptions, options, conversion rights, warrants, or other agreements, securities or commitments of any kind obligating the Company or any of its Significant Subsidiaries to issue, grant, deliver or sell, or cause to be issued, granted, delivered or sold, any Equity Securities of the Company or any of its Significant Subsidiaries.

"DESIGNATED PURCHASER" has the meaning set forth in Section 11.09(b) hereof.

"DESIGNATED PURCHASER PERSON" has the meaning set forth in the definition of "Affiliate."

"DIVIDEND SHARES" means securities issued as dividends in respect of Senior Preferred Stock.
"DGCL" means the Delaware General Corporation Law.

"DGCL SECTION 203" has the meaning set forth in Section 3.02(a) hereof.

"EMPLOYMENT AGREEMENT" means any employment or consulting agreement or other similar arrangement between the Company or any of its Significant Subsidiaries, on the one hand, and any Representative of the Company or any of its Significant Subsidiaries, on the other.

"ENVIRONMENTAL LAWS" means any federal, state or local law, statute, ordinance, order, decree, rule or regulation relating to releases, discharges, emissions or disposals to air, water, land or groundwater of Hazardous Materials; to the use handling or disposal of polychlorinated byphenyls, asbestos or urea formaldehyde or any other Hazardous Material; to the treatment, storage, disposal or management of Hazardous Materials; to exposure to toxic, hazardous or other controlled, prohibited or regulated substances; and to the transportation, release or any other use of Hazardous Materials, including the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. 9601, et seq. ("CERCLA"), the Resource Conservation and Recovery Act, 42 U.S.C. 6901, et seq. ("RCRA"), the Toxic Substances Control Act, 15 U.S.C. 2601 et seq. ("TSCA"), the Occupational, Safety and Health Act, 29 U.S.C. 651 et seq., the Clean Air Act, 42 U.S.C. 7401 et seq., the Federal Water Pollution Control Act, 33 U.S.C. 1251 et seq., the Safe Drinking Water Act, 42 U.S.C. 1802 et seq. ("SDWA") and the Emergency Planning and Community Right to Know Act, 42 U.S.C. 11001 et seq. ("EPCRA"), and other comparable state and local laws and all rules and regulations promulgated pursuant thereto or published thereunder.

"EQUITY SECURITIES" of any Person, means any and all common stock, preferred stock and any other class of capital stock of, and any partnership or limited liability company interests in, such Person or any other similar interests of any Person that is not a corporation, partnership or limited liability company.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended, and all regulations promulgated thereunder, as in effect from time to time.

"EXCHANGE ACT" means the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder from time to time.

"EXCLUSIVITY PERIOD" has the meaning set forth in Section 7.04(b) hereof.

"EXPIRATION DATE" means the date that is 30 calendar months after the later to occur of the (i) Series A Shareholder Approval Date; (ii) Bank Approval Date; (iii) Board Approval Date; and (iv) Option Approval Date; PROVIDED, HOWEVER, that in the event a Restriction Event occurs, the Expiration Date shall occur no earlier than the date that is 90 days after the first day after such Restriction Event on which the Company may sell Option Shares to the Investor without restriction under the Indenture; PROVIDED FURTHER, HOWEVER, that in any event, the Expiration Date shall occur no later than the date that is 54 calendar months after the Series A Shareholder Approval Date.

"45-TRADING DAY REFERENCE PERIOD" means a period of 45 consecutive Trading Days; PROVIDED, that the final Trading Day in such period shall occur no earlier than the 180th day after the Series A Shareholder Approval Date.

"GAAP" means U.S. generally accepted accounting principles as in effect at the relevant time or for the relevant period.

"GOVERNMENTAL ENTITY" means any government or political subdivision or department thereof, any governmental or regulatory body, commission, board, bureau, agency or instrumentality, or any court or arbitrator or alternative dispute resolution body, in each case whether federal, state, local or foreign.

"GROUP" has the same meaning as is used with respect to that
"GUARANTEE" means any direct or indirect obligation, contingent or otherwise, to guarantee (or having the economic effect of guaranteeing) Indebtedness in any manner, including, without limitation, any monetary obligation to purchase or pay (or advance or supply funds for the purchase or payment of) such Indebtedness (whether arising by agreement to purchase assets, goods, securities or services, to take-or-pay, or to maintain financial statement conditions or otherwise).

"HAZARDOUS MATERIALS" shall mean each and every element, compound, chemical mixture, contaminant, pollutant, material, waste or other substance which is defined, determined or identified as hazardous or toxic under Environmental Laws or the release of which is regulated under Environmental Laws. Without limiting the generality of the foregoing, the term includes: "hazardous substances" as defined in CERCLA; "extremely hazardous substances" as defined in EPCRA; "hazardous waste" as defined in RCRA; "hazardous materials" as defined in HMTA; "chemical substance or mixture" as defined in TSCA; crude oil, petroleum products or any fraction thereof; radioactive materials including source, byproduct or special nuclear materials; asbestos or asbestos-containing materials; chlorinated fluorocarbons ("CFCs"); and radon.

"HSR ACT" means the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the regulations promulgated thereunder.

"INDEBTEDNESS" means, with respect to any Person, without duplication, (i) all obligations of such Person for money borrowed, (ii) all obligations of such Person evidenced by bonds, debentures, notes, or other similar instruments, (iii) all obligations of such Person upon which interest charges are customarily paid, (iv) all obligations of such Person under conditional sale or other title retention agreements relating to property or assets purchased by such Person, (v) all obligations of such Person issued or assumed as the deferred purchase price of property or services (excluding (x) trade accounts payable and accrued obligations incurred in the ordinary course of business and (y) deferred earn-out and other performance-based payment obligations incurred in connection with any Permitted Acquisition (as such term is defined in the Credit Agreement as in effect on the date hereof) or any similar transactions consummated prior to February 12, 1998), (vi) all Indebtedness of others secured by (or for which the holder of such Indebtedness has an existing right, contingent or otherwise, to be secured by) any Lien on property owned or acquired by such Person, whether or not the obligations secured thereby have been assumed, (vii) all Guarantees by such Person of Indebtedness of others, (viii) all capital lease obligations of such Person, (ix) all obligations (determined on the basis of actual, not notional, obligations) of such Person in respect of interest rate protection agreements, foreign currency exchange agreements or other interest or exchange rate hedging arrangements and (x) all obligations of such Person as an account party in respect of letters of credit and bankers' acceptances issued in support of obligations that constitute Indebtedness under any other clause of this definition (unless such obligations are fully cash collateralized), PROVIDED that all obligations in respect of letters of credit shall be deemed Indebtedness to the extent drawings thereunder are unreimbursed (after any applicable grace period) regardless of the purpose for which such letter of credit was issued. The Indebtedness of any Person shall include the recourse Indebtedness of any partnership in which such Person is a general partner. Notwithstanding the foregoing, no portion of Indebtedness that becomes the subject of a defeasance (whether a legal defeasance or a "covenant" or "in substance" defeasance) shall, at any time that such defeasance remains in effect, be treated as Indebtedness for purposes hereof.

"INDEMNIFIED COMPANY PARTIES" has the meaning set forth in Section 11.04(b) hereof.

"INDEMNIFIED PARTIES" has the meaning set forth in Section 11.04(a) hereof.

"INDENTURE" means the Indenture entered into between the Company and Marine Midland Bank, as Trustee, dated as of February 12, 1998, as the same may be amended, restated, supplemented, extended, renewed or increased
from time to time, replaced, substituted, refunded

or refinanced or otherwise modified from time to time, in whole or in part, and
any successive replacements, substitutions, refundings or refinancings.

"INITIAL CLOSING" means the closing of the Initial Share Purchase pursuant to Section 2.03 hereof.

"INITIAL CLOSING DATE" has the meaning set forth in Section 2.03(a) hereof.

"INITIAL SHARE PURCHASE" has the meaning set forth in Section 2.01 hereof.

"INITIAL SHARE PURCHASE PRICE" has the meaning set forth in Section 2.01 hereof.

"INSOLVENCY EVENT" means (i) the Company or any of its Subsidiaries commences a voluntary case concerning itself under Title 11 of the United States Code as now or hereafter in effect, or under any state insolvency, liquidation, rehabilitation or similar statute or any successor statutes thereto ("INSOLVENCY STATUTES"); (ii) an involuntary case is commenced against the Company or any of its Subsidiaries under an Insolvency Statute; (iii) a custodian is appointed under any applicable Insolvency Statute for, or takes charge of, all or any substantial part of the property of the Company or any of its Subsidiaries; (iv) any other proceeding under any reorganization, arrangement, adjustment of debt, relief of debtors, dissolution or similar law of any jurisdiction, whether now or hereafter in effect, relating to the Company or any of its Subsidiaries is commenced (a) by the Company or any of its Subsidiaries or (b) by any other Person; (v) the Company or any of its Subsidiaries is adjudicated insolvent or bankrupt; (vi) any order of relief or other order approving any such case or proceeding is entered; (vii) the Company or any of its Subsidiaries makes a general assignment for the benefit of creditors; or (viii) the Company or any of its Subsidiaries shall state in writing that it is unable to pay, or shall be unable to pay, its debts, generally as they become due.

"INSOLVENCY STATUTES" has the meaning set forth in the definition of "Insolvency Event."

"INTELLECTUAL PROPERTY" means all intellectual property rights including, but not limited to, patents, patent rights, trade secrets, know-how, trademarks, service marks, trade names, copyrights, licenses and proprietary processes and formulae.

"INVESTMENT AGREEMENT" has the meaning set forth in the recitals hereto.

"INVESTOR" has the meaning set forth in the preamble hereto.

"INVESTOR DOCUMENTS" means each document, instrument or certificate, other than the Transaction Agreements, to be executed and delivered by the Investor in connection with the consummation of the transactions contemplated by this Agreement.

"INVESTOR GROUP" means, collectively, the Investor, the Designated Purchasers, if any, and the respective Affiliates of such Persons.

"INVESTOR INFORMATION" has the meaning set forth in Section 8.13(b) hereof.

"INVESTOR NOMINEES" has the meaning set forth in Section 5.02(a) hereof.

"INVESTOR ORIGINAL NUMBER OF CONVERSION SHARES" means that number of the Original Number of Conversion Shares Beneficially Owned by the Investor and its Affiliates, in the aggregate, as of the Initial Closing. For
the purposes of this definition, from and after the Option Closing, the Conversion Shares issuable in respect of the Option Shares shall be deemed to have existed as of and following the Initial Closing. For the purposes of determining the percentage of the Investor Original Number of Conversion Shares that is Beneficially Owned by the Investor or any of its Affiliates, such calculation shall be made assuming all conditions precedent to the receipt of Conversion Shares in respect of then-outstanding shares of Senior Preferred Stock have occurred or been satisfied, including, without limitation, receipt by the Company of the necessary Shareholder Approvals and conversion of the Senior Preferred Stock in accordance with the terms thereof.

"INVESTOR PRICE" has the meaning set forth in Section 8.05(b) hereof.

"INVESTOR REPRESENTATION AND WARRANTY LETTER" means a letter from the Investor to the Company, dated the Option Closing Date, substantially in the form of Exhibit H hereto.

"JOINT VENTURES" means (i) Charter and its Subsidiaries and (ii) the entities listed on Schedule 1.01(B) hereto.

"JUNIOR CERTIFICATE OF DESIGNATIONS" has the meaning set forth in the recitals hereto.

"JUNIOR PREFERRED STOCK" has the meaning set forth in the recitals hereto.

"JUNIOR SHARES" means the shares of Junior Preferred Stock issued or issuable upon conversion of the Series B Preferred Stock.

"TO THE KNOWLEDGE OF THE COMPANY AND ITS SUBSIDIARIES" and similar phrases with respect to the Company or to the Company and its Subsidiaries, mean to the actual knowledge of any of Henry T. Harbin, Cliff Donnelly, Clarissa C. Marques, David J. Hansen, James R. Bedenbaugh, Linton Newlin or Jeff Hudkins.

"LAW" means any law, treaty, statute, ordinance, code, rule, regulation, judgment, decree, order, writ, award, injunction or determination of any Governmental Entity.

"LIEN" means any mortgage, pledge, lien, security interest, claim, voting agreement, conditional sale agreement, title retention agreement, restriction, option or encumbrance of any kind, character or description whatsoever.

"LOSSES" has the meaning set forth in Section 11.04(a) hereof.

"MATERIAL ADVERSE EFFECT" means a material adverse effect on the financial condition, results of operations, prospects, business, or regulatory status of the Company and its Subsidiaries taken as a whole.

"NOLS" has the meaning set forth in Section 3.13(d) hereof.

"NOTICE DATE" has the meaning set forth in Section 8.05(b) hereof.

"NYSE" means the New York Stock Exchange, Inc.

"NYSE RULES" has the meaning set forth in Section 3.03(c) hereof.

"OFFER TO PURCHASE" has the meaning set forth in Section 8.05(b) hereof.

"OPTION" has the meaning set forth in Section 2.02(a) hereof.

"OPTION APPROVAL" means the last Regulatory Approval that is required to be obtained to permit the exercise of the Option by the Investor as
"OPTION APPROVAL DATE" means the effective date of the Option Approval.

"OPTION CLOSING" means the closing of the Option Purchase pursuant to Section 2.04 hereof.

"OPTION CLOSING DATE" has the meaning set forth in Section 2.04(a) hereof.

"OPTION EXERCISE NOTICE" has the meaning set forth in Section 2.02(a) hereof.

"OPTION CARRY FEE" means $500,000.

"OPTION FUNDING FEE" means $250,000.


"OPTION PURCHASE" has the meaning set forth in Section 2.02(a) hereof.

"OPTION PURCHASE PRICE" has the meaning set forth in Section 2.02(a) hereof.

"OPTION SHARES" has the meaning set forth in Section 2.02(a) hereof.

"ORGANIC CHANGE" means, with respect to the Company, any transaction (including without limitation any recapitalization, capital reorganization or reclassification of any class of capital stock, any consolidation or amalgamation of the Company with, or merger of the Company into, any other Person, any merger of another Person into the Company (other than a merger which does not result in a reclassification, conversion, exchange or cancellation of outstanding shares of capital stock of the Company), any sale or transfer or lease of all or substantially all of the assets of the Company or any compulsory share exchange) pursuant to which any class of capital stock of the Company is converted into the right to receive other securities, cash or other property.

"ORIGINAL NUMBER OF CONVERSION SHARES" means the number of Conversion Shares as of the Initial Closing (assuming that all conditions precedent to receipt of Conversion Shares in respect of the then-outstanding shares of Senior Preferred Stock have occurred, including conversion of the Senior Preferred Stock), which number shall be adjusted in accordance with any adjustment made to the number of Conversion Shares issuable upon conversion of the Senior Preferred Stock pursuant to the provisions set forth in Article IX of each Senior Certificate of Designations. For the purposes of this definition, from and after the Option Closing, the Conversion Shares issuable in respect of the Option Shares shall be deemed to have existed as of and following the Initial Closing. For the purposes of determining the percentage of the Original Number of Conversion Shares that is Beneficially Owned by the Investor, any Designated Purchaser or any of their respective Affiliates, such calculation shall be made assuming all conditions precedent to receipt of Conversion Shares in respect of the then-outstanding shares of Senior Preferred Stock have occurred or been satisfied, including, without limitation, receipt by the Company of the necessary Shareholder Approvals and conversion of the Senior Preferred Stock in accordance with the terms thereof.

"PERSON" means any individual, corporation, company, association, partnership, limited liability company, joint venture, trust, unincorporated organization, or Governmental Entity.

"PLACEMENT FEE" means $1,625,000.
"PLAN" has the meaning set forth in Section 3.14(a) hereof.

"POLICIES" has the meaning set forth in Section 3.19 hereof.

"PREFERRED STOCK" means the Junior Preferred Stock and the Senior Preferred Stock.

"PRIVATE PLACEMENT LEGEND" has the meaning set forth in Section 8.10(a) hereof.

"PROCEEDING" has the meaning set forth in Section 3.11 hereof.

"PROPOSAL" means any inquiry, indication of interest, proposal or offer from any Person relating to an Alternative Transaction.

"PROPOSED ASSET SALE LETTER" means the letter from the Company to the Investor dated as of the date hereof.

"PROXY STATEMENT" means a proxy statement used in connection with a Shareholder Meeting.

"PURCHASE AGREEMENT" means a legal, valid and binding agreement of a Person or Persons (each, a "PURCHASER") pursuant to which such Purchaser or Purchasers agrees to purchase Covered Securities which agreement is enforceable against such Purchaser or Purchasers in accordance with its terms (subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights generally and to general principles of equity).

"RAINWATER-MAGELLAN WARRANT" has the meaning set forth in the definition of "Company Warrants."


"REGISTRATION RIGHTS AGREEMENT" means the Registration Rights Agreement of even date herewith between the Company and the Investor, which agreement shall not become effective until the Initial Closing.

"REGULATORY APPROVALS" means (i) any and all certificates, permits, licenses, franchises, concessions, grants, consents, approvals, orders, registrations, authorizations, waivers, variances or clearances from, or filings or registrations with, Governmental Entities, and (ii) any and all waiting periods imposed by applicable laws.

"REPRESENTATIVES" means, with respect to any Person, any of such Person's officers, directors, employees, agents, attorneys, accountants, consultants, equity financing partners or financial advisors or other Person associated with, or acting on behalf of, such Person.

"REQUIRED REGULATORY APPROVAL" means a Regulatory Approval (i) necessary under the HSR Act or required under the Securities Act, the Exchange Act or the securities laws of the several states of the United States, for or in connection with the consummation by the parties thereto of the transactions contemplated by the Transaction Agreements; (ii) consisting of the filing by the Company of the Certificates of Designations with the Secretary of State of the State of Delaware; (iii) set forth on Schedule 1.01(C) hereto; (iv) with respect to which a filing, notification or similar action has been made or taken with insurance regulatory authorities in the State of Tennessee prior to the Initial Closing; or (v) relating to the Option and with respect to which a filing, notification or similar action with the appropriate Governmental Entity will be taken following the Initial Closing.

"RESPONSE PERIOD" has the meaning set forth in Section 8.05(b) hereof.

"RESTRICTION EVENT" has the meaning set forth in Section 2.02(d) hereof.

"REVOCACTION NOTICE" has the meaning set forth in Section 2.01(b) hereof.
"RIGHTS" has the meaning set forth in Section 3.20 hereof.

"RIGHTS PLAN" has the meaning set forth in Section 3.20 hereof.

"SEC REPORTS" has the meaning set forth in Section 3.07(a) hereof.

"SECURITIES ACT" means the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder from time to time.

"SENIOR CERTIFICATES OF DESIGNATIONS" has the meaning set forth in the recitals hereto.

"SENIOR PREFERRED STOCK" has the meaning set forth in the recitals hereto.

"SENIOR SUBORDINATED NOTES" means the Senior Subordinated Notes of the Company issued pursuant to the Indenture.

"SERIES A CERTIFICATE OF DESIGNATIONS" has the meaning set forth in the recitals hereto.

"SERIES A DEBENTURES" has the meaning set forth in the recitals hereto.

"SERIES A PREFERRED STOCK" has the meaning set forth in the recitals hereto.

"SERIES A SHAREHOLDER APPROVAL" means the approval by the stockholders of the Company, in accordance with the DGCL and in accordance with and in satisfaction of Paragraph 312.00 of the NYSE's Listed Company Manual and the related NYSE Rules and interpretations of (i) the issuance of Common Stock in respect of accrued and unpaid dividends on the Series A Preferred Stock (including upon the conversion or exchange thereof), (ii) the issuance of the Option Shares upon the exercise of the Option, and (iii) the issuance of Common Stock upon the conversion or exchange of the Option Shares, in each case in accordance with the terms hereof and the Series A Certificate of Designations.

"SERIES A SHAREHOLDER APPROVAL DATE" means the date on which the Company obtains the Series A Shareholder Approval.

"SERIES A SHAREHOLDER APPROVAL PROPOSAL" means a proposal made by the Board of Directors to the stockholders of the Company in accordance with the DGCL to consider and vote on the Series A Shareholder Approval.

"SERIES B CERTIFICATE OF DESIGNATIONS" has the meaning set forth in the recitals hereto.

"SERIES B DEBENTURES" has the meaning set forth in the recitals hereto.

"SERIES B PREFERRED STOCK" has the meaning set forth in the recitals hereto.

"SERIES B SHAREHOLDER APPROVAL" means the approval by the stockholders of the Company, in accordance with the DGCL and in accordance with and in satisfaction of Paragraph 312.00 of the NYSE's Listed Company Manual and the related NYSE Rules and interpretations of (i) the issuance of Common Stock in respect of accrued and unpaid dividends on the Series B Preferred Stock (including upon the conversion or exchange thereof), (ii) the issuance of Common Stock upon the conversion or exchange of the Series B Preferred Stock, and (iii) the vesting of voting rights in respect of the Series B Preferred Stock, in each case in accordance with the terms hereof and the Series B Certificate of Designations.
"SERIES B SHAREHOLDER APPROVAL PROPOSAL" means a proposal made by the Board of Directors to the stockholders of the Company in accordance with the DGCL to consider and vote on the Series B Shareholder Approval.

"SHAREHOLDER APPROVALS" means the Series A Shareholder Approval and the Series B Shareholder Approval.


"SHAREHOLDER MEETING" has the meaning set forth in Section 8.13(a) hereof.

"SIGNIFICANT SUBSIDIARY" means any direct or indirect Subsidiary of the Company listed on Schedule 1.01(D) hereto.

"SOLICITATION DATE" means, with respect to any Covered Securities, the earlier of (i) the eleventh day following the day on which an Offer to Purchase with respect to such Covered Securities is given and (ii) the date on which the Investor shall have, or shall be deemed to have, declined to purchase such Covered Securities, in each case pursuant to Section 8.05(b) hereof.

"STANDSTILL PERIOD" has the meaning set forth in Section 6.01(a) hereof.

"STATE STATUTORY ACCOUNTING PRACTICES" has the meaning set forth in Section 3.07(c) hereof.

"SUBSEQUENT REPORTS" has the meaning set forth in Section 3.07(a) hereof.

"SUBSIDIARY" means as to any Person, any other Person of which more than 50% of the shares of the voting stock or other voting interests are owned or controlled, or the ability to select or elect more than 50% of the directors or similar managers is held, directly or indirectly, by such first Person or one or more of its Subsidiaries or by such first Person and one or more of its Subsidiaries; PROVIDED, HOWEVER, that no Joint Venture shall be considered (i) a "Subsidiary" of the Company or (ii) a "Subsidiary" of any Subsidiary of the Company.

"TAX" or "TAXES" means all taxes, including any interest, liabilities, fines, penalties or additions to tax that may become payable in respect thereof, imposed by any Governmental Entity, which taxes shall include, without limiting the generality of the foregoing, income taxes (including, but not limited to, United States federal income taxes and state income taxes), payroll and employee withholding taxes, unemployment insurance, social security, sales and use taxes, excise taxes, franchise taxes, gross or net receipts taxes, occupation taxes, real and personal property taxes, AD VALOREM taxes, stamp taxes, transfer taxes, capital taxes, import duties, withholding taxes, workers' compensation, and other obligations of the same or of a similar nature whether arising before, on or after the Closing Date.

"TPG PERSON" has the meaning set forth in the definition of "Affiliate."

"TRADING DAY" means any day on which the NYSE is open for trading, or if the shares of Common Stock are not listed on the NYSE, any day on which the principal national securities exchange or national quotation system on which the shares of Common Stock are listed, admitted to trading or quoted is open for trading.

"TRANSACTION AGREEMENTS" means this Agreement and the Registration Rights Agreement.

"VOTING POWER" means, with respect to any Voting Securities, the aggregate number of votes attributable to such Voting Securities that could generally be cast by the holders thereof for the election of directors at the time of determination (assuming such election were then being held).
"VOTING SECURITIES" means, (i) with respect to the Company, the Equity Securities of the Company entitled to vote generally for the election of directors of the Company, and (ii) with respect to any other Person, any securities of or interests in such Person entitled to vote generally for the election of directors or any similar managing person of such Person.

"WHOLLY-OWNED SUBSIDIARY" means, as to any Person, a Subsidiary of such Person of which 100% of the Equity Securities (other than directors' qualifying shares or similar shares) is owned, directly or indirectly, by such Person.

"YEAR 2000 PROBLEM" means the risk that computer hardware or software applications will not record, store, process, calculate and present calendar dates falling on and after January 1, 2000, and calculate information dependent upon or relating to such dates, in the same manner and with the same functionality, data integrity and performance as such products record, store, process, calculate and present calendar dates falling on or before December 31, 1999, and calculate information dependent on or relating to such dates.

Section 1.02. GENERAL INTERPRETIVE PRINCIPLES. Whenever used in this Agreement, except as otherwise expressly provided or unless the context otherwise requires, any noun or pronoun shall be deemed to include the plural as well as the singular and to cover all genders. The name assigned this Agreement and the Section captions used herein are for convenience of reference only and shall not be construed to affect the meaning, construction or effect hereof. Unless otherwise specified, the terms "hereof," "herein" and similar terms refer to this Agreement as a whole (including the exhibits and schedules hereto), and references herein to Articles or Sections refer to Articles or Sections of this Agreement.

Section 1.03. EFFECT OF AMENDMENT AND RESTATEMENT. The parties hereto agree that the Investment Agreement shall be amended and restated as set forth herein. Except as expressly set forth herein, and except for representations, warranties and agreements set forth in the Company Representation and Warranty Letter or in the Investor Representation and Warranty Letter, all representations, warranties, covenants and agreements contained herein shall for the purposes hereof be deemed to have been made as of July 19, 1999. When used herein, the phrases "as of the date hereof," "the date of this Agreement," "of even date herewith" and substantially similar phrases shall be deemed to refer to July 19, 1999.

ARTICLE II
INITIAL SHARE PURCHASE AND OPTION

SECTION 2.01. INITIAL SHARE PURCHASE. Upon the terms and subject to the conditions set forth in this Agreement, and in reliance upon the representations and warranties hereinafter set forth, at the Initial Closing, the Company will issue, sell and deliver to the Investor, and the Investor will purchase from the Company 59,063 shares of Series A Preferred Stock, free and clear of all Liens, for an aggregate purchase price of $59,063,000 (the "INITIAL SHARE PURCHASE PRICE"). The transaction described in this Section 2.01 is referred to herein as the "INITIAL SHARE PURCHASE."

SECTION 2.02. OPTION. (a) Following the later to occur of the (i) Series A Shareholder Approval Date, (ii) Bank Approval Date, (iii) Board Approval Date and (iv) Option Approval Date, the Investor shall have an irrevocable option (the "OPTION") to purchase an additional 21,000 shares of Series A Preferred Stock (the "OPTION SHARES") for an aggregate purchase price of $21,000,000 (the "OPTION PURCHASE PRICE"). The Option may be exercised by the Investor at any time, in whole and not in part, during the period commencing on the later to occur of the (i) Series A Shareholder Approval Date, (ii) Bank Approval Date, (iii) Board Approval Date and (iv) Option Approval Date and ending on the Expiration Date. Except as expressly provided in Section 2.02(b) hereof, exercise of the Option shall be at the Investor's sole discretion. In the event that the Investor elects to exercise the Option, the Investor shall deliver a written notice (an "OPTION EXERCISE NOTICE") to that effect to the Company not later than the Expiration Date. Delivery of the Option Exercise Notice in accordance with the terms hereof shall constitute a binding agreement
on the part of the Investor to purchase, and on the part of the Company to
issue, sell and deliver, the Option Shares at the Option Closing on the terms
and subject to the conditions set forth herein. The purchase of the Option
Shares pursuant to the Option is referred to herein as the "OPTION PURCHASE."

(b) Subject to Section 2.02(c) hereof, in the event that the Closing
Price exceeds the Conversion Price on each Trading Day in a 45-Trading Day
Reference Period, the Company shall have the right, at its option and election,
to require the Investor to exercise the Option, in whole and not in part, and to
purchase the Option Shares on the terms and subject to the conditions set forth
herein. In the event that the Company elects to require the Investor to exercise
the Option and to purchase the Option Shares in accordance with this
Section 2.02(b), the Company shall deliver a written notice (a "MANDATORY
EXERCISE NOTICE") to that effect to the Investor not later than the third
Business Day after the last day of the relevant 45-Trading Day Reference Period.
The Mandatory Exercise Notice shall set forth in reasonable detail the
supporting data used by the Company in its determination that it has the right
to require the Investor to exercise the Option. Delivery of the Mandatory
Exercise Notice in accordance with the terms hereof shall constitute exercise
of the Option by the Investor, and shall constitute a binding agreement on the
part of the Investor to purchase, and on the part of the Company to issue, sell
and deliver, the Option Shares at the Option Closing, on the terms and subject
to the conditions set forth herein; PROVIDED, HOWEVER, that in the event the
conditions set forth in Section 9.03 hereof are not satisfied or waived on or
prior to the tenth Business Day following the delivery of the Mandatory
Exercise Notice, (i) the Investor shall not be deemed to have exercised the
Option, (ii) the Investor shall not be obligated to purchase the Option Shares,
(iii) the Mandatory Exercise Notice shall be deemed to have been withdrawn, and
(iv) the Company shall not have the right to require exercise of the Option and
shall not deliver a subsequent Mandatory Exercise Notice for a period of 30 days
following such tenth Business Day. The Company shall not deliver a Mandatory
Exercise Notice if, to the knowledge of the Company, the conditions set forth in
Section 9.04(b), (c) or (d) hereof cannot be satisfied. The Company's right to
require the Investor to exercise the Option and purchase the Option Shares
pursuant to this Section 2.02(b) shall expire on, and no Mandatory Exercise
Notice may be delivered later than, the date that is 30 calendar months after
the Series A Shareholder Approval Date.

(c) Notwithstanding anything in this Section 2.02 to the contrary, the
Company shall not require the Investor to exercise the Option and the Investor
shall not be required to purchase the Option Shares pursuant to a Mandatory
Exercise Notice unless (i) the Common Stock shall have been validly listed for
trading on the NYSE or other national securities exchange or quoted on a
nationwide recognized quotation system on each day in the relevant 45-Trading
Day Reference Period and on the Option Closing Date, (ii) the average daily
trading volume in the Common Stock during the relevant 45-Trading Day Reference
Period is at least 60% of the average daily trading volume in the Common Stock
for the 180-day period ending on the date of the Investment Agreement, (iii) as
of the Option Closing, the Shelf Registration Statement (as such term is defined
in the Registration Rights Agreement) is effective under the Securities Act and
is available for use in connection with the offer and sale of shares of Series A
Preferred Stock and Common Stock by those holders that have such right under the
Registration Rights Agreement (it being understood that if a Shelf Suspension
(as such term is defined in the Registration Rights Agreement) is in effect, the
Shelf Registration Statement shall not be deemed effective or available for use),
(iv) no Change of Control shall have occurred since the date hereof,
(v) the Company shall not have breached or defaulted under this Agreement or the
Certificates of Designations in any material respect, (other than breaches or
defaults that have been cured or waived prior to the date of the Mandatory
Exercise Notice) and (vi) the Company is permitted to sell all of the Option
Shares to the Investor on the Option Closing Date under the Indenture.
Notwithstanding anything in this Section 2.02 to the contrary, the Company may
not require the Investor to exercise the Option and purchase the Option Shares
pursuant to a Mandatory Exercise Notice if such exercise or purchase would:
(a) violate any provision of the Certificate of Incorporation or Bylaws;
(b) conflict with, contravene or result in a breach or violation of any of the
terms or provisions of, or constitute a default (with or without notice or the
passage of time) under, or result in or give rise to a right of termination,
cancellation, acceleration or modification of any right or obligation under, or
give rise to a right to put or to compel a tender offer for outstanding
securities of the Company or any of its Subsidiaries under, or require any
consent, waiver or approval under, any note, bond, debt instrument, indenture,
mortgage, deed of trust, lease, loan agreement, joint venture agreement,
Regulatory Approval, contract or any other agreement, instrument or obligation
to which the Company or any of its Subsidiaries is a party or by which the
Company or any of its Subsidiaries or any property of the Company or any of its
Subsidiaries is bound; (c) result in the creation or imposition of any Lien upon
any assets or properties of the Company or any of its Subsidiaries; or
(d) violate any Law applicable to the Company or any of its Subsidiaries.

(d) Notwithstanding anything in this Section 2.02 to the contrary, in
the event (a "RESTRICTION EVENT") that an Option Exercise Notice has been
delivered and the Company is prohibited from selling any Option Shares to the
Investor pursuant to (A) the provisions set forth

in Section 4.03(a) of the Indenture (as in effect on the date hereof) or
(B) under comparable provisions of any Indenture so long as such comparable
provisions are not materially more restrictive than those referred to in clause
(A), the Company shall not be required to sell Option Shares to the Investor at
the Option Closing to the extent that the Company is prohibited from doing so
pursuant to such provisions. In such event, the Investor shall have the right to
(i) exercise the Option in part and purchase (a "PARTIAL PURCHASE") at the
Option Closing that number of Option Shares that the Company is permitted to
sell under the Indenture (as in effect on the date hereof) or (ii) withdraw the
Option Exercise Notice (a "WITHDRAWAL"). In connection with any Partial
Purchase, the Option Purchase Price shall be proportionately reduced to reflect
the actual number of Option Shares purchased at the Option Closing. Following
the Option Closing at which a Partial Purchase is completed, the Option shall
remain effective with respect to the Option Shares that the Company was not
permitted to sell at the Option Closing under the Indenture on the same terms
and conditions set forth herein, except that the Option Purchase Price shall be
proportionately reduced to reflect the number of Option Shares still subject to
the Option. In the event of a Withdrawal, no Option Exercise Notice shall deemed
to have been delivered hereunder, except for the purposes of this
Section 2.02(d).

SECTION 2.03. INITIAL SHARE PURCHASE CLOSING. (a) Subject to the
satisfaction or, if permissible, waiver of the conditions set forth in
Sections 9.01 and 9.02 hereof, the Initial Closing shall take place at the
offices of Cleary, Gottlieb, Steen & Hamilton, One Liberty Plaza, New York,
New York, at 10:00 a.m., New York City time, on the third Business Day
following satisfaction or, if permissible, waiver, of the conditions set forth in
Sections 9.01 and 9.02 hereof, or at such other time and place as the
parties may agree (the date on which the Initial Closing occurs, the "INITIAL
CLOSING DATE").

(b) At the Initial Closing, (i) the Company will deliver to the
Investor certificates representing the shares of Series A Preferred Stock to be
purchased by, and sold to, the Investor pursuant to Section 2.01 hereof
(registered in the names and in the denominations designated by the Investor at
least two Business Days prior to the Initial Closing Date), together with the
other documents, certificates and opinions to be delivered pursuant to
Section 9.01 hereof, and (ii) the Investor, in full payment for the shares of
Series A Preferred Stock to be purchased by, and sold to, the Investor pursuant
to Section 2.01 hereof, will pay to the Company as provided in Section 2.01
hereof, an aggregate amount equal to the Initial Share Purchase Price, against
which amount to be paid to the Company any amounts due to the Investor pursuant
to Section 11.01(a) hereof or otherwise shall be netted (PROVIDED, that the
Investor shall continue to be entitled to seek reimbursement after the Initial
Closing for amounts that are properly reimbursable pursuant to Section 11.01(a)
hereof), in immediately available funds, and the Investor shall deliver to the
Company the other documents, certificates and opinions to be delivered pursuant
to Section 9.02 hereof. The amount to be paid to the Company will be paid by
wire transfer to First Union National Bank, Macon, Georgia, Acct. Name: Magellan
Health Services, Inc., Acct. No.: 2080000077640, ABA No. 061000227.

SECTION 2.04. OPTION CLOSING. (a) In the event the Option is exercised
in accordance with the terms hereof, subject to the satisfaction or, if
permissible, waiver of the conditions set forth in Sections 9.03 and 9.04
hereof, the Option Closing shall take place at the offices of Cleary, Gottlieb,
Steen & Hamilton, One Liberty Plaza, New York, New York, at 10:00 a.m., New York City time, on the third Business Day following exercise or deemed exercise, as the case may be, of the Option by delivery of the relevant notice and satisfaction or, if permissible, waiver, of the conditions set forth in Sections 9.03 and 9.04 hereof, or at such other time and place as the parties may agree (the date on which Option Closing occurs, the "OPTION CLOSING DATE"). In the event the Option is exercised or deemed exercised in accordance with the terms hereof, the Company and the Investor shall use their best efforts so as to effect the Option Closing no later than the third Business Day following the date of delivery of the relevant notice relating to exercise; PROVIDED, HOWEVER, that if a Mandatory Exercise Notice has been delivered, the Investor shall have right to delay the Option Closing for a period of ten Business Days from the date of delivery of the Mandatory Exercise Notice.

(b) At the Option Closing, (i) the Company will deliver to the Investor certificates representing the shares of Series A Preferred Stock to be purchased by, and sold to, the Investor pursuant to Section 2.02 hereof (registered in the names and in the denominations designated by the Investor at least two Business Days prior to the Option Closing Date), together with the other documents, certificates and opinions to be delivered pursuant to Section 9.03 hereof (including, without limitation, the Company Representation and Warranty Letter), and (ii) the Investor, in full payment for the shares of Series A Preferred Stock to be purchased by, and sold to, the Investor pursuant to Section 2.02 hereof, will pay to the Company an amount equal to the Option Purchase Price, against which amount to be paid to the Company any amounts due to the Investor pursuant to Section 11.01(a) hereof or otherwise shall be netted (PROVIDED, that the Investor shall continue to be entitled to seek reimbursement after the Option Closing for amounts that are properly reimbursable pursuant to Section 11.01(a) hereof), in immediately available funds, and the Investor shall deliver to the Company the other documents and certificates to be delivered pursuant to Section 9.04 hereof (including, without limitation, the Investor Representation and Warranty Letter). The amount to be paid to the Company will be paid by wire transfer to First Union National Bank, Macon, Georgia, Acct. Name: Magellan Health Services, Inc., Acct. No.: 2080000077640, ABA No. 061000227, or as otherwise directed by the Company.

ARTICLE III

REPRESENTATIONS AND WARRANTIES OF THE COMPANY

The Company hereby represents and warrants to, and agrees with, the Investor as follows:

SECTION 3.01. CORPORATE ORGANIZATION AND QUALIFICATION. Each of the Company and each of its Significant Subsidiaries is a corporation or limited liability company duly organized or formed, as the case may be, validly existing and in good standing under the laws of the jurisdiction of its organization and has all requisite power and authority to own or lease and operate its properties and to conduct its business as it is currently being conducted and is proposed to be conducted. Each of the Company and each of its Significant Subsidiaries is duly licensed, authorized or qualified as a foreign corporation or limited liability company for the transaction of business and is in good standing under the laws of each other jurisdiction in which its ownership, lease or operation of property or conduct of business requires such qualification, except where its failure to be so licensed, authorized or qualified would not have, individually or in the aggregate, a Material Adverse Effect. The Company has delivered to the

Investor a complete and correct copy of the certificate of incorporation and the bylaws or comparable governing instruments of the Company and each of its Significant Subsidiaries, each as amended to date and each of which as so delivered is in full force and effect. The Company has delivered to the Investor a complete and correct copy of the minute books of the Company and each of its Significant Subsidiaries, and each such minute book includes minutes of the meetings of, and resolutions adopted by, the stockholders or members of such entity, the board of directors or comparable governing body of such entity and the committees of the board of directors or comparable governing body of such
SECTION 3.02. AUTHORIZATION OF AGREEMENTS. (a) The Company has all requisite corporate power and authority to execute, deliver and perform its obligations under the Transaction Agreements and the Company Documents. The execution, delivery and performance of the Transaction Agreements and the Company Documents, and the consummation by the Company of the transactions contemplated hereby and thereby, have been duly authorized by all necessary corporate action on the part of the Company. The Board of Directors has approved the entry by the Company into this Agreement and has approved the consummation of the transactions contemplated by the Transaction Agreements for all purposes under the DGCL, including for purposes of paragraph (a)(1) of Section 203 of the DGCL ("DGCL SECTION 203"). The Company has delivered to the Investor true and correct copies of resolutions adopted by the Board of Directors to the foregoing.

(b) This Agreement and the Registration Rights Agreement have been duly executed and delivered by the Company, and each such agreement constitutes a legal, valid and binding obligation of the Company, enforceable against the Company in accordance with its terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights generally and to general principles of equity.

SECTION 3.03. CONSENTS; NO CONFLICTS. (a) Except for the Required Regulatory Approvals, no Regulatory Approval from, or registration, disclosure, declaration or filing with, any Governmental Entity is required to be made or obtained by the Company or any of its Significant Subsidiaries in connection with the execution, delivery and performance of the Transaction Agreements and the Company Documents and the consummation of the transactions contemplated thereby.

(b) Except as set forth on Schedule 3.03(b) hereto, the execution and delivery of each of this Agreement and the Registration Rights Agreement does not, and the execution and delivery of each of the Company Documents will not, and, subject to the receipt of the Required Regulatory Approvals, the performance of the obligations set forth herein and therein and the consummation of the transactions contemplated hereby and thereby will not, (i) violate any provision of the Certificate of Incorporation or the Bylaws or the comparable governing instruments of any of the Significant Subsidiaries; (ii) give rise to any preemptive rights, rights of first refusal or other similar rights on behalf of any Person under any applicable Law or any provision of the Certificate of Incorporation or Bylaws or any agreement or instrument applicable to the Company or any of its Significant Subsidiaries; (iii) conflict with, contravene or result in a breach or violation of any of the terms or provisions of, or constitute a default (with or without notice or the passage of time) under, or result in or give rise to a right of termination, cancellation, acceleration or modification of any right or obligation under, or give rise to a right to put or to compel a tender offer for outstanding securities of the Company or any of its Significant Subsidiaries under, or require any consent, waiver or approval under, any note, bond, debt instrument (including, without limitation, the Credit Agreement), indenture, mortgage, deed of trust, lease, loan agreement, joint venture agreement, Regulatory Approval, contract or any other agreement, instrument or obligation to which the Company or any of its Significant Subsidiaries is a party or by which the Company or any of its Significant Subsidiaries or any property of the Company or any of its Significant Subsidiaries is bound (other than in each case in connection with a "Change in Control," as such term is defined in the Indenture, or a "Change of Control," as such term is defined in the Credit Agreement, or a "Change in Control," as such term is defined in the Indenture, resulting from the appointment of members of the Board of Directors pursuant to Section D of Article VIII of the Senior Certificates of Designations or resulting from any action taken by the Investor or any of its Affiliates that is permitted under Section 6.01(b) hereof); PROVIDED, HOWEVER, that the issuance of the Option Shares may be subject to a Restriction Event at the time the Company is obligated to issue the Option Shares; (iv) result in the creation or imposition of any Lien upon any assets or properties of the Company or any of its Significant Subsidiaries or (v) violate any Law applicable to the Company or any of its Significant Subsidiaries.

(c) Except for the Shareholder Approvals, no consent or approval of the Company's stockholders is required by Law, the Certificate of Incorporation, the
(d) The execution and delivery of the Transaction Agreements and the consummation of transactions contemplated hereby and thereby will not constitute a "Change of Control" or "Change in Control" (or similar concept) as such term (or concept) is defined in the Credit Agreement, the Indenture or any other material contract, agreement, indenture, mortgage, note, lease or other instrument to which the Company or any of its Significant Subsidiaries is a party or by which the Company or any such Subsidiary is bound or to which the properties of the Company or any such Subsidiary is subject (other than in connection with a "Change in Control," as such term is defined in the Credit Agreement, or a "Change of Control," as such term is defined in the Indenture, resulting from the appointment of additional members of the Board of Directors pursuant to Section D of Article VIII of the Senior Certificates of Designations or resulting from any action taken by the Investor or any of its Affiliates that is permitted under Section 6.01(b) hereof).

SECTION 3.04. CAPITALIZATION; SECURITIES. (a) As of the date hereof, the authorized capital stock of the Company consists of (i) 80,000,000 shares of Common Stock, of which 31,788,288 shares were outstanding as of July 13, 1999, 6,034,079 shares are reserved for issuance under the Option Plans, 4,732,333 shares are reserved for issuance pursuant to the Company Warrants and 23,262 shares are reserved for issuance pursuant to the option granted to Paul G. Shoffeit, which is disclosed on Schedule 3.04(d) hereto, and (ii) 10,000,000 shares of preferred stock, without par value, of which no shares are outstanding, no shares have been designated and no shares are reserved for issuance. All of such outstanding shares of Common Stock were duly authorized and validly issued and are fully paid and non-assessable and are validly listed for trading on the NYSE.

(b) Except for the Option, the Company Warrants and the options granted pursuant to the Option Plans or as set forth on Schedule 3.04(b) hereto, there are no authorized or outstanding (or any obligations to authorize or issue) Derivative Securities.

(c) As of the date hereof, the Company and its Subsidiaries have no outstanding Indebtedness other than (i) Indebtedness outstanding pursuant to the Credit Agreement not in excess of $500,000,000 in principal amount in the aggregate, (ii) Senior Subordinated Notes with an aggregate principal amount of $625,000,000, (iii) inter-company Indebtedness among Subsidiaries of the Company or among Subsidiaries of the Company and the Company, and (iv) other Indebtedness not in excess of $25,000,000 in principal amount in the aggregate. A true, complete and correct copy of each of the Credit Agreement, the Indenture and each other instrument or agreement governing Indebtedness of the Company or any of its Subsidiaries the principal amount of which exceeds $10,000,000, including the respective exhibits and schedules thereto and any other material documents executed in connection therewith, has been delivered to the Investor.

(d) Subject to the filing of the Certificates of Designations with the Secretary of State of the State of Delaware, the shares of Preferred Stock (other than the Option Shares or shares issuable in respect of the Option Shares) to be issued pursuant to this Agreement have been duly and validly authorized and, when issued as contemplated by this Agreement, will have been validly issued and will be fully paid and non-assessable. The Conversion Shares (other than shares issuable in respect of the Option Shares) have been duly and validly authorized and validly reserved for issuance, and when issued upon the conversion of the Senior Preferred Stock will have been validly issued and will be fully paid and non-assessable. Subject to receipt of the Series A Shareholder Approval, the Board Approval and the Option Approval, (i) the Option Shares to be issued pursuant to this Agreement will be duly and validly authorized and validly reserved for issuance and, when issued as contemplated by this Agreement, will have been validly issued and will be fully paid and non-assessable; and (ii) the Conversion Shares issuable in respect of the Option Shares will have been duly and validly authorized and validly reserved for issuance, and when issued upon the conversion of the Option Shares will have been validly issued and will be fully paid and non-assessable. Except as set forth in Schedule 3.04(d) hereto, the registration of the Senior Preferred Stock, Junior Shares, Conversion Shares, Dividend Shares or Debentures pursuant
to the Registration Rights Agreement will not give rise to any registration rights on behalf of any Person under any agreement or instrument applicable to the Company (other than the Registration Rights Agreement). Except as set forth in Schedule 3.04(d) hereto, other than pursuant to the Registration Rights Agreement, no Person has any right to require the Company to register securities of the Company under the Securities Act, and there are no shareholder or similar agreements to which the Company is a party. Prior to the issuance thereof, the Debentures will have been duly and validly authorized by the Company and, upon execution and delivery thereof in accordance with the terms of the Senior Preferred Stock, will constitute legal, valid and binding obligations of the Company, enforceable against the Company in accordance with their terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights generally and to general principles of equity.

SECTION 3.05. SUBSIDIARIES; EQUITY INVESTMENTS. (a) Schedule 3.05(a) hereto lists, for each Significant Subsidiary of the Company, the name of such Subsidiary,

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together with (i) the jurisdiction and nature (e.g., corporation, partnership, limited liability company) of its organization, (ii) the number and percentage of shares of each class of such Subsidiary's Equity Securities owned by the Company or any of its Wholly-Owned Subsidiaries, (iii) the identity of the record holder(s) and the name and number of shares of each class of such Subsidiary's Equity Securities owned by any Person other than the Company or its Wholly-Owned Subsidiaries, and (iv) the identity of any Person other than the Company or its Wholly-Owned Subsidiaries that has the right (including upon the passage of time or upon the occurrence of specified events) to acquire any of such Subsidiary's Equity Securities. Such list is true, correct and complete as of the date hereof. The Equity Securities of each such Subsidiary owned, directly or indirectly, by the Company are held free and clear of all Liens except as set forth on Schedule 3.05(a), and all Equity Securities of such Subsidiary have been duly authorized and validly issued and are fully paid and nonassessable.

(b) Except for the Equity Securities of the Subsidiaries of the Company, the Equity Securities listed on Schedule 3.05(b) hereto, and any Equity Securities acquired after the date hereof in transactions permitted pursuant to Section 7.02(a) hereof, the Company does not, directly or indirectly, (i) Beneficially Own or own of record any Equity Securities of, or any other equity interest in, any other Person or (ii) have any other equity investment or other ownership interest in any other Person other than, in each case, such investments or other ownership interests valued at less than $1,000,000 individually and $5,000,000 in the aggregate.

(c) Other than as set forth on Schedule 3.05(c) hereto, as of the date hereof, neither the Company nor any of its Significant Subsidiaries is obligated, pursuant to any agreement or instrument applicable to the Company or such Subsidiary, to purchase any Equity Securities of, or make any other equity investment in, any Person, other than such Equity Securities or other equity investments valued at less than $1,000,000 individually and $5,000,000 in the aggregate.

(d) Schedule 1.01(D) hereto includes all Subsidiaries of the Company that are "Significant Subsidiaries" (as such term is defined in Regulation S-X under the Exchange Act, as in effect on the date hereof) of the Company.

SECTION 3.06. DIVIDENDS, STOCK REPURCHASES, ETC. Other than as set forth on Schedule 3.06 hereto, pursuant to this Agreement, the Indenture (as in effect on the date hereof) or the Credit Agreement (as in effect on the date hereof), or as restricted or limited by applicable Law, there are no contractual or other restrictions or limitations on the ability of the Company or any of its Significant Subsidiaries to pay any dividends or make any other distributions on, or to purchase, redeem or otherwise acquire, any of its Equity Securities.

Section 3.07. COMPANY REPORTS; FINANCIAL STATEMENTS. (a) The Company has delivered to the Investor a true and complete copy of (i) the Company's Annual Report on Form 10-K for each of the fiscal years ended September 30, 1998, 1997, 1996, 1995 and 1994; (ii) the Company's Quarterly Report on Form 10-Q for each of the periods ended December 31, 1998 and March 31, 1999 and (iii) each registration statement, report on Form 8-K, proxy statement, information statement or other report or statement filed by the Company with the
the "SEC REPORTS"). As of their respective dates, the SEC Reports and any registration statement, report, proxy statement, information statement or other statement filed by the Company with the Commission before the Initial Closing Date (collectively, the "SUBSEQUENT REPORTS") (i) was, or will be, as the case may be, timely filed with the Commission; (ii) complied, or will comply, as the case may be, in all material respects, with the applicable requirements of the Exchange Act and the Securities Act, and (iii) did not, or will not, as the case may be, contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. Other than the SEC Reports or, with respect to Subsequent Reports required to be filed after the date hereof, such filings as have been made, the Company has not filed or been required to file any other reports or statements with the Commission since September 30, 1994.

(b) Each of the consolidated balance sheets (including the related notes and schedules) included in or incorporated by reference into the SEC Reports or any Subsequent Reports fairly presents, or will fairly present, as the case may be, in all material respects, the consolidated financial position of the entities to which it applies as of the date thereof, and each of the consolidated statements of income (or statements of results of operations), stockholders' equity and cash flows (including the related notes and schedules) included in or incorporated by reference into the SEC Reports or any Subsequent Reports, fairly presents or will fairly present, as the case may be, in all material respects, the results of operations, retained earnings and cash flows, as the case may be, of the entities to which it applies (on a consolidated basis) for the periods or as of the dates, as the case may be, set forth therein, in each case in accordance with GAAP applied on a consistent basis throughout the periods covered (except as stated therein or in the notes thereto) and in compliance with the rules and regulations of the Commission.

(c) The Annual Statements and Quarterly Statements of each Subsidiary of the Company that is required to file such statements (each, a "REGULATED SUBSIDIARY"), as filed with the Department of Insurance, Superintendent of Insurance or similar insurance regulatory authority of the state of domicile of such Regulated Subsidiary (with respect to each Regulated Subsidiary, its "APPLICABLE INSURANCE DEPARTMENT") for the fiscal year ended September 30, 1998 and the quarters ended December 31, 1998 and March 31, 1999, respectively, together with any notes, exhibits and schedules thereto, have been prepared in accordance with the accounting practices prescribed or permitted by the Applicable Insurance Department for purposes of financial reporting to the applicable state's insurance regulators ("STATE STATUTORY ACCOUNTING PRACTICES"), and such accounting practices have been applied on a basis consistent with State Statutory Accounting Practices throughout the periods involved, except as expressly set forth in any notes, exhibits and schedules thereto.

(d) The regulatory capital funding requirements of the Regulated Subsidiaries are, in all material respects, as previously disclosed by the Company to the Investor (the "CAPITAL FUNDING REQUIREMENTS DISCLOSURE").

(e) The Company is eligible to register securities for offer and sale on Form S-3 under the Securities Act.

SECTION 3.08. UNDISCLOSED LIABILITIES. Except as disclosed on Schedule 3.08 hereto, at September 30, 1998, there were no liabilities or obligations of any nature (whether accrued, absolute, fixed, contingent, liquidated, unliquidated or otherwise and whether due or to become due) required by GAAP to be set forth on (i) the Balance Sheet (as defined below) of the Company except as reflected or reserved against on the consolidated balance sheet of the Company at September 30, 1998 as set forth in the SEC Reports (the "BALANCE SHEET") or in the notes thereto or (ii) the consolidated balance sheet of any other entity included in the SEC Reports except as reflected or reserved against
on such balance sheet included in the Company's Annual Report on Form 10-K for
the fiscal year ended September 30, 1998, as amended through the date hereof, or
in the notes thereto. Since September 30, 1998, the Company has not incurred any
liabilities or obligations except such as would not, individually or in the
aggregate, have a Material Adverse Effect.

SECTION 3.09. ABSENCE OF CERTAIN CHANGES. Except for transactions
contemplated by the Transaction Agreements (including, without limitation,
transactions expressly permitted pursuant to Section 7.02 hereof), transactions
with respect to which the Investor shall have given its prior written consent,
or transactions disclosed in the SEC Reports, on Schedule 3.09 hereto or in the
Proposed Asset Sale Letter, from September 30, 1998 to the Initial Closing, the
Company and its Significant Subsidiaries have conducted their business in the
ordinary and usual course, and there has not been any of the following:

(i) any change or amendment to the Certificate of Incorporation or
Bylaws or the certificate or articles of incorporation, bylaws or other
organizational documents of any Significant Subsidiaries of the Company;

(ii) any issuance or sale, or any direct or indirect purchase,
redemption or other acquisition of any shares of their respective Equity
Securities or any Derivative Securities by the Company or any of its
Significant Subsidiaries, other than pursuant to this Agreement, the Company
Warrants or the Option Plans;

(iii) any dividend or other distribution declared, set aside, paid or
made with respect to their respective Equity Securities by the Company or
any of its Significant Subsidiaries, except (x) dividends or other
distributions made to the Company or to any Subsidiary of the Company and
(y) dividends and distributions declared, set aside, paid or made by any
joint venture in which the Company or any Significant Subsidiary owns an
equity interest, which dividends and distributions were declared, set aside,
paid or made in accordance with the organizational documents or related
service agreements of such joint venture as in effect on the date of such
payment;

(iv) any acquisition or disposition of assets by the Company and its
Subsidiaries having a fair value or for a purchase price in excess of
$5,000,000, in the aggregate, other than acquisitions or dispositions made
in the ordinary course of business and acquisitions or dispositions among
the Company and its Subsidiaries or among such Subsidiaries;

(v) any increase in excess of $5,000,000 in the Indebtedness of the
Company and its Subsidiaries, taken as a whole, other than (x) advances to
the Company pursuant to the revolving credit facility under the Credit
Agreement in an amount not in excess of

$60,000,000, in the aggregate, outstanding at any time and (y) changes in
inter-company Indebtedness among the Company and its Subsidiaries or among
Subsidiaries of the Company, which changes were permitted under the Credit
Agreement (as in effect on the date hereof);

(vi) any amendment of any mortgage, Lien, lease, Regulatory Approval,
loan agreement, indenture or other agreement, instrument or document, which
amendment is material to the Company and its Subsidiaries, taken as a whole;

(vii) any default, event of default or breach (or any event which, with
notice or the passage of time or both, would constitute a default, event of
default or breach) by the Company or any of its Subsidiaries of any credit,
financing or other agreement or instrument relating to any Indebtedness
(including, without limitation, the Credit Agreement or the Indenture),
which default, event of default or breach is material to the Company and its
Subsidiaries, taken as a whole;

(viii) any damage, destruction, theft or other casualty loss (whether
or not covered by insurance) that is material to the Company and its
Subsidiaries taken as a whole;

(ix) any commitment, agreement or transaction entered into, amended, or
terminated (or any waiver of any rights or remedies under any of the
foregoing) by the Company or any of its Subsidiaries (including any

agreement with respect to any ongoing or threatened litigation) that is material to the Company and its Subsidiaries, taken as a whole, other than in the ordinary course of business;

(x) any entry into or amendment of any material employment, severance, compensation, consulting, retention, change of control or similar agreement with, or any material increase in the compensation or benefits payable or to become payable by the Company or any of its Subsidiaries to, any employee of the Company or any of its Subsidiaries (other than agreements terminable without penalty or similar payment by the Company or such Subsidiary, as the case may be, on not more than 30 days' notice and increases in compensation payable or to become payable to employees (other than directors or officers) in the ordinary course of business consistent with past practice);

(xi) any change in the financial accounting methods, principles or practices of the Company and its Subsidiaries for financial accounting purposes, except as required by GAAP or applicable Law;

(xii) any adoption of any agreement or understanding with respect to any Control Transaction, merger, consolidation or other reorganization with respect to the Company or any of its Significant Subsidiaries, or any adoption of any plan, agreement or arrangement with respect to, or resolutions providing for, the liquidation or dissolution of the Company or any of its Significant Subsidiaries;

(xiii) any settlement or compromise of any Proceeding other than those in which the amount paid (to the extent not reimbursed with the proceeds of any Policy) does not exceed $2,000,000;

(xiv) any change, condition, occurrence, circumstance or other event that, individually or in the aggregate, has had or is reasonably likely to have a Material Adverse Effect; or

(xv) any commitment or agreement to do any of the foregoing, except as otherwise required or expressly permitted by this Agreement.

SECTION 3.10. PROPERTY. (a) Except as set forth on Schedule 3.10(a) hereto, each of the Company and its Significant Subsidiaries has good and marketable title to all property owned by each of them, in each case free and clear of any Liens, except for Liens created pursuant to the Credit Agreement (as in effect on the date hereof) or permitted to exist under Section 6.02 under the Credit Agreement (as in effect on the date hereof), and any real property and buildings held under lease by the Company or any such Subsidiary are held under a valid, subsisting and enforceable lease, with such exceptions as are not material and do not interfere with the use made or proposed to be made of such property and buildings by the Company or such Subsidiary.

(b) Each of the Company and its Significant Subsidiaries owns or possesses the rights to use, and is in compliance with, in all material respects, all Intellectual Property that is used or required by it in the conduct of its business and all such Intellectual Property is in full force and effect and will not cease to be in full force and effect in accordance with its terms by virtue of the consummation of the transactions contemplated by the Transaction Agreements. Neither the Company nor any of its Subsidiaries has received any notice of, and they have no knowledge of, (i) any infringement of or conflict with asserted rights of others with respect to any Intellectual Property owned or used by the Company or any of its Subsidiaries, (ii) any challenge to the ownership of or validity or effectiveness of any license for the use of any Intellectual Property owned or used by the Company or any of its Subsidiaries, or (iii) any claim against the use by the Company or any of its Subsidiaries of any Intellectual Property owned or used by it, except, in each case, for such matters that would not, individually or in the aggregate, have a Material Adverse Effect.

SECTION 3.11. LITIGATION. Except as expressly disclosed in the SEC Reports or on Schedule 3.11 hereto, there are no claims, suits, actions, proceedings, arbitrations or investigations (each, a "PROCEEDING") pending or, to the knowledge of the Company or its Subsidiaries, explicitly threatened, against or affecting the Company or any of its Subsidiaries, that involve a claim against the Company or any of its Subsidiaries in a stated amount in excess of $5,000,000, that may involve criminal liability or result in or
involve criminal proceedings, that may affect the status of any Regulatory Approval maintained by the Company or any Subsidiary, that may affect the authority of the Company or any Subsidiary to participate in the federal Medicare program, any state Medicaid program or any other material third party payor program that, individually or in the aggregate, are reasonably likely to have a Material Adverse Effect; and except as so disclosed, there are no judgments, decrees, injunctions, rules, stipulations or orders outstanding against or applicable to the Company or any of its Subsidiaries or against or applicable to any of their respective properties or businesses that, individually or in the aggregate, are reasonably likely to have a Material Adverse Effect. It is understood that this Section 3.11 shall not apply to any Joint Venture.

SECTION 3.12. COMPLIANCE WITH LAWS; REGULATORY APPROVALS. Except as disclosed in the SEC Reports or in Schedule 3.12 hereto, since January 1, 1994, the businesses of the Company and its Significant Subsidiaries have been conducted, and the businesses of the Company and its Significant Subsidiaries currently are being conducted, in compliance with all applicable Laws in all material respects. Since January 1, 1994, all material Regulatory Approvals required by the Company and its Significant Subsidiaries to conduct their respective businesses have been obtained, and all material Regulatory Approvals required by the Company and its Significant Subsidiaries to conduct their respective businesses as now conducted by them are in full force and effect. Except as disclosed in the SEC Reports or on Schedule 3.12 hereto, the Company and its Significant Subsidiaries are in compliance with the terms and requirements of such Regulatory Approvals in all material respects. Except as disclosed on Schedule 3.12 hereto, since January 1, 1994, none of the Company or any of its Significant Subsidiaries has received any written notice or other written communication from or on behalf of any Governmental Entity regarding (i) any prior, pending, threatened or possible revocation, withdrawal, suspension, termination or modification of, or the imposition of any material conditions with respect to, any Regulatory Approval or the participation by the Company, or any such Subsidiary, in the federal Medicare program, any state Medicaid program, or any other third party payor program, except for any such revocation, withdrawal, suspension, termination, modification or condition that would not have a Material Adverse Effect, (ii) any material violation of any Law by the Company or any such Subsidiary, (iii) any prior, pending, threatened or possible investigation involving or otherwise relating to any material Regulatory Approval or the participation by the Company, or any such Subsidiary, in the federal Medicare Program, any state Medicaid program, or any other material third party payor program or (iv) any other limitations on the conduct of business by the Company or any such Subsidiary that would have a Material Adverse Effect. To the knowledge of the Company and its Subsidiaries, no currently proposed Law or proposed change in existing Law is reasonably likely to have a Material Adverse Effect. It is understood that this Section 3.12 shall not apply to any Joint Venture.

SECTION 3.13. TAXES. (a) Except as disclosed on Schedule 3.13 hereto, the Company and its Subsidiaries have timely filed (taking into account available extensions) all U.S. federal, state, local, foreign and other tax returns (including any information returns), reports and statements that are required to have been filed with the appropriate taxing authorities. All information provided in such returns, reports and statements is complete and accurate in all material respects. The Company and its Subsidiaries have paid all amounts due in respect of Taxes (whether or not actually shown on such returns, reports or statements), or have otherwise set up reserves in accordance with GAAP in respect of all Taxes for the periods covered by such Tax Returns, as well as all other Taxes, penalties, interest, fines, deficiencies, assessments and governmental charges that have become due or payable (including, without limitation, all Taxes that the Company and its Subsidiaries are obligated to withhold from amounts paid or payable to or benefits conferred upon employees, creditors and third parties). As of the date hereof, there is no proposed liability for any material Tax to be imposed upon the Company or any of the Subsidiaries for the fiscal year ended September 30, 1998 and all prior years for which there is not an adequate reserve, considering such reserves in the aggregate.

(b) Except as disclosed on Schedule 3.13 hereto, no audits or investigations relating to any Taxes for which the Company or its Subsidiaries may be liable are pending or
threatened in writing by any taxing authority. Except as disclosed on Schedule 3.13 hereto, there are no agreements or applications by the Company or any of its Subsidiaries for the extension of the time for filing any tax return or paying any Tax nor have there been any waivers of any statutes of limitation for the assessment of any Taxes.

(c) Neither the Company nor any of its Subsidiaries is a party to any agreements relating to the sharing or allocation of Taxes.

(d) As of October 1, 1998, for federal income tax purposes, the Company had net operating loss carryforwards ("NOLs") arising in the years, and for each such year, in the amounts, disclosed on Schedule 3.13(d) hereto. Except as disclosed on Schedule 3.13(d) hereto, to the knowledge of the Company and its Subsidiaries, based on their reasonable good faith analysis of the applicable facts (which, to the knowledge of the Company and its Subsidiaries, have in all material respects been disclosed to, or have otherwise been obtained by, the Investor and the accounting firm representing the Investor in connection with this Agreement) and relevant legal authorities: (i) assuming the shares of Series A Preferred Stock to be sold hereunder were deemed to be issued on the date of this Agreement, (a) the NOLs of the Company and its Subsidiaries are not subject to limitation under Code Section 382 and will not become subject to limitation under Code Section 382 immediately following such deemed issuance of the Series A Preferred Stock, and (b) taking into account such deemed issuance, the increase in the percentage of the Company's stock owned by one or more 5% shareholders, within the meaning of Code Section 382 and the relevant Treasury Regulations promulgated thereunder, during the three-year testing period ending on the date of such deemed issuance, relative to the lowest percentage of stock owned by such shareholders during such testing period, does not exceed 35%; (ii) the NOLs of the Company and its Subsidiaries are not separate return limitation year ("SRLY") losses within the meaning of Code Section 1502 and the Treasury Regulations promulgated thereunder; and (iii) the Investor and the accounting firm representing the Investor are aware of all transfers or issuances of the Company's shares which have occurred during the three-year testing period ending on the date of issuance of the Series A Preferred Stock of which the Company has knowledge and which involve more than 5% of the Company's outstanding shares or which were issued to, or acquired by, an owner of more than 5% of the Company's outstanding shares. The representations made in clause (i) of this Section 3.13(d), when reaffirmed by the Company as of the Initial Closing Date pursuant to Section 9.01(a) hereof, shall be modified by taking into account the actual issuance of the Series A Preferred Stock at the Initial Closing.

(e) Except as disclosed on Schedule 3.13(e) hereto, the Company or its Subsidiaries have withheld from its employees and timely paid to the appropriate taxing authority proper and accurate amounts in all material respects through all periods in compliance in all material respects with all employee Tax withholding provisions of all applicable Laws.

SECTION 3.14. ERISA AND OTHER EMPLOYMENT MATTERS.

(a) Schedule 3.14(a) lists each material employee benefit plan (within the meaning of Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA")), whether or not subject to ERISA, and each material bonus, incentive or deferred compensation, stock option or other equity based, severance, termination, or fringe benefit or other material benefit, plan, program or policy, maintained, sponsored or contributed to by the Company or any of its Subsidiaries or to which any such Person is or has been obligated to contribute (collectively, the "PLANS"). Neither the Company nor any of its Subsidiaries is or, within the preceding six years, has been obligated to contribute to any "multiemployer plan" as defined in Section 3(37) of ERISA. Except as set forth on Schedule 3.14(a), none of the Company nor any of its Subsidiaries has an express or implied commitment, (i) to create, incur liability with respect to or cause to exist any material employee benefit plan, program or arrangement other than the Plans or (ii) except for amendments necessary or appropriate to comply with applicable Law, to modify, change or terminate any Plan. Schedule 3.14(a) indicates which of such Plans is
subject to ERISA.

(b) Except as set forth in Schedule 3.14(b), neither the execution and delivery of the Transaction Agreements nor the consummation of the transactions contemplated thereby will (i) accelerate the time of payment, vesting or funding of, or increase or modify the amount or terms of, any compensation or benefits that are or may become payable from or by the Company or any of its Subsidiaries to or in respect of any current or former executive officer or other key employee of any such Person, or (ii) constitute a Change in Control under any of the Employment Agreements with any such executive officer or other key employee.

(c) All employer and employee contributions, premiums and expenses payable to or in respect of any Plan or required by Law or any Plan or labor agreement or arrangement have been timely paid, or, if not yet due, have been fully and adequately accrued as a liability on the Company's financial statements included in the SEC Reports and no Plan is subject to Section 412 of the Code or Section 302 of ERISA.

(d) Except as set forth on Schedule 3.14(d), (i) no trade or business, whether or not incorporated, is or has been treated as a single employer together with the Company for any purpose under ERISA or Section 414 of the Code other than the Company's Subsidiaries, (ii) no material liability under Title I or IV of ERISA or the penalty or excise tax provisions of the Code relating to employee benefit plans or employee compensation has been incurred (directly or indirectly, including as a result of any indemnification obligation or agreement) by the Company or any of its Subsidiaries and is still outstanding, and no event, transaction or condition has occurred or exists which is reasonably expected to result in any material liability to the Company, any of its Subsidiaries or, following the Initial Closing, the Investor or any Affiliate thereof, and (iii) no reportable event, within the meaning of Section 4043 of ERISA and the regulations of the PBGC promulgated thereunder, has occurred that is reasonably expected to result in the imposition of any material liability to the Company or any of its Subsidiaries, or will occur in connection with the consummation of the transactions contemplated by this Agreement, with respect to any Plan.

(e) Each Plan has been operated and administered and is in compliance with all applicable Laws except for any failures that, individually and in the aggregate, would not result in any material liability of the Company or any of its Subsidiaries. Except as set forth in Schedule 3.14(e), each Plan that is intended to qualify under Section 401(a) of the Code has received a favorable determination from the Internal Revenue Service as to its qualification and, to the knowledge of the Company and its Subsidiaries, no event or condition has occurred or exists since the date of such letter that could result in the disqualification of such Plan.

(f) Except for the agreements set forth on Schedule 3.14(f), none of the Company or any of its Subsidiaries is a party to any collective bargaining agreements and there are no labor unions or other organizations representing, or to the knowledge of the Company and its Subsidiaries, purporting to represent or attempting to represent, any employee of the Company or any of its Subsidiaries.

(g) Neither the Company nor any of its Subsidiaries has violated any provision of Law regarding the terms and conditions of employment of employees, former employees or prospective employees or other labor related matters, including, without limitation, Laws relating to discrimination, fair labor standards and occupational health and safety, wrongful discharge or violation of the personal rights of employees, former employees or prospective employees, which is reasonably likely to have, individually or in the aggregate, a Material Adverse Effect.

SECTION 3.15. CONTRACTS. (a) Except as set forth on Schedule 3.15(a) hereto and other than the Option Plans, neither the Company nor any of its Subsidiaries is a party or subject to any of the following (whether written or oral, express or implied): (i) any Employment Agreement or understanding or obligation, with respect to severance, termination, retention or change in control, to pay liabilities or fringe benefits, with any present or former Representative of the Company or any of its Subsidiaries, who is or may be entitled to receive pursuant to the terms thereof, compensation in excess of $400,000 upon termination of such Person's employment or engagement; or (ii) any plan, contract or understanding providing for bonuses, pensions, options,
deferred compensation, retirement payments, royalty payments, profit sharing or similar payment or benefit with respect to any present or former Representative of the Company or any of its Subsidiaries, who is or may be entitled to receive pursuant to the terms thereof, base compensation in excess of $400,000 in any single year.

(b) Except as set forth on Schedule 3.15(b) hereto, none of the Company, any of its Subsidiaries, or to the knowledge of the Company and its Subsidiaries, any other party, is in breach or violation or in default in the performance or observance of any term or provision of any contract, agreement, indenture, mortgage, loan agreement, note, lease or other instrument to which the Company or any such Subsidiary is a party or by which the Company or any such Subsidiary is bound or to which any of the properties of the Company or any such Subsidiary is subject, which breach, violation or default is reasonably likely to, individually or in the aggregate, involve a claim against the Company or any of its Subsidiaries in an amount in excess of $3,000,000 or have a Material Adverse Effect.

(c) The maximum amount payable by the Company on or after the date hereof pursuant to deferred earn-out and other performance-based payment obligations in connection with any acquisition or similar transaction effected prior to the date hereof will not exceed $294,000,000, in the aggregate.

SECTION 3.16. CLIENT RELATIONS. Schedule 3.16 hereto contains an accurate and complete listing for the Company and its Subsidiaries, taken as a whole, of the clients that generated in excess of $6,000,000 in revenues and the revenues for each such client for the fiscal year ended September 30, 1998. Except as set forth on Schedule 3.16 hereto, as of the date hereof, no current client of the Company or any of its Subsidiaries that in the fiscal year ended September 30, 1998 generated in excess of $6,000,000 in revenues has advised the Company or any of its Subsidiaries that it is not continuing, or is terminating, or is making a material adverse change with respect to, its business with the Company or any of its Subsidiaries.

SECTION 3.17. FINANCIAL ADVISORS AND BROKERS; FAIRNESS OPINION.
(a) Except for Evercore Partners, Inc. and Morgan Stanley Dean Witter no Person has acted, directly or indirectly, as a broker, finder or financial advisor of the Company in connection with the Transaction Agreements or the transactions contemplated thereby, and no Person is entitled to receive any broker's, finder's or similar fee or commission in respect thereof based in any way on any agreement, arrangement or understanding made by or on behalf of the Company, any of its Subsidiaries or any of their respective directors, officers or employees. True and correct copies of all agreements between the Company, on the one hand, and Evercore Partners, Inc. or Morgan Stanley Dean Witter (or any of their respective Affiliates), on the other, have been delivered to the Investor.

(b) The Company has received an opinion of Morgan Stanley Dean Witter to the effect that the consideration to be paid to the Company for the shares of Series A Preferred Stock to be sold hereunder is fair, from a financial point of view, to the Company.

SECTION 3.18. EXEMPTION FROM REGISTRATION. Assuming the representations and warranties of the Investor set forth in Article IV hereof are true and correct in all material respects, the offer and sale of the Series A Preferred Stock made pursuant to this Agreement and the acquisition of the Conversion Shares upon conversion of the Senior Preferred Stock will be in compliance with the Securities Act and any applicable state securities laws and will be exempt from the registration requirements of the Securities Act and such state securities laws.

SECTION 3.19. INSURANCE. Set forth on Schedule 3.19 hereto is a description that is correct and complete in all material respects (specifying the insurer, the policy number or covering note number with respect to binders and amount of coverage) of insurance policies, binders, contracts or instruments (collectively, the "POLICIES") to which the Company or any of its Subsidiaries is a party or by which any of their assets or any of their employees, officers or directors (in such capacity) are covered by property, fire, professional liability, fiduciary and other insurance. True and complete copies of all such Policies have been made available to the Investor. Except as set forth on
Schedule 3.19 hereto, all such Policies are in full force and effect in accordance with their respective terms and will remain in full force and effect after the Initial Closing. Except as set forth on Schedule 3.19 hereto, neither the Company nor any of its Subsidiaries has received any notice of default with respect to any provision of any such Policies, or any notice that the Insurer is unwilling to renew any such Policy following the currently scheduled expiration of such Policy or intends to materially modify any term of any such renewed Policy as compared to the existing Policy. With respect to its directors' and officers' liability insurance policies, neither the Company nor any of its Subsidiaries has failed to give any notice or present any claim thereunder in due and timely fashion or as required by any such policies so as to jeopardize full recovery under such Policies.

SECTION 3.20. RIGHTS AGREEMENT. No "Distribution Date" or "Stock Acquisition Date" (as such terms are defined in the Rights Agreement, dated as of July 21, 1992, between the Company and First Union Bank of North Carolina, as Rights Agent (the "RIGHTS PLAN")) has occurred as of this date. The execution and delivery of the Transaction Agreements and the consummation of the transactions contemplated hereby will not result in the ability of any Person to exercise any rights ("RIGHTS") issued under the "Rights Plan" or cause the Rights to separate from the shares of Common Stock to which they are attached or to be triggered or become exercisable.

SECTION 3.21. DISCLOSURE. No representation or warranty by the Company in this Agreement, and no exhibit, document, statement, certificate or Schedule furnished or to be furnished to the Investor pursuant to the terms hereof, contains or will contain any untrue statement of a material fact, or omits or will omit to state a material fact necessary to make the statements or facts contained herein or therein not misleading or necessary to provide the Investor with adequate and complete information as to the Company, its Significant Subsidiaries or its Subsidiaries, as the case may be, and the businesses, assets and liabilities of the Company, its Significant Subsidiaries or its Subsidiaries, as the case may be.

SECTION 3.22. YEAR 2000 COMPLIANCE. The Company has carried out a review to evaluate the extent to which the business or operations of the Company or any of its Subsidiaries will be affected by the Year 2000 Problem. The Year 2000 Problem will not have a Material Adverse Effect or result in any material loss or interference with the business or operations of the Company or its Subsidiaries. The Company reasonably believes, after due inquiry, that the suppliers, vendors, customers or other material third parties used or served by the Company and its Subsidiaries are addressing or will address the Year 2000 Problem in a timely manner. The Company is in compliance in all material respects with all applicable requirements of any Governmental Entity or applicable Law relating to the Year 2000 Problem. The Company has delivered to the Investor complete and accurate copies of all of its internal plans, including estimates of the anticipated associated costs, for addressing the Year 2000 Problem as it relates to the Company and its Subsidiaries.

SECTION 3.23. ENVIRONMENTAL MATTERS. Except as set forth on Schedule 3.23 hereto, the Company and its Subsidiaries are (i) in compliance in all material respects with any and all applicable Environmental Laws, (ii) have received and are in compliance in all material respects with all permits, licenses or other approvals required under applicable Environmental Laws for the conduct of their respective businesses, and (iii) have not received notice of any actual or potential material liability for the investigation or remediation of any disposal or release of Hazardous Materials.

SECTION 3.24. CONTROLS. The Company and each of its Subsidiaries maintains internal information systems and controls sufficient to provide reasonable assurance that (i) material transactions are executed in accordance with management's general or specific authorizations, and (ii) material transactions (including payment of claims and collection of receivables) are executed in accordance with their terms and applicable Law and are recorded as necessary to permit preparation of financial statements in conformity with GAAP and to maintain asset accountability.

SECTION 3.25. JOINT VENTURE MATTERS. Except as disclosed in the SEC Reports or in Schedule 3.25 hereto, to the knowledge of the Company and its Subsidiaries, since January 1, 1994 (or with respect to any Joint Venture (and
only with respect to such Joint Venture), if later, the date on which the Company or any of its Subsidiaries first acquired an equity interest in such Joint Venture or any of the businesses conducted by such Joint Venture), none of the following has occurred that, individually or in the aggregate, has had, or would be reasonably likely to have, a Material Adverse Effect:

(a) the failure of any Joint Venture to comply with all applicable Laws and Regulatory Approvals in the conduct of its business;

(b) the failure of any Joint Venture to obtain and maintain in full force and effect all Regulatory Approvals necessary to conduct its business;

(c) the revocation, withdrawal, suspension or termination of, or any threatened or pending revocation, withdrawal, suspension or termination of, or the imposition of any material conditions with respect to, any Regulatory Approval necessary for any Joint Venture to conduct its business;

(d) the revocation, withdrawal, suspension or termination of, or any threatened or pending revocation, withdrawal, suspension or termination of, or the imposition of any material conditions with respect to, the participation by any Joint Venture in the federal Medicare program, any state Medicaid program, or any other third party payor program;

(e) the initiation of, or explicit threat of initiation of, any Proceeding by any Person, or the initiation of, or explicit threat of initiation of, any investigation by any Governmental Entity, against or affecting any Joint Venture, that may involve criminal liability or result in or involve criminal proceedings, that may affect the status of any Regulatory Approval maintained by such Joint Venture that is necessary for such Joint Venture to conduct its business, or that may affect the authority of such Joint Venture to participate in the federal Medicare program, any state Medicaid program or any other third party payor program;

(f) the institution of any judgment, decree, injunction, rule, stipulation or order against or applicable to any Joint Venture or against or applicable to any of its properties or businesses; or

(g) any other event or occurrence with respect to any Joint Venture that has had, or would be reasonably likely to have, a Material Adverse Effect.

ARTICLE IV

REPRESENTATIONS AND WARRANTIES OF THE INVESTOR

The Investor represents and warrants to, and agrees with, the Company as follows:

SECTION 4.01. ORGANIZATION. The Investor is a limited liability company duly organized, validly existing and in good standing under the laws of the State of Delaware and has all requisite power and authority to own or lease and operate its properties and to conduct its business as it is now being conducted and is proposed to be conducted.

SECTION 4.02. AUTHORIZATION OF AGREEMENTS. (a) The Investor has all requisite power and authority as a limited liability company to execute, deliver and perform its obligations under the Transaction Agreements and the Investor Documents. The execution, delivery and performance of the Transaction Agreements and the Investor Documents, and the consummation by the Investor of the transactions contemplated thereby, have been duly authorized by all necessary
action on the part of the Investor.

(b) This Agreement and the Registration Rights Agreement have been duly executed and delivered by the Investor, and each such agreement constitutes a legal, valid and binding obligation of the Investor, enforceable against the Investor in accordance with its terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights generally and to general principles of equity.

SECTION 4.03. CONSENTS; NO CONFLICTS. (a) Except for the Required Regulatory Approvals, no Regulatory Approval from, or registration, declaration or filing with, any Governmental Entity is required to be made or obtained by the Investor in connection with the execution, delivery and performance of the Transaction Agreements and the consummation of the transactions contemplated thereby.

(b) The execution and delivery of this Agreement and the Registration Rights Agreement does not, and the execution and delivery of each of the Investor Documents will not, and subject to the receipt of the Required Regulatory Approvals, the performance of the obligations set forth herein and therein and the consummation of the transactions contemplated hereby and thereby will not, (i) violate any provision of the certificate of formation of the Investor; (ii) conflict with, contravene or result in a breach or violation of any of the terms or provisions of, or constitute a default (with or without notice or the passage of time) under, or result in or give rise to a right of termination, cancellation, acceleration or modification of any right or obligation under, or require any consent, waiver or approval under, any note, bond, debt instrument, indenture, mortgage, deed of trust, lease, loan agreement, joint venture agreement, Regulatory Approval, contract or any other agreement, instrument or obligation to which the Investor is a party or by which the Investor or any of its property is bound, or (iii) violate any Law applicable to the Investor.

SECTION 4.04. FINANCIAL ADVISORS AND BROKERS. No Person has acted directly or indirectly as a broker, finder or financial advisor of the Investor in connection with the Transaction Agreements or the transactions contemplated thereby, and no Person is entitled to receive any broker's, finder's or similar fee or commission in respect thereof based in any way on any agreement, arrangement or understanding made by or on behalf of the Investor or any of its directors, officers or employees.

SECTION 4.05. OWNERSHIP OF EQUITY SECURITIES; PURPOSE OF INVESTMENT. Except as permitted pursuant to Section 11.09 hereof, the Investor is acquiring the Series A Preferred Stock under this Agreement for its own account solely for the purpose of investment and not with a view to, or for sale in connection with, any distribution thereof in violation of the Securities Act. The Investor acknowledges that the Senior Preferred Stock and the Conversion Shares have not been registered under the Securities Act and may be sold or disposed of in the absence of such registration only pursuant to an exemption from the registration requirements of the Securities Act. As of the date hereof, other than pursuant to this Agreement, the Investor does not Beneficially Own, directly or indirectly, or have any option or right to acquire, any securities of the Company.

ARTICLE V

GOVERNANCE

SECTION 5.01 BOARD SIZE. For so long as the Investor is entitled to designate an Investor Nominee for election to the Board of Directors, the Board of Directors shall consist of no more than 12, nor less than 7, directors.

SECTION 5.02 BOARD REPRESENTATION. (a) The Board of Directors shall elect a total of three nominees designated in writing by the Investor prior to the Initial Closing (such persons, or replacements designated by the Investor, the "INVESTOR NOMINEES"), to the Board of Directors effective as of the Initial Closing Date, to be allocated to Class I, Class II and Class III as specified by the Investor. Commencing with the annual meeting of stockholders of the Company the record date for which next follows the Initial Closing Date, and at each annual meeting of stockholders of the Company thereafter, the Investor shall be
entitled to present to the Board of Directors or the nominating committee thereof a number of nominees for election to the class of directors up for election to the Board of Directors at such annual meeting equal to the number of Investor Nominees in such class immediately prior to such election and the Company shall use its best efforts to cause the election to the Board of Directors of such Investor Nominees. If the Board of Directors shall cease to be a classified board, the Investor shall be entitled to present to the Board of Directors or the nominating committee thereof three nominees for election to the Board of Directors at each annual meeting of stockholders of the Company. In the event of the death, disability, resignation or removal of an Investor Nominee, the Investor shall designate a replacement for such director, which replacement the Company shall cause to be elected to the Board of Directors.

(b) The Company shall cause each Investor Nominee designated for election to the Board of Directors pursuant to Section 5.02(a) hereof to be included in the slate of nominees recommended by the Board of Directors to the stockholders of the Company for election as directors at the relevant annual meeting and shall use its best efforts to cause the election of each such Investor Nominee, including soliciting proxies in favor of the election of such person.

(c) Notwithstanding the foregoing provisions of this Section 5.02, the Investor shall not be entitled to designate Investor Nominees for election to the Board of Directors in the event that the Investor and its Affiliates Beneficially Own, in the aggregate, less than 50% of the Investor Original Number of Conversion Shares. In the event that the Investor shall not be entitled to designate Investor Nominees for election to the Board of Directors, the Investor Nominees shall resign from the Board of Directors no later than the thirtieth day after the day on which the Investor becomes aware that the aggregate Beneficial Ownership of it and its Affiliates is reduced below the threshold ownership level of Investor Original Number of Conversion Shares specified in this Section 5.02(c). If an Investor Nominee does not resign on or prior to such thirtieth day as required pursuant to the immediately preceding sentence, a majority of the Board of Directors (excluding any Investor Nominees) shall have the right to remove such Investor Nominee from the Board of Directors.

(d) If the Board of Directors shall determine in good faith in the exercise of its fiduciary duties, that nomination of any person designated by the Investor for election to the Board of Directors would be contrary to the best interests of the Company, then the Company shall promptly notify the Investor of such determination (either in person, if such determination shall be made at a Board of Directors meeting at which an Investor Nominee is present or by telephone (promptly confirmed in writing), if such determination shall be made at a Board of Directors meeting at which an Investor Nominee is not present) and thereafter the Investor shall have a period of no less than five Business Days to designate a new person for nomination for election to the Board of Directors as an Investor Nominee. The Board of Directors has approved the executives of the Investor set forth on Schedule 5.02(d) hereto as Investor Nominees for all purposes hereof as of the date hereof.

SECTION 5.03. COMMITTEES; MEETINGS. (a) Effective as of the Initial Closing Date, and for so long as an Investor Nominee serves as a member of the Board of Directors, the Investor shall have the option to have one Investor Nominee appointed as a member to any committee of the Board of Directors; PROVIDED, HOWEVER, that in the event the rules of the primary national securities exchange or national quotation system on which the Common Stock is then listed or quoted prohibits the appointment of an Investor Nominee to one of the committees of the Board of Directors, no Investor Nominee shall be appointed to such committee. In the event the Investor elects to have an Investor Nominee appointed to a committee of the Board of Directors, the Investor shall so notify the Company in writing, and the Company shall appoint such nominee to such committee within 10 days of the delivery of such notice by the Investor.

(b) From and after the Initial Closing Date, for so long as an Investor Nominee serves as a member of the Board of Directors, each Investor Nominee shall be invited to attend all regular and special meetings of the Board of Directors and any committee of the Board of Directors of which such Investor Nominee is a member. The Company shall notify each Investor Nominee of any such meeting no later than the time at which it notifies any other member of the
Board of Directors of such meeting. So long as the Investor has the right to have Investor Nominees elected to committees of the Board of Directors, the Board of Directors shall have an audit committee and a compensation committee.

ARTICLE VI

STANDSTILL

SECTION 6.01. STANDSTILL AGREEMENT. (a) The Investor covenants and agrees with the Company that, from the date hereof through the Initial Closing Date and thereafter (subject to paragraphs (b) and (c) below) for a period of two years following the Initial Closing Date (the "STANDSTILL PERIOD"), the Investor and its Affiliates shall not, without the prior approval of the Board of Directors:

   (i) acquire, seek, propose or offer to acquire or agree to acquire (other than (w) in accordance with the terms of this Agreement and the Certificates of Designations; (x) as a result of a stock split, stock dividend or other recapitalization by the Company or the exercise of rights or warrants distributed to stockholders; (y) as a result of transfers among members of the Investor Group of Series A Preferred Stock acquired pursuant to Article II hereof or Voting Securities acquired pursuant to the exercise or conversion of, or in respect of dividends payable on, any Series A Preferred Stock acquired pursuant to Article II hereof, PROVIDED that the transferor did not itself acquire the transferred securities in violation of this Section 6.01(a); or (z) in a transaction in which the Investor and/or its Affiliates acquire Beneficial Ownership of more than 50% of the Voting Power of the Voting Securities of a previously non-Affiliated business entity that owns less than 5% of the aggregate Voting Power of the outstanding Voting Securities of the Company if such acquisition is not made in contemplation of any acquisition prohibited under this subparagraph (a)), or commence or propose to commence any tender offer or exchange offer seeking to acquire, Beneficial Ownership of any additional Voting Securities of the Company;

   (ii) become a member of a Group with respect to the Voting Securities of the Company, other than a Group (x) composed solely of itself and its Affiliates, or (y) to the extent of any Series A Preferred Stock acquired pursuant to Article II hereof or Voting Securities acquired pursuant to the exercise or conversion of, or in respect of dividends payable on, any Series A Preferred Stock acquired pursuant to Article II hereof, composed of members of the Investor Group;

   (iii) solicit any proxies or stockholder consents, or become a participant (other than by voting), or encourage any Person to become a participant, in a proxy or consent solicitation with respect to any of the Company's Voting Securities, in each case other than solicitations to holders of shares of Preferred Stock with respect to matters as to which the Preferred Stock is entitled to vote;

   (iv) call any special meeting of holders of Common Stock; or

   (v) make any public disclosure, or take any action which could require the Company to make any public disclosure, with respect to an offer, proposal or transaction that if made or consummated without the prior approval of the Board of Directors, would not be permitted under this Section 6.01.

(b) Notwithstanding anything to the contrary in this Section 6.01, the provisions of Section 6.01(a) shall cease to be applicable in the event that (i) the Company enters into a definitive agreement with respect to a Control Transaction; (ii) a bona fide offer (other than an offer made only to the Investor and its Affiliates) is made by any Person (other than the Investor or an Affiliate of the Investor) to acquire more than 20% of any class of the Company's Voting Securities; (iii) an Insolvency Event occurs; (iv) the Company is in default on any of its Indebtedness the outstanding principal amount of which is in excess of $10,000,000, which default is not cured or waived for 75 days and as a result of which default the maturity of such Indebtedness has been accelerated or the holders thereof have the right to accelerate the maturity of such Indebtedness; or (v) the Board of Directors (other than the Investor Nominees) so
determines. In the event the Company is soliciting proposals or offers with respect to a Control Transaction from any Person (a "BIDDING PROCESS") (other than the Investor or an Affiliate of the Investor), the Company shall release the Investor and its Affiliates from the restrictions contained in Section 6.01(a) to the extent necessary for the Investor and its Affiliates to be permitted, on the same terms as bidders approved by the Company, to make such a proposal or offer; PROVIDED, HOWEVER, that if the Investor withdraws from the bidding process or the Company terminates the bidding process, the Investor shall thereafter continue to be subject to the restrictions contained in Section 6.01(a).

(c) Notwithstanding anything to the contrary in Section 6.01(a) hereof, during the Standstill Period, the Investor and its Affiliates may acquire, seek, propose or offer to acquire or agree to acquire, or commence or propose to commence any tender offer seeking to acquire Beneficial Ownership of Voting Securities of the Company (in addition to any Series A Preferred Stock acquired pursuant to Article II hereof or Voting Securities acquired pursuant to the exercise or conversion of, or in respect of dividends payable on, any Series A Preferred Stock acquired pursuant to Article II hereof) representing up to 10% of the Voting Power of the then-outstanding Voting Securities of the Company or, if the Option is not exercised on or before the Expiration Date, up to 15% of the Voting Power of the then-outstanding Voting Securities of the Company; PROVIDED that no such action shall be taken if, as a result thereof, the Voting Securities of the Company Beneficially Owned by the Investor and its Affiliates, in the aggregate, would represent in excess of 34.9% of the aggregate Voting Power of the outstanding Voting Securities of the Company.

(d) The Company shall use its best efforts to prevent the consummation of any of the transactions permitted by this Section 6.01 from resulting in the ability of any Person to exercise any Rights issued under the Rights Plan (or similar device adopted after the date hereof) or causing the Rights to separate from the shares of Common Stock to which they are attached or to be triggered or become exercisable.

(e) Section 6.01(a) hereof shall not apply to, nor in any manner restrict or limit, any Investor Nominee in his or her capacity as a director of the Company.

ARTICLE VII
PRE-CLOSING COVENANTS

SECTION 7.01. TAKING OF NECESSARY ACTION. (a) Each of the parties hereto agrees to use its best efforts promptly to take or cause to be taken all actions and promptly to do or cause to be done all things necessary, proper or advisable under applicable laws and regulations to consummate and make effective the transactions contemplated by this Agreement in accordance with the terms of the Agreement (including, without limitation, the purchase of the Option Shares following the exercise or deemed exercise of the Option). Without limiting the foregoing, the Investor and the Company will use their best efforts to make all filings with respect to (including filings under the HSR Act), and to obtain, all Required Regulatory Approvals and other Regulatory Approvals necessary or, in the opinion of the Investor or the Company, advisable, in order to permit the consummation of the transactions contemplated hereby and to obtain the Board Approval and the Bank Approval.

(b) The Company shall use its best efforts to obtain the Board Approval and the Bank Approval on or prior to January 15, 2000.

SECTION 7.02. CONDUCT OF BUSINESS. (a) From the date hereof until the Initial Closing Date, except as set forth on Schedule 7.02 hereto or as provided in Section 7.02(b) hereof, the Company shall conduct its business and shall cause its Subsidiaries to conduct their respective businesses in, and only in, the ordinary course and shall use, and shall cause its Subsidiaries to use, their best efforts to preserve intact their respective present business organizations, operations, goodwill and relationships with
third parties (including, without limitation, clients and providers) and to keep
available the services of the present directors, officers and key employees.
Without limiting the generality of the foregoing, from the date hereof until the
Initial Closing Date, without the prior written consent of the Investor (except
as expressly permitted or required by this Agreement):

(i) the Company shall not, and shall cause each of its
Subsidiaries not to, sell any of the assets of the Company or its
Subsidiaries (or the securities of entities holding the same) to any
Person, other than the Company or a Wholly-Owned Subsidiary of the
Company, in one transaction or a Series of related transactions, in
which the fair value of the assets being sold, or the total
consideration (in the form of cash or property and including any
contingent consideration and any Indebtedness or other obligations
assumed) to be received by the Company and its Subsidiaries, exceeds
$2,000,000;

(ii) other than in the ordinary course of business consistent
with past practice, the Company shall not, and shall cause each of its
Subsidiaries not to, acquire any assets, in one transaction or Series
of related transactions, in which the total consideration (in the form
of cash or property and including any contingent consideration and any
Indebtedness or other obligations assumed) to be paid by the Company
and its Subsidiaries exceeds $2,000,000;

(iii) the Company shall not, and shall cause each of its
Subsidiaries or Significant Subsidiaries, as the case may be, not to
take any of the actions or enter into any of the agreements,
commitments or transactions described in clause (i), (ii), (iii), (v),
(vi), (ix), (x), (xi), (xii) or (xiii) of Section 3.09 hereof;

(iv) the Company shall not, and shall cause each of its
Subsidiaries not to, take any action that it knows or has reason to
believe would cause a representation or warranty of the Company set
forth herein to be untrue in any material respect if made at such
time, or a covenant of the Company set forth in Article VIII to fail
to be satisfied as of the Initial Closing Date, and

(v) the Company shall not, and shall cause each of its
Subsidiaries not to, commit or agree to do any of the foregoing.

(b) Notwithstanding anything to the contrary in
Section 7.02(a) hereof, the Company and its Subsidiaries may sell the assets
described in the Proposed Asset Sale Letter on terms not materially worse to
the Company than those set forth in the Proposed Asset Sale Letter.
Notwithstanding anything to the contrary in Section 7.02(a) hereof, nothing in
Section 7.02(a) hereof shall restrict the Company or any of its Subsidiaries
from paying dividends, making distributions, paying Indebtedness owed to the
Company or any other Subsidiaries, making loans or advances to the Company or
any other Subsidiaries, or selling, leasing or transferring any properties or
assets to the Company or any of its Subsidiaries, in each case to the extent
that any such restriction would be prohibited by Section 6.06(b) of the Credit
Agreement (as in effect on the date hereof) or Section 4.05 of the Indenture (as
in effect on the date hereof).

SECTION 7.03. NOTIFICATIONS. At all times prior to the
Initial Closing Date, and in the event the Option is exercised or deemed
exercised pursuant to Section 2.02 hereof, following such exercise and prior to
the Option Closing Date, the Investor shall promptly notify the Company and the
Company shall promptly notify the Investor in writing of any fact, change,
condition, circumstance or occurrence or nonoccurrence of any event which will
or is reasonably likely to result in the failure to satisfy the conditions to be
complied with or satisfied by it hereunder; PROVIDED, HOWEVER, that the delivery
of any notice pursuant to this Section 7.03 shall not limit or otherwise affect
the remedies available hereunder to any party receiving such notice.

SECTION 7.04. ALTERNATIVE TRANSACTIONS. (a) The Company
shall immediately cease and terminate any existing solicitation, initiation,
encouragement, activity, discussion or negotiation with any Persons conducted
heretofore by the Company, its Subsidiaries or any of their respective
Representatives with respect to any proposed, potential or contemplated
Alternative Transaction.

(b) From the date hereof until the earlier of (i) the Initial Closing Date and (ii) the termination of this Agreement (the "EXCLUSIVITY PERIOD"), the Company shall not, shall not permit any of its Subsidiaries or Affiliates to, and shall not authorize or permit any of its or their Representatives to, directly or indirectly, (A) solicit or initiate, or encourage the submission of, any Proposal, (B) participate in any discussions or negotiations regarding, or furnish to any Person any information with respect to, or take any other action to facilitate any inquiries or the making of any proposal that constitutes, or may reasonably be expected to lead to, any Proposal or Alternative Transaction, other than a transaction with the Investor or its Affiliates, or (C) authorize, engage in, or enter into any agreement or understanding with respect to, any Alternative Transaction; PROVIDED that the Company may, in response to an unsolicited written Proposal from a third party, engage in the activities specified in clause (B) and (C) of this Section 7.04(b), if (x) in the opinion of the Company's outside legal counsel, such action is required for the Board of Directors to comply with its fiduciary duties under applicable Law, (y) the Company shall have notified the Investor not later than 24 hours after having received the relevant Proposal (which notice shall identify the Person making the Proposal and set forth the material terms thereof) and (z) the Company shall have refrained from taking any action specified in clause (C) of this Section 7.04(b) until the third day following the receipt by the Investor of the notification referred to in clause (y) of this Section 7.04(b). The Company will keep the Investor fully informed of the status and details of any such Proposal or request and any related discussions or negotiations. The Company will promptly notify the Investor of any Proposal (which notice shall identify the Person making the Proposal and set forth the material terms thereof) that the Company, any of its Subsidiaries or Affiliates or any of its or their Representatives may receive during the Exclusivity Period.

SECTION 7.05. DEBENTURE INDENTURES. (a) Not later than 60 days subsequent to the Initial Closing, the Company and the Investor shall jointly prepare an indenture having the same economic terms as the Series A Preferred Stock (including, without limitation, an interest rate that is the same as the dividend rate on the Series A Preferred Stock) and having other terms substantially identical to the terms of the Series A Preferred Stock and otherwise mutually acceptable in form and substance, with respect to the Series A Debentures.

(b) Not later than 60 days subsequent to the original issuance of any shares of Series B Preferred Stock, the Company and the Investor shall jointly prepare an indenture having the same economic terms as the Series B Preferred Stock (including, without limitation, an interest rate that is the same as the dividend rate on the Series B Preferred Stock) and having other terms substantially identical to the terms of the Series B Preferred Stock and otherwise mutually acceptable in form and substance, with respect to the Series B Debentures.

ARTICLE VIII
ADDITIONAL COVENANTS

SECTION 8.01. FINANCIAL AND OTHER INFORMATION. (a) So long as members of the Investor Group Beneficially Own, in the aggregate, at least 10% of the Original Number of Conversion Shares, the Company shall (and shall cause each of its Subsidiaries to) afford to members of the Investor Group that then Beneficially Own Conversion Shares and their Representatives reasonable access, upon reasonable notice and in such manner as will not unreasonably interfere with the conduct of the Company's (or such Subsidiary's) business, to their respective properties, books, contracts, commitments and records (including information regarding any pending or threatened Proceeding to which the Company or any of its Subsidiaries is, or reasonably expects to be, a party) and to discuss the business, affairs, finances, regulatory status and other matters related to the purchase and Beneficial Ownership of the Senior Preferred Stock and Conversion Shares with Representatives of the Company; PROVIDED, HOWEVER, that neither the Company nor any Subsidiary shall be required to disclose any such information pursuant to this Section 8.01 to the extent that, in the opinion of outside legal counsel to the Company, such disclosure would result in the Company's inability to assert the attorney-client privilege with respect to such information; and PROVIDED, FURTHER, that any such inspection...
shall be subject to all reasonable health, safety and patient confidentiality procedures regularly enforced by the Company and its Subsidiaries.

(b) Upon the written request of the Company, each member of the Investor Group shall inform the Company of the number of Conversion Shares and Original Number of Conversion Shares then Beneficially Owned by such member of the Investor Group. Such information shall be delivered to the Company within five Business Days of the delivery of such request to such member of the Investor Group. To the extent such information is not available to the public, the Company shall keep such information confidential.

SECTION 8.02. LIMITATION ON DIVIDEND PAYMENTS AND REPURCHASES. From and after the Initial Closing, so long as members of the Investor Group Beneficially Own, in the aggregate, at least 50% of the Original Number of Conversion Shares, the Company shall not, without the prior written approval of the holders of at least 60% of the Conversion Shares then Beneficially Owned by members of the Investor Group, (i) declare or pay any dividend on, or make any other distribution with respect to, any of its Equity Securities (other than the Preferred Stock), or (ii) purchase, redeem or otherwise acquire, and shall cause its Subsidiaries not to purchase, redeem or otherwise acquire, any of the Equity Securities (other than the Preferred Stock) or debt securities of the Company (including, without limitation, the Senior Subordinated Notes, but not including any debt securities issued in exchange for the Senior Preferred Stock), except with respect to (x) the Senior Subordinated Notes or Indebtedness outstanding pursuant to the Credit Agreement, as may be required pursuant to the terms of the Indenture or the Credit Agreement, and (y) purchases of Equity Securities of the Company or any of its Subsidiaries from executives and other management-level employees of the Company or any of its Subsidiaries in connection with customary employment and severance arrangements. Nothing set forth in this Section 8.02 shall prohibit the Company from making principal payments on any Indebtedness outstanding on the date of this Agreement or permitted to be incurred pursuant to this Agreement.

SECTION 8.03. LIMITATION ON INDEBTEDNESS. From and after the Initial Closing, so long as members of the Investor Group Beneficially Own, in the aggregate, at least 50% of the Original Number of Conversion Shares, the Company shall not, without the prior written approval of the holders of at least 60% of the Conversion Shares then Beneficially Owned by members of the Investor Group, incur or permit its Subsidiaries to incur Indebtedness in excess of $100,000,000, in the aggregate, in any twelve-month period. Notwithstanding the foregoing, an incurrence of Indebtedness pursuant to a bank revolving credit facility (including the revolving credit facility under the Credit Agreement) or short-term credit facility which Indebtedness is repaid in whole or in part during the same twelve-month period in which such Indebtedness was incurred, shall not constitute an incurrence of Indebtedness to the extent of such repayment for purposes of the preceding sentence from and after such repayment.

SECTION 8.04. ACQUISITIONS AND DISPOSITIONS. Except with respect to transactions disclosed in the Proposed Asset Sale Letter concluded on terms not materially worse to the Company than those terms set forth in the Proposed Asset Sale Letter, from and after the Initial Closing, so long as members of the Investor Group Beneficially Own, in the aggregate, at least 50% of the Original Number of Conversion Shares, the Company shall not, without the prior written approval of the holders of at least 60% of the Conversion Shares then Beneficially Owned by members of the Investor Group, approve, authorize, engage in, or enter into any agreement or understanding with respect to, transactions to (i) acquire assets (other than the acquisition of "Violet" as described in Schedule 7.02 hereof) having a fair value, or for which consideration is paid (in the form of cash or property and including any contingent consideration and any Indebtedness or other obligations assumed), in excess of $100,000,000, in the aggregate, in any twelve-month period or (ii) dispose of assets having a fair value, or for which consideration is received (in the form of cash or property and including any contingent consideration and any Indebtedness or other obligations assumed), in excess of $100,000,000 in the aggregate, in any twelve-month period.

SECTION 8.05. EQUITY ISSUANCES. (a) From and after the Initial Closing, so long as members of the Investor Group Beneficially Own, in the aggregate, at least 50% of the Original Number of Conversion Shares, the Company and each of its Subsidiaries shall not, without the prior written
approval of the holders of at least 60% of the Conversion Shares then

Beneficially Owned by members of the Investor Group, issue or sell any Equity
Securities of the Company or any Significant Subsidiary or any Derivative
Securities in a transaction or Series of related transactions (such transaction
or Series of related transactions, a "10% TRANSACTION") as a direct or indirect
result of which any Person (other than any institutionally managed, publicly
held mutual fund registered with the Commission) or Group would have, or have
the right to acquire, Beneficial Ownership of Equity Securities representing 10%
or more of the aggregate Voting Power of the then-outstanding Voting Securities
of the Company or any such Significant Subsidiary; PROVIDED, HOWEVER, that the
Company may issue its Equity Securities in a 10% Transaction without any such
approval if (i) the consideration to be received by the Company in such
transaction is solely in the form of cash, (ii) the transaction is completed
pursuant to a Purchase Agreement, and (iii) the Company has complied with the
procedures set forth in Section 8.05(b) hereof with respect to such transaction;
and PROVIDED FURTHER, that, notwithstanding the foregoing none of the following
shall constitute a 10% Transaction: (i) any transaction expressly permitted
pursuant to Section 7.02 hereof, (ii) any transaction set forth in the Proposed
Asset Sale Letter concluded on terms not materially worse to the Company than
those terms set forth in the Proposed Asset Sale Letter, (iii) any exercise of
the Rainwater-Magellan Warrant or Rainwater Pre-emptive Rights and (iv) the
issuance of the Series B Preferred Stock or the Option Shares pursuant to the
terms hereof.

(b) (i) Prior to any offer or sale by the Company of any of
its Equity Securities (the "COVERED SECURITIES") in a 10% Transaction,
the Company shall give written notice (a "PROPOSED SALE NOTICE") to
the Investor of the Company's desire to sell the Covered Securities,
which notice shall identify (A) the number of Covered Securities,
(B) the terms of the Covered Securities and (C) any other material
terms and conditions of the proposed offer or sale (other than a
proposed sale price). The date on which such Proposed Sale Notice is
given is referred to herein as the "NOTICE DATE." On and prior to
the Solicitation Date with respect to any Covered Securities, and
following the Solicitation Date if the Company shall have delivered an
Acceptance Notice with respect to such Covered Securities, the Company
shall not, shall not permit any of its Subsidiaries or Affiliates to,
and shall not authorize or permit any of its or their Representatives
to, directly or indirectly, solicit or encourage the submission of any
proposal from any Person (other than the Investor and its Affiliates),
participate in any discussion or negotiations with any Person (other
than the Investor and its Affiliates), or authorize, engage in or
enter any agreement or understanding with any Person (other than the
Investor and its Affiliates), with respect to the issuance or sale of
such Covered Securities.

(ii) The Investor shall have forty days following the Notice
Date (the "RESPONSE PERIOD") to notify the Company in writing (such
notification, an "OFFER TO PURCHASE") of its offer, or an offer by any
of its Affiliates, to purchase in cash all (but not less than all) of
the Covered Securities referred to in the relevant Proposed Sale
Notice. During the Response Period, if requested by the Investor or
any of its Affiliates, the Company shall negotiate in good faith with
the Investor or such Affiliate with respect to the terms of a proposed
purchase of Covered Securities by the Investor or such Affiliate. Any
Offer to Purchase shall set forth a proposed cash purchase price for
such Covered Securities (the "INVESTOR PRICE") and the proposed
closing date for the purchase and may include other material terms and
conditions of the proposed purchase. The Investor shall not be

obligated to deliver an Offer to Purchase, and if an Offer to Purchase
is not given prior to the end of the Response Period, the Investor
shall be deemed to have declined to purchase such Covered Securities.

(iii) The Company shall have ten days following the delivery
of an Offer to Purchase to accept the offer made by the Investor or
its Affiliates to purchase all (but not less than all) of the Covered
Securities on the terms and subject to the conditions set forth in the
Offer to Purchase by giving the Investor written notice to that effect
(an "ACCEPTANCE NOTICE"). If, in accordance with the terms of the
preceding sentence, the Company accepts the offer made by the Investor
or its Affiliates to purchase such Covered Securities on the terms and
subject to the conditions set forth in the Offer to Purchase, the
closing for such transaction shall take place at a time and place
reasonably acceptable to the Investor and the Company. If the Company
does not give an Acceptance Notice in accordance with the terms of the
first sentence of this paragraph, the Company shall be deemed to have
rejected the offer set forth in the relevant Offer to Purchase.

(iv) If the Company has complied with the foregoing
provisions of this Section 8.05(b) and shall not have given an
Acceptance Notice with respect to any Covered Securities following the
Solicitation Date with respect to such Covered Securities, the Company
may enter into a Purchase Agreement with any other Person with respect
to all (but not less than all) of such Covered Securities within forty
days following such Solicitation Date (or within sixty days following
such Solicitation Date, if such Purchase Agreement constitutes a
customary underwriting agreement (an "UNDERWRITING AGREEMENT") that
contemplates a bona fide offering of the Covered Securities to the
public that is registered under the Securities Act) and sell all (but
not less than all) of the Covered Securities pursuant to such Purchase
Agreement within seventy days following such Solicitation Date (or
within one hundred days following such Solicitation Date if such sale
is made pursuant to an Underwriting Agreement and constitutes a bona
fide offering of the Covered Securities to the public that is
registered under the Securities Act); PROVIDED that (i) the purchase
price for such Covered Securities in such sale is at least 105% of the
related Investor Price, if any, and (ii) the terms and conditions of
such sale are otherwise not materially worse for the Company than
those set forth in the related Offer to Purchase. If the Company has
not executed a Purchase Agreement with respect to such Covered
Securities within forty days or sixty days, as the case may be,
following the relevant Solicitation Date, or has not completed a sale
of all of such Covered Securities within seventy days or one hundred
days, as the case may be, following the relevant Solicitation Date,
the Company shall no longer be permitted to sell such Covered
Securities without again fully complying with all the provisions of
this Section 8.05, and all the restrictions contained in this
Section 8.05 shall again be in effect with respect to such Covered
Securities.

SECTION 8.06. PUBLICITY. Except as required by Law or by
obligations pursuant to any listing agreement with or requirement of any
national securities exchange or national quotation system on which the Common
Stock is listed, admitted to trading or quoted, neither the Company (nor any of
its Affiliates) nor the Investor (nor any of its Affiliates) shall, without the
prior written consent of each other party hereto, which consent shall not be
unreasonably withheld or delayed, make any public announcement or issue any
press release with respect to the transactions contemplated by this Agreement.
Prior to making any public disclosure required by applicable Law or pursuant to
any listing agreement with or requirement of any relevant national exchange or
national quotation system, the disclosing party shall consult with the other
parties hereto, to the extent feasible, as to the content and timing of such
public announcement or press release.

SECTION 8.07. STATUS OF DIVIDENDS. The Company agrees to
treat the Series A Preferred Stock and Series B Preferred Stock as equity for
all Tax purposes unless the Company determines that there is no reasonable basis
for such position. The Company shall take no action (other than as required by
Law) that would jeopardize the availability of the dividends received deduction
under Section 243(a)(1) of the Code for the distributions on the Series A
Preferred Stock and Series B Preferred Stock that are paid out of current or
accumulated earnings and profits, if any.

SECTION 8.08. DIRECTOR AND OFFICER INDEMNIFICATION. (a) So
long as any Investor Nominee serves as a member of the Board of Directors or as
an officer of the Company, the Company shall provide to each such individual
indemnification and directors' and officers' insurance having terms and
provisions no less favorable to such individuals than the indemnification and
directors' and officers' insurance provided to other directors and officers of
the Company (including, without limitation, coverage for matters based in whole
or in part on, or arising in whole or in part out of, any matter existing or
occurring while such Investor Nominee was a director, even though such Investor
Nominee may no longer be a director at the time any claim for indemnification or
coverage under insurance is made).

(b) So long as any Investor Nominee serves as a member of
the Board of Directors or as an officer of the Company, the Company shall not
amend the Certificate of Incorporation or Bylaws so as to adversely affect the
rights of any such person with respect to indemnification by the Company for any
Losses incurred by such person in such person's capacity as an officer or
director of the Company.

SECTION 8.09. LISTING; RESERVATION. (a) So long as any
member of the Investor Group Beneficially Owns Conversion Shares, Junior Shares
or Dividend Shares, the Company shall use its best efforts to ensure that the
Common Stock continues to be listed for trading on the NYSE. The Company will
use its best efforts so that upon issuance all Conversion Shares and Dividend
Shares will be listed for trading on the NYSE.

(b) From and after the Initial Closing, the Company shall at
all times reserve and keep available, out of its authorized and unissued Common
Stock, solely for the purpose of issuing Common Stock upon the conversion of the
Senior Preferred Stock and Junior Shares, such number of shares of Common Stock
free of preemptive rights as shall be sufficient to issue Common Stock upon the
conversion of all outstanding shares of Senior Preferred Stock and Junior Shares.

SECTION 8.10. LEGEND. (a) The Investor agrees to the
placement on (i) certificates representing Senior Preferred Stock issued to the
Investor pursuant to the terms hereof, (ii) certificates representing Conversion
Shares, Junior Shares or Dividend Shares, and

(iii) any certificate issued at any time in exchange or substitution for any
certificate bearing such legend, a legend (the "PRIVATE PLACEMENT LEGEND")
substantially as set forth below:

THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN
REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED
(THE "SECURITIES ACT"), OR ANY STATE SECURITIES LAW, AND MAY
NOT BE OFFERED, SOLD, TRANSFERRED OR OTHERWISE DISPOSED OF
EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT OR
PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT
TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND
APPLICABLE STATE SECURITIES LAWS.

(b) The Private Placement Legend shall be removed from a
certificate representing Senior Preferred Stock, Conversion Shares, Junior
Shares or Dividend Shares if the securities represented thereby are sold
pursuant to an effective registration statement under the Securities Act or
there is delivered to the Company such satisfactory evidence, which may include
an opinion of independent counsel, as reasonably may be requested by the
Company, to confirm that neither such legend nor the restrictions on transfer
set forth therein are required to ensure that transfers of such securities will
not violate the registration and prospectus delivery requirements of the
Securities Act.

SECTION 8.11. LIMITATION ON RESTRICTIONS ON PAYMENT OF
DIVIDENDS. From and after the Initial Closing, without the prior written
approval of the holders of at least 60% of the Conversion Shares then
Beneficially Owned by members of the Investor Group, except (i) as provided in
this Agreement, the Credit Agreement (as in effect on the date hereof) or the
Indenture (as in effect on the date hereof), (ii) as permitted under
Section 6.06(b)(B), 6.06(b)(C) (PROVIDED that in the case of 6.06(b)(C) such
encumbrance or restriction applies only to such acquired "Subsidiary" or
"Guarantor," as such terms are used in such Section), 6.06(b)(E), 6.06(b)(F)
or 6.06(b)(G) of the Credit Agreement (as in effect on the date hereof), or
Section 4.05(1)-(12) of the Indenture (as in effect on the date hereof), or (iii) as permitted under comparable provisions of any Credit Agreement or any Indenture to those specified in clause (ii) above so long as such comparable provisions do not permit any restrictions in addition to those set forth under the provisions specified in clause (ii) above, the Company shall not, and shall not permit any of its Subsidiaries to, directly or indirectly, create, cause or suffer to exist or become effective any contractual or other restrictions or limitations on the ability of the Company or any of its Subsidiaries to pay any dividends or make any other distributions on, or to purchase, redeem or otherwise acquire, any of its Equity Securities.

SECTION 8.12. CHIEF EXECUTIVE OFFICER. From and after the Initial Closing, for so long as members of the Investor Group Beneficially Own, in the aggregate, at least 50% of the Original Number of Conversion Shares, the Company shall not, without the prior written approval of the holders of at least 60% of the Conversion Shares then Beneficially Owned by members of the Investor Group, hire, terminate or materially limit the responsibilities of the chief executive officer of the Company.

SECTION 8.13. SHAREHOLDER APPROVALS. (a) Until the Series A Shareholder Approval is duly obtained by the Company, the Company shall take all action necessary to present the Series A Shareholder Approval Proposal for a vote at each meeting of stockholders of the Company held after the execution of this Agreement, and if shares of Series B Preferred Stock are outstanding, until the Series B Shareholder Approval is duly obtained by the Company, the Company shall take all action necessary to present the Series B Shareholder Approval Proposal for a vote at each meeting of stockholders of the Company held after the execution of this Agreement, in each case in accordance with applicable Law, the Certificate of Incorporation and Bylaws. Each such meeting of stockholders at which either the Series A Shareholder Approval or Series B Shareholder Approval is considered is referred to herein as a "SHAREHOLDER MEETING." The Company shall use its best efforts to obtain the required approval of its stockholders of the Shareholder Approval Proposal or Proposals under consideration at each Shareholder Meeting in order to give effect thereto under the Certificate of Incorporation, the Bylaws, the DGCL and the NYSE Rules. The Company shall file with the Commission a Proxy Statement with respect to the first Shareholder Meeting held after the execution of this Agreement no later than January 15, 2000, and the Company shall use its best efforts to hold such Shareholder Meeting no later than April 5, 2000.

(b) Each Proxy Statement shall contain the recommendation of the Board of Directors that the stockholders approve the Shareholder Approval Proposal or Proposals, as applicable. The Company shall notify the Investor promptly of the receipt by it of any comments from the Commission or its staff and of any request by the Commission for amendments or supplements to such Proxy Statement or for additional information, and will supply the Investor with copies of all correspondence between the Company and its representatives, on the one hand, and the Commission or the members of its staff or of any other Governmental Entities, on the other hand, with respect to such Proxy Statement. The Company shall give the Investor and its counsel a reasonable opportunity to review and comment on those portions of such Proxy Statement describing or referring to a Shareholder Approval Proposal or any member of the Investor Group (the "INVESTOR INFORMATION") prior to the filing of the Proxy Statement with the Commission and shall give the Investor and its counsel a reasonable opportunity to review and comment on all amendments and supplements to the Investor Information and all responses to requests for additional information and replies to comments prior to their being filed with, or sent to, the Commission with respect to the Investor Information. The Company shall give reasonable consideration to any comments the Investor or its counsel may provide with respect to the Investor Information or any amendment or supplement thereto.

(c) Notwithstanding anything to the contrary contained in this Section 8.13, the Company shall not be required to take any of the actions described in Section 8.13 (a) or (b) hereof with respect to a Shareholder Approval Proposal, if in the opinion of outside legal counsel to the Company, the relevant Shareholder Approval is not required under the NYSE Rules to permit the actions described in such Shareholder Approval Proposal.

(d) Each Proxy Statement, as of the date it is mailed to stockholders of the Company and as of the date of the relevant Shareholder
Meeting, will not include any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading; PROVIDED, HOWEVER, that this Section 8.13(d) shall not apply to any information provided to the Company in writing by any member of the Investor Group with respect to such member expressly for inclusion in the Proxy Statement.

SECTION 8.14. ORGANIC CHANGE. (a) Upon the consummation of an Organic Change (other than a transaction in which the Company is not the surviving entity), then lawful provision shall be made as part of the terms of such transaction whereby the terms of the Option shall be modified, without payment of any additional consideration by the Investor, so as to provide that upon the exercise of the Option following the consummation of such Organic Change, the Investor shall have the right to acquire and receive (in lieu of or in addition to the shares acquirable and receivable prior to the Organic Change), without payment of additional consideration therefor (except as would otherwise have been required by the terms of the Option as in effect prior to such Organic Change), such securities, cash and other property as the Investor would have received if it had exercised the Option immediately prior to such Organic Change. Lawful provision also shall be made as part of the terms of the Organic Change so that all other terms of the Option shall remain in full force and effect following such Organic Change. The provisions of this subsection (a) shall similarly apply to successive Organic Changes of the character described in this subsection (a).

(b) The Company shall not enter into an Organic Change that is a transaction in which the Company is not the surviving entity unless lawful provision shall be made as part of the terms of such transaction whereby the surviving entity shall issue an option (the “NEW OPTION”) to the Investor, without payment of any additional consideration by the Investor, with terms that provide that upon the exercise of such option, the Investor shall acquire and receive (in lieu of or in addition to the shares acquirable and receivable prior to the Organic Change), without payment of additional consideration therefor (except as would otherwise have been required by the terms of the Option as in effect prior to such Organic Change), such securities, cash and other property as the Investor would have received if it had exercised the Option immediately prior to such Organic Change. All other terms of the New Option shall be substantially equivalent to the terms of the Option. The provisions of this subsection (b) shall similarly apply to successive Organic Changes of the character described in this subsection (b).

SECTION 8.15. NO ADJUSTMENTS; MAINTENANCE OF SHELF.

(a) Except in connection with an Organic Change, until the Expiration Date, the Company shall not take any action with respect to the Series A Preferred Stock which, if such action were taken with respect to the Common Stock, would require an adjustment in the Conversion Price (as such term is defined in the Series A Certificate of Designations) pursuant to Article IX of the Series A Certificate of Designations.

(b) Notwithstanding anything to the contrary in the Registration Rights Agreement, in the event the Company delivers a Mandatory Exercise Notice, the Company shall not exercise its right to declare a Shelf Suspension (as such term is defined in the Registration Rights Agreement) pursuant to Section 2.1(c) of the Registration Rights Agreement during the period beginning on the Option Closing Date and ending 90 days after the Option Closing Date.

ARTICLE IX

CONDITIONS

SECTION 9.01. CONDITIONS TO INVESTOR'S OBLIGATIONS WITH RESPECT TO THE INITIAL SHARE PURCHASE. The obligation of the Investor to
purchase and pay for the Series A Preferred Stock pursuant to Section 2.01 hereof at the Initial Closing is subject to satisfaction or waiver of each of the following conditions precedent:

(a) REPRESENTATIONS AND WARRANTIES; COVENANTS. The representations and warranties of the Company set forth in Article III hereof qualified as to materiality shall have been true and correct in all respects, and those not so qualified shall have been true and correct in all material respects, on and as of the date hereof and as of the Initial Closing as if made on the Initial Closing Date (except where such representation and warranty speaks by its terms as of a different date, in which case it shall be true and correct as of such date, or except where such representation and warranty is not true or correct solely as a result of actions expressly permitted by Section 7.02 hereof). The Company shall have performed in all material respects all obligations and complied with all agreements, undertakings, covenants and conditions required hereunder to be performed by it at or prior to the Initial Closing. The Company shall have delivered to the Investor at the Initial Closing a certificate in form and substance reasonably satisfactory to the Investor dated the Initial Closing Date and signed by the chief executive officer and the chief financial officer of the Company to the effect that the conditions set forth in this Section 9.01(a) have been satisfied.

(b) OPINIONS OF COUNSEL. The Investor shall have received at the Initial Closing (i) from King & Spalding, special counsel to the Company, a written opinion dated the Initial Closing Date, substantially as set forth in Exhibit D hereto and (ii) from special regulatory counsel to the Company, which counsel is reasonably acceptable to the Investor, a written opinion dated the Initial Closing Date, in form and substance reasonably satisfactory to the Investor.

(c) FAIRNESS OPINION. Morgan Stanley Dean Witter shall have delivered a written opinion to the Board of Directors to the effect that the consideration paid to the Company for the shares of Series A Preferred Stock sold pursuant to Section 2.01 hereof, is fair, from a financial point of view, to the Company, and a true and correct copy of such opinion shall have been delivered to the Investor.

(d) ESTABLISHMENT OF PREFERRED STOCK. (i) The Company shall have amended the Certificate of Incorporation by filing with the Secretary of State of the State of Delaware the Certificates of Designations in the form of Exhibits A, B and C hereto containing the resolutions of the Board of Directors of the Company creating the Preferred Stock and setting forth the terms and conditions of the Preferred Stock. A copy of the revised Certificate of Incorporation (including the Certificates of Designations), certified by the State of Delaware, shall have been delivered to the Investor. (ii) The Company shall have executed and delivered to the Investor the shares of Series A Preferred Stock to be purchased by the Investor pursuant to Section 2.01 hereof.

(e) COMPLIANCE WITH LAWS; NO ADVERSE ACTION OR DECISION. Since the date hereof, (i) no Law shall have been promulgated, enacted or entered that restrains, enjoins, prevents, materially delays, prohibits or otherwise makes illegal the performance of any of the Transaction Agreements or Company Documents; (ii) no preliminary or permanent injunction or other order by any Governmental Entity that restrains, enjoins, prevents, delays, prohibits or otherwise makes illegal the performance of any of the Transaction Agreements or Company Documents shall have been issued and remain in effect; and (iii) no Governmental Entity shall have instituted any Proceeding that seeks to restrain, enjoin, prevent, delay, prohibit or otherwise make illegal the performance of any of the Transaction Agreements or Company Documents.

(f) CONSENTS. All Regulatory Approvals (including, without limitation, the Required Regulatory Approvals) from any Governmental Entity and all consents, waivers or approvals from any other Person (including, without limitation, under the Credit Agreement) required
for or in connection with the execution and delivery of the Transaction Agreements and the Company Documents and the consummation of the transactions contemplated thereby shall have been obtained or made on terms reasonably satisfactory to the Investor, and all waiting periods specified under applicable Law (including, without limitation, the waiting period under the HSR Act), the expiration of which is necessary for such consummation, shall have expired or been terminated.

(g) PROCEEDINGS. All corporate and other proceedings to be taken by the Company in connection with the Transaction Agreements and the Company Documents with respect to the transactions contemplated thereby to be completed at the Initial Closing and documents incident thereto shall have been completed in form and substance reasonably satisfactory to the Investor, and the Investor shall have received all such counterpart originals or certified or other copies of the Transaction Agreements and the Company Documents and such other documents as it may reasonably request.

(h) BOARD REPRESENTATION. (i) As contemplated by Section 5.02 hereof, three Investor Nominees designated by the Investor shall have been elected to the Board of Directors effective as of the Initial Closing Date. (ii) Directors' and officers' liability insurance shall be available to the Investor Nominees on terms satisfactory to the Investor and in an amount of coverage at least equal to $50,000,000.

(i) NO MATERIAL ADVERSE EFFECT; NO INSOLVENCY EVENT; NO ALTERNATIVE TRANSACTION OR CONTROL TRANSACTION. No event shall have occurred which has had, or is reasonably likely to have, a Material Adverse Effect; no Insolvency Event shall have occurred; and no Control Transaction or Alternative Transaction shall have been consummated or agreement, understanding, or arrangement with respect thereto entered into.

(j) AGREEMENT. The Registration Rights Agreement shall be in full force and effect.

SECTION 9.02. CONDITIONS OF THE COMPANY'S OBLIGATIONS WITH RESPECT TO THE INITIAL SHARE PURCHASE. The obligation of the Company to issue and sell the Series A Preferred

Stock pursuant to Section 2.01 hereof at the Initial Closing is subject to satisfaction or waiver of each of the following conditions precedent:

(a) REPRESENTATIONS AND WARRANTIES; COVENANTS. The representations and warranties of the Investor set forth in Article IV hereof qualified as to materiality shall have been true and correct in all respects, and those not so qualified shall have been true and correct in all material respects, on and as of the date hereof and as of the Initial Closing as if made on the Initial Closing Date (except where such representation and warranty speaks by its terms as of a different date, in which case it shall be true and correct as of such date). The Investor shall have performed in all material respects all obligations and complied with all agreements, undertakings, covenants and conditions required by it to be performed at or prior to the Initial Closing, and the Investor shall have delivered to the Company at the Initial Closing a certificate in form and substance reasonably satisfactory to the Company dated the Initial Closing Date and signed on behalf of a member of the Investor to the effect that the conditions set forth in this Section 9.02(a) have been satisfied.

(b) OPINION OF COUNSEL. The Company shall have received at the Initial Closing from Cleary, Gottlieb, Steen & Hamilton, counsel to the Investor, a written opinion dated the Initial Closing Date, to the effect set forth in Exhibit F hereto.

(c) COMPLIANCE WITH LAWS; NO ADVERSE ACTION OR DECISION. Since the date hereof, (i) no Law shall have been promulgated, enacted or entered that restrains, enjoins, prevents, materially delays, prohibits or otherwise makes illegal the performance of any of the
Transaction Agreements or the Company Documents with respect to the transactions contemplated thereby to be completed at the Initial Closing; (ii) no preliminary or permanent injunction or other order by any Governmental Entity that restrains, enjoins, prevents, delays, prohibits or otherwise makes illegal the performance of any of the Transaction Agreements or the Company Documents with respect to the transactions contemplated thereby to be completed at the Initial Closing shall have been issued and remain in effect; and (iii) no Governmental Entity shall have instituted any action, claim, suit, investigation or other proceeding that seeks to restrain, enjoin, prevent, delay, prohibit or otherwise make illegal the performance of any of the Transaction Agreements or the Company Documents with respect to the transactions contemplated thereby to be completed at the Initial Closing.

(d) CONSENTS. All Regulatory Approvals (including, without limitation, the Required Regulatory Approvals) from any Governmental Entity and all consents, waivers or approvals from any other Person (including, without limitation, under the Credit Agreement) required for or in connection with the execution and delivery of the Transaction Agreements and the Company Documents and the consummation of the transactions contemplated thereby shall have been obtained or made on terms reasonably satisfactory to the Company, and all waiting periods specified under applicable Law (including, without limitation, the waiting period under the HSR Act), the expiration of which is necessary for such consummation, shall have expired or been terminated.

SECTION 9.03. CONDITIONS OF THE INVESTOR'S OBLIGATION WITH RESPECT TO THE OPTION PURCHASE. The obligation of the Investor to purchase and pay for the Option Shares pursuant to Section 2.02 hereof at the Option Closing is subject to satisfaction or waiver of each of the following conditions precedent:

(a) REPRESENTATIONS AND WARRANTIES; COVENANTS. The Company shall have delivered the Company Representation and Warranty Letter to the Investor. The representations and warranties of the Company set forth in the Company Representation and Warranty Letter qualified as to materiality shall be true and correct in all respects, and those not so qualified shall be true and correct in all material respects, on and as of the Option Closing Date (except where such representation and warranty speaks by its terms as of a different date, in which case it shall be true and correct as of such date). The Company shall have performed in all material respects all obligations and complied with all agreements, undertakings, covenants and conditions required hereunder to be performed by it at or prior to the Option Closing. The Company shall have delivered to the Investor at the Option Closing a certificate in form and substance reasonably satisfactory to the Investor dated the Option Closing Date and signed by the chief executive officer and the chief financial officer of the Company to the effect that the conditions set forth in this Section 9.03(a) have been satisfied.

(b) OPINION OF COUNSEL. The Investor shall have received at the Option Closing from independent, outside legal counsel to the Company, a written opinion dated the Option Closing Date, to the effect set forth in Exhibit E hereto.

(c) COMPLIANCE WITH LAWS; NO ADVERSE ACTION OR DECISION. Since the date hereof, (i) no Law shall have been promulgated, enacted or entered that restrains, enjoins, prevents, materially delays, prohibits or otherwise makes illegal the performance of any of the Transaction Agreements or Company Documents; (ii) no preliminary or permanent injunction or other order by any Governmental Entity that restrains, enjoins, prevents, delays, prohibits or otherwise makes illegal the performance of any of the Transaction Agreements or Company Documents shall have been issued and remain in effect; and (iii) no Governmental Entity shall have instituted any proceeding that seeks to restrain, enjoin, prevent, delay, prohibit or otherwise make illegal the performance of any of the Transaction Agreements or Company Documents.
(d) CONSENTS. All Regulatory Approvals (including, without limitation, the Required Regulatory Approvals) from any Governmental Entity and all consents, waivers or approvals from any other Person (including, without limitation, under the Credit Agreement) required for or in connection with the Option Purchase shall have been obtained or made on terms reasonably satisfactory to the Investor, and all waiting periods specified under applicable Law (including, without limitation, the waiting period under the HSR Act), the expiration of which is necessary for such consummation, shall have expired or been terminated.

(e) PROCEEDINGS. All corporate and other proceedings to be taken by the Company in connection with the Transaction Agreements and the Company Documents with respect to the transactions contemplated thereby to be completed at the Option

Closing including, without limitation, the Board Approval, and documents incident thereto shall have been completed in form and substance reasonably satisfactory to the Investor, and the Investor shall have received all such counterpart originals or certified or other copies of the Transaction Agreements and the Company Documents and such other documents as it may reasonably request.

(f) NO MATERIAL ADVERSE EFFECT; NO INSOLVENCY EVENT; NO ALTERNATIVE TRANSACTION OR CONTROL TRANSACTION. No event shall have occurred which has had, or is reasonably likely to have, a Material Adverse Effect; no Insolvency Event shall have occurred; and no Control Transaction or Alternative Transaction shall have been consummated or agreement, understanding, or arrangement with respect thereto entered into.

(g) AGREEMENT. The Registration Rights Agreement shall be in full force and effect.

SECTION 9.04. CONDITIONS OF THE COMPANY'S OBLIGATION WITH RESPECT TO THE OPTION PURCHASE. The obligation of the Company to issue and sell the Option Shares pursuant to Section 2.02 hereof at the Option Closing is subject to satisfaction or waiver of each of the following conditions precedent:

(a) REPRESENTATIONS AND WARRANTIES; COVENANTS. The Investor shall have delivered the Investor Representation and Warranty Letter to the Company. The representations and warranties of the Investor set forth in the Investor Representation and Warranty Letter qualified as to materiality shall be true and correct in all respects, and those not so qualified shall be true and correct in all material respects, on and as of the Option Closing Date (except where such representation and warranty speaks by its terms as of a different date, in which case it shall be true and correct as of such date). The Investor shall have performed in all material respects all obligations and complied with all agreements, undertakings, covenants and conditions required hereunder to be performed by it at or prior to the Option Closing. The Investor shall have delivered to the Company at the Option Closing a certificate in form and substance reasonably satisfactory to the Company dated the Option Closing Date and signed on behalf of a member of the Investor to the effect that the conditions set forth in this Section 9.04(a) have been satisfied.

(b) COMPLIANCE WITH LAWS; NO ADVERSE ACTION OR DECISION. Since the date hereof, (i) no Law shall have been promulgated, enacted or entered that restrains, enjoins, prevents, materially delays, prohibits or otherwise makes illegal the performance of any of the Transaction Agreements or the Company Documents with respect to the transactions contemplated thereby to be completed at the Option Closing; (ii) no preliminary or permanent injunction or other order by any Governmental Entity that restrains, enjoins, prevents, delays, prohibits or otherwise makes illegal the performance of any of the Transaction Agreements or the Company Documents with respect to the transactions contemplated thereby to be completed at the Option Closing shall have been issued and remain in effect; and (iii) no Governmental Entity shall have instituted any action, claim, suit,
investigation or other proceeding that seeks to restrain, enjoin,

prevent, delay, prohibit or otherwise make illegal the performance of
any of the Transaction Agreements or the Company Documents with
respect to the transactions contemplated thereby to be completed at
the Option Closing.

(c) CONSENTS. All Regulatory Approvals (including, without
limitation, the Required Regulatory Approvals) from any Governmental
Entity and all consents, waivers or approvals from any other Person
(including, without limitation, under the Credit Agreement) required
for or in connection with the Option Purchase shall have been obtained
or made on terms reasonably satisfactory to the Company, and all
waiting periods specified under applicable Law (including, without
limitation, the waiting period under the HSR Act), the expiration of
which is necessary for such consummation, shall have expired or been
terminated.

(d) NO RESTRICTION EVENT. The Company shall not be
prohibited from selling any Option Shares to the Investor pursuant to
(A) the provisions set forth in Section 4.03(a) of the Indenture (as
in effect on the date hereof) or (B) under comparable provisions of
any Indenture so long as such comparable provisions are not materially
more restrictive than those referred to in clause (A).

ARTICLE X
TERMINATION

SECTION 10.01. TERMINATION OF AGREEMENT. Subject to
Section 10.02 hereof, this Agreement may be terminated by notice in writing at
any time prior to the Initial Closing by:

(a) the Investor or the Company, if the Initial Closing
shall not have occurred on or before January 15, 2000; PROVIDED, HOWEVER, that
the right to terminate this Agreement under this Section 10.01(a) shall not be
available to any party whose failure to fulfill any obligation under this
Agreement has been the cause of, or resulted in, the failure of the Initial
Closing to occur on or before such date;

(b) the Investor or the Company, if any Governmental Entity
of competent jurisdiction shall have issued any judgment, injunction, order,
ruling or decree or taken any other action restraining, enjoining or otherwise
prohibiting the consummation of the transactions contemplated by the Transaction
Agreements and such judgment, injunction, order, ruling, decree or other action
becomes final and nonappealable; PROVIDED that the party seeking to terminate
this Agreement pursuant to this clause (b) shall have used its best efforts to
have such judgment, injunction, order, ruling or decree lifted, vacated or
denied;

(c) the Investor, if the Company shall have taken any action
described in clause (B) or (C) of Section 7.04(b) hereof; or

(d) the Investor or the Company, if the Investor and the
Company so mutually agree in writing.

SECTION 10.02. EFFECT OF TERMINATION. (a) If this Agreement
is terminated in accordance with Section 10.01 hereof and the transactions
contemplated hereby are not

consummated, this Agreement shall become null and void and of no further force
and effect except that (i) the terms and provisions of this Section 10.02,
Section 8.06 and Article XI hereof shall remain in full force and effect and
(ii) any termination of this Agreement shall not relieve any party hereto from
any liability for any breach of its obligations hereunder.

(b) If (i) this Agreement is terminated in accordance with
Section 10.01(a) hereof and as of the date set forth in Section 10.01(a) hereof the conditions set forth in Section 9.01(a) hereof shall not have been satisfied, (ii) a Proposal is made to the Company or any of its Representatives with respect to an Alternative Transaction (whether or not the same Alternative Transaction as is ultimately consummated or as to which a written agreement, letter of intent, agreement in principle, memorandum of understanding or similar writing is ultimately entered into) prior to the Cut-Off Date (as defined below) or a Proposal with respect to an Alternative Transaction is publicly announced by the Person contemplating such transaction or a Representative of such Person prior to the Cut-Off Date, and (iii) an agreement with respect to a Control Transaction or Alternative Transaction is entered into or a Control Transaction or Alternative Transaction is consummated within eighteen months after the Cut-Off Date, the Company shall pay the Investor (or its assignees) the Alternative Transaction Fee on the earlier of (A) the date on which such agreement with respect to an Alternative Transaction is entered into and (B) the date on which an Alternative Transaction is consummated. The term "CUT-OFF DATE" shall mean the date of termination of this Agreement.

(c) If this Agreement is terminated in accordance with Section 10.01(c) hereof, the Company shall pay the Investor (or its assignees) the Alternative Transaction Fee on the second Business Day following such termination.

ARTICLE XI
MISCELLANEOUS

SECTION 11.01. FEES AND EXPENSES. (a) Except as provided below or in the Registration Rights Agreement, each party shall be responsible for the payment of all expenses incurred by it in connection with the Transaction Agreements and the transactions contemplated thereby, including, without limitation, all fees and expenses of its legal counsel and all third-party consultants engaged by it to assist in such transactions. Notwithstanding the foregoing, in the event this Agreement is terminated, the Company shall reimburse the Investor for all expenses incurred by the Investor in connection with the Transaction Agreements and the transactions contemplated thereby, including, without limitation, all fees and expenses of the Investor's legal counsel and all third-party consultants engaged by the Investor to assist in such transactions; PROVIDED, that no amount in excess of $1,500,000 shall be payable pursuant to this sentence; and PROVIDED, FURTHER, that no amount whatsoever shall be payable pursuant to this sentence if the Alternative Transaction Fee is paid by the Company pursuant to Section 10.02(b) hereof. In the event the Initial Share Purchase is consummated, upon the Initial Closing, the Company shall pay the Investor the Placement Fee. In the event that an Option Purchase is consummated by the Investor or any of its Affiliates, upon the Option Closing related thereto the Company shall pay the Investor the Option Funding Fee. In the event that the Series A Shareholder Approval is not duly obtained at the first meeting of the stockholders of the Company held after the execution of this Agreement, the Company shall pay the Investor the Option Carry Fee. In the event the Investor or any of its Affiliates commences a tender offer for the Common Stock that is approved by the Board of Directors prior to the commencement thereof, the Company shall reimburse the Investor or such Affiliate an amount equal to 50% of all expenses incurred by the Investor and its Affiliates in connection with such tender offer, including, without limitation, all fees and expenses of their legal counsel and all third-party consultants engaged by them to assist in the tender offer. Such reimbursements shall be due to the Investor at the Initial Closing, or promptly following any earlier termination of this Agreement for any reason, as the case may be, or in the case of fees and expenses incurred thereafter, promptly upon demand therefor.

(b) All amounts payable under this Agreement shall be paid in immediately available funds to an account or accounts designated by the recipient of such amounts.

SECTION 11.02. SURVIVAL OF REPRESENTATIONS AND WARRANTIES. Notwithstanding any investigation conducted or notice or knowledge obtained by or on behalf of any party hereto, each representation or warranty in this Agreement or in the Schedules hereto or certificates delivered pursuant to this Agreement shall survive the Initial Closing for a period of two years; PROVIDED,
HOWEVER, that each representation and warranty made in Sections 3.13 and 3.23 hereof or in any Schedule or certificate related thereto, shall survive the Initial Closing until the sixtieth day following the expiration of the applicable statute of limitations with respect to any action that may be brought relating to the matters described in such representation and warranty; and PROVIDED FURTHER, HOWEVER, that each representation and warranty made in Sections 3.03, 3.09, 3.11 and 3.12 hereof or in any Schedule or certificate related thereto, shall survive the Initial Closing for a period of four years and PROVIDED FURTHER, HOWEVER, that each representation and warranty made in the Company Representation and Warranty Letter, the Investor Representation and Warranty Letter, pursuant to Section 11.13 hereof, or in any certificate related thereto, shall survive the Option Closing for a period of two years. Any claim for indemnification under this Article XI arising out of the inaccuracy or breach of any representation or warranty must be made prior to the termination of the applicable survival period. For all purposes hereunder, when executed and delivered, the Company Representation and Warranty Letter and the Investor Representation and Warranty Letter shall be deemed to be a part of this Agreement.

SECTION 11.03. SPECIFIC PERFORMANCE. The parties hereto specifically acknowledge that monetary damages are not an adequate remedy for violations of this Agreement, and that any party hereto may, in its sole discretion, apply to a court of competent jurisdiction for specific performance or injunctive or such other relief as such court may deem just and proper in order to enforce this Agreement or prevent any violation hereof and, to the extent permitted by applicable law and to the extent the party seeking such relief would have been entitled to obtain on the merits to obtain such relief, each party waives any objection to the imposition of such relief.

SECTION 11.04. INDEMNIFICATION. (a) The Company agrees to indemnify and hold harmless the Investor, each Designated Purchaser, each member thereof, each limited or general partner of each such member, each limited or general partner of each such limited or general partner, each of their Affiliates and each of their Representatives (collectively, the "INDEMNIFIED PARTIES") from and against any and all Losses, penalties, judgments, suits, costs, claims, liabilities, damages and expenses (including, without limitation, reasonable attorneys' fees and disbursements but excluding Taxes imposed as a result of being a direct or indirect owner of the Senior Preferred Stock or realizing income or gain with respect thereto) (collectively, "LOSSES"), incurred by, imposed upon or asserted against any of the Indemnified Parties as a result of, relating to or arising out of, (i) the breach of any representation, warranty, agreement or covenant made by the Company in any Transaction Agreement or in any certificate delivered by the Company pursuant to any Transaction Agreement (each of which shall be deemed to have been made for the benefit of all members of the Investor Group) and (ii) the purchase and/or direct or indirect ownership of the Senior Preferred Stock, Junior Shares, Dividend Shares or Conversion Shares (including, without limitation, any litigation to which an Indemnified Party is made party as a result thereof), PROVIDED, HOWEVER, that nothing in this clause (ii) shall require the Company to indemnify any Indemnified Party with respect to any Loss resulting solely from a decline in the market value of the Senior Preferred Stock, Junior Shares, Dividend Shares or Conversion Shares.

(b) The Investor agrees to indemnify and hold harmless the Company and each of its Representatives (collectively, the "INDEMNIFIED COMPANY PARTIES") from and against any and all Losses incurred by any of the Indemnified Company Parties as a result of, or arising out of, the breach of any representation, warranty, agreement or covenant made by the Investor in the Transaction Agreements or in any certificate delivered by the Investor pursuant to the Transaction Agreements.

(c) The following provisions shall apply to claims for Losses from claims by a third party ("CLAIM"). The indemnifying party shall have the absolute right, in its sole discretion and expense, to elect to defend, contest or otherwise protect against any such Claim with legal counsel of its own selection. The Indemnified Parties or the Indemnified Company Parties, as the case may be, shall have the right, but not the obligation, to participate, at their own expense, in the defense thereof through counsel of their own choice and shall have the right, but not the obligation, to assert any and all
crossclaims or counterclaims they may have. The Indemnified Parties or the Indemnified Company Parties, as the case may be, shall, and shall cause their Affiliates to, at all times cooperate in all reasonable ways with, make their relevant files and records available for inspection and copying by, and make their employees available or otherwise render reasonable assistance to, the indemnifying party (i) in its defense of any action for which indemnity is sought hereunder and (ii) its prosecution under the last sentence of this Section 11.04(c) of any related claim, cross-complaint, counterclaim or right of subrogation. In the event the indemnifying party fails timely to defend, contest or otherwise protect against any such suit, action, investigation, claim or proceeding, the Indemnified Parties or the Indemnified Company Parties, as the case may be, shall have the right, but not the obligation, to defend, contest, assert cross-claims or counterclaims or otherwise protect against the same. No claim or action subject hereto may be settled unless the Indemnified Parties or the Indemnified Company Parties, as the case may be, and the indemnifying party consent thereto, such consent not to be unreasonably withheld. The indemnifying party shall be subrogated to the claims or rights of the Indemnified Parties or the Indemnified Company Parties, as the case may be, as against any other persons with respect to any Loss paid by the indemnifying party under this Section 11.04(c).

(d) All payments under this Section 11.04 shall be due promptly following the occurrence of the related Loss; PROVIDED, HOWEVER, that if a final, non-appealable judicial determination is made that an Indemnified Party or Indemnified Company Party is not entitled to any such payment it will promptly repay the appropriate amounts to the appropriate indemnifying party.

SECTION 11.05. NOTICES. All notices and other communications hereunder shall be in writing and shall be deemed to have been duly given, if delivered personally, by telecopier or sent by first class mail, postage prepaid, as follows:

(i) If to the Company, to:
Magellan Health Services, Inc.
6950 Columbia Gateway Drive
Fourth Floor
Columbia, Maryland 21046
Attention: General Counsel

With a copy to:

King & Spalding
191 Peachtree Street
Atlanta, Georgia 30303-1763
Attention: Philip A. Theodore, Esq.

(ii) If to the Investor, to:
TPG MAGELLAN LLC
201 Main Street
Suite 2420
Fort Worth, Texas 76102
Attention: Jonathan J. Coslet
Senior Vice President

With a copy to:

Cleary, Gottlieb, Steen & Hamilton
One Liberty Plaza
New York, New York 10006
Attention: Michael A. Gerstenzang, Esq.

If to any other holder of shares of Preferred Stock, Debentures, or Conversion Shares, addressed to such holder at the address of such holder in the record books of the Company; or to such other address or addresses as shall be designated in writing. All notices shall be effective when received.
SECTION 11.06. ENTIRE AGREEMENT; AMENDMENT. This Agreement and the documents described herein or attached or delivered pursuant hereto (including, without limitation, the Registration Rights Agreement and the Certificates of Designations) set forth the entire agreement between the parties hereto with respect to the transactions contemplated by this Agreement and supersedes the letter agreement dated July 2, 1999, between the Company and the Investor which is terminated in its entirety hereby. Any provision of this Agreement may only be amended, modified or supplemented in whole or in part at any time by an agreement in writing among the parties hereto executed in the same manner as this Agreement. No failure on the part of any party to exercise, and no delay in exercising, any right shall operate as waiver thereof, nor shall any single or partial exercise by either party of any right preclude any other or future exercise thereof or the exercise of any other right. No investigation by the Investor of the Company prior to or after the date hereof shall stop or prevent the Investor from exercising any right hereunder or be deemed to be a waiver of any such right.

SECTION 11.07. COUNTERPARTS. This Agreement may be executed in two or more counterparts, each of which shall be deemed to constitute an original, but all of which together shall constitute one and the same document.

SECTION 11.08. GOVERNING LAW. This Agreement shall be governed by, and interpreted in accordance with, the laws of the State of New York applicable to contracts made and to be performed in that State without reference to its conflict of laws rules. The parties hereto agree that the appropriate and exclusive forum for any disputes arising out of this Agreement solely between the Company and the Investor shall be the United States District Court for the Southern District of New York, and, if such court will not hear any such suit, the courts of the state of the Company's incorporation, and the parties hereto irrevocably consent to the exclusive jurisdiction of such courts, and agree to comply with all requirements necessary to give such courts jurisdiction. The parties hereto further agree that the parties will not bring suit with respect to any disputes arising out of this Agreement except as expressly set forth for the execution or enforcement of judgment, in any jurisdiction other than the above specified courts. Each of the parties hereto irrevocably consents to the service of process in any action or proceeding hereunder by the mailing of copies thereof by registered or certified airmail, postage prepaid, to the address specified in Section 11.05 hereof. The foregoing shall not limit the rights of any party hereto to serve process in any other manner permitted by the law or to obtain execution of judgment in any other jurisdiction. The parties further agree, to the extent permitted by law, that final and unappealable judgment against any of them in any action or proceeding contemplated above shall be conclusive and may be enforced in any other jurisdiction within or outside the United States by suit on the judgment, a certified or exemplified copy of which shall be conclusive evidence of the fact and the amount of indebtedness. The parties agree to waive any and all rights that they may have to a jury trial with respect to disputes arising out of this Agreement.

SECTION 11.09. SUCCESSORS AND ASSIGNS. (a) Except as otherwise expressly provided herein, the provisions hereof shall inure to the benefit of, and be binding upon, the Company's successors and assigns. Except as provided in Section 11.09(b) hereof, neither this Agreement nor any rights hereunder shall be assignable by any party hereto without the prior written consent of the other party hereto; PROVIDED, HOWEVER, that the Investor may assign all or part of its interest in this Agreement and its rights hereunder to any of its Affiliates and, thereafter, the term "Investor," as applied to the assigning Investor, shall include any such Affiliate to the extent of such assignment and shall mean the assigning Investor and such Affiliates taken collectively.

(b) Notwithstanding the foregoing, prior to the Option Closing the Investor may assign its rights with respect to the purchase of up to 49% of the Series A Preferred Stock to be purchased by the Investor hereunder to any Person or Persons not Affiliated with the Investor (each such Person, a "DESIGNATED PURCHASER"). The Investor shall not assign pursuant to this Section 11.09(b) any of its rights under this Agreement other than the right to purchase or receive Series A Preferred Stock. Except as expressly provided
in this Agreement, no Designated Purchaser shall have any rights under this Agreement or any rights of the Investor (other than rights that by their terms are available to all holders of Series A Preferred Stock and Conversion Shares generally) under the Certificates of Designations. As a condition to any assignment pursuant to this Section 11.09(b), each Designated Purchaser shall deliver to the Company a letter, dated as of the Initial Closing Date or, if later, the date of such assignment, in form and substance reasonably satisfactory to the Company, pursuant to which such Designated Purchaser shall (i) make the representation set forth in Section 4.05 hereof, (ii) agree to comply with the provisions set forth in Sections 8.01(b) and 8.06 hereof as if it were the Investor thereunder and (iii) if as a result of an assignment contemplated by this Section 11.09(b) such Designated Purchaser would as of the Initial Closing, or, if later, the date of such assignment, Beneficially Own Voting Securities of the Company representing more than 5% of the Voting Power of the Voting Securities of the Company, agree to comply with the provisions of Article VI hereof as if it were the Investor thereunder. Any assignment to such Designated Purchaser that does not comply with the preceding provisions of this Section 11.09(b) shall be null and void, and (i) if such assignment is made at or prior to the Initial Closing, the Investor shall purchase all Series A Preferred Stock that would have been purchased by such Designated Purchaser at the Initial Closing and (ii) if such assignment is made subsequent to the Initial Closing and at or prior to the Option Closing and the Option is exercised or deemed exercised, the Investor shall purchase all Option Shares that would have been purchased by such Designated Purchaser.

(c) Notwithstanding anything in this Agreement to the contrary, in the event that any Person other than the Investor or any Affiliate of the Investor shall have the right to exercise any portion of the Option, (i) such Person may exercise such portion as if it were the Investor hereunder and (ii) the Option may be exercised in part to the extent necessary to permit each holder of the right to exercise a portion of the Option to independently exercise such portion (in whole and not in part); PROVIDED, HOWEVER, that except as permitted pursuant to Section 2.02(d), no portion of the Option shall be exercised for (A) less than 5,000 Option Shares by the Investor, any Designated Purchaser or any of their respective Affiliates or (B) less than 1,500 Option Shares by any other Person.

SECTION 11.10. NO THIRD-PARTY BENEFICIARIES. This Agreement is for the sole benefit of the parties hereto and their respective successors and permitted assigns and nothing herein, express or implied, is intended or shall confer upon any other Person any legal or equitable right, benefit or remedy of any nature whatsoever under or by reason of this Agreement, except that the provisions of Section 8.08 shall inure to the benefit of and be enforceable by the Investor Nominees and the provisions of Section 11.04 shall inure to the benefit of and be enforceable by each Indemnified Party.

SECTION 11.11. ALLOCATION. The Investor shall reasonably determine, and the Company shall accept, the allocation of the Initial Share Purchase Price among the Series A Preferred Stock and Option issued to the Investor pursuant to Section 2.01 and Section 2.02 hereof, respectively.

SECTION 11.12. PRE-EMPTIVE RIGHTS. (a) In the event the transactions contemplated hereby give rise to any pre-emptive rights on behalf of any Person to purchase shares of Series A Preferred Stock and such rights are validly exercised by such Person prior to the Initial Closing, to the extent necessary under the Certificate of Incorporation, the Bylaws, the NYSE Rules or applicable Law to permit the Initial Closing to occur without first obtaining the approval of the stockholders of the Company, the number of shares of Series A Preferred Stock to be purchased by the Investor pursuant to Section 2.01 hereof and the Initial Purchase Price each shall be reduced appropriately and a proportional increase shall be made in the number of Option Shares that may be purchased by the Investor pursuant to Section 2.02 hereof and the Option Purchase Price.

(b) In the event the transactions contemplated hereby give rise to any pre-emptive rights on behalf of any Person to purchase shares of Series A Preferred Stock and such rights are validly exercised by such Person subsequent to the Initial Closing but prior to the Series A Shareholder Approval Date, as soon as practicable following the receipt by the Company of the consent
of the Required Lenders (as defined in the Credit Agreement), the Investor shall return to the Company such number of shares of Series A Preferred Stock purchased by the Investor pursuant to Section 2.01 that is necessary to permit the Company to satisfy such pre-emptive rights, the Company shall return to the Investor a corresponding portion of the Initial Share Purchase Price and a proportional increase shall be made in the number of Option Shares that may be purchased by the Investor pursuant to Section 2.02 hereof and the Option Purchase Price.

SECTION 11.13. NOL LETTER. On the date of the original issuance of the Option Shares, the Company shall deliver a letter to the Investor restating the matters set forth in Section 3.13(d) hereof updated as necessary to reflect the then-current circumstances. Such letter shall constitute a representation and warranty of the Company hereunder.

SECTION 11.14. CERTAIN AMENDMENTS TO THE SERIES B CERTIFICATE OF DESIGNATIONS AND JUNIOR CERTIFICATE OF DESIGNATIONS. For so long as members of the Investor Group Beneficially Own, in the aggregate, at least 50% of the Original Number of Conversion Shares, the Company shall not, without the prior written approval of the holders of at least 60% of the Conversion Shares then Beneficially Owned by members of the Investor Group, (i) amend, alter or repeal any provision of the Certificate of Incorporation or the Bylaws, if the amendment, alteration or repeal alters or changes the powers, preferences or special rights of the Series B Preferred Stock or the Junior Preferred Stock so as to affect them adversely; or (ii) authorize or take any other action if such action alters or changes any of the rights of the Series B Preferred Stock or the Junior Preferred Stock in any respect or otherwise would be inconsistent with the provisions of this Agreement and the holders of any class or Series of the capital stock of the Corporation is entitled to vote thereon. Notwithstanding anything in the foregoing to the contrary, (i) the restrictions set forth in the previous sentence shall apply only during the period commencing on the Initial Closing Date and ending on the date of the original issuance of the Series B Preferred Stock and (ii) if no shares of Series B Preferred Stock are issued and outstanding on the Series A Shareholder Approval Date, the Company shall be permitted to amend the Certificate of Incorporation to eliminate the Series B Preferred Stock and the Junior Preferred Stock.

IN WITNESS WHEREOF, this Agreement has been executed on behalf of the parties hereto by their respective duly authorized officers, all as of the date first above written.

TPG MAGELLAN LLC
By: /s/ Jonathan J. Coslet
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Name: Jonathan J. Coslet
Title: Senior Vice President

MAGELLAN HEALTH SERVICES, INC.
By: /s/ Clifford W. Donnelly
-------------------------------
Name: Clifford W. Donnelly
Title: Executive Vice President and Chief Financial Officer

EXHIBIT A
Form of Series A Certificate of Designations
CERTIFICATE OF DESIGNATIONS
OF
SERIES A CUMULATIVE CONVERTIBLE PREFERRED STOCK
OF
MAGELLAN HEALTH SERVICES, INC.
(PURSUANT TO SECTION 151 OF THE
DELAWARE GENERAL CORPORATION LAW)

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Magellan Health Services, Inc., a corporation organized and existing under the General Corporation Law of the State of Delaware (the "CORPORATION"), hereby certifies that the following resolutions were adopted by the Board of Directors of the Corporation (the "BOARD OF DIRECTORS") pursuant to authority of the Board of Directors as required by Section 151 of the General Corporation Law of the State of Delaware:

RESOLVED, that pursuant to the authority granted to and vested in the Board of Directors in accordance with the provisions of the Restated Certificate of Incorporation of the Corporation, as amended (the "CERTIFICATE OF INCORPORATION"), the Board of Directors hereby creates a series of the Corporation's previously authorized preferred stock, without par value (the "PREFERRED STOCK"), and hereby states the designation and number thereof, and fixes the voting powers, preferences and relative, participating, optional and other special rights, and the qualifications, limitations and restrictions thereof, as follows:

Series A Cumulative Convertible Preferred Stock:

I. DESIGNATION AND AMOUNT

The designation of this series of shares shall be "Series A Cumulative Convertible Preferred Stock" (the "SERIES A PREFERRED STOCK"); the stated value per share shall be $1,000 (the "STATED VALUE"); and the number of shares constituting such series shall be [_________]. Shares of Series A Preferred Stock may be issued by the Company from time to time by a resolution or resolutions of the Board of Directors. The number of shares of the Series A Preferred Stock may be decreased from time to time by a resolution or resolutions of the Board of Directors; PROVIDED, HOWEVER, that such number shall not be decreased below the sum of the aggregate number of shares of the Series A Preferred Stock then outstanding and the number of shares of the Series A Preferred Stock that the Corporation may be obligated to issue pursuant to the Investment Agreement.

II. RANK

A. With respect to dividend rights, the Series A Preferred Stock shall rank (i) junior to each other class or series of Preferred Stock which by its terms ranks senior to the Series A Preferred Stock as to payment of dividends, (ii) on a parity with each other class or series of Preferred Stock which by its terms ranks on a parity with the Series A Preferred Stock as to payment of dividends, including, if issued, the Series B Cumulative Convertible Preferred Stock, without par value (the "SERIES B PREFERRED STOCK"), of the Corporation, and (iii) prior to the Corporation's Series C Junior Participating Preferred Stock, par value $0.01 per share (the "JUNIOR PREFERRED STOCK"), and Common Stock, par value $0.25 per share (the "COMMON STOCK"), and, except as specified above, all other classes and series of capital stock of the Corporation hereafter issued by the Corporation. With respect to dividends, all equity securities of the Corporation to which the Series A Preferred Stock ranks senior, including the Common Stock, are collectively referred to herein as the "JUNIOR DIVIDEND SECURITIES"; all equity securities of the Corporation with which the Series A Preferred Stock ranks on a parity, including the Series B Preferred Stock, are collectively referred to herein as the "PARITY DIVIDEND SECURITIES"; and all equity securities of the Corporation (other than convertible debt securities) to which the Series A Preferred Stock ranks junior, with respect to dividends, are collectively referred to herein as the "SENIOR DIVIDEND SECURITIES."

B. With respect to the distribution of assets upon liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, the Series A Preferred Stock shall rank (i) junior to each other class or series of Preferred Stock which by its terms ranks senior to the
Series A Preferred Stock as to distribution of assets upon liquidation, dissolution or winding up, (ii) on a parity with each other class or series of Preferred Stock which by its terms ranks on a parity with the Series A Preferred Stock as to distribution of assets upon liquidation, dissolution or winding up of the Corporation, including the Series B Preferred Stock, and (iii) prior to the Junior Preferred Stock and the Common Stock, and, except as specified above, all other classes and series of capital stock of the Corporation hereinafter issued by the Corporation. With respect to the distribution of assets upon liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, all equity securities of the Corporation to which the Series A Preferred Stock ranks senior, including the Common Stock, are collectively referred to herein as "JUNIOR LIQUIDATION SECURITIES" (and together with the Junior Dividend Securities are referred to herein as the "JUNIOR SECURITIES"); all equity securities of the Corporation (other than convertible debt securities) to which the Series A Preferred Stock ranks on parity, including the Series B Preferred Stock, are collectively referred to herein as "PARITY LIQUIDATION SECURITIES" (and together with the Parity Dividend Securities are referred to herein as the "PARITY SECURITIES"); and all equity securities of the Corporation to which the Series A Preferred Stock ranks junior are collectively referred to herein as "SENIOR LIQUIDATION SECURITIES" (and together with the Senior Dividend Securities are referred to herein as the "SENIOR SECURITIES").

III. DIVIDENDS

A. DIVIDENDS. Shares of Series A Preferred Stock shall accumulate dividends at a rate of 6.50% PER ANNUM, payment of which shall be made in cash except as otherwise provided in this Article III. Dividends shall be paid in four equal quarterly installments on the last day of March, June, September and December of each year, or if any such date is not a Business Day, on the Business Day next preceding such day (each such date, regardless of whether any dividends have been paid or declared and set aside for payment on such date, a "DIVIDEND PAYMENT DATE"), to holders of record (the "REGISTERED HOLDERS") as they appear on the stock record books of the Corporation on the fifteenth day prior to the relevant Dividend Payment Date; PROVIDED, HOWEVER, that the Corporation may elect not to make any dividend payment due hereunder on any Dividend Payment Date (other than as required in connection with any redemption of shares of Series A Preferred Stock or any liquidation, dissolution or winding up of the Corporation), and any such amount then due in respect of dividends shall constitute an Arrearage (as defined below). Dividends shall be paid only when, as and if declared by the Board of Directors out of funds at the time legally available for the payment of dividends. Dividends shall begin to accumulate on outstanding shares of Series A Preferred Stock from the date of issuance and shall be deemed to accumulate from day to day whether or not earned or declared until paid. Dividends shall accumulate on the basis of a 360-day year consisting of twelve 30-day months (four 90-day quarters) and the actual number of days elapsed in the period for which payable.

B. ACCUMULATION. Dividends on the Series A Preferred Stock shall be cumulative, and from and after any Dividend Payment Date on which any dividend that has accumulated or been deemed to have accumulated through such date has not been paid in full or any payment date set for a redemption on which such redemption payment has not been paid in full, additional dividends shall accumulate in respect of the amount of such unpaid dividends or unpaid redemption payment (such amount, the "ARREARAGE") at the annual rate then in effect as provided in Section A of this Article III (or such lesser rate as may be the maximum rate that is then permitted by applicable law). Such additional dividends in respect of any Arrearage shall be deemed to accumulate from day to day whether or not earned or declared until paid. Dividends shall accumulate on the basis of a 360-day year consisting of twelve 30-day months (four 90-day quarters) and the actual number of days elapsed in the period for which payable. References in any Article herein to dividends that have accumulated or that have been deemed to have accumulated with respect to the Series A Preferred Stock shall include the amount, if any, of any Arrearage together with any dividends accumulated or deemed to have accumulated on such Arrearage pursuant to the immediately preceding two sentences. Additional dividends in respect of any Arrearage may be declared and paid at any time, in whole or in part, without reference to any regular Dividend Payment Date, to Registered Holders as they appear on the stock record books of
the Corporation on such record date as may be fixed by the Board of Directors (which record date shall be no less than 10 days prior to the corresponding payment date).

C. PAYMENT IN COMMON STOCK. Notwithstanding the provisions of Section A of this Article III, (i) any dividend payment (such payment, a "NON-ARREARAGE PAYMENT") made in full on the first Dividend Payment Date on which such payment is due (without taking into account the proviso to the second sentence of Section A of this Article III in determining the first Dividend Payment Date on which such payment is due) and (ii) any payment (such payment, an "ARREARAGE PAYMENT") made at any time prior to the second anniversary of the original issuance of the Series A Preferred Stock in respect of any dividend Arrearage, may be made in the form of shares of Common Stock; PROVIDED that:

(i) the Common Stock is then validly listed for trading on the NYSE or other national securities exchange or quoted on a nationally recognized quotation system;

(ii) such shares of Common Stock have been duly authorized and when issued in connection with such payment, will be validly issued, fully paid and non-assessable;

(iii) the issuance of such shares of Common Stock in satisfaction of such payment does not: (a) violate any provision of the Certificate of Incorporation or the Bylaws; (b) give rise to any preemptive rights, rights of first refusal or other similar rights on behalf of any Person under any applicable Law or any provision of the Certificate of Incorporation or the Bylaws or any agreement or instrument applicable to the Corporation or any of its Subsidiaries; (c) conflict with, contravene or result in a breach or violation of any of the terms or provisions of, or constitute a default (with or without notice or the passage of time) under, or result in or give rise to a right of termination, cancellation, acceleration or modification of any right or obligation under, or give rise to a right to put or to compel a tender offer for outstanding securities of the Corporation or any of its Subsidiaries under, or require any consent, waiver or approval under, any note, bond, debt instrument, indenture, mortgage, deed of trust, lease, loan agreement, joint venture agreement, Regulatory Approval, contract or any other agreement, instrument or obligation to which the Corporation or any of its Subsidiaries or any property of the Corporation or any of its Subsidiaries is bound (assuming for the purpose of this clause (c) that all conditions precedent to the conversion of Series A Preferred Stock have been satisfied and that all outstanding shares of the Series A Preferred Stock have been converted into Common Stock); (d) result in the creation or imposition of any Lien upon any assets or properties of the Corporation or any of its Subsidiaries; or (e) violate any Law applicable to the Corporation or any of its Subsidiaries;

(iv) (a) no default or event of default, or event that with notice or the passage of time would constitute a default or event of default, has occurred and is continuing (or will occur as a result of the issuance of shares of Common Stock in satisfaction of such payment), under any contract, agreement, indenture, mortgage, note, lease or other instrument evidencing Indebtedness of the Corporation or any of its Subsidiaries (other than inter-company Indebtedness between the Corporation and any of its Subsidiaries or between Subsidiaries of the Corporation) the outstanding principal amount of which is in excess of $10,000,000 and as a result of such default, event of default or event the holders thereof have accelerated or have the right to accelerate (or would have the right to accelerate with notice or the passage of time) the maturity thereof, and (b) the Corporation has not been notified that a breach of the Investment Agreement or the terms of the Series A Preferred Stock or Series B Preferred Stock has occurred and is continuing;

(v) (a) with respect to any Non-Arrearage Payment, the Trailing Average Value (as defined below) is equal to or greater than the product of (A) 0.40, multiplied by (B) the Conversion Price, and (b) with respect to any Arrearage Payment, the Trailing Average Value
as defined below) is equal to or greater than the product of (A) 0.60, multiplied by (B) the Conversion Price;

(vi) (a) with respect to any Non-Arrearage Payment, the average daily trading volume in the Common Stock during the period used to calculate the Trailing Average Value is at least 50% of the average daily trading volume in the Common Stock for the 180-day period ending on the date of the Investment Agreement, and (b) with respect to any Arrearage Payment, the average daily trading volume in the Common Stock during the period used to calculate the Trailing Average Value is at least 67% of the average daily trading volume in the Common Stock for the 180-day period ending on the date of the Investment Agreement;

(vii) the issuance of such shares of Common Stock in satisfaction of such payment does not require the approval or affirmative vote of the holders of any class or series of the Corporation's Equity Securities; and

(viii) as of the relevant Dividend Payment Date, the Shelf Registration Statement (as such term is defined in the Registration Rights Agreement) is effective under the Securities Act and is available for use in connection with the offer and sale of such shares of Common Stock by those holders of Series A Preferred Stock that have such right under the Registration Rights Agreement (it being understood that if a Shelf Suspension (as such term is defined in the Registration Rights Agreement) is in effect, the Shelf Registration Statement shall not be deemed effective or available for use); PROVIDED, HOWEVER, that in the case of any Non-Arrearage Payment (and only in the case of a Non-Arrearage Payment), this clause (viii) shall not prohibit the issuance of shares of Common Stock in satisfaction of such payment if the Shelf Registration Statement is not effective or not available for use in accordance with Section 2.1(c) of the Registration Rights Agreement.

For the purpose of this Section C, the value of a share of Common Stock used to pay dividends on the Series A Preferred Stock shall equal (the "TRAILING AVERAGE VALUE") the average of the Closing Prices per share of Common Stock for the twenty consecutive Trading Days ending on the second Trading Day prior to the relevant Dividend Payment Date; PROVIDED, HOWEVER, that in the event that an adjustment to the Conversion Price takes effect pursuant to Section B of Article IX hereof during the period used to compute such average, the Closing Prices used to compute such average for all Trading Days ended prior to the time such adjustment takes effect shall be similarly adjusted. Except as otherwise expressly provided in this Section C, Common Stock may not be used to make any payment in respect of any Arrearage.

D. METHOD OF PAYMENT. Dividends paid on the shares of Series A Preferred Stock in an amount less than the total amount of such dividends at the time accumulated and payable on all outstanding shares of Series A Preferred Stock shall be allocated pro rata on a share-by-share basis among all such shares then outstanding. Notwithstanding the provisions of Section C of this Article III, any such partial payment shall be made in cash. Dividends that are declared and paid in an amount less than the full amount of dividends accumulated on the Series A Preferred Stock (and on any Arrearage) shall be applied first to the earliest dividend which has not theretofore been paid. All cash payments of dividends on the shares of Series A Preferred Stock shall be made in such coin or currency of the United States of America as at the time of payment is legal tender for payment of public and private debts.

IV. LIQUIDATION PREFERENCE

In the event of a liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, the holders of then-outstanding shares of Series A Preferred Stock shall be entitled to receive out of the assets of the Corporation, whether such assets are capital or surplus of any nature, an amount per share equal to the greater of (A) the sum of (i) the Stated Value thereof and (ii) the dividends, if any, accumulated or deemed
to have accumulated thereon to the date of final distribution to such holders, whether or not such dividends are declared, and (B) the amount that would be payable to such holders if the holders had converted all outstanding shares of Series A Preferred Stock into shares of Common Stock immediately prior to such liquidation, dissolution or winding up, and shall, after the holders of Common Stock have received an amount per share of Common Stock equal to the amount paid per share of Series A Preferred Stock, be entitled to participate on a pro rata basis with the holders of Common Stock. After any such payment in full, the holders of Series A Preferred Stock shall not, as such, be entitled to any further participation in any distribution of assets of the Corporation. All the assets of the Corporation available for distribution to stockholders after the liquidation preferences of any Senior Liquidation Securities shall be distributed ratably (in proportion to the full distributable amounts to which holders of Series A Preferred Stock and Parity Liquidation Securities, if any, are respectively entitled upon such dissolution, liquidation or winding up) among the holders of the then-outstanding shares of Series A Preferred Stock and Parity Liquidation Securities, if any, when such assets are not sufficient to pay in full the aggregate amounts payable thereon.

Neither a consolidation or merger of the Corporation with or into any other Person or Persons, nor a sale, conveyance, lease, exchange or transfer of all or part of the Corporation's assets for cash, securities or other property to a Person or Persons shall be deemed to be a liquidation, dissolution or winding up of the Corporation for purposes of this Article IV, but the holders of shares of Series A Preferred Stock shall nevertheless be entitled from and after any such consolidation, merger or sale, conveyance, lease, exchange or transfer of all or part of the Corporation's assets to the rights provided by this Article IV following any such transaction. Notice of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, stating the payment date or dates when, and the place or places where, the amounts distributable to each holder of shares of Series A Preferred Stock in such circumstances shall be payable, shall be given by first-class mail, postage prepaid, mailed not less than 45 days prior to any payment date stated therein, to holders of record as they appear on the stock record books of the Corporation as of the date such notices are first mailed.

V. MANDATORY CONVERSION AND REDEMPTION

A. MANDATORY CONVERSION. (a) If the 180-Day Average Price and the related Two-Week Average Price for any 180-Day Reference Period (which Reference Period shall have ended no earlier than the first anniversary of the original issuance of the Series A Preferred Stock and no later than the second anniversary of the original issuance of the Series A Preferred Stock), both exceed 200% of the Conversion Price, then the Corporation shall have the right, at its option and election, to exchange the then-outstanding shares of Series A Preferred Stock for Common Stock as if such then-outstanding shares of Series A Preferred Stock had been converted by the holders thereof pursuant to Article IX hereof on the date of such exchange.

(b) If the 45-Trading Day Average Price and the related Two-Week Average Price for any 45-Trading Day Reference Period (which Reference Period shall have ended no earlier than the second anniversary of the original issuance of the Series A Preferred Stock), both exceed 200% of the Conversion Price, then the Corporation shall have the right, at its option and election, to exchange the then-outstanding shares of Series A Preferred Stock, in whole and not in part, for shares of Common Stock, as if such then-outstanding shares of Series A Preferred Stock had been converted by the holders thereof pursuant to Article IX hereof on the date of such exchange.

(c) Notwithstanding anything in this Section A to the contrary, the Corporation shall not have the right to exchange the Series A Preferred Stock for Common Stock pursuant to this Section A unless (i) the Common Stock shall have been validly listed for trading on the NYSE or other national securities exchange or quoted on a nationally recognized quotation system on each day in the relevant Reference Period and as of the date of such exchange, (ii) the average daily trading volume in the Common Stock during the relevant Reference Period and during the two-week calendar period ending on the last day of the relevant Reference Period is at least 50% of the average daily trading volume in the Common Stock for the 180-day period ending on the date of the Investment Agreement, (iii) the Corporation shall have obtained the Series A
Shareholder Approval, (iv) as of the date of such exchange, the Shelf Registration Statement (as such term is defined in the Registration Rights Agreement) is effective under the Securities Act and is available for use in connection with the offer and sale of such shares of Common Stock by those holders that have such right under the Registration Rights Agreement (it being understood that if a Shelf Suspension (as such term is defined in the Registration Rights Agreement) is in effect, the Shelf Registration Statement shall not be deemed effective or available for use), and (v) the Corporation simultaneously exchanges all of its outstanding Series B Preferred Stock pursuant to subsection (a) or (b) of Section A of Article V of the Certificate of Designations for the Series B Preferred Stock. The Corporation may not effect any such exchange if such exchange would: (a) violate any provision of the certificate of incorporation or the bylaws of the Corporation; (b) conflict with, contravene or result in a breach or violation of any of the terms or provisions of, or constitute a default (with or without notice or the passage of time) under, or result in or give rise to a right of termination, cancellation, acceleration or modification of any right or obligation under, or give rise to a right to put or to compel a tender offer for outstanding securities of the Corporation or any of its Subsidiaries under, or require any consent, waiver or approval under, any note, bond, debt instrument, indenture, mortgage, deed of trust, lease, loan agreement, joint venture agreement, Regulatory Approval, contract or any other agreement, instrument or obligation to which the Corporation or any of its Subsidiaries is a party or by which the Corporation or any of its Subsidiaries or any property of the Corporation or any of its Subsidiaries is bound; (c) result in the creation or imposition of any Lien upon any assets or properties of the Corporation or any of its Subsidiaries; or (d) violate any Law applicable to the Corporation or any of its Subsidiaries.

(d) Notice of an exchange of shares of Series A Preferred Stock pursuant to this Section A (a "NOTICE OF EXCHANGE") shall be sent to the holders of record of the shares of Series A Preferred Stock by first class mail, postage prepaid, at each such holder’s address as it appears on the stock record books of the Corporation, not more than three Business Days subsequent to the last day of the relevant Reference Period. The Notice of Exchange shall set forth the date fixed for the exchange (the "EXCHANGE DATE") and shall set forth in reasonable detail the calculations and supporting data used by the Corporation in its determination that it had the right to effect such exchange. From and after the Exchange Date, all dividends on the shares of Series A Preferred Stock that are exchanged shall cease to accumulate and all rights of the holders thereof as holders of Series A Preferred Stock shall cease and terminate, except if the Corporation shall default in its obligation to deliver shares of Common Stock and cash in lieu of fractional shares to holders on the Exchange Date, in which case all such rights shall continue unless and until such shares are exchanged (or redeemed or converted) in accordance with the terms hereof. Prior to the Exchange Date, each holder shall provide a written notice to the Corporation specifying the name or names in which such holder wishes the certificate or certificates for shares of Common Stock to be issued. If no such notice is delivered, such shares of Common Stock and cash in lieu of fractional shares, if any, shall be delivered to such holder. In case such notice shall specify a name or names other than that of such holder, such notice shall be accompanied by payment of all transfer taxes payable upon the issuance of shares of Common Stock in such name or names. Other than such taxes, the Corporation will pay any and all issue and other taxes (other than taxes based on income) that may be payable in respect of any issue or delivery of shares of Common Stock on exchange of Series A Preferred Stock pursuant to this Section A. On or after the Exchange Date, each holder of shares of Series A Preferred Stock that are to be exchanged shall surrender the certificate evidencing such shares of Series A Preferred Stock to the Corporation at the place designated in the Notice of Exchange. As promptly as practical, and in any event within three Business Days after the Exchange Date, the Corporation shall deliver or cause to be delivered as directed by the holder of shares of Series A Preferred Stock being exchanged (i) certificates representing the number of validly issued, fully paid and nonassessable full shares of Common Stock to which such holder shall be entitled and (ii) cash in lieu of fractional shares, if any, to which such holder shall be entitled. Except as otherwise specified in this Article V, for the purposes hereof, such exchange shall be deemed a conversion effected pursuant to Article IX and the terms and procedures set forth in Article IX shall apply. For such purpose, the applicable Conversion Date shall be the Exchange Date.
In the event the Corporation delivers a Notice of Exchange, the Corporation shall be obligated to effect the exchange described therein, PROVIDED that each of the conditions to such exchange set forth in subsections (a), (b) and (c) above is (i) satisfied or (ii) waived by the holders of a majority of the shares of Series A Preferred Stock then outstanding.

Notwithstanding anything to the contrary in the Registration Rights Agreement, in the event the Corporation effects an exchange pursuant to this Section A, the Corporation shall not exercise its right to declare a Shelf Suspension (as such term is defined in the Registration Rights Agreement) pursuant to Section 2.1(c) of the Registration Rights Agreement during the period beginning on the Exchange Date and ending 90 days after the Exchange Date.

B. MANDATORY REDEMPTION. The Corporation shall not have any right to redeem any shares of Series A Preferred Stock prior to the Mandatory Redemption Date (as defined below). On the tenth anniversary of the original issuance of the Series A Preferred Stock (the "MANDATORY REDEMPTION DATE"), the Corporation shall redeem (the "MANDATORY REDEMPTION") all outstanding shares of Series A Preferred Stock by paying the redemption price therefor in cash out of funds legally available for such purpose. The redemption price for each share of Series A Preferred Stock shall equal the sum of (i) the amount, if any, of all unpaid dividends accumulated thereon to the date of actual payment of the Redemption Price, whether or not such dividends have been declared, and (ii) the Stated Value thereof (such sum, the "REDEMPTION PRICE").

C. NOTICE AND REDEMPTION PROCEDURES. Notice of the redemption of shares of Series A Preferred Stock pursuant to Section B of this Article V (a "NOTICE OF REDEMPTION") shall be sent to the holders of record of the shares of Series A Preferred Stock to be redeemed by first class mail, postage prepaid, at each such holder's address as it appears on the stock record books of the Corporation, not more than 100 nor fewer than 60 days prior to the date fixed for redemption, which date shall be set forth in such notice (the "REDEMPTION DATE"); PROVIDED, HOWEVER, that failure to give such Notice of Redemption to any holder, or any defect in such Notice of Redemption to any holder shall not affect the validity of the proceedings for the redemption of any shares of Series A Preferred Stock held by any other holder. In order to facilitate the redemption of shares of Series A Preferred Stock, the Board of Directors may fix a record date for the determination of the holders of shares of Series A Preferred Stock to be redeemed, in each case, not more than 10 days prior to the date the Notice of Redemption is mailed. On or after the Redemption Date, except with respect to shares of Series A Preferred Stock for which the Conversion Date has occurred on or prior to such Redemption Date, each holder of the shares called for redemption shall surrender the certificate evidencing such shares to the Corporation at the place designated in such notice and thereupon be entitled to receive payment of the Redemption Price. From and after the Redemption Date, all dividends on shares of Series A Preferred Stock shall cease to accumulate and all rights of the holders thereof as holders of Series A Preferred Stock shall cease and terminate, except if the Corporation shall default in payment of the Redemption Price on the Redemption Date in which case all such rights shall continue unless and until such shares are redeemed and such price is paid in accordance with the terms hereof.

D. CHANGE OF CONTROL. In the event there occurs a Change of Control, any holder of record of shares of Series A Preferred Stock, in accordance with the procedures set forth in Section E of this Article V, may require the Corporation to redeem any or all of the shares of Series A Preferred Stock held by such holder in an amount per share equal to the sum of (i) the amount, if any, of all unpaid dividends accumulated thereon to the date of actual payment thereof, whether or not such dividends have been declared, and (ii) 101% of Stated Value (the "CHANGE OF CONTROL PRICE"). By accepting a share of Series A Preferred Stock the holder thereof shall be deemed to have acknowledged and agreed that (a) such holder's right to receive payment of the Change in Control Price is subject and subordinated in right of payment to the payment in full and discharge of all amounts of principal, interest and fees (however denominated) then outstanding under the Credit Agreement and the Senior Subordinated Notes and (b) until payment in full of all such amounts (however denominated) under the Credit Agreement and the Senior Subordinated Notes has
been made in cash, no payment, whether directly or indirectly, by exercise of any right of set off or otherwise in respect of the Change of Control Price shall be made by the Corporation, and, notwithstanding anything to the contrary in Section F of this Article V, no deposit in respect of the Change of Control Price shall be made pursuant to Section F of this Article V. In the event that any payment by, or distribution of the assets of, the Corporation of any kind or character (whether in cash, property or securities, whether directly or indirectly, by exercise of any right of set-off or otherwise and whether as a result of a bankruptcy proceeding with respect to the Corporation or otherwise) shall be received by a holder of Series A Preferred Stock at any time when such payment is prohibited by this paragraph, such payment shall be held in trust for the benefit of, and shall be paid over to, the lenders under the Credit Agreement or the holders of Senior Subordinated Notes, as the case may be, as their interests may appear. The preceding two sentences address the relative rights of holders of Series A Preferred Stock or Debentures, on the one hand, and the lenders under the Credit Agreement or the holders of Senior Subordinated Notes, as the case may be, on the other hand, and nothing in this Certificate of Designations shall impair, as between the Corporation and the holders of Series A Preferred Stock or Debentures, the obligation of the Corporation, which is absolute and unconditional with respect of the Series A Preferred Stock and Debentures in accordance with their terms. Upon a Change of Control, the Corporation shall pay all amounts outstanding under the Credit Agreement and the Indenture to the extent necessary in order to permit the payment of the Change of Control Price hereunder.

E. CHANGE OF CONTROL NOTICE AND REDEMPTION PROCEDURES. Notice of any Change of Control shall be sent to the holders of record of the outstanding shares of Series A Preferred Stock not more than five days following a Change of Control, which notice (a "CHANGE OF CONTROL NOTICE") shall describe the transaction or transactions constituting such Change of Control and set forth each holder's right to require the Corporation to redeem any or all shares of Series A Preferred Stock held by him or her out of funds legally available therefor, the redemption date, which date shall be not less than 30 nor more than 45 days from the date of such Change of Control Notice, (the "CHANGE OF CONTROL REDEMPTION DATE") and the procedures to be followed by such holders in exercising his or her right to cause such redemption; PROVIDED, HOWEVER, that if all of the outstanding shares of Series A Preferred Stock are owned by more than 50 holders or groups of Affiliated holders and if the Series A Preferred Stock is listed on any national securities exchange or quoted on any national quotation system, the Corporation shall give such Change of Control Notice by publication in a newspaper of general circulation in the Borough of Manhattan, The City of New York, within 30 days following such Change of Control and, in any case, a similar notice shall be mailed concurrently to each holder of shares of Series A Preferred Stock. Failure by the Corporation to give the Change of Control Notice as prescribed by the preceding sentence, or the formal insufficiency of any such Change of Control Notice, shall not prejudice the rights of any holder of shares of Series A Preferred Stock to cause the Corporation to redeem any such shares held by him or her. In the event a holder of shares of Series A Preferred Stock shall elect to require the Corporation to redeem any or all such shares of Series A Preferred Stock pursuant to Section D hereof, such holder shall deliver, prior to the Change of Control Redemption Date as set forth in the Change of Control Notice, or, if the Change of Control Notice is not given as required by this Section E, at any time following the last day the Corporation was required to give the Change of Control Notice in accordance with this Section E (in which case the Change of Control Redemption Date shall be the date which is the later of (x) 45 days following the last day the Corporation was required to give the Change of Control Notice in accordance with this Section E and (y) 30 days following the delivery of such election by such holder), a written notice, in the form specified by the Corporation (if the Corporation did in fact give the notice required by this Section E), to the Corporation so stating, and specifying the number of shares to be redeemed pursuant to Section D of this Article V; PROVIDED, HOWEVER, that if all of the outstanding shares of the Series A Preferred Stock are owned by 50 or fewer holders or groups of affiliated holders, such holders or groups
may deliver a notice or an election to redeem at any time within 90 days following the occurrence of a Change of Control without awaiting receipt of a Change of Control Notice or the expiration of the time allowed for the delivery of a Change of Control Notice hereunder. The Corporation shall redeem the number of shares so specified on the Change of Control Redemption Date fixed by the Corporation or as provided in the preceding sentence. The Corporation shall comply with the requirements of Rules 13e-4 and 14e-1 under the Exchange Act and any other securities laws and regulations thereunder to the extent such laws and regulations are applicable in connection with the repurchase of the shares of Series A Preferred Stock as a result of a Change of Control. From and after the time the Change of Control Redemption Price is paid in accordance with the terms hereof with respect to any share of Series A Preferred Stock, all dividends on such share of Series A Preferred Stock shall cease to accumulate and all rights of the holder thereof as a holder of Series A Preferred Stock shall cease and terminate.

F. DEPOSIT OF FUNDS. The Corporation shall, no later than 11:00 a.m., New York City time, on any Redemption Date or Change of Control Redemption Date pursuant to this Article V, deposit with its transfer agent or other redemption agent in the Borough of Manhattan, The City of New York having a capital and surplus of at least $500,000,000, as a trust fund for the benefit of the holders of the shares of Series A Preferred Stock to be redeemed, cash that is sufficient in amount to redeem the shares to be redeemed in accordance with the Notice of Redemption or Change of Control Notice, with irrevocable instructions and authority to such transfer agent or other redemption agent to pay to the respective holders of such shares, as evidenced by a list of such holders certified by an officer of the Corporation, the Redemption Price or Change of Control Redemption Price, as the case may be, upon surrender of their respective share certificates. Such deposit shall be deemed to constitute full payment of such shares to the holders, and from and after the date of such deposit, all rights of the holders of the shares of Series A Preferred Stock that are to be redeemed as stockholders of the Corporation with respect to such shares, except the right to receive the Redemption Price upon the surrender of their respective certificates and all rights under Articles IX and XI hereof, shall cease and terminate. In case holders of any shares of Series A Preferred Stock called for redemption shall not, within two years after such deposit, claim the cash deposited for redemption thereof, such transfer agent or other redemption agent shall, upon demand, pay over to the Corporation the balance so deposited. Thereupon, such transfer agent or other redemption agent shall be relieved of all responsibility to the holders thereof and the sole right of such holders, with respect to shares to be redeemed, shall be to receive the Redemption Price as general creditors of the Corporation. Any interest accrued on any funds so deposited shall belong to the Corporation, and shall be paid to it from time to time on demand.

VI. EXCHANGE OF SERIES A PREFERRED STOCK FOR DEBENTURES

A. After the Option has been exercised or has expired or is no longer exercisable in whole or in part, the Series A Preferred Stock shall be exchangeable at the option of the Corporation and to the extent permitted by applicable law and the terms of the instruments governing the Corporation's then-outstanding Indebtedness, in whole but not in part, on any Dividend Payment Date for unsecured Junior Subordinated Convertible Debentures (issued pursuant to an indenture (the "SERIES A INDENTURE") prepared in accordance with the Investment Agreement), in principal amount of $1,000 per share of Series A Preferred Stock (a "DEBENTURE" and, collectively, the "DEBENTURES"), in accordance with this Article VI:

(i) Each share of Series A Preferred Stock shall be exchangeable at the offices of the Corporation and at such other place or places, if any, as the Board of Directors may designate. Except with the prior written consent of the holders of all outstanding shares of Series A Preferred Stock, the Corporation may not exchange any shares of Series A Preferred Stock if (a) full cumulative dividends through the date of exchange have not been paid, accrued or set aside for payment on all outstanding shares of the Series A Preferred Stock, (b) the Corporation has failed to amend its Certificate of Incorporation in accordance with Delaware law to confer the power to vote upon holders of the Debentures as shall be contemplated by the
(ii) Prior to giving notice of its intention to exchange, the Corporation shall execute and deliver to a bank or trust company and, if required by applicable law, qualify under the Trust Indenture Act of 1939, as amended, the Series A Indenture.

(iii) The Corporation shall mail written notice of its intention to exchange Series A Preferred Stock for Debentures (the "EXCHANGE NOTICE") to each holder of record of shares of Series A Preferred Stock not less than 60 nor more than 100 days prior to the date fixed for exchange. The Exchange Notice shall notify holders of their right to deliver an Objection Notice (as defined below) pursuant to Section B of this Article VI.

(iv) Prior to effecting any exchange provided above, the Corporation shall deliver to each holder of shares of Series A Preferred Stock an opinion of nationally recognized legal counsel to the effect that: (a) each of the Series A Indenture and the Debentures have been duly authorized and executed by the Corporation and, when delivered by the Corporation in exchange for shares of Series A Preferred Stock, will constitute valid and legally binding obligations of the Corporation enforceable against the Corporation in accordance with their terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights generally and to general principles of equity; (b) the exchange of the Debentures for the shares of Series A Preferred Stock will not violate the provisions of this Article VI or of the Delaware General Corporation Law, including Section 221 thereof; and (c) the exchange of the Debentures for the shares of Series A Preferred Stock is exempt from the registration requirements of the Securities Act or that the exchange of such Debentures has been duly registered under the Securities Act.

(v) The Corporation may not effect any exchange provided above if such exchange would: (a) violate any provision of the certificate of incorporation or the bylaws of the Corporation; (b) conflict with, contravene or result in a breach or violation of any of the terms or provisions of, or constitute a default (with or without notice or the passage of time) under, or result in or give rise to a right of termination, cancellation, acceleration or modification of any right or obligation under, or give rise to a right to put or to compel a tender offer for outstanding securities of the Corporation or any of its Subsidiaries under, or require any consent, waiver or approval that has not been obtained or granted under, any note, bond, debt instrument, indenture, mortgage, deed of trust, lease, loan agreement, joint venture agreement, Regulatory Approval, contract or any other agreement, instrument or obligation to which the Corporation or any of its Subsidiaries is a party or by which the Corporation or any of its Subsidiaries or any property of the Corporation or any of its Subsidiaries is bound; (c) result in the creation or imposition of any Lien upon any assets or properties of the Corporation or any of its Subsidiaries; or (d) violate any Law applicable to the Corporation or any of its Subsidiaries;

(vi) Upon the exchange of shares of Series A Preferred Stock for Debentures, the rights of the holders of shares of Series A Preferred Stock as stockholders of the Corporation shall terminate and such shares shall no longer be deemed outstanding; and

(vii) Before any holder of shares of Series A Preferred Stock shall be entitled to receive Debentures, such holder shall surrender the certificate or certificates therefor, at the office of the Corporation or at such other place or places, if any, as the Board of Directors shall have designated, and shall state in writing the name or names (with addresses) in which he or she wishes the certificate or certificates for the Debentures to be issued. The Corporation will, as soon as practicable thereafter, issue and deliver at said office or place to such holder of shares of Series A Preferred Stock, or to his or her nominee or nominees, certificates for the Debentures to which he
or she shall be entitled as aforesaid. Shares of Series A Preferred Stock shall be deemed to have been exchanged as of the close of business on the date fixed for exchange as provided above, and the Person or Persons entitled to receive the Debentures issuable upon such exchange shall be treated for all purposes (including the accrual and payment of interest) as the record holder or holders of such Debentures as of the close of business on such date.

B. For purposes of clause (c) of paragraph (i) of Section A of this Article VI, an exchange of shares of Series A Preferred Stock shall be deemed to be an exchange that could result in a tax consequence to any holder which is materially adverse only if such holder shall have delivered to the Corporation a written notice to such effect on or before the fifteenth day after its receipt of the Exchange Notice (an "OBJECTION NOTICE"), which Objection Notice shall specify in reasonable detail the nature of such tax consequence which could result from the exchange. If the Corporation receives an Objection Notice, then the Corporation shall not exchange the shares of Series A Preferred Stock to which it mailed the Exchange Notice, and within 15 days after its receipt of the Objection Notice mail written notice to the effect that it is canceling the proposed exchange of shares of Series A Preferred Stock to each holder of record of shares of Series A Preferred Stock to which it mailed the Exchange Notice. Notwithstanding the foregoing, if the Corporation, based on the advice of nationally recognized tax counsel, believes that the tax consequences described in an Objection Notice are incorrect, the Corporation may contact the holder who delivered such notice to discuss the tax consequences described therein. If such holder withdraws such notice within 15 days of its delivery, the Corporation shall be permitted to consummate the proposed exchange.

VII. RESTRICTIONS ON DIVIDENDS

So long as any shares of the Series A Preferred Stock are outstanding, the Board of Directors shall not declare, and the Corporation shall not pay or set apart for payment any dividend on any Junior Securities or Parity Securities or make any payment on account of, or set apart for payment money for a sinking or other similar fund for, the repurchase, redemption or other retirement of, any Junior Securities or Parity Securities or any warrants, rights or options exercisable for or convertible into any Junior Securities or Parity Securities (other than the securities that are convertible or exchangeable into any Junior Securities or Parity Securities), or make any distribution in respect of the Junior Securities or Parity Securities, either directly or indirectly, and whether in cash, obligations or shares of the Corporation or other property (other than distributions or dividends in Junior Securities to the holders of Junior Securities), and shall not permit any Person directly or indirectly controlled by the Corporation to purchase or redeem any Junior Securities or Parity Securities or any warrants, rights, calls or options exercisable for or convertible into any Junior Securities or Parity Securities (other than the repurchase, redemption or other retirement of debentures or other debt securities that are convertible or exchangeable into any Junior Securities or Parity Securities) unless prior to or concurrently with such declaration, payment, setting apart for payment, repurchase, redemption or other retirement or distribution, the case may be, all accumulated and unpaid dividends on shares of the Series A Preferred Stock not paid on the dates provided for in Section A of Article III hereof (including Arrearages and accumulated dividends thereon and regardless of whether the Corporation shall have had the right to elect to defer such payments as provided for in Article III hereof) shall have been paid, except that when dividends are not paid in full as aforesaid upon the shares of Series A Preferred Stock, all dividends declared on the Series A Preferred Stock and any series of Parity Dividend Securities shall be declared and paid pro rata so that the amount of dividends so declared and paid on Series A Preferred Stock and such series of Parity Dividend Securities shall in all cases bear to each other the same ratio that accumulated dividends (including interest accrued on or additional dividends accumulated in respect of such accumulated dividends) on the shares of Series A Preferred Stock and such Parity Dividend Securities bear to each other. Notwithstanding the foregoing, this paragraph shall not prohibit (i) the acquisition, repurchase, exchange, conversion, redemption or other retirement for value of shares of Series A Preferred Stock or any Parity Dividend Security by the Corporation in accordance with the terms of such securities or (ii) the acquisition, repurchase, exchange,
conversion, redemption or other retirement for value by the Corporation of any Junior Dividend Securities by the Corporation in accordance with obligations in existence at the time of original issuance of the Series A Preferred Stock.

VIII. VOTING RIGHTS

A. The holders of shares of Series A Preferred Stock shall have no voting rights except as set forth below or as otherwise from time to time required by law.

B. So long as any shares of the Series A Preferred Stock are outstanding, each share of Series A Preferred Stock shall entitle the holder thereof to vote on all matters voted on by holders of Common Stock, and the shares of Series A Preferred Stock shall vote together with shares of Common Stock (and any shares of Series B Preferred Stock entitled to vote) as a single class. With respect to any such vote, each share of Series A Preferred Stock shall entitle its holder to a number of votes equal to the number of shares of Common Stock into which such share of Series A Preferred Stock is convertible at the time of the record date with respect to such vote (assuming all conditions precedent to such conversion have been satisfied and that such conversion had occurred as of the record date for such vote, PROVIDED, that if the Series A Shareholder Approval has not been obtained as of such record date, it shall not be assumed that the Series A Shareholder Approval had been obtained as of such record date). Notwithstanding the foregoing, holders of shares of Series A Preferred Stock shall not be entitled to vote with the holders of Common Stock on any proposal related to the approval of the issuance of shares of Common Stock in payment of dividends on the Series A Preferred Stock or upon the issuance of Common Stock with respect to Arrearages upon the conversion of the Series A Preferred Stock into shares of Common Stock.

C. If on any date (i) dividends payable on the Series A Preferred Stock or Series B Preferred Stock shall not have been paid in full when required pursuant to the terms hereof or (ii) the Corporation shall have failed to satisfy its obligation to redeem shares of Series A Preferred Stock or Series B Preferred Stock pursuant to the terms of the relevant Certificate of Designations (provided, that for the purpose of this Section C, any obligation of the Corporation to repurchase shares of Series B Preferred Stock or make a Make-Whole Payment pursuant to Section G of Article V of the Certificate of Designations with respect to the Series B Preferred Stock, shall not be considered an obligation to redeem such shares), then the number of directors constituting the Board of Directors shall, without further action, be increased by two, or if the requisite increase in the number of directors constituting the Board of Directors would require the approval of the Corporation’s stockholders or is prohibited by the Investment Agreement, then the number of directors constituting the Board of Directors shall be increased to the extent the approval of the Corporation’s stockholders is not required and the Investment Agreement would not be breached and a number of directors (other than Investor Nominees) shall resign from the Board of Directors so that the holders of shares of Series A Preferred Stock and, if then entitled to vote with respect to such matters, the holders of shares of Series B Preferred Stock, voting together as a single class without regard to series, may elect two directors to the Board of Directors, and the holders of a majority of the outstanding shares of Series A Preferred Stock and any shares of Series B Preferred Stock entitled to vote with respect to such matters, voting together as a single class without regard to series, shall have, in addition to the other voting rights set forth herein, the exclusive right to elect two directors (the “ADDITIONAL DIRECTORS”) of the Corporation to fill such newly-created or vacated directorships. Additional Directors shall continue as directors and such additional voting right shall continue until such time as (a) all dividends accumulated on the Series A Preferred Stock and Series B Preferred Stock shall have been paid in full as required pursuant to the terms hereof or (b) any redemption obligation with respect to the Series A Preferred Stock or Series B Preferred Stock that has become due shall have been satisfied or all necessary funds shall have been set aside for payment, as the case may be, at which time such Additional Directors shall cease to be directors and such additional voting right of the holders of shares of Series A Preferred Stock and Series B Preferred Stock shall terminate subject to revesting in the event of each and every subsequent event of the character indicated above.

D. So long as members of the Investor Group Beneficially Own a
majority of the outstanding shares of Series A Preferred Stock and Series B Preferred Stock, if any default or event of default has occurred and is continuing under any contract, agreement, indenture, mortgage, note, lease or other instrument evidencing Indebtedness of the Corporation or any of its Subsidiaries (other than inter-company Indebtedness between the Corporation and any of its Subsidiaries or between Subsidiaries of the Corporation) the outstanding principal amount of which is in excess of $10,000,000, and as a result of such default or event of default the holders thereof have accelerated or have the right to accelerate the maturity thereof, and such default, event of default or event is not cured or waived within 75 days of the occurrence thereof, then the number of directors constituting the Board of Directors shall, upon the request of members of the Investor Group who Beneficially Own a majority of the outstanding shares of Series A Preferred Stock and Series B Preferred Stock then Beneficially Owned by members of the Investor Group delivered to the Corporation in writing, be increased by that number that is necessary to enable the Investor Group to designate a majority of the members of the Board of Directors (including the Investor Nominees), or if such requisite increase in the number of directors constituting the Board of Directors would require the approval of the Corporation's stockholders or is prohibited by the Investment Agreement, then the number of directors constituting the Board of Directors shall be increased to the extent the approval of the Corporation's stockholders is not required and the Investment Agreement would not be breached and a number of directors (other than Investor Nominees) shall resign from the Board of Directors so as to enable the Investor Group to designate a majority of the Board of Directors (including the Investor Nominees), and the holders of a majority of the outstanding shares of Series A Preferred Stock then held by the Investor Group and any shares of Series B Preferred Stock entitled to vote with respect to such matters then held by the Investor Group, voting together as a single class without regard to series, shall have, in addition to the other voting rights set forth herein, the exclusive right, voting separately as a class, to elect that number of directors (the "MAJORITY DIRECTORS") of the Corporation necessary to fill such newly-created or vacated directorships. Majority Directors shall continue as directors and such additional voting right shall continue until such time as such default, event of default or event is cured, at which time such Majority Directors shall cease to be directors and such additional voting right of the Series A Preferred Stock and Series B Preferred Stock shall terminate subject to re vesting in the event of each and every subsequent event of the character indicated above.

E. So long as the Investor or any of its Affiliates Beneficially Owns any shares of Series A Preferred Stock, in the event that one or more of the Investor Nominees required to be designated for election to the Board of Directors pursuant to the Investment Agreement are not so designated or are not elected to the Board of Directors, then the number of directors constituting the Board of Directors shall, without further action, be increased by the number of such Investor Nominees not elected to the Board of Directors pursuant to the Investment Agreement, or if such requisite increase in the number of directors constituting the Board of Directors would require the approval of the Corporation's stockholders or is prohibited by the Investment Agreement, then the number of directors constituting the Board of Directors shall be increased to the extent the approval of the Corporation's stockholders is not required and the Investment Agreement would not be breached and a number of directors (other than Investment Nominees) shall resign from the Board of Directors, so as to enable the Investor and its Affiliates to designate as directors the number of Investor Nominees not elected to the Board of Directors pursuant to the Investment Agreement, and the Investor and its Affiliates shall have, in addition to the other voting rights set forth herein, the exclusive right, voting separately as a single class, to elect a number of directors to the Board of Directors equal to the number of such Investor Nominees not elected to the Board of Directors. Directors elected pursuant to this Section E shall continue as directors and such additional voting right shall continue until such time as the requisite number of Investor Nominees are elected to the Board of Directors pursuant to the Investment Agreement, at which time the directors elected by the Investor and its Affiliates would continue as directors and such additional voting right shall continue until such time as the requisite number of Investor Nominees are elected to the Board of Directors.
pursuant to this Section E shall cease to be directors (unless elected as Investor Nominees), and such additional voting rights shall terminate subject to revesting in the event of each and every subsequent event of the character indicated above.

F. (a) The foregoing rights of holders of shares of Series A Preferred Stock to take any action as provided in this Article VIII may be exercised at any annual meeting of stockholders or at a special meeting of stockholders held for any purpose as hereinafter provided or at any adjournment thereof, or by the written consent, delivered to the Secretary of the Corporation, of the holders of the minimum number of shares required to take such action. So long as such right to vote continues (and unless such right has been exercised by written consent of the minimum number of shares required to take such action), the Chairman of the Board of Directors may call, and upon the written request of holders of record of 25% of the outstanding shares of Series A Preferred Stock, addressed to the Secretary of the Corporation at the principal office of the Corporation, shall call, a special meeting of the holders of shares entitled to vote as provided herein. Such meeting shall be held as soon as reasonably practicable after delivery of such request to the Secretary, at the place and upon the notice provided by law and in the Bylaws for the holding of meetings of stockholders.

(b) Each director elected pursuant to Section C, D or E hereof shall serve until the next annual meeting or until his or her successor shall be elected and shall qualify, unless the director's term of office shall have terminated pursuant to the provisions of Section C, D or E hereof, as the case may be. In case any vacancy shall occur among the directors elected pursuant to Section C, D or E hereof, such vacancy shall be filled for the unexpired portion of the term by vote of the remaining director or directors theretofore elected pursuant to the same Section (or such director's or directors' successor in office), if any. If any such vacancy is not so filled within 20 days after the creation thereof or if all of the directors so elected shall cease to serve as directors before their term shall expire, the holders of the shares of Series A Preferred Stock then outstanding and entitled to vote for such director pursuant to the provisions of Section C, D or E hereof, as the case may be, may elect successors to hold office for the unexpired terms of any vacant directorships, by written consent as provided herein, or at a special meeting of such holders called as provided herein. The holders of a majority of the shares entitled to vote for directors pursuant to Section C, D or E hereof, as the case may be, shall have the right to remove with or without cause at any time and replace any directors such holders have elected pursuant to such section, by written consent as herein provided, or at a special meeting of such holders called as provided herein.

G. Without the consent or affirmative vote of the holders of at least sixty-seven percent (67%) of the outstanding shares of Series A Preferred Stock, voting separately as a class, the Corporation shall not: (i) authorize, create or issue, or increase the authorized amount of, (a) any Senior Securities or (b) any class or series of capital stock or any security convertible into or exercisable for any class or series of capital stock, that is redeemable mandatorily or redeemable at the option of the holder thereof at any time on or prior to the Mandatory Redemption Date (whether or not only upon the occurrence of a specified event); (ii) amend, alter or repeal any provision of the Certificate of Incorporation or the Bylaws, if the amendment, alteration or repeal alters or changes the powers, preferences or special rights of the Series A Preferred Stock so as to affect them adversely; or (iii) authorize or take any other action if such action alters or changes any of the rights of the Series A Preferred Stock in any respect or otherwise would be inconsistent with the provisions of this Certificate of Designations and the holders of any class or series of the capital stock of the Corporation is entitled to vote thereon.

H. OTHER SECURITIES. The Corporation shall not, from and after the date of the original issuance of the Series A Preferred Stock, enter into any agreement, amend or modify any existing agreement or obligation, or issue any security that prohibits, conflicts with or is inconsistent with, or would be breached by, the Corporation's performance of its obligations hereunder.

IX. CONVERSION
A. CONVERSION. (a) At the option and election of the holder thereof, each share of Series A Preferred Stock, including all unpaid dividends accumulated thereon to the Conversion Date (as defined below), whether or not such dividends have been declared, may be converted in the manner provided herein at any time into fully paid and nonassessable shares of Common Stock. As of the Conversion Date with respect to a share of Series A Preferred Stock, subject to subsections (d) and (e) of this Section A, such share shall be converted into that number (the "CONVERSION NUMBER") of shares of Common Stock equal to the quotient of (i) the sum of (A) the Stated Value plus (B) all unpaid dividends accumulated on such share of Series A Preferred Stock to the Conversion Date whether or not such dividends have been declared, divided by (ii) the Conversion Price in effect on the Conversion Date.

(b) Conversion of shares of the Series A Preferred Stock may be effected by any holder thereof upon the surrender to the Corporation at the principal office of the Corporation or at the office of any agent or agents of the Corporation, as may be designated by the Board of Directors of the Corporation in the discretion of the Corporation, of the certificate for such shares of Series A Preferred Stock to be converted accompanied by a written notice stating that such holder elects to convert all or a specified whole number of shares represented by such certificate in accordance with the provisions of this Section A and specifying the name or names in which such holder wishes the certificate or certificates for shares of Common Stock to be issued. In case such notice shall specify a name or names other than that of such holder, such notice shall be accompanied by payment of all transfer taxes payable upon the issuance of shares of Common Stock in such name or names. Other than such taxes, the Corporation will pay any and all issue and other taxes (other than taxes based on income) that may be payable in respect of any issue or delivery of shares of Common Stock on conversion of Series A Preferred Stock pursuant hereto. As promptly as practical, and in any event within three Business Days after the Conversion Date, the Corporation shall deliver or cause to be delivered as directed by the holder of shares of Series A Preferred Stock being converted (i) certificates representing the number of validly issued, fully paid and nonassessable full shares of Common Stock to which such holder shall be entitled to, (ii) any cash that is required to be paid pursuant to subsection (c) of this Section A, (iii) certificates representing any shares of Series B Preferred Stock that are evidenced by the surrendered certificate or certificates is being converted, a new certificate or certificates, of like tenor, for the number of shares of Series A Preferred Stock evidenced by such surrendered certificate or certificates less the number of shares of Series A Preferred Stock being converted. Such conversion shall be deemed to have occurred at the close of business on the date (the "CONVERSION DATE") of the giving of such notice by the holder of the Series A Preferred Stock to be converted and of such surrender of the certificate or certificates representing the shares of Series A Preferred Stock to be converted so that as of such time the rights of the holder thereof as to the shares being converted shall cease except for the right to receive shares of Common Stock, shares of Series B Preferred Stock and/or cash in accordance herewith, and the person entitled to receive the shares of Common Stock and/or shares of Series B Preferred Stock issued as a result of such conversion shall be treated for all purposes as having become the holder of such shares of Common Stock and/or shares of Series B Preferred Stock at such time.

(c) In the event that the Series A Preferred Stock is to be redeemed pursuant to Article V hereof, from and after the Redemption Date, the right of a holder to convert shares of Series A Preferred Stock pursuant to this Section A shall cease and terminate, except if the Corporation shall default in payment of the Redemption Price on the Redemption Date in which case all such rights shall continue unless and until such shares are redeemed and such price is paid in full in accordance with the terms hereof. Notwithstanding anything in the foregoing to the contrary, if the Conversion Date shall occur with respect to any shares of Series A Preferred Stock on or prior to any Redemption Date, such shares of Series A Preferred Stock shall be converted by the Corporation into Common Stock in the manner provided in this Section A.

(d) In connection with the conversion of any shares of Series A Preferred Stock, no fractions of shares of Common Stock shall be issued, but in lieu thereof the Corporation shall pay a cash adjustment in respect of such fractional interest in an amount equal to such fractional
interest multiplied by the Closing Price per share of Common Stock on the Conversion Date (or on the Trading Day immediately preceding the Conversion Date, if the Conversion Date is not a Trading Day). If more than one share of Series A Preferred Stock shall be surrendered for conversion by the same holder on the Conversion Date, the number of full shares of Common Stock issuable on conversion thereof shall be computed on the basis of the total number of shares of Series A Preferred Stock so surrendered.

(e) Notwithstanding anything in the foregoing to the contrary, in the event that a Conversion Date with respect to a share of Series A Preferred Stock occurs prior to the date on which the Series A Shareholder Approval is obtained, as of such Conversion Date, subject to subsection (d) of this Section A, such share shall be converted into that number of shares of Common Stock equal to the quotient of (i) the Stated Amount thereof, divided by (ii) the Conversion Price in effect on the Conversion Date, and upon delivery of such shares in accordance with the terms hereof, the Corporation shall pay in cash all accrued and unpaid dividends on such share as directed by the holder thereof; PROVIDED, HOWEVER, that if, as of such Conversion Date, the Corporation is prohibited by the terms of the Credit Agreement (as in effect on the date of the Investment Agreement or any Credit Agreement containing restrictions regarding such payments that are no more restrictive that those in effect on the date of the Investment Agreement) or the Indenture (as in effect on the date of the Investment Agreement or any Indenture containing restrictions regarding such payments that are no more restrictive that those in effect on the date of the Investment Agreement) from paying such accrued and unpaid dividends in cash as required pursuant to this sentence, in satisfaction of such accrued and unpaid dividends and in lieu of such cash payment, the Corporation may deliver shares of Series B Preferred Stock having an aggregate stated value equal to the aggregate amount of such accrued and unpaid dividends. Until the Series A Shareholder Approval is obtained, the Corporation shall not (A) utilize amounts available under Section 6.06(a)(ii) of the Credit Agreement (or any comparable provision of the Credit Agreement) for any purpose except to pay dividends in respect of the Series A Preferred Stock in cash as required pursuant to this subsection (e) or to make payments with respect to the Series B Preferred Stock, or (B) amend the Credit Agreement in any manner so as to reduce the amounts available to pay dividends in respect of the Series A Preferred Stock in cash under Section 6.06(a)(ii) of the Credit Agreement (or any comparable provision of the Credit Agreement). Notwithstanding the foregoing, this paragraph shall not prohibit (i) the acquisition, repurchase, exchange, conversion, redemption or other retirement for value of shares of Series A Preferred Stock or any Parity Dividend Security by the Corporation in accordance with the terms of such securities, (ii) purchases of Equity Securities of the Corporation or any of its Subsidiaries from executives and other management-level employees of the Corporation or any of its Subsidiaries in connection with customary employment and severance arrangements, or (iii) the acquisition, repurchase, exchange, conversion, redemption or other retirement for value by the Corporation of any Junior Dividend Securities by the Corporation in accordance with obligations in existence at the time of original issuance of the Series A Preferred Stock.

(f) The Corporation shall at all times reserve and keep available for issuance upon the conversion of the Series A Preferred Stock in accordance with the terms hereof, such number of its authorized but unissued shares of Common Stock as will from time to time be sufficient to permit the conversion of all outstanding shares of Series A Preferred Stock, and shall take all action required to increase the authorized number of shares of Common Stock if necessary to permit the conversion of all outstanding shares of Series A Preferred Stock.

B. ADJUSTMENT OF CONVERSION PRICE. Except in connection with an Organic Change, which shall be subject to Section C below, the Conversion Price shall be subject to adjustment from time to time as follows:

(a) STOCK DIVIDENDS. In case the Corporation after the date of the original issuance of the Series A Preferred Stock shall pay a dividend or make a distribution to all holders of shares of Common Stock in shares of Common Stock, then in any such case the Conversion Price in effect at the opening of business on the day following the record date for the determination of stockholders entitled to receive such dividend or distribution shall be reduced
to a price obtained by multiplying such Conversion Price by a fraction of which
(x) the numerator shall be the number of shares of Common Stock outstanding at
the close of business on such record date and (y) the denominator shall be the
sum of such number of shares of Common Stock outstanding and the total number of
shares of Common Stock constituting such dividend or distribution, such
reduction to become effective immediately after the opening of business on the
day following such record date. For purposes of this subsection (a), the number
of shares of Common Stock at any time outstanding shall not include shares held
in the treasury of the Corporation but shall include shares issuable in respect of
scrip certificates issued in lieu of fractions of shares of Common Stock. The
Corporation will not pay any dividend or make any distribution on shares of
Common Stock held in the treasury of the Corporation.

(b) STOCK SPLITS AND REVERSE SPLITS. In case after the date
of the original issuance of the Series A Preferred Stock outstanding shares of
Common Stock shall be subdivided into a greater number of shares of Common
Stock, the Conversion Price in effect at the opening of business on the day
following the day upon which such subdivision becomes effective shall be

proportionately reduced, and, conversely, in case after the original issuance of
the Series A Preferred Stock outstanding shares of Common Stock shall be
combined into a smaller number of shares of Common Stock, the Conversion Price
in effect at the opening of business on the day following the day upon which
such combination becomes effective shall be proportionately increased, such
reduction or increase, as the case may be, to become effective immediately after
the opening of business on the day following the day upon which such subdivision
or combination becomes effective.

(c) ISSUANCES BELOW MARKET. In case the Corporation after
the date of the original issuance of the Series A Preferred Stock shall issue
rights or warrants to holders of shares of Common Stock entitling them to
subscribe for or purchase shares of Common Stock at a price per share less than
the Closing Price per share on the record date for the determination of
stockholders entitled to receive such rights or warrants, the Conversion Price
in effect at the opening of business on the day following such record date shall
be adjusted to a price obtained by multiplying such Conversion Price by a
fraction of which (x) the numerator shall be the number of shares of Common
Stock outstanding at the close of business on such record date PLUS the number
of shares of Common Stock that the aggregate offering price of the total number
of shares so to be offered would purchase at such Closing Price and (y) the
denominator shall be the number of shares of Common Stock outstanding at the
close of business on such record date PLUS the number of additional shares of
Common Stock so to be offered would purchase at such Closing Price and (y) the
denominator shall be the number of shares of Common Stock outstanding at the
close of business on such record date PLUS the number of additional shares of
Common Stock so to be offered would purchase at such Closing Price and (y) the
denominator shall be the number of shares of Common Stock outstanding at the
close of business on such record date PLUS the number of additional shares of
Common Stock so to be offered would purchase at such Closing Price and (y) the
denominator shall be the number of shares of Common Stock outstanding at the
close of business on such record date PLUS the number of additional shares of
Common Stock so to be offered would purchase at such Closing Price and (y) the
denominator shall be the number of shares of Common Stock outstanding at the
close of business on such record date PLUS the number of additional shares of
Common Stock so to be offered would purchase at such Closing Price and (y) the
denominator shall be the number of shares of Common Stock outstanding at the
close of business on such record date PLUS the number of additional shares of
Common Stock so to be offered would purchase at such Closing Price and (y) the
denominator shall be the number of shares of Common Stock outstanding at the
close of business on such record date PLUS the number of additional shares of
Common Stock so to be offered would purchase at such Closing Price and (y) the
denominator shall be the number of shares of Common Stock outstanding at the
close of business on such record date PLUS the number of additional shares of
Common Stock so to be offered would purchase at such Closing Price and (y) the
denominator shall be the number of shares of Common Stock outstanding at the
close of business on such record date PLUS the number of additional shares of
Common Stock so to be offered would purchase at such Closing Price and (y) the
denominator shall be the number of shares of Common Stock outstanding at the

Provided, however, that no adjustment shall be made if the
Corporation issues or distributes to each holder of Series A Preferred Stock the
rights or warrants that each such holder would have been entitled to receive had
the Series A Preferred Stock held by such holder been converted prior to such
record date. For purposes of this subsection (c), the number of shares of Common
Stock at any time outstanding shall not include shares held in the treasury of the
Corporation but shall include shares issuable in respect of scrip
certificates issued in lieu of fractions of shares of Common Stock. The
Corporation shall not issue any rights or warrants in respect of shares of
Common Stock held in the treasury of the Corporation. Rights or warrants issued
by the Corporation to all holders of Common Stock entitling the holders thereof
to subscribe for or purchase Equity Securities, which rights or warrants (i) are
deemed to be transferred with such shares of Common Stock, (ii) are not
exercisable and (iii) are also issued in respect of future issuances of Common
Stock, including shares of Common Stock issued upon conversion of shares of
Series A Preferred Stock, in each case in clauses (i) through (iii) until the
occurrence of a specified event or events (a "TRIGGER EVENT"), shall for
purposes of this subsection (c) not be deemed issued until the occurrence of the
earliest Trigger Event.

(d) SPECIAL DIVIDENDS. In case the Corporation after the
date of the original issuance of the Series A Preferred Stock shall distribute
to all holders of Common Stock evidences of its indebtedness or assets
(excluding any regular periodic cash dividend but including any extraordinary
cash dividend), Equity Securities (other than Common Stock) or rights to
subscribe (excluding those referred to in subsection (c) above) for Equity
Securities other than Common Stock, in each such case the Conversion Price in
the Board of Directors in its good faith judgment) of the portion of assets or evidences of indebtedness or Equity Securities or subscription rights so distributed applicable to one share of Common Stock, and (y) the denominator shall be such Closing Price, such adjustment to become effective immediately prior to the opening of business on the day following such record date; PROVIDED, HOWEVER, that no adjustment shall be made (1) if the Corporation issues or distributes to each holder of Series A Preferred Stock the subscription rights referred to above that each such holder would have been entitled to receive had the Series A Preferred Stock held by such holder been converted prior to such record date or (2) if the Corporation grants to each such holder the right to receive, upon the conversion of the Series A Preferred Stock held by such holder at any time after the distribution of the evidences of indebtedness or assets or Equity Securities referred to above, the evidences of indebtedness or assets or Equity Securities that such holder would have been entitled to receive had such Series A Preferred Stock been converted prior to such record date. The Corporation shall provide any holder of Series A Preferred Stock, upon receipt of a written request therefor, with any indenture or other instrument defining the rights of the holders of any indebtedness, assets, subscription rights or Equity Securities referred to in this subsection (d). Rights or warrants issued by the Corporation to all holders of Common Stock entitling the holders thereof to subscribe for or purchase Equity Securities, which rights or warrants (i) are deemed to be transferred with such shares of Common Stock, (ii) are not exercisable and (iii) are also issued in respect of future issuances of Common Stock, including shares of Common Stock issued upon conversion of shares of Series A Preferred Stock, in each case in clauses (i) through (iii) until the occurrence of a Trigger Event, shall for purposes of this subsection (d) not be deemed issued until the occurrence of the earliest Trigger Event.

(e) TENDER OR EXCHANGE OFFER. In case, after the date of the original issuance of the Series A Preferred Stock, a tender or exchange offer made by the Corporation or any subsidiary of the Corporation for all or any portion of the Common Stock shall be consummated and such tender offer shall involve an aggregate consideration having a fair market value (as determined by the Board of Directors in its good faith judgment) at the last time (the "OFFER TIME") tenders may be made pursuant to such tender or exchange offer (as it may be amended) that, together with the aggregate of the cash plus the fair market value (as determined by the Board of Directors in its good faith judgment), as of the Offer Time, of consideration payable in respect of any tender or exchange offer by the Corporation or any such subsidiary for all or any portion of the Common Stock consummated preceding the Offer Time and in respect of which no Conversion Price adjustment pursuant to this subsection (e) has been made, exceeds 5% of the product of the Closing Price of the Common Stock at the Offer Time multiplied by the number of shares of Common Stock outstanding (including any tendered shares) at the Offer Time, the Conversion Price shall be reduced so that the same shall equal the price determined by multiplying the Conversion Price in effect immediately prior to the Offer Time by a fraction of which (x) the numerator shall be (i) the product of the Closing Price of the Common Stock at the Offer Time multiplied by the number of shares of Common Stock outstanding (including any tendered shares) at the Offer Time minus (ii) the fair market value (determined as aforesaid) of the aggregate consideration payable to stockholders based on the acceptance (up to any maximum specified in the terms of the tender or exchange offer) of all shares validly tendered and not withdrawn as of the Offer Time (the shares deemed so accepted, up to any such maximum, being referred to as the "PURCHASED Shares") and (y) the denominator shall be the product of (i) such Closing Price at the Offer Time multiplied by (ii) such number of outstanding shares at the Offer Time minus the number of Purchased Shares, such reduction to become effective immediately prior to the opening of business on the day...
following the Offer Time. For purposes of this subsection (e), the number of shares of Common Stock at any time outstanding shall not include shares held in the treasury of the Corporation but shall include shares issuable in respect of scrip certificates issued in lieu of fractions of shares of Common Stock.

(f) CLOSING PRICE DETERMINATION. For the purpose of any computation under subsections (c) and (d) of this Section B, the Closing Price of Common Stock on any date shall be deemed to be the average of the Closing Prices for the five consecutive Trading Days ending on the day in question (or if such day is not a Trading Day, the next preceding Trading Day), PROVIDED, HOWEVER, that (i) if the "ex" date for any event (other than the issuance or distribution requiring such computation) that requires an adjustment to the Conversion Price pursuant to this Section occurs on or after the 20th Trading Day prior to the day in question and prior to the "ex" date for the issuance or distribution requiring such computation, the Closing Price for each Trading Day prior to the "ex" date for such other event shall be adjusted by multiplying such Closing Price by the same fraction which the Conversion Price is so required to be adjusted as a result of such other event, (ii) if the "ex" date for any event (other than the issuance or distribution requiring such computation) that requires an adjustment to the Conversion Price pursuant to this Section occurs on or after the "ex" date for the issuance or distribution requiring such computation and on or prior to the day in question, the Closing Price for each Trading Day on and after the "ex" date for such other event shall be adjusted by multiplying such Closing Price by the reciprocal of the fraction by which the Conversion Price is so required to be adjusted as a result of such other event, and (iii) if the "ex" date for the issuance or distribution requiring such computation is on or prior to the day in question, after taking into account any adjustment required pursuant to clause (ii) of this proviso, the Closing Price for each Trading Day on or after such "ex" date shall be adjusted by adding thereto the fair market value on the day in question (as determined by the Board of Directors in a manner consistent with any determination of such value for the purposes of subsection (d) of this Section B) of the assets, evidences of indebtedness, Equity Securities or subscription rights being distributed applicable to one share of Common Stock as of the close of business on the day before such "ex" date. For the purposes of any computation under subsection (e) of this Section B, the Closing Price on any date shall be deemed to be the average of the daily Closing Prices for the five consecutive Trading Days ending at the Offer Time; PROVIDED, HOWEVER, that if the "ex" date for any event (other than the tender or exchange offer requiring such computation) that requires an adjustment to the Conversion Price pursuant to this Section occurs on or after the date of commencement of such tender or exchange offer and prior to the Offer Time for such tender or exchange offer, the Closing Price for each Trading Day prior to the "ex" date for such other event shall be adjusted by multiplying such Closing Price by the same fraction by which the Conversion Price is so required to be adjusted as a result of such other event. For purposes of this subsection (f), the term "ex" date, (i) when used with respect to any issuance or distribution, means the first date on which the Common Stock trades regular way on the NYSE or on the relevant exchange or in the relevant market from which the Closing Price was obtained without the right to receive such issuance or distribution, (ii) when used with respect to any subdivision or combination of shares of Common Stock, means the first date on which the Common Stock trades regular way on the NYSE or such exchange or in such market after the time at which such subdivision or combination becomes effective, and (iii) when used with respect to any tender or exchange offer means the first date on which the Common Stock trades regular way on the NYSE or such exchange or in such market after the Offer Time of such tender or exchange offer.

(g) The Corporation may make such reductions in the Conversion Price, in addition to those required by clauses (a), (b), (c), (d), (e) and (f) of this Section B, as it considers to be advisable to avoid or diminish any income tax to holders of Common Stock or rights to purchase Common Stock resulting from any dividend or distribution of stock or from any event treated as such for income tax purposes. Whenever the Conversion Price is reduced pursuant to the preceding sentence, the Corporation shall mail to the holders of then-outstanding shares of Series A Preferred Stock a notice of the reduction at least fifteen (15) days prior to the date the reduced Conversion Price takes effect, and such notice shall state the reduced Conversion Price and the period it will be in effect.
(h) No adjustment in the Conversion Price shall be required unless such adjustment would require an increase or decrease of at least one percent (1%) in the Conversion Price; PROVIDED, HOWEVER, that any adjustments which by reason of this subsection (h) are not required to be made shall be carried forward and taken into account in any subsequent adjustment.

(i) Notwithstanding any other provision of this Section B, no adjustment to the Conversion Price shall reduce the Conversion Price below $0.25, and any such purported adjustment shall instead reduce the Conversion Price to $0.25. The Corporation hereby covenants not to take any action that would or does result in any adjustment in the Conversion Price that, if made without giving effect to the previous sentence, would cause the Conversion Price to be less than $0.25.

(j) Whenever the Conversion Price is adjusted as herein provided, a notice stating that the Conversion Price has been adjusted and setting forth the adjusted Conversion Price shall promptly be mailed by the Corporation to the holders of the Series A Preferred Stock.

C. ORGANIC CHANGE.

(a) CORPORATION SURVIVES. Upon the consummation of an Organic Change (other than a transaction in which the Corporation is not the surviving entity), then lawful provision shall be made as part of the terms of such transaction whereby the terms hereof shall be modified, without payment of any additional consideration by any holder, so as to provide that upon the conversion of shares of Series A Preferred Stock following the consummation of such Organic Change, a holder of Series A Preferred Stock shall have the right to acquire and receive (in lieu of or in addition to the shares of Common Stock acquirable and receivable prior to the Organic Change), without payment of additional consideration therefor (except as would otherwise have been required by the terms of the Series A Preferred Stock as in effect prior to such Organic Change), such securities, cash and other property as such holder would have received if such holder had converted such shares of Series A Preferred Stock into Common Stock immediately prior to such Organic Change. Lawful provision also shall be made as part of the terms of the Organic Change so that all other terms hereof shall remain in full force and effect following such an Organic Change. The provisions of this subsection (a) shall similarly apply to successive Organic Changes of the character described in this subsection (a).

(b) CORPORATION DOES NOT SURVIVE. The Corporation shall not enter into an Organic Change that is a transaction in which the Corporation is not the surviving entity unless lawful provision shall be made as part of the terms of such transaction whereby the surviving entity shall issue new securities (the "NEW SECURITIES") to each holder of Series A Preferred Stock, without payment of any additional consideration by such holder, with terms that provide that upon the conversion of the New Securities, the holder of such securities shall have the right to acquire and receive (in lieu of or in addition to the shares of Common Stock acquirable and receivable prior to the Organic Change), without payment of additional consideration therefor (except as would otherwise have been required by the terms of the Series A Preferred Stock as in effect prior to such Organic Change), such securities, cash and other property as such holder would have received if such holder had converted such shares of Series A Preferred Stock into Common Stock immediately prior to such Organic Change. The certificate or articles of incorporation or other constituent document of the surviving entity shall provide for such adjustments which, for events subsequent to the effective date of such certificate or articles of incorporation or other constituent document, shall be equivalent to the adjustments provided for in Section B of this Article IX. All other terms of such New Securities shall be substantially equivalent to the terms provided herein. The provisions of this subsection (b) shall similarly apply to successive Organic Changes of the character described in of this subsection (b).

D. CERTAIN EVENTS. If any event similar to or of the type contemplated by the provisions of Section B or Section C of this Article IX, but not expressly provided for by such provisions, occurs, then the Board of Directors of the Corporation, will make an appropriate and equitable adjustment in the Conversion Price so as to protect the rights of the holders of Series A Preferred Stock; PROVIDED, that no such adjustment will decrease the number of shares of Common Stock issuable upon conversion of the Series A Preferred Stock.
E. NOTICE OF APPROVAL DATE. When and if the Approval Date shall occur, the Corporation shall promptly mail or cause to be mailed a notice of such occurrence to each holder of Series A Preferred Stock.

X. ADDITIONAL DEFINITIONS

For the purposes of this Certificate of Designations of Series A Preferred Stock, the following terms shall have the meanings indicated:

"AFFILIATE" has the meaning set forth in Rule 12b-2 under the Exchange Act as in effect on the date of the Investment Agreement. The term "Affiliated" has a correlative meaning. Notwithstanding the foregoing, for all purposes hereof, the Investor, and each Person controlled by, controlling or under common control with the Investor (each, a "TPG PERSON"), shall not be deemed an "Affiliate" of any Designated Purchaser Person (as defined below), and no Designated Purchaser, and no Person controlled by, controlling or under common control with such Designated Purchaser (each, a "DESIGNATED PURCHASER PERSON"), shall be deemed an "Affiliate" of any TPG Person or any other Designated Purchaser Person, in any such case solely as a consequence of this Agreement or the transactions contemplated hereby.

"APPROVAL DATE" means the date, if any, on which the Corporation obtains the Series A Shareholder Approval.

"BENEFICIALLY OWN" with respect to any securities means having "beneficial ownership" of such securities (as determined pursuant to Rule 13d-3 under the Exchange Act as in effect on the date of the Investment Agreement, except that a Person shall be deemed to Beneficially Own all such securities that such Person has the right to acquire whether such right is exercisable immediately or after the passage of time). The terms "Beneficial Ownership" and "Beneficial Owner" have correlative meanings. Notwithstanding the foregoing, for all purposes hereof, (i) no TPG Person shall be deemed to Beneficially Own any securities that are held by any Designated Purchaser Person, and no Designated Purchaser Person shall be deemed to Beneficially Own any securities that are held by any TPG Person or any other Designated Purchaser Person, in any such case solely as a consequence of this Agreement or the transactions contemplated hereby, and (ii) no member of the Investor Group shall be deemed to Beneficially Own any Option Shares or securities issuable in respect of the Option Shares unless and until the Option is exercised.

"BUSINESS DAY" means any day, other than a Saturday, Sunday or a day on which banking institutions in the State of New York are authorized or obligated by law or executive order to close.

"BYLAWS" means the Bylaws of the Corporation, as amended from time to time.

"CHANGE OF CONTROL" shall be deemed to have occurred if (a) any person or group (within the meaning of Rule 13d-5 under the Exchange Act as in effect on February 12, 1998) shall own directly or indirectly, beneficially or of record, shares representing more than 35% of the aggregate ordinary voting power represented by the issued and outstanding Equity Securities of the Corporation, other than any Person or Group that owned at least 5% of such Equity Securities on the Closing Date (as such term is defined in the Credit Agreement as in effect on the date of the Investment Agreement); (b) a majority of the seats (other than vacant seats) on the board of directors of the Corporation shall at any time be occupied by persons who were neither (i) nominated by the board of directors of the Corporation nor (ii) appointed by directors so nominated; (c) any change in control (or similar event, however denominated) with respect to the Corporation shall occur under and as defined in any indenture or agreement in respect of Indebtedness for borrowed money in excess of the aggregate principal amount of $10,000,000 to which any Borrower (as such term is defined in the Credit Agreement as in effect on the date of the Investment Agreement) or any Guarantor (as such term is defined in the Credit Agreement as in effect on the date of the Investment Agreement) is a party, other than the Existing Parent Borrower Notes Indenture (as such term is defined in the Credit Agreement as in effect on the date of the Investment Agreement) in connection with a Permitted CBHS Sale (as such term is defined in the Credit Agreement as in effect on the date of the Investment Agreement); or (d) a "Change in Control" or "Change of Control" (or similar event) shall have occurred under the Credit Agreement or the Senior Subordinated Notes, unless, in
the case of a "Change of Control" under the Indenture, the aggregate principal
amount outstanding under the Senior Subordinated Notes is less than $10,000,000.
Notwithstanding the foregoing, no event described above shall constitute a
"Change of Control" if such event resulted directly from any action taken by the
Investor or any of its Affiliates.

"CLOSING" shall have the meaning assigned to such term in the
Investment Agreement.

"CLOSING PRICE" with respect to a share of Common Stock on any
day means, subject to subsection (f) of Section B of Article IX if applicable,
the last reported sale price on that day or, in case no such reported sale takes
place on such day, the average of the last reported bid and asked prices,
regular way, on that day, in either case, as reported in the consolidated
transaction reporting system with respect to securities listed on the NYSE or,
if the shares of Common Stock are not listed on the NYSE, as reported in the
principal consolidated transaction reporting system with respect to securities
listed on the principal national securities exchange on which the shares of
Common Stock are listed or, if the shares of Common Stock are not listed on NYSE
and not listed on any national securities exchange, the last quoted price or, if
not so quoted, the average of the high bid and low asked prices on such other
nationally recognized quotation system then in use, or, if on any such day the
shares of Common Stock are not quoted on any such quotation system, the average
of the closing bid and asked prices as furnished by a professional market maker
selected by the Board of Directors in good faith making a market in the shares
of Common Stock. If the shares of Common Stock are not publicly held or so
listed, quoted or publicly traded, the "Closing Price" means the fair market
value of a share of Common Stock, as determined in good faith by the Board of
Directors.

"CONVERSION PRICE" shall mean $9.375, as adjusted from time to
time pursuant to Section B of Article IX hereof. With respect to any share of
Series A Preferred Stock issued after the date of the original issuance of the
Series A Preferred Stock, the Conversion Price of such share shall be determined
as if such share were issued on the date of the original issuance of the
Series A Preferred Stock.

"CONVERSION SHARES" has the meaning set forth in the
Investment Agreement.

"CREDIT AGREEMENT" means the Credit Agreement, dated as of
February 12, 1998, among the Corporation, the banks and other financial
institutions named therein, and The Chase Manhattan Bank, as Administrative
Agent, together with all other documents entered into pursuant to or in
connection with the Credit Agreement, in each case, as the same may be amended,
restated, supplemented, extended, renewed or increased from time to time,
replaced, substituted, refunded or refinanced or otherwise modified from time to
time, in whole or in part, and any successive replacements, substitutions,
refundings or refinancings.

"DESIGNATED PURCHASER" has the meaning set forth in the
Investment Agreement.

"DESIGNATED PURCHASER PERSON" has the meaning set forth in the
definition of "Affiliate."

"EQUITY SECURITIES" of any Person, means any and all common
stock, preferred stock and any other class of capital stock of, and any
partnership or limited liability company interests in, such Person or any other
similar interests of any Person that is not a corporation, partnership or
limited liability company.

"EXCHANGE ACT" means the U.S. Securities Exchange Act of 1934,
as amended, and the rules and regulations promulgated thereunder, from time to
time.

"45-TRADING DAY AVERAGE PRICE" means the average of the
Closing Prices per share of Common Stock for the Trading Days in any period of
45 consecutive Trading Days (a
"45-TRADING DAY REFERENCE PERIOD"); PROVIDED, HOWEVER, that in the event that an adjustment to the Conversion Price takes effect pursuant to Section B of Article IX hereof during the period used to compute such average, the Closing Prices used to compute such average for all Trading Days ended prior to the time such adjustment takes effect shall be similarly adjusted.

"45-TRADING DAY REFERENCE PERIOD" has the meaning set forth in the definition of "45-Trading Day Average Price."

"GOVERNMENTAL ENTITY" means any government or political subdivision or department thereof, any governmental or regulatory body, commission, board, bureau, agency or instrumentality, or any court or arbitrator or alternative dispute resolution body, in each case whether federal, state, local or foreign.

"GROUP" has the meaning set forth in Rule 13d-5 under the Exchange Act.

"GUARANTEE" means any direct or indirect obligation, contingent or otherwise, to guarantee (or having the economic effect of guaranteeing) Indebtedness in any manner, including, without limitation, any monetary obligation to purchase or pay (or advance or supply funds for the purchase or payment of) such Indebtedness (whether arising by agreement to purchase assets, goods, securities or services, to take-or-pay, or to maintain financial statement conditions or otherwise).

"INDEBTEDNESS" means, with respect to any Person, without duplication, (i) all obligations of such Person for money borrowed, (ii) all obligations of such Person evidenced by bonds, debentures, notes, or other similar instruments, (iii) all obligations of such Person upon which interest charges are customarily paid, (iv) all obligations of such Person under conditional sale or other title retention agreements relating to property or assets purchased by such Person, (v) all obligations of such Person issued or assumed as the deferred purchase price of property or services (excluding (x) trade accounts payable and accrued obligations incurred in the ordinary course of business and (y) deferred earn-out and other performance-based payment obligations incurred in connection with any Permitted Acquisition (as such term is defined in the Credit Agreement as in effect on the date of the Investment Agreement) or any similar transactions consummated prior to February 12, 1998), (vi) all Indebtedness of others secured by (or for which the holder of such Indebtedness has an existing right, contingent or otherwise, to be secured by) any Lien on property owned or acquired by such Person, whether or not the obligations secured thereby have been assumed, (vii) all Guarantees by such Person of Indebtedness of others, (viii) all capital lease obligations of such Person, (ix) all obligations (determined on the basis of actual, not notional, obligations) of such Person in respect of interest rate protection agreements, foreign currency exchange agreements or other interest or exchange rate hedging arrangements and (x) all obligations of such Person as an account party in respect of letters of credit and bankers' acceptances issued in support of obligations that constitute Indebtedness under any other clause of this definition (unless such obligations are fully cash collateralized), PROVIDED that all obligations in respect of letters of credit shall be deemed Indebtedness to the extent drawings thereunder are unreimbursed (after any applicable grace period) regardless of the purpose for which such letter of credit was issued. The Indebtedness of any Person shall include the recourse Indebtedness of any partnership in which such Person is a general partner. Notwithstanding the foregoing, no portion of Indebtedness that becomes the subject of a defeasance (whether a legal defeasance or a "covenant" or "in substance" defeasance) shall, at any time that such defeasance remains in effect, be treated as Indebtedness for purposes hereof.

"INDENTURE" means the Indenture entered into between the Corporation and the Marine Midland Bank, as Trustee, dated as of February 12, 1998, as the same may be amended, restated, supplemented, extended, renewed or increased from time to time, replaced, substituted, refunded or refinanced or otherwise modified from time to time, in whole or in part, and any successive replacements, substitutions, refundings or refinancings.
"INVESTMENT AGREEMENT" means the Investment Agreement, dated as of July 19, 1999, by and between the Investor and the Corporation, as amended, supplemented or otherwise modified from time to time.

"INVESTOR" has the meaning set forth in the Investment Agreement.

"INVESTOR GROUP" means, collectively, the Investor, the Designated Purchasers, if any, and the respective Affiliates of such Persons.

"INVESTOR NOMINEE" means a person designated for election to the Board of Directors by the Investor pursuant to the Investment Agreement.

"LAW" means any law, treaty, statute, ordinance, code, rule, regulation, judgment, decree, order, writ, award, injunction or determination of any Governmental Entity.

"LIEN" means any mortgage, pledge, lien, security interest, claim, voting agreement, conditional sale agreement, title retention agreement, restriction, option or encumbrance of any kind, character or description whatsoever.

"MAKE-WHOLE PAYMENT" has the meaning set forth in the Certificate of Designations with respect to the Series B Preferred Stock.

"NYSE" means the New York Stock Exchange, Inc.

"NYSE RULES" has the meaning set forth in the Investment Agreement.

"180-DAY AVERAGE PRICE" means the average of the Closing Prices per share of Common Stock for the Trading Days in any period of 180 consecutive calendar days (a "180-DAY REFERENCE PERIOD"); PROVIDED, HOWEVER, that in the event that an adjustment to the Conversion Price takes effect pursuant to Section B of Article IX hereof during the period used to compute such average, the Closing Prices used to compute such average for all Trading Days ended prior to the time such adjustment takes effect shall be similarly adjusted.

"180-DAY REFERENCE PERIOD" has the meaning set forth in the definition of "180-Day Average Price."

"OPTION" has the meaning set forth in the Investment Agreement.

"OPTION SHARES" has the meaning set forth in the Investment Agreement.

"ORGANIC CHANGE" means, with respect to the Corporation, any transaction (including without limitation any recapitalization, capital reorganization or reclassification of any class of capital stock, any consolidation or amalgamation of the Corporation with, or merger of the Corporation into, any other Person, any merger of another Person into the Corporation (other than a merger which does not result in a reclassification, conversion, exchange or cancellation of outstanding shares of capital stock of the Corporation), any sale or transfer or lease of all or substantially all of the assets of the Corporation or any compulsory share exchange) pursuant to which any class of capital stock of the Corporation is converted into the right to receive other securities, cash or other property.

"PERSON" means any individual, corporation, company, association, partnership, limited liability company, joint venture, trust or unincorporated organization, or a government or any agency or political subdivision thereof.

"REFERENCE PERIOD" means a 45-Trading Day Reference Period or a 180-Day Reference Period, as the case may be.

"REGISTRATION RIGHTS AGREEMENT" means the Registration Rights Agreement, dated as of July 19, 1999, by and between the Investor and the
Corporation, as amended, supplemented or otherwise modified from time to time.

"REGULATORY APPROVALS" means any and all certificates, permits, licenses, franchises, concessions, grants, consents, approvals, orders, registrations, authorizations, waivers, variances or clearances from, or filings or registrations with, Governmental Entities.

"SECURITIES ACT" means the U.S. Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder, from time to time.

"SENIOR SUBORDINATED NOTES" means the Senior Subordinated Notes of the Corporation issued pursuant to the Indenture.

"SERIES A SHAREHOLDER APPROVAL" means the approval by the stockholders of the Corporation, in accordance with the General Corporation Law of the State of Delaware and in accordance with and in satisfaction of Paragraph 312.00 of the NYSE's Listed Company Manual and the related NYSE Rules and interpretations of (i) the issuance of Common Stock in respect of accrued and unpaid dividends on the Series A Preferred Stock (including upon the conversion or exchange thereof), (ii) the issuance of the Option Shares upon the exercise of the Option and (iii) the issuance of Common Stock upon the conversion or exchange of the Option Shares, in each case in accordance with the terms hereof and the Investment Agreement.

"SUBSIDIARY" means as to any Person, any other Person of which more than 50% of the shares of the voting stock or other voting interests are owned or controlled, or the ability to select or elect more than 50% of the directors or similar managers is held, directly or indirectly, by such first Person or one or more of its Subsidiaries or by such first Person and one or more of its Subsidiaries; PROVIDED, HOWEVER, that no Joint Venture (as such term is defined in the Investment Agreement) shall be considered (i) a "Subsidiary" of the Corporation or (ii) a "Subsidiary" of any Subsidiary of the Corporation.

"TPG PERSON" has the meaning set forth in the definition of "Affiliate."

"TRADING DAY" means any day on which the NYSE is open for trading, or if the shares of Common Stock are not quoted on the NYSE, any day on which the principal national securities exchange or national quotation system on which the shares of Common Stock are listed, admitted to trading or quoted is open for trading, or if the shares of Common Stock are not so listed, admitted to trading or quoted, any Business Day.

"TWO-WEEK AVERAGE PRICE" means the average of the Closing Prices per share of Common Stock for the Trading Days in the two-calendar week period ending on the last day of a Reference Period; PROVIDED, HOWEVER, that in the event that an adjustment to the Conversion Price takes effect pursuant to Section B of Article IX hereof during the period used to compute such average, the Closing Prices used to compute such average for all Trading Days ended prior to the time such adjustment takes effect shall be similarly adjusted.

"VOTING SECURITIES" means the shares of Common Stock and any other securities of the Corporation entitled to vote generally for the election of directors.

XI. MISCELLANEOUS

A. NOTICES. Any notice referred to herein shall be in writing and, unless first-class mail shall be specifically permitted for such notices under the terms hereof, shall be deemed to have been given upon personal delivery thereof, upon transmittal of such notice by telecopy (with confirmation of receipt by telecopy or telex) or five days after transmittal by registered or certified mail, postage prepaid, addressed as follows:

(i) if to the Corporation, to its office at 6950 Columbia Gateway Drive, Fourth Floor, Columbia, Maryland 21046 (Attention: General Counsel) or to the transfer agent for the Series A Preferred Stock;
(ii) if to a holder of the Series A Preferred Stock, to such holder at the address of such holder as listed in the stock record books of the Corporation (which may include the records of any transfer agent for the Series A Preferred Stock); or

(iii) to such other address as the Corporation or such holder, as the case may be, shall have designated by notice similarly given.

B. REACQUIRED SHARES. Any shares of Series A Preferred Stock redeemed, purchased or otherwise acquired by the Corporation, directly or indirectly, in any manner whatsoever shall be retired and canceled promptly after the acquisition thereof (and shall not be deemed to be outstanding for any purpose) and, if necessary to provide for the lawful redemption or purchase of such shares, the capital represented by such shares shall be reduced in accordance with the Delaware General Corporation Law. All such shares of Series A Preferred Stock shall upon their cancellation and upon the filing of an appropriate certificate with the Secretary of State of the State of Delaware, become authorized but unissued shares of Preferred Stock, without par value, of the Corporation and may be reissued as part of another series of Preferred Stock, without par value, of the Corporation subject to the conditions or restrictions on issuance set forth herein.

C. ENFORCEMENT. Any registered holder of shares of Series A Preferred Stock may proceed to protect and enforce its rights and the rights of such holders by any available remedy by proceeding at law or in equity to protect and enforce any such rights, whether for the specific enforcement of any provision in this Certificate of Designations or in aid of the exercise of any power granted herein, or to enforce any other proper remedy.

D. TRANSFER TAXES. Except as otherwise agreed upon pursuant to the terms of this Certificate of Designations, the Corporation shall pay any and all documentary, stamp or similar issue or transfer taxes and other governmental charges that may be imposed under the laws of the United States of America or any political subdivision or taxing authority thereof or therein in respect of any issue or delivery of Common Stock or Debentures on conversion or exchange of, or other securities or property issued on account of, shares of Series A Preferred Stock pursuant hereto or certificates representing such shares or securities. The Corporation shall not, however, be required to pay any such tax or other charge that may be imposed in connection with any transfer involved in the issue or transfer and delivery of any certificate for Common Stock or Debentures or other securities or property in a name other than that in which the shares of Series A Preferred Stock so converted or exchanged, or on account of which such securities were issued, were registered and no such issue or delivery shall be made unless and until the Person requesting such issue has paid to the Corporation the amount of any such tax or has established to the satisfaction of the Corporation that such tax has been paid or is not payable.

E. TRANSFER AGENT. The Corporation may appoint, and from time to time discharge and change, a transfer agent for the Series A Preferred Stock. Upon any such appointment or discharge of a transfer agent, the Corporation shall send notice thereof by first-class mail, postage prepaid, to each holder of record of shares of Series A Preferred Stock.

F. RECORD DATES. In the event that the Series A Preferred Stock shall be registered under either the Securities Act or the Exchange Act, the Corporation shall establish appropriate record dates with respect to payments and other actions to be made with respect to the Series A Preferred Stock.

G. SUBORDINATION TO SENIOR SUBORDINATED NOTES. By accepting a share of Series A Preferred Stock or Debenture, the holder thereof shall be deemed to have acknowledged and agreed that (a) such holder's right to receive payments in respect of the Series A Preferred Stock or Debenture is subject and subordinated in right of payment to the payment in full and discharge of all amounts (however denominated) then due and payable under the Senior Subordinated Notes, and (b) until payment in full of all such amounts (however denominated) under the Senior Subordinated Notes has been made in cash, no payment, whether directly or indirectly, by exercise of any right of set off or otherwise in
respect of the Series A Preferred Stock or Debenture shall be made by the Corporation, and no deposit in respect of the Series A Preferred Stock or Debenture shall be made pursuant to the terms hereof. In the event that any payment by, or distribution of the assets of, the Corporation of any kind or character (whether in cash, property or securities, whether directly or indirectly, by exercise of any right of set-off or

otherwise and whether as a result of a bankruptcy proceeding with respect to the Corporation or otherwise) shall be received by a holder of Series A Preferred Stock at any time when such payment is prohibited by this paragraph, such payment shall be held in trust for the benefit of, and shall be paid over to, the holders of Senior Subordinated Notes as their interests may appear. The preceding two sentences address the relative rights of holders of Series A Preferred Stock or Debentures, on the one hand, and the holders of Senior Subordinated Notes, on the other hand, and nothing in this Certificate of Designations shall impair, as between the Corporation and the holders of Series A Preferred Stock or Debentures, the obligation of the Corporation, which is absolute and unconditional, to pay amounts due in respect of the Series A Preferred Stock and Debentures in accordance with their terms. This Section G shall not be construed to limit in any manner the subordination provisions set forth in Section D of Article V hereof.

IN WITNESS WHEREOF, this Certificate of Designations is executed on behalf of the Corporation by its Chief Financial Officer and attested by its Assistant Secretary, this [ ] day of [ ], 1999.

MAGELLAN HEALTH SERVICES, INC.

By: ---------------------------------
Name: Cliff Donnelly
Title: Chief Financial Officer

[Corporate Seal]

ATTEST:
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EXHIBIT B
Form of Series B Certificate of Designations

CERTIFICATE OF DESIGNATIONS
OF SERIES B CUMULATIVE CONVERTIBLE PREFERRED STOCK
OF MAGELLAN HEALTH SERVICES, INC.
(PURSUANT TO SECTION 151 OF THE DELAWARE GENERAL CORPORATION LAW)

Magellan Health Services, Inc., a corporation organized and existing under the General Corporation Law of the State of Delaware (the "CORPORATION"), hereby certifies that the following resolutions were adopted by the Board of Directors of the Corporation (the "BOARD OF DIRECTORS") pursuant to authority of the Board of Directors as required by Section 151 of the General Corporation Law of the State of Delaware:

RESOLVED, that pursuant to the authority granted to and vested in the Board of Directors in accordance with the provisions of the Restated Certificate of Incorporation of the Corporation, as amended (the "CERTIFICATE OF INCORPORATION"), the Board of Directors hereby creates a series of the Corporation's previously authorized preferred stock, without par value (the "PREFERRED STOCK"), and hereby states the designation and number thereof, and
fixes the voting powers, preferences and relative, participating, optional and other special rights, and the qualifications, limitations and restrictions thereof, as follows:

Series B Cumulative Convertible Preferred Stock:

I. DESIGNATION AND AMOUNT

The designation of this series of shares shall be "Series B Cumulative Convertible Preferred Stock" (the "SERIES B PREFERRED STOCK"); the stated value per share shall be $1,000 (the "STATED VALUE"); and the number of shares constituting such series shall be [______]. Shares of Series B Preferred Stock may be issued by the Company from time to time by a resolution or resolutions of the Board of Directors. The number of shares of the Series B Preferred Stock may be decreased from time to time by a resolution or resolutions of the Board of Directors; PROVIDED, HOWEVER, that such number shall not be decreased below the sum of the aggregate number of shares of the Series B Preferred Stock that the Corporation may be obligated to issue pursuant to the terms of the Series A Preferred Stock (as defined below).

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II. RANK

A. With respect to dividend rights, the Series B Preferred Stock shall rank (i) junior to each other class or series of Preferred Stock which by its terms ranks senior to the Series B Preferred Stock as to payment of dividends, (ii) on a parity with each other class or series of Preferred Stock which by its terms ranks on a parity with the Series B Preferred Stock as to payment of dividends, including the Series A Cumulative Convertible Preferred Stock, without par value (the "SERIES A PREFERRED STOCK"), of the Corporation and (iii) prior to the Corporation's Series C Junior Participating Preferred Stock, par value $0.01 per share (the "JUNIOR PREFERRED STOCK"), and Common Stock, par value $0.25 per share (the "COMMON STOCK"), and, except as specified above, all other classes and series of capital stock of the Corporation hereafter issued by the Corporation. With respect to dividends, all equity securities of the Corporation to which the Series B Preferred Stock ranks senior, including the Common Stock, are collectively referred to herein as the "JUNIOR DIVIDEND SECURITIES"; all equity securities of the Corporation with which the Series B Preferred Stock ranks on a parity, including the Series A Preferred Stock, are collectively referred to herein as the "PARITY DIVIDEND SECURITIES"; and all equity securities of the Corporation (other than convertible debt securities) to which the Series B Preferred Stock ranks junior, with respect to dividends, are collectively referred to herein as the "SENIOR DIVIDEND SECURITIES."

B. With respect to the distribution of assets upon liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, the Series B Preferred Stock shall rank (i) junior to each other class or series of Preferred Stock which by its terms ranks senior to the Series B Preferred Stock as to distribution of assets upon liquidation, dissolution or winding up, (ii) on a parity with each other class or series of Preferred Stock which by its terms ranks on a parity with the Series B Preferred Stock as to distribution of assets upon liquidation, dissolution or winding up of the Corporation, including the Series A Preferred Stock, and (iii) prior to the Junior Preferred Stock and Common Stock, and, except as specified above, all other classes and series of capital stock of the Corporation hereinafter issued by the Corporation. With respect to the distribution of assets upon liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, all equity securities of the Corporation to which the Series B Preferred Stock ranks senior, including the Common Stock, are collectively referred to herein as "JUNIOR LIQUIDATION SECURITIES" (and together with the Junior Dividend Securities are referred to herein as the "JUNIOR SECURITIES"); all equity securities of the Corporation (other than convertible debt securities) to which the Series B Preferred Stock ranks on parity, including the Series A Preferred Stock, are collectively referred to herein as "PARITY LIQUIDATION SECURITIES" (and together with the Parity Dividend Securities are referred to herein as the "PARITY SECURITIES"); all equity securities of the Corporation to which the Series B Preferred Stock ranks junior are collectively referred to herein as "SENIOR LIQUIDATION SECURITIES" (and together with the Senior Dividend Securities are referred to herein as the "SENIOR SECURITIES").
III. DIVIDENDS

A. DIVIDENDS. Shares of Series B Preferred Stock shall accumulate dividends at a rate of 6.50% PER ANNUM; PROVIDED, that in the event that the Series B Shareholder Approval has not been obtained by the Corporation on or prior to the Anniversary Date, shares of Series B Preferred Stock shall accumulate dividends at a rate of 12.00% PER ANNUM from and after the Anniversary Date through the Approval Date. After the Approval Date, shares of Series B Preferred Stock shall accumulate dividends at a rate of 6.50% PER ANNUM. Payment of dividends shall be made in cash except as otherwise provided in this Article III. Dividends shall be paid in four equal quarterly installments on the last day of March, June, September and December of each year, or if any such date is not a Business Day, on the Business Day next preceding such day (each such date, regardless of whether any dividends have been paid or declared and set aside for payment on such date, a "DIVIDEND PAYMENT Date"), to holders of record (the "REGISTERED HOLDERS") as they appear on the stock record books of the Corporation on the fifteenth day prior to the relevant Dividend Payment Date; PROVIDED, HOWEVER, that the Corporation may elect not to make any dividend payment due hereunder on any Dividend Payment Date (other than as required in connection with any redemption or repurchase of shares of Series B Preferred Stock or any liquidation, dissolution or winding up of the Corporation), and any such amount then due in respect of dividends shall constitute an Arrearage (as defined below). Dividends shall be paid only when, as and if declared by the Board of Directors out of funds at the time legally available for the payment of dividends. Dividends shall begin to accumulate on outstanding shares of Series B Preferred Stock from the date of issuance and shall be deemed to accumulate from day to day whether or not earned or declared until paid. Dividends shall accumulate on the basis of a 360-day year consisting of twelve 30-day months (four 90-day quarters) and the actual number of days elapsed in the period for which payable. Dividends payable at more than one annual rate for any dividend period or partial dividend period shall be pro-rated on the basis of the number of days in such dividend period or partial dividend period, calculated as aforesaid, and the actual number of days elapsed for which dividends are payable at each such annual rate.

B. ACCUMULATION. Dividends on the Series B Preferred Stock shall be cumulative, and from and after any Dividend Payment Date on which any dividend that has accumulated or been deemed to have accumulated through such date has not been paid in full or any payment date set for a redemption or repurchase on which such redemption or repurchase payment has not been paid in full, additional dividends shall accumulate in respect of the amount of such unpaid dividends or unpaid redemption or repurchase payment (such amount, the "ARREARAGE") at the annual rate then in effect as provided in Section A of this Article III (or such lesser rate as may be the maximum rate that is then permitted by applicable law). Such additional dividends in respect of any Arrearage shall be deemed to accumulate from day to day whether or not earned or declared until the Arrearage is paid, shall be calculated as of such successive Dividend Payment Date and shall constitute an additional Arrearage from and after any Dividend Payment Date to the extent not paid on such Dividend Payment Date. References in any Article herein to dividends that have accumulated or that have been deemed to have accumulated with respect to the Series B Preferred Stock shall include the amount, if any, of any Arrearage together with any dividends accumulated or deemed to have accumulated on such Arrearage pursuant to the immediately preceding two sentences. Additional dividends in respect of any Arrearage may be declared and paid at any time, in whole or in part, without reference to any regular Dividend Payment Date, to Registered Holders as they appear on the stock record books of the Corporation on such record date as may be fixed by the Board of Directors (which record date shall be no less than 10 days prior to the corresponding payment date).

C. PAYMENT IN COMMON STOCK. Notwithstanding the provisions of Section A of this Article III, (i) any dividend payment (such payment, a "NON-ARREARAGE PAYMENT") made in full on the first Dividend Payment Date on which such payment is due (without
taking into account the proviso to the fourth sentence of Section A of this Article III in determining the first Dividend Payment Date on which such payment is due) and (ii) any payment (such payment, an "ARREARAGE PAYMENT") made at any time prior to the second anniversary of the original issuance of the Series A Preferred Stock in respect of any dividend Arrearage, may be made in the form of shares of Common Stock; PROVIDED that:

(i) the Common Stock is then validly listed for trading on the NYSE or other national securities exchange or quoted on a nationally recognized quotation system;

(ii) such shares of Common Stock have been duly authorized and when issued in connection with such payment, will be validly issued, fully paid and non-assessable;

(iii) the issuance of such shares of Common Stock in satisfaction of such payment does not: (a) violate any provision of the Certificate of Incorporation or the Bylaws; (b) give rise to any preemptive rights, rights of first refusal or other similar rights on behalf of any Person under any applicable Law or any provision of the Certificate of Incorporation or the Bylaws or any agreement or instrument applicable to the Corporation or any of its Subsidiaries; (c) conflict with, contravene or result in a breach or violation of any of the terms or provisions of, or constitute a default (with or without notice or the passage of time) under, or result in or give rise to a right of termination, cancellation, acceleration or modification of any right or obligation under, or give rise to a right to put or to compel a tender offer for outstanding securities of the Corporation or any of its Subsidiaries under, or require any consent, waiver or approval under, any note, bond, debt instrument, indenture, mortgage, deed of trust, lease, loan agreement, joint venture agreement, Regulatory Approval, contract or any other agreement, instrument or obligation to which the Corporation or any of its Subsidiaries is a party or by which the Corporation or any of its Subsidiaries or any property of the Corporation or any of its Subsidiaries is bound (assuming for the purpose of this clause (c) that all conditions precedent to the conversion of Series B Preferred Stock have been satisfied and that all outstanding shares of the Series B Preferred Stock have been converted into Common Stock); (d) result in the creation or imposition of any Lien upon any assets or properties of the Corporation or any of its Subsidiaries; or (e) violate any Law applicable to the Corporation or any of its Subsidiaries;

(iv) (a) no default or event of default, or event that with notice or the passage of time would constitute a default or event of default, has occurred and is continuing (or will occur as a result of the issuance of shares of Common Stock in satisfaction of such payment), under any contract, agreement, indenture, mortgage, note, lease or other instrument evidencing Indebtedness of the Corporation or any of its Subsidiaries (other than inter-company Indebtedness between the Corporation and any of its Subsidiaries or between Subsidiaries of the Corporation) the outstanding principal amount of which is in excess of $10,000,000 and as a result of such default, event of default or event the holders thereof have accelerated or have the right to accelerate (or would have the right to accelerate with notice or the passage of time) the maturity thereof, and (b) the Corporation has not been notified that a breach of the Investment Agreement or the terms of the Series A Preferred Stock or Series B Preferred Stock has occurred and is continuing;

(v) (a) with respect to any Non-Arrearage Payment, the Trailing Average Value (as defined below) is equal to or greater than the product of (A) 0.40, multiplied by (B) the Conversion Price, and (b) with respect to any Arrearage Payment, the Trailing Average Value (as defined below) is equal to or greater than the product of (A) 0.60, multiplied by (B) the Conversion Price;

(vi) (a) with respect to any Non-Arrearage Payment, the average daily trading volume in the Common Stock during the period used to calculate the Trailing Average Value is at least 50% of the average
daily trading volume in the Common Stock for the 180-day period ending on the date of the Investment Agreement, and (b) with respect to any Arrearage Payment, the average daily trading volume in the Common Stock during the period used to calculate the Trailing Average Value is at least 67% of the average daily trading volume in the Common Stock for the 180-day period ending on the date of the Investment Agreement;

(vii) the issuance of such shares of Common Stock in satisfaction of such payment does not require the approval or affirmative vote of the holders of any class or series of the Corporation's Equity Securities; and

(viii) as of the relevant Dividend Payment Date, the Shelf Registration Statement (as such term is defined in the Registration Rights Agreement) is effective under the Securities Act and is available for use in connection with the offer and sale of such shares of Common Stock by those holders of Series B Preferred Stock that have such right under the Registration Rights Agreement (it being understood that if a Shelf Suspension (as such term is defined in the Registration Rights Agreement) is in effect, the Shelf Registration Statement shall not be deemed effective or available for use); PROVIDED, HOWEVER, that in the case of any Non-Arrearage Payment (and only in the case of a Non-Arrearage Payment), this clause (viii) shall not prohibit the issuance of shares of Common Stock in satisfaction of such payment if the Shelf Registration Statement is not effective or not available for use in accordance with Section 2.1(c) of the Registration Rights Agreement.

For the purpose of this Section C, the value of a share of Common Stock used to pay dividends on the Series B Preferred Stock shall equal (the "TRAILING AVERAGE VALUE") the average of the Closing Prices per share of Common Stock for the twenty consecutive Trading Days ending on the second Trading Day prior to the relevant Dividend Payment Date; PROVIDED, HOWEVER, that in the event that an adjustment to the Conversion Price takes effect pursuant to Section B of Article IX hereof during the period used to compute such average, the Closing Prices used to compute such average for all Trading Days ended prior to the time such adjustment takes effect shall be similarly adjusted. Except as otherwise expressly provided in this Section C, Common Stock may not be used to make any payment in respect of any Arrearage.

D. METHOD OF PAYMENT. Dividends paid on the shares of Series B Preferred Stock in an amount less than the total amount of such dividends at the time accumulated and payable

on all outstanding shares of Series B Preferred Stock shall be allocated pro rata on a share-by-share basis among all such shares then outstanding. Notwithstanding the provisions of Section C of this Article III, any such partial payment shall be made in cash. Dividends that are declared and paid in an amount less than the full amount of dividends accumulated on the Series B Preferred Stock (and on any Arrearage) shall be applied first to the earliest dividend which has not theretofore been paid. All cash payments of dividends on the shares of Series B Preferred Stock shall be made in such coin or currency of the United States of America as at the time of payment is legal tender for payment of public and private debts.

IV. LIQUIDATION PREFERENCE

In the event of a liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, the holders of then-outstanding shares of Series B Preferred Stock shall be entitled to receive out of the assets of the Corporation, whether such assets are capital or surplus of any nature, an amount per share equal to the greater of (A) the sum of (i) the Stated Value thereof and (ii) the dividends, if any, accumulated or deemed to have accumulated thereon to the date of final distribution to such holders, whether or not such dividends are declared, and (B) the amount that would be payable to such holders if the holders had converted all outstanding shares of Series B Preferred Stock into shares of Common Stock immediately prior to such liquidation, dissolution or winding up, and shall, after the holders of Common Stock have received an amount per share of Common Stock equal to the amount paid per share of Series B Preferred Stock, be entitled to participate on a pro rata basis with the holders of Common Stock. After any such payment in full, the
holders of Series B Preferred Stock shall not, as such, be entitled to any further participation in any distribution of assets of the Corporation. All the assets of the Corporation available for distribution to stockholders after the liquidation preferences of any Senior Liquidation Securities shall be distributed ratably (in proportion to the full distributable amounts to which holders of Series B Preferred Stock and Parity Liquidation Securities, if any, are respectively entitled upon such dissolution, liquidation or winding up) among the holders of the then-outstanding shares of Series B Preferred Stock and Parity Liquidation Securities, if any, when such assets are not sufficient to pay in full the aggregate amounts payable thereon.

Neither a consolidation or merger of the Corporation with or into any other Person or Persons, nor a sale, conveyance, lease, exchange or transfer of all or part of the Corporation's assets for cash, securities or other property to a Person or Persons shall be deemed to be a liquidation, dissolution or winding up of the Corporation for purposes of this Article IV, but the holders of shares of Series B Preferred Stock shall nevertheless be entitled from and after any such consolidation, merger or sale, conveyance, lease, exchange or transfer of all or part of the Corporation's assets to the rights provided by this Article IV following any such transaction. Notice of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, stating the payment date or dates when, and the place or places where, the amounts distributable to each holder of shares of Series B Preferred Stock in such circumstances shall be payable, shall be given by first-class mail, postage prepaid, mailed not less than 45 days prior to any payment date stated therein, to holders of record as they appear on the stock record books of the Corporation as of the date such notices are first mailed.

V. MANDATORY CONVERSION, REDEMPTION AND REPURCHASE

A. MANDATORY CONVERSION. (a) If the 180-Day Average Price and the related Two-Week Average Price for any 180-Day Reference Period (which Reference Period shall have ended no earlier than the first anniversary of the original issuance of the Series A Preferred Stock and no later than the second anniversary of the original issuance of the Series A Preferred Stock), both exceed 200% of the Conversion Price, then the Corporation shall have the right, at its option and election, to exchange the then-outstanding shares of Series B Preferred Stock, in whole and not in part, for shares of Common Stock, as if such then-outstanding shares of Series B Preferred Stock had been converted by the holders thereof pursuant to Article IX hereof on the date of such exchange.

(b) If the 45-Trading Day Average Price and the related Two-Week Average Price for any 45-Trading Day Reference Period (which Reference Period shall have ended no earlier than the second anniversary of the original issuance of the Series A Preferred Stock), both exceed 200% of the Conversion Price, then the Corporation shall have the right, at its option and election, to exchange the then-outstanding shares of Series B Preferred Stock, in whole and not in part, for shares of Common Stock, as if such then-outstanding shares of Series B Preferred Stock had been converted by the holders thereof pursuant to Article IX hereof on the date of such exchange.

(c) Notwithstanding anything in this Section A to the contrary, the Corporation shall not have the right to exchange the Series B Preferred Stock for Common Stock pursuant to this Section A unless (i) the Common Stock shall have been validly listed for trading on the NYSE or other national securities exchange or quoted on a nationally recognized quotation system on each day in the relevant Reference Period and as of the date of such exchange, (ii) the average daily trading volume in the Common Stock during the relevant Reference Period and during the two-week calendar period ending on the last day of the relevant Reference Period is at least 50% of the average daily trading volume in the Common Stock for the 180-day period ending on the date of the Investment Agreement, (iii) the Corporation shall have obtained the Series B Shareholder Approval, (iv) as of the date of such exchange, the Shelf Registration Statement (as such term is defined in the Registration Rights Agreement) is effective under the Securities Act and is available for use in connection with the offer and sale of such shares of Common Stock by those holders that have such right under the Registration Rights Agreement (it being understood that if a Shelf Suspension (as such term is defined in the Registration Rights Agreement) is in effect, the Shelf Registration Statement shall not be deemed effective or available for use), and (v) the Corporation simultaneously exchanges the Series A Preferred Stock pursuant to subsection (a)
or (b) of Section A of Article V of the Certificate of Designations for the Series A Preferred Stock. The Corporation may not effect any such exchange if such exchange would: (a) violate any provision of the certificate of incorporation or the bylaws of the Corporation; (b) conflict with, contravene or result in a breach or violation of any of the terms or provisions of, or constitute a default (with or without notice or the passage of time) under, or result in or give rise to a right of termination, cancellation, acceleration or modification of any right or obligation under, or give rise to a right to put or to compel a tender offer for outstanding securities of the Corporation or any of its Subsidiaries under, or require any consent, waiver or approval under, any note, bond, debt instrument, indenture, mortgage, deed of trust, lease, loan agreement, joint venture agreement, Regulatory Approval, contract or any other agreement, instrument or obligation to which the Corporation or any of its Subsidiaries is a party or by which the Corporation or any of its Subsidiaries or any property of the Corporation or any of its Subsidiaries is bound; (c) result in the creation or imposition of any Lien upon any assets or properties of the Corporation or any of its Subsidiaries; or (d) violate any Law applicable to the Corporation or any of its Subsidiaries.

(d) Notice of an exchange of shares of Series B Preferred Stock pursuant to this Section A (a "NOTICE OF EXCHANGE") shall be sent to the holders of record of the shares of Series B Preferred Stock by first class mail, postage prepaid, at each such holder's address as it appears on the stock record books of the Corporation, not more than three Business Days subsequent to the last day of the relevant Reference Period. The Notice of Exchange shall set forth the date fixed for the exchange (the "EXCHANGE DATE") and shall set forth in reasonable detail the calculations and supporting data used by the Corporation in its determination that it had the right to effect such exchange. From and after the Exchange Date, all dividends on the shares of Series B Preferred Stock that are exchanged shall cease to accumulate and all rights of the holders thereof as holders of Series B Preferred Stock shall cease and terminate, except if the Corporation shall default in its obligation to deliver shares of Common Stock and cash in lieu of fractional shares to holders on the Exchange Date, in which case all such rights shall continue unless and until such shares are exchanged (or redeemed, repurchased or converted) in accordance with the terms hereof. Prior to the Exchange Date, each holder shall provide a written notice to the Corporation specifying the name or names in which such holder wishes the certificate or certificates for shares of Common Stock to be issued. If no such notice is delivered, such shares of Common Stock and cash in lieu of fractional shares, if any, shall be delivered to such holder. In case such notice shall specify a name or names other than that of such holder, such notice shall be accompanied by payment of all transfer taxes payable upon the issuance of shares of Common Stock in such name or names. Other than such taxes, the Corporation will pay any and all issue and other taxes (other than taxes based on income) that may be payable in respect of any issue or delivery of shares of Common Stock on exchange of Series B Preferred Stock pursuant to this Section A. On or after the Exchange Date, each holder of shares of Series B Preferred Stock that are to be exchanged shall surrender the certificate evidencing such shares of Series B Preferred Stock to the Corporation at the place designated in the Notice of Exchange. As promptly as practical, and in any event within three Business Days after the Exchange Date, the Corporation shall deliver or cause to be delivered as directed by the holder of shares of Series B Preferred Stock being exchanged (i) certificates representing the number of validly issued, fully paid and nonassessable full shares of Common Stock to which such holder shall be entitled and (ii) cash in lieu of fractional shares, if any, to which such holder shall be entitled. Except as otherwise specified in this Article V, for the purposes hereof, such exchange shall be deemed a conversion effected pursuant to Article IX and the terms and procedures set forth in Article IX shall apply. For such purpose, the applicable Conversion Date shall be the Exchange Date.

(e) In the event the Corporation delivers a Notice of Exchange, the Corporation shall be obligated to effect the exchange described therein, PROVIDED that each of the conditions to such exchange set forth in subsections (a), (b) and (c) above is (i) satisfied or (ii) waived by the holders of a majority of the shares of Series B Preferred Stock then outstanding.
(f) Notwithstanding anything to the contrary in the Registration Rights Agreement, in the event the Corporation effects an exchange pursuant to this Section A, the Corporation shall not exercise its right to declare a Shelf Suspension (as such term is defined in the Registration Rights Agreement) pursuant to Section 2.1(c) of the Registration Rights Agreement during the period beginning on the Exchange Date and ending 90 days after the Exchange Date.

B. MANDATORY REDEMPTION. The Corporation shall not have any right to redeem any shares of Series B Preferred Stock prior to the Mandatory Redemption Date (as defined below). On the tenth anniversary of the original issuance of the Series A Preferred Stock (the "MANDATORY REDEMPTION DATE"), the Corporation shall redeem (the "MANDATORY REDEMPTION") all outstanding shares of Series B Preferred Stock by paying the redemption price therefor in cash out of funds legally available for such purpose. The redemption price for each share of Series B Preferred Stock shall equal the sum of (i) the amount, if any, of all unpaid dividends accumulated thereon to the date of actual payment of the Redemption Price, whether or not such dividends have been declared, and (ii) the Stated Value thereof (such sum, the "REDEMPTION PRICE").

C. NOTICE AND REDEMPTION PROCEDURES. Notice of the redemption of shares of Series B Preferred Stock pursuant to Section B of this Article V (a "NOTICE OF REDEMPTION") shall be sent to the holders of record of the shares of Series B Preferred Stock to be redeemed by first class mail, postage prepaid, at each such holder's address as it appears on the stock record books of the Corporation, not more than 100 nor fewer than 60 days prior to the date fixed for redemption, which date shall be set forth in such notice (the "REDEMPTION DATE"); PROVIDED, HOWEVER, that failure to give such Notice of Redemption to any holder, or any defect in such Notice of Redemption to any holder shall not affect the validity of the proceedings for the redemption of any shares of Series B Preferred Stock held by any other holder. In order to facilitate the redemption of shares of Series B Preferred Stock, the Board of Directors may fix a record date for the determination of the holders of shares of Series B Preferred Stock to be redeemed, in each case, not more than 10 days prior to the date the Notice of Redemption is mailed. On or after the Redemption Date, except with respect to shares of Series B Preferred Stock for which the Conversion Date has occurred on or prior to such Redemption Date, each holder of the shares called for redemption shall surrender the certificate evidencing such shares to the Corporation at the place designated in such notice and shall thereupon be entitled to receive payment of the Redemption Price. From and after the Redemption Date, all dividends on shares of Series B Preferred Stock shall cease to accumulate and all rights of the holders thereof as holders of Series B Preferred Stock shall cease and terminate, except if the Corporation shall default in payment of the Redemption Price on the Redemption Date in which case all such rights shall continue unless and until such shares are redeemed and such price is paid in accordance with the terms hereof.

D. CHANGE OF CONTROL. In the event there occurs a Change of Control, any holder of record of shares of Series B Preferred Stock, in accordance with the procedures set forth in Section E of this Article V, may require the Corporation to redeem any or all of the shares of Series B Preferred Stock held by such holder in an amount per share equal to the sum of (i) the amount, if any, of all unpaid dividends accumulated thereon to the date of actual payment thereof, whether or not such dividends have been declared, and (ii) 101% of Stated Value (the "CHANGE OF CONTROL PRICE"). By accepting a share of Series B Preferred Stock the holder thereof shall be deemed to have acknowledged and agreed that (a) such holder's right, to receive payment of the Change in Control Price is subject and subordinated in right of payment to the payment in full and discharge of all amounts of principal, interest and fees (however denominated) then outstanding under the Credit Agreement and the Senior Subordinated Notes and (b) until payment in full of all such amounts (however denominated) under the Credit Agreement and the Senior Subordinated Notes has been made in cash, no payment, whether directly or indirectly, by exercise of any right of set off or otherwise in respect of the Change of Control Price shall be made by the Corporation, and, notwithstanding anything to the contrary in Section F of this Article V, no deposit in respect of the Change of Control Price shall be made pursuant to Section F of this Article V. In the event that any payment by, or distribution of the assets of, the Corporation of any kind or character (whether in cash,
property or securities, whether directly or indirectly, by exercise of any right of set-off or otherwise and whether as a result of a bankruptcy proceeding with respect to the Corporation or otherwise) shall be received by a holder of Series B Preferred Stock at any time when such payment is prohibited by this paragraph, such payment shall be held in trust for the benefit of, and shall be paid over to, the lenders under the Credit Agreement or the holders of Senior Subordinated Notes, as the case may be, as their interests may appear. The preceding two sentences address the relative rights of holders of Series B Preferred Stock or Debentures, on the one hand, and the lenders under the Credit Agreement or the holders of Senior Subordinated Notes, as the case may be, on the other hand, and nothing in this Certificate of Designations shall impair, as between the Corporation and the holders of Series B Preferred Stock or Debentures, the obligation of the Corporation, which is absolute and unconditional, to pay amounts due in respect of the Series B Preferred Stock and Debentures in accordance with their terms. Upon a Change of Control, the Corporation shall pay all amounts outstanding under the Credit Agreement and the Indenture to the extent necessary in order to permit the payment of the Change of Control Price hereunder.

E. CHANGE OF CONTROL NOTICE AND REDEMPTION PROCEDURES. Notice of any Change of Control shall be sent to the holders of record of the outstanding shares of Series B Preferred Stock not more than five days following a Change of Control, which notice (a "CHANGE OF CONTROL NOTICE") shall describe the transaction or transactions constituting such Change of Control and set forth each holder's right to require the Corporation to redeem any or all shares of Series B Preferred Stock held by him or her out of funds legally available therefor, the redemption date, which date shall be not less than 30 nor more than 45 days from the date of such Change of Control Notice, (the "CHANGE OF CONTROL REDEMPTION DATE") and the procedures to be followed by such holders in exercising his or her right to cause such redemption; PROVIDED, HOWEVER, that if all of the outstanding shares of Series B Preferred Stock are owned by more than 50 holders or groups of Affiliated holders and if the Series B Preferred Stock is listed on any national securities exchange or quoted on any national quotation system, the Corporation shall give such Change of Control Notice by publication in a newspaper of general circulation in the Borough of Manhattan, The City of New York, within 30 days following such Change of Control and, in any case, a similar notice shall be mailed concurrently to each holder of shares of Series B Preferred Stock. Failure by the Corporation to give the Change of Control Notice as prescribed by the preceding sentence, or the formal insufficiency of any such Change of Control Notice, shall not prejudice the rights of any holder of shares of Series B Preferred Stock to cause the Corporation to redeem any such shares held by him or her. In the event a holder of shares of Series B Preferred Stock shall elect to require the Corporation to redeem any or all such shares of Series B Preferred Stock pursuant to Section D hereof, such holder shall deliver, prior to the Change of Control Redemption Date as set forth in the Change of Control Notice, or, if the Change of Control Notice is not given as required by this Section E, at any time following the last day the Corporation was required to give the Change of Control Notice in accordance with this Section E (in which case the Change of Control Redemption Date shall be the date which is the later of (x) 45 days following the last day the Corporation was required to give the Change of Control Notice in accordance with this Section E and (y) 30 days following the delivery of such election by such holder), a written notice, in the form specified by the Corporation (if the Corporation did in fact give the notice required by this Section E), to the Corporation so stating, and specifying the number of shares to be redeemed pursuant to Section D of this Article V; PROVIDED, HOWEVER, that if all of the outstanding shares of the Series B Preferred Stock are owned by 50 or fewer holders or groups of affiliated holders, such holders or groups may deliver a notice or an election to redeem at any time within 90 days following the occurrence of a Change of Control without awaiting receipt of a Change of Control Notice or the expiration of the time allowed for the delivery of a Change of Control Notice hereunder. The Corporation shall redeem the number of shares so specified on the Change of Control Redemption Date fixed by the Corporation or as provided in the preceding sentence. The Corporation shall comply with the requirements of Rules 13e-4 and 14e-1 under the Exchange Act and any other securities laws and regulations thereunder to the extent such laws and regulations are applicable in connection with the repurchase of the shares of Series B Preferred Stock as a result of a Change of Control. From and after the time the Change of Control Redemption Price is paid in accordance with the terms hereof with respect to any share of
F. DEPOSIT OF FUNDS. The Corporation shall, no later than 11:00 a.m., New York City time, on any Redemption Date or Change of Control Redemption Date pursuant to this Article V, deposit with its transfer agent or other redemption agent in the Borough of Manhattan, The City of New York having a capital and surplus of at least $500,000,000, as a trust fund for the benefit of the holders of the shares of Series B Preferred Stock to be redeemed, cash that is sufficient in amount to redeem the shares to be redeemed in accordance with the Notice of Redemption or Change of Control Notice, with irrevocable instructions and authority to such transfer agent or other redemption agent to pay to the respective holders of such shares, as evidenced by a list of such holders certified by an officer of the Corporation, the Redemption Price or Change of Control Redemption Price, as the case may be, upon surrender of their respective share certificates. Such deposit shall be deemed to constitute full payment of such shares to the holders, and from and after the date of such deposit, all rights of the holders of the shares of Series B Preferred Stock that are to be redeemed as stockholders of the Corporation with respect to such shares, except the right to receive the Redemption Price upon the surrender of their respective certificates and all rights under Articles IX and XI hereof, shall cease and terminate. In case holders of any shares of Series B Preferred Stock called for redemption shall not, within two years after such deposit, claim the cash deposited for redemption thereof, such transfer agent or other redemption agent shall, upon demand, pay over to the Corporation the balance so deposited. Thereupon, such transfer agent or other redemption agent shall be relieved of all responsibility to the holders thereof and the sole right of such holders, with respect to shares to be redeemed, shall be to receive the Redemption Price as general creditors of the Corporation. Any interest accrued on any funds so deposited shall belong to the Corporation, and shall be paid to it from time to time on demand.

G. CERTAIN REPURCHASES. (a) If, at any time after April 5, 2002, one or more members of the Investor Group (collectively, the "SELLING INVESTORS") sell shares of Series A Preferred Stock and/or Common Shares, in a transaction or series of related transactions (such sale, an "INVESTOR SALE"), to any Person other than a member of the Investor Group, the Corporation shall, if the Selling Investors so elect, repurchase (a "CORPORATION REPURCHASE") from the Selling Investors, for cash, shares of Series B Preferred Stock representing a number of Conversion Shares equal to the Sale Number less the number of Make-Whole Conversion Shares with respect to such Investor Sale. The price paid by the Corporation in any Corporation Repurchase shall equal the Investor Sale Price per Conversion Share represented by the securities purchased in such Corporation Repurchase. Subject to subsection (b) of this Section G, in the event that the Selling Investors include shares of Series B Preferred Stock in an Investor Sale, the Corporation shall pay the Selling Investors, with respect to the Make-Whole Conversion Shares, an amount per Make-Whole Conversion Share equal to the Investor Sale Price less the amount per Make-Whole Conversion Share paid in such Investor Sale (such payment, the "MAKE-WHOLE PAYMENT"). Notwithstanding the foregoing, the Corporation shall have no obligation to effect a Corporation Repurchase or make a Make-Whole Payment unless the Selling Investors afford the Corporation a reasonable opportunity to include in the Investor Sale up to that number of shares of Common Stock that would be sufficient to permit the Corporation to satisfy its obligations pursuant to this Section G, and the Corporation shall have no obligation to effect a Corporation Repurchase or make a Make-Whole Payment with respect to any Investor Sale that is consummated after the Approval Date. Each Corporation Repurchase and Make-Whole Payment shall be completed by the Corporation within 15 days of the consummation of the related Investor Sale.

(b) Prior to any sale by the Selling Investors of any shares of Series B Preferred Stock in an Investor Sale, the Selling Investors shall give written notice to the Corporation of the Selling Investors' desire to sell such shares, which notice shall identify the number of such shares the Selling Investors desire to sell (such notice, a "SERIES B SALE NOTICE"). The Series B Sale Notice shall be given at least 10 Business Days prior to the consummation of the related Investor Sale. The Selling Investors shall not include such shares in such Investor Sale if, within 5 Business Days of the delivery of the Series B Sale Notice, the Corporation delivers a written notice to the Selling
Investors to the effect that it will effect a Corporation Repurchase with respect to such shares following the completion of such Investor Sale.

(c) Prior to the Approval Date, the Corporation shall not effect any direct or indirect redemption or repurchase of Common Stock unless it has complied with the procedures set forth in this subsection (c). In the event the Corporation intends to effect any direct or indirect redemption or repurchase of Common Stock, the Corporation shall first offer (a "REPURCHASE OFFER") to repurchase shares of Series B Preferred Stock and Junior Preferred Stock at the Repurchase Price (as defined below) per Conversion Share represented by the shares of Series B Preferred Stock and Junior Preferred Stock to be repurchased. The Corporation shall give written notice (a "PROPOSED REPURCHASE NOTICE") of such offer to each holder of Series B Preferred Stock and each holder of Junior Preferred Stock which notice shall specify (i) the aggregate number (the "REPURCHASE NUMBER") of Conversion Shares represented by shares of

Series B Preferred Stock and Junior Preferred Stock that the Corporation is willing to repurchase, and (ii) the proposed repurchase price for each such Conversion Share (the "REPURCHASE PRICE"). The date on which such Proposed Repurchase Notice is given is referred to herein as the "NOTICE DATE." To accept a Repurchase Offer, a holder must, within 20 days of the Notice Date, notify the Corporation in writing of its acceptance of the Repurchase Offer and the number of shares of Series B Preferred Stock and number of shares of Junior Preferred Stock it wishes to have repurchased by the Corporation. If a holder does not provide such notice to the Corporation within such 20-day period, then such holder shall be deemed to have rejected the Repurchase Offer. Within 5 days following the end of such 20-day period, the Corporation shall repurchase the securities specified by each accepting holder at the Repurchase Price per Conversion Share represented by such securities. The date on which such repurchases are effected is referred to herein as the "REPURCHASE DATE." If the aggregate number of Conversion Shares represented by the shares of Series B Preferred Stock and Junior Preferred Stock with respect to which holders have accepted the Repurchase Offer exceeds the Repurchase Number, the Corporation shall repurchase such securities on a pro rata basis based on the number of Conversion Shares with respect to which each such holder accepted the Repurchase Offer. During the period commencing on the Repurchase Date and ending on the 120th day after the Notice Date, the Corporation may repurchase and redeem, at a price not in excess of the Repurchase Price per share, up to an aggregate number of shares of its Common Stock equal to the Repurchase Number less the number of Conversion Shares represented by the shares of Series B Preferred Stock and Junior Preferred Stock repurchased pursuant to the Repurchase Offer. After such 120th day, in order to directly or indirectly repurchase or redeem shares of Common Stock, the Corporation must again comply with the procedures set forth in this subsection (c). Notwithstanding the foregoing, this paragraph shall not prohibit (i) purchases of Equity Securities of the Corporation or any of its Subsidiaries from executives and other management-level employees of the Corporation or any of its Subsidiaries in connection with customary employment and severance arrangements, or (ii) the acquisition, repurchase, exchange, conversion, redemption or other retirement for value by the Corporation of any Junior Dividend Securities by the Corporation in accordance with obligations in existence at the time of original issuance of the Series A Preferred Stock.

(d) Until the Series B Shareholder Approval is obtained, the Corporation shall not (A) utilize amounts available under Section 6.06(a)(ii) of the Credit Agreement (or any comparable provision of any Credit Agreement) for any purpose except to effect repurchases or make payments in respect of the Series B Preferred Stock as required pursuant to this Section G or to make payments with respect to the Series A Preferred Stock, or (B) amend the Credit Agreement in any manner so as to reduce the amounts available to effect repurchases or make payments in respect of the Series B Preferred Stock as required pursuant to this Section G under Section 6.06(a)(ii) of the Credit Agreement (or any comparable provision of any Credit Agreement). Notwithstanding the foregoing, this paragraph shall not prohibit (i) the acquisition, repurchase, exchange, conversion, redemption or other retirement for value of shares of Series B Preferred Stock or any Parity Dividend Security by the Corporation in accordance with the terms of such securities, (ii) purchases of Equity Securities of the Corporation or any of its Subsidiaries from executives and other management-level employees of the Corporation or any of its Subsidiaries in connection with customary employment and severance arrangements, or (iii) the acquisition, repurchase, exchange, conversion, redemption or other
Corporation of any Junior Dividend Securities by the Corporation in accordance with obligations in existence at the time of original issuance of the Series A Preferred Stock.

(e) If a Make-Whole Payment would result in an event of default under the Credit Agreement or the Indenture, the Corporation shall not be obligated to make such Make-Whole Payment until such time as the Make-Whole Payment would not result in an event of default under the Credit Agreement or the Indenture, as the case may be; PROVIDED that if the Make-Whole Payment would not result in such an event of default if made from the proceeds of the sale of Equity Securities of the Corporation, the Corporation shall use commercially reasonable efforts to effect a sale of Equity Securities to permit it to make the Make-Whole Payment and avoid such an event of default. In the event (i) the Corporation defaults with respect to its obligation to make a Make-Whole Payment or (ii) a Make-Whole Payment is delayed pursuant to the preceding sentence, a late-payment charge shall accrue with respect to the Make-Whole Payment at a per annum rate equal to the dividend rate then in effect pursuant to Section A of Article III hereof from (A) the time of such default in the case of clause (i) above or (B) from the time such Make-Whole Payment would have been due except for the operation of the preceding sentence in the case of clause (ii) above, and shall accrue until such amount and such charge is paid.

VI. EXCHANGE OF SERIES B PREFERRED STOCK FOR DEBENTURES

A. After the Option has expired or is no longer exercisable in whole or in part, the Series B Preferred Stock shall be exchangeable at the option of the Corporation and to the extent permitted by applicable law and the terms of the instruments governing the Corporation's then-outstanding Indebtedness, in whole but not in part, on any Dividend Payment Date for unsecured Junior Subordinated Convertible Debentures (issued pursuant to an indenture (the "SERIES B INDENTURE") prepared in accordance with the Investment Agreement), in principal amount of $1,000 per share of Series B Preferred Stock (a "DEBENTURE" and, collectively, the "DEBENTURES"), in accordance with this Article VI:

(i) Each share of Series B Preferred Stock shall be exchangeable at the offices of the Corporation and at such other place or places, if any, as the Board of Directors may designate. Except with the prior written consent of the holders of all outstanding shares of Series B Preferred Stock, the Corporation may not exchange any shares of Series B Preferred Stock if (a) full cumulative dividends through the date of exchange, have not been paid, accrued or set aside for payment on all outstanding shares of the Series B Preferred Stock, (b) the Corporation has failed to amend its Certificate of Incorporation in accordance with Delaware law to confer the power to vote upon holders of the Debentures as shall be contemplated by the Series B Indenture or (c) such exchange could result in any adverse tax consequence to any such holder.

(ii) Prior to giving notice of its intention to exchange, the Corporation shall execute and deliver to a bank or trust company and, if required by applicable law, qualify under the Trust Indenture Act of 1939, as amended, the Series B Indenture.

(iii) The Corporation shall mail written notice of its intention to exchange Series B Preferred Stock for Debentures (the "EXCHANGE NOTICE") to each holder of record of shares of Series B Preferred Stock not less than 60 nor more than 100 days prior to the date fixed for exchange. The Exchange Notice shall notify holders of their right to deliver an Objection Notice (as defined below) pursuant to Section B of this Article VI.

(iv) Prior to effecting any exchange provided above, the
Corporation shall deliver to each holder of shares of Series B Preferred Stock an opinion of nationally recognized legal counsel to the effect that: (a) each of the Series B Indenture and the Debentures have been duly authorized and executed by the Corporation and, when delivered by the Corporation in exchange for shares of Series B Preferred Stock, will constitute valid and legally binding obligations of the Corporation enforceable against the Corporation in accordance with their terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights generally and to general principles of equity; (b) the exchange of the Debentures for the shares of Series B Preferred Stock will not violate the provisions of this Article VI or of the Delaware General Corporation Law, including Section 221 thereof; and (c) the exchange of the Debentures for the shares of Series B Preferred Stock is exempt from the registration requirements of the Securities Act or that the exchange of such Debentures has been duly registered under the Securities Act.

(v) The Corporation may not effect any exchange provided above if such exchange would: (a) violate any provision of the certificate of incorporation or the bylaws of the Corporation; (b) conflict with, contravene or result in a breach or violation of any of the terms or provisions of, or constitute a default (with or without notice or the passage of time) under, or result in or give rise to a right of termination, cancellation, acceleration or modification of any right or obligation under, or give rise to a right to put or to compel a tender offer for outstanding securities of the Corporation or any Subsidiary; or require any consent, waiver or approval that has not been obtained or granted under, any note, bond, debt instrument, indenture, mortgage, deed of trust, lease, loan agreement, joint venture agreement, Regulatory Approval, contract or any other agreement, instrument or obligation to which the Corporation or any of its Subsidiaries is a party or by which the Corporation or any of its Subsidiaries or any property of the Corporation or any of its Subsidiaries is bound; (c) result in the creation or imposition of any Lien upon any assets or properties of the Corporation or any of its Subsidiaries; or (d) violate any Law applicable to the Corporation or any of its Subsidiaries.

(vi) Upon the exchange of shares of Series B Preferred Stock for Debentures, the rights of the holders of shares of Series B Preferred Stock as stockholders of the Corporation shall terminate and such shares shall no longer be deemed outstanding.

(vii) Before any holder of shares of Series B Preferred Stock shall be entitled to receive Debentures, such holder shall surrender the certificate or certificates therefor, at the office of the Corporation or at such other place or places, if any, as the Board of Directors shall have designated, and shall state in writing the name or names (with addresses) in which he or she wishes the certificate or certificates for the Debentures to be issued. The Corporation will, as soon as practicable thereafter, issue and deliver at said office or place to such holder of shares of Series B Preferred Stock, or to his or her nominee or nominees, certificates for the Debentures to which he or she shall be entitled as aforesaid. Shares of Series B Preferred Stock shall be deemed to have been exchanged as of the close of business on the date fixed for exchange as provided above, and the Person or Persons entitled to receive the Debentures issuable upon such exchange shall be treated for all purposes (including the accrual and payment of interest) as the record holder or holders of such Debentures as of the close of business on such date.

B. For purposes of clause (c) of paragraph (i) of Section A of this Article VI, an exchange of shares of Series B Preferred Stock shall be deemed to be an exchange that could result in a tax consequence to any holder which is materially adverse only if such holder shall have delivered to the Corporation a written notice to such effect on or before the fifteenth day after its receipt of the Exchange Notice (an "OBJECTION NOTICE"), which Objection Notice shall specify in reasonable detail the nature of such tax consequence which could result from the exchange. If the Corporation receives an Objection
Notice, then the Corporation shall not exchange the shares of Series B Preferred Stock and the Corporation shall, within 15 days after its receipt of the Objection Notice mail written notice to the effect that it is canceling the proposed exchange of shares of Series B Preferred Stock to each holder of record of shares of Series B Preferred Stock to which it mailed the Exchange Notice. Notwithstanding the foregoing, if the Corporation, based on the advice of nationally recognized tax counsel, believes that the tax consequences described in an Objection Notice are incorrect, the Corporation may contact the holder who delivered such notice to discuss the tax consequences described therein. If such holder withdraws such notice within 15 days of its delivery, the Corporation shall be permitted to consummate the proposed exchange.

VII. RESTRICTIONS ON DIVIDENDS

So long as any shares of the Series B Preferred Stock are outstanding, the Board of Directors shall not declare, and the Corporation shall not pay or set apart for payment any dividend on any Junior Securities or Parity Securities or make any payment on account of, or set apart for payment money for a sinking or other similar fund for, the repurchase, redemption or other retirement of, any Junior Securities or Parity Securities or any warrants, rights or options exercisable for or convertible into any Junior Securities or Parity Securities (other than the repurchase, redemption or other retirement of debentures or other debt securities that are convertible or exchangeable into any Junior Securities or Parity Securities), or make any distribution in respect of the Junior Securities or Parity Securities, either directly or indirectly, and whether in cash, obligations or shares of the Corporation or other property (other than distributions or dividends in Junior Securities to the holders of Junior Securities), and shall not permit any Person directly or indirectly controlled by the Corporation to purchase or redeem any Junior Securities or Parity Securities or any warrants, rights, calls or options exercisable for or convertible into any Junior Securities or Parity Securities (other than the repurchase, redemption or other retirement of debentures or other debt securities that are convertible or exchangeable into any Junior Securities or Parity Securities) unless prior to or concurrently with such declaration, payment, setting apart for payment, repurchase, redemption or other retirement or distribution, as the case may be, all accumulated and unpaid dividends on shares of the Series B Preferred Stock not paid on the dates provided for in Section A of Article III hereof (including Arrearages and accumulated dividends thereon and regardless of whether the Corporation shall have had the right to elect to defer such payments as provided for in Article III hereof) shall have been paid, except that when dividends are not paid in full as aforesaid upon the shares of Series B Preferred Stock, all dividends declared on the Series B Preferred Stock and any series of Parity Dividend Securities shall be declared and paid pro rata so that the amount of dividends so declared and paid on Series B Preferred Stock and such series of Parity Dividend Securities shall in all cases bear to each other the same ratio that accumulated dividends (including interest accrued on or additional dividends accumulated in respect of such accumulated dividends) on the shares of Series B Preferred Stock and such Parity Dividend Securities bear to each other. Notwithstanding the foregoing, this paragraph shall not prohibit (i) the acquisition, repurchase, exchange, conversion, redemption or other retirement for value of shares of Series B Preferred Stock or any Parity Dividend Security by the Corporation in accordance with the terms of such securities or (ii) the acquisition, repurchase, exchange, conversion, redemption or other retirement for value by the Corporation of any Junior Dividend Securities by the Corporation in accordance with obligations in existence at the time of original issuance of the Series A Preferred Stock.

VIII. VOTING RIGHTS

A. The holders of shares of Series B Preferred Stock shall have no voting rights except as set forth below or as otherwise from time to time required by law.

B. Through the Approval Date, shares of Series B Preferred Stock shall have no voting rights. After the Approval Date, so long as any shares of the Series B Preferred Stock are outstanding, each share of Series B Preferred Stock shall entitle the holder thereof to vote on all matters voted on by holders of Common Stock, and the shares of Series B Preferred Stock shall vote together with shares of Common Stock (and any shares of Series A Preferred Stock that are outstanding at such time).
Stock entitled to vote) as a single class. With respect to any such vote, each share of Series B Preferred Stock shall entitle its holder to a number of votes equal to the number of shares of Common Stock into which such share of Series B Preferred Stock is convertible at the time of the record date with respect to such vote (assuming all conditions precedent to such conversion have been satisfied and that such conversion had occurred as of the record date for such vote).

C. If on any date after the Approval Date (i) dividends payable on the Series A Preferred Stock or Series B Preferred Stock shall not have been paid in full when required pursuant to the terms hereof or (ii) the Corporation shall have failed to satisfy its obligation to redeem shares of Series A Preferred Stock or Series B Preferred Stock pursuant to the terms of the relevant Certificate of Designations (provided, that for the purpose of this Section C, any obligation of the Corporation to repurchase shares of Series B Preferred Stock pursuant to Section G of Article V of this Certificate of Designations shall not be considered an obligation to redeem such shares), then the number of directors constituting the Board of Directors shall, without further action, be increased by two, or if the requisite increase in the number of directors constituting the Board of Directors would require the approval of the Corporation's stockholders or is prohibited by the Investment Agreement, then the number of directors constituting the Board of Directors shall be increased to the extent the approval of the Corporation's stockholders is not required and the Investment Agreement would not be breached and a number of directors (other than Investor Nominees) shall resign from the Board of Directors so that the holders of shares of Series A Preferred Stock and Series B Preferred Stock, voting together as a single class without regard to series, may elect two directors to the Board of Directors, and the holders of a majority of the outstanding shares of Series A Preferred Stock and Series B Preferred Stock, voting together as a single class without regard to series, shall have, in addition to the other voting rights set forth herein, the exclusive right to elect two directors (the "ADDITIONAL DIRECTORS") of the Corporation to fill such newly-created or vacated directorships. Additional Directors shall continue as directors and such additional voting right shall continue until such time as (a) all dividends accumulated on the Series A Preferred Stock and Series B Preferred Stock shall have been paid in full as required pursuant to the terms hereof or (b) any redemption obligation with respect to the Series A Preferred Stock or Series B Preferred Stock that has become due shall have been satisfied or all necessary funds shall have been set aside for payment, as the case may be, at which time such Additional Directors shall cease to be directors and such additional voting right of the holders of shares of Series A Preferred Stock and Series B Preferred Stock shall terminate subject to revesting in the event of each and every subsequent event of the character indicated above.

D. After the Approval Date, so long as members of the Investor Group Beneficially Own a majority of the outstanding shares of Series A Preferred Stock and Series B Preferred Stock, if any default or event of default has occurred and is continuing under any contract, agreement, indenture, mortgage, note, lease or other instrument evidencing Indebtedness of the Corporation or any of its Subsidiaries (other than inter-company Indebtedness between the Corporation and any of its Subsidiaries or between Subsidiaries of the Corporation) the outstanding principal amount of which is in excess of $10,000,000, and as a result of such default, event of default or event the holders thereof have accelerated or have the right to accelerate the maturity thereof, and such default or event of default is not cured or waived within 75 days of the occurrence thereof, then the number of directors constituting the Board of Directors shall, upon the request of members of the Investor Group who Beneficially Own a majority of the outstanding shares of Series A Preferred Stock and Series B Preferred Stock then Beneficially Owned by members of the Investor Group delivered to the Corporation in writing, be increased by that number that is necessary to enable the Investor Group to designate a majority of the members of the Board of Directors (including the Investor Nominees), or if such requisite increase in the number of directors constituting the Board of Directors would require the approval of the Corporation's stockholders or is prohibited by the Investment Agreement, then the number of directors constituting the Board of Directors shall be increased to the extent the approval of the Corporation's stockholders is not required and the Investment Agreement would not be breached and a number of directors (other than Investor Nominees) shall resign from the Board of Directors so as to enable the Investor
Group to designate a majority of the Board of Directors (including the Investor Nominees), and the holders of a majority of the outstanding shares of Series A Preferred Stock and Series B Preferred Stock then held by the Investor Group, voting together as a single class without regard to series, shall have, in addition to the other voting rights set forth herein, the exclusive right, voting separately as a class, to elect that number of directors (the "MAJORITY DIRECTORS") of the Corporation necessary to fill such newly-created or vacated directorships. Majority Directors shall continue as directors and such additional voting right shall continue until such time as such default or event is cured, at which time such Majority Directors shall cease to be directors and such additional voting right of the Series A Preferred Stock and Series B Preferred Stock shall terminate subject to revesting in the event of each and every subsequent event of the character indicated above.

E. Reserved.

F. (a) The foregoing rights of holders of shares of Series B Preferred Stock to take any action as provided in this Article VIII may be exercised at any annual meeting of stockholders or at a special meeting of stockholders held for such purpose as hereinafter provided or at any adjournment thereof, or by the written consent, delivered to the Secretary of the Corporation, of the holders of the minimum number of shares required to take such action. So long as such right to vote continues (and unless such right has been exercised by written consent of the minimum number of shares required to take such action), the Chairman of the Board of Directors may call, and upon the written request of holders of record of 25% of the outstanding shares of Series B Preferred Stock, addressed to the Secretary of the Corporation at the principal office of the Corporation, shall call, a special meeting of the holders of shares entitled to vote as provided herein. Such meeting shall be held as soon as reasonably practicable after delivery of such request to the Secretary, at the place and upon the notice provided by law and in the Bylaws for the holding of meetings of stockholders.

(b) Each director elected pursuant to Section C, D or E hereof shall serve until the next annual meeting or until his or her successor shall be elected and shall qualify, unless the director's term of office shall have terminated pursuant to the provisions of Section C, D or E hereof, as the case may be. In case any vacancy shall occur among the directors elected pursuant to Section C, D or E hereof, such vacancy shall be filled for the unexpired portion of the term by vote of the remaining director or directors theretofore elected pursuant to the same Section (or such director's or directors' successor in office), if any. If any such vacancy is not so filled within 20 days after the creation thereof or if all of the directors so elected shall cease to serve as directors before their term shall expire, the holders of the shares of Series B Preferred Stock then outstanding and entitled to vote for such director pursuant to the provisions of Section C, D or E hereof, as the case may be, may elect successors to hold office for the unexpired terms of any vacant directorships, by written consent as provided herein, or at a special meeting of such holders called as provided herein. The holders of a majority of the shares entitled to vote for directors pursuant to Section C, D or E hereof, as the case may be, shall have the right to remove with or without cause at any time and replace any directors such holders have elected pursuant to such section, by written consent as herein provided, or at a special meeting of such holders called as provided herein.

G. Without the consent or affirmative vote of the holders of at least sixty-seven percent (67%) of the outstanding shares of Series B Preferred Stock, voting separately as a class, the Corporation shall not: (i) authorize, create or issue, or increase the authorized amount of, (a) any Senior Securities or (b) any class or series of capital stock or any security convertible into or exercisable for any class or series of capital stock, that is redeemable mandatorily or redeemable at the option of the holder thereof at any time on or prior to the Mandatory Redemption Date (whether or not only upon the occurrence of a specified event); (ii) amend, alter or repeal any provision of the Certificate of Incorporation or the Bylaws, if the amendment, alteration or repeal alters or changes the powers, preferences or special rights of the Series B Preferred Stock so as to affect them adversely; or (iii) authorize or take any other action if such action alters or changes any of the rights of the Series B Preferred Stock in any respect or otherwise would be inconsistent with the provisions of this Certificate of Designations and the holders of any class or series of the capital stock of
the Corporation is entitled to vote thereon.

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H. OTHER SECURITIES. The Corporation shall not, from and after the date of original issuance of the Series A Preferred Stock, enter into any agreement, amend or modify any existing agreement or obligation, or issue any security that prohibits, conflicts or is inconsistent with, or would be breached by, the Corporation's performance of its obligations hereunder.

IX. CONVERSION

A. CONVERSION. (a) At the option and election of the holder thereof, each share of Series B Preferred Stock, including all unpaid dividends accumulated thereon to the Conversion Date (as defined below), whether or not such dividends have been declared, may be converted in the manner provided herein, into (i) fully paid, duly authorized and nonassessable shares of Series C Junior Participating Preferred Stock, without par value, of the Corporation (the "JUNIOR PREFERRED STOCK"), on any Conversion Date occurring prior to the Approval Date, and (ii) fully paid and nonassessable shares of Common Stock, on any Conversion Date occurring on or after the Approval Date. As of the Conversion Date with respect to a share of Series B Preferred Stock, subject to subsections (d) and (e) of this Section A, such share shall be converted into that number (the "CONVERSION Number") of Conversion Shares (as defined below) equal to the quotient of (i) the sum of (A) the Stated Value thereof plus (B) all unpaid dividends accumulated on such share of Series B Preferred Stock to the Conversion Date whether or not such dividends have been declared, divided by (ii) the Conversion Price in effect on the Conversion Date.

(b) Conversion of shares of the Series B Preferred Stock may be effected by any holder thereof upon the surrender to the Corporation at the principal office of the Corporation or at the office of any agent or agents of the Corporation, as may be designated by the Board of Directors of the Corporation and identified to the holders in writing upon such designation, of the certificate for such shares of Series B Preferred Stock to be converted accompanied by a written notice stating that such holder elects to convert all or a specified whole number of shares represented by such certificate in accordance with the provisions of this Section A and specifying the name or names in which such holder wishes the certificate or certificates for Conversion Shares to be issued. In case such notice shall specify a name or names other than that of such holder, such notice shall be accompanied by payment of all transfer taxes payable upon the issuance of Conversion Shares in such name or names. Other than such taxes, the Corporation will pay any and all issue and other taxes (other than taxes based on income) that may be payable in respect of any issue or delivery of Conversion Shares on conversion of Series B Preferred Stock pursuant hereto. As promptly as practical, and in any event within three Business Days after the Conversion Date, the Corporation shall deliver or cause to be delivered as directed by the holder of Series B Preferred Stock being converted (i) certificates representing the number of validly issued, fully paid and nonassessable full Conversion Shares to which such holder shall be entitled to, (ii) any cash that is required to be paid pursuant to subsections (d) and (e) of this Section A, and (iii) if less than the full number of shares of Series B Preferred Stock evidenced by the surrendered certificate or certificates is being converted, a new certificate or certificates, of like tenor, for the number of shares of Series B Preferred Stock evidenced by such surrendered certificate or certificates less the number of shares of Series B Preferred Stock being converted. Such conversion shall be deemed to have occurred at the close of business on the date (the "CONVERSION DATE") of the giving of such notice by the holder of the Series B Preferred Stock to be converted and of such surrender of the certificate or certificates representing the shares of Series B Preferred Stock to be converted so that as of such time the rights of the holder thereof as to the shares being converted shall cease except for the right to receive Conversion Shares and/or cash in accordance herewith, and the person entitled to receive the Conversion Shares issued as a result of such conversion shall be treated for all purposes as having become the holder of such Conversion Shares at such time.

(c) In the event that the Series B Preferred Stock is to be
redeemed or repurchased pursuant to Article V hereof, from and after the Redemption Date or the applicable repurchase date, the right of a holder to convert shares of Series B Preferred Stock pursuant to this Section A shall cease and terminate, except if the Corporation shall default in payment of the Redemption Price on the Redemption Date or the repurchase price on the applicable repurchase date, in which case all such rights shall continue unless and until such shares are redeemed or repurchased and such redemption or repurchase price is paid in full in accordance with the terms hereof. Notwithstanding anything in the foregoing to the contrary, if the Conversion Date shall occur with respect to any shares of Series B Preferred Stock on or prior to any Redemption Date or repurchase date, such shares of Series B Preferred Stock shall be converted by the Corporation into Conversion Shares in the manner provided in this Section A.

(d) In connection with the conversion of any shares of Series B Preferred Stock, no fractions of Conversion Shares shall be issued, but in lieu thereof the Corporation shall pay a cash adjustment in respect of such fractional interest in an amount equal to such fractional interest multiplied by the Closing Price per share of Common Stock on the Conversion Date (or on the Trading Day immediately preceding the Conversion Date, if the Conversion Date is not a Trading Day). If more than one share of Series B Preferred Stock shall be surrendered for conversion by the same holder on the same Conversion Date, the number of full Conversion Shares issuable on conversion thereof shall be computed on the basis of the total number of shares of Series B Preferred Stock so surrendered.

(e) The Corporation shall at all times reserve and keep available for issuance upon the conversion of the Series B Preferred Stock in accordance with the terms hereof, such number of its authorized but unissued shares of Junior Preferred Stock and Common Stock as will from time to time be sufficient to permit the conversion of all outstanding shares of Series B Preferred Stock, and shall take all action required to increase the authorized number of shares of Junior Preferred Stock or Common Stock if necessary to permit the conversion of all outstanding shares of Series B Preferred Stock, except that from and after the Approval Date no shares of Junior Preferred Stock shall be required to be so reserved.

B. ADJUSTMENT OF CONVERSION PRICE. Except in connection with an Organic Change, which shall be subject to Section C below, the Conversion Price shall be subject to adjustment from time to time as follows:

(a) STOCK DIVIDENDS. In case the Corporation after the date of the original issuance of the Series A Preferred Stock shall pay a dividend or make a distribution to all holders of shares of Common Stock in shares of Common Stock, then in any such case the Conversion Price in effect at the opening of business on the day following the record date for the determination of stockholders entitled to receive such dividend or distribution shall be reduced to a price obtained by multiplying such Conversion Price by a fraction of which (x) the numerator shall be the number of shares of Common Stock outstanding at the close of business on such record date and (y) the denominator shall be the sum of such number of shares of Common Stock outstanding and the total number of shares of Common Stock constituting such dividend or distribution, such reduction to become effective immediately after the opening of business on the day following such record date. For purposes of this subsection (a), the number of shares of Common Stock at any time outstanding shall not include shares held in the treasury of the Corporation but shall include shares issuable in respect of scrip certificates issued in lieu of fractions of shares of Common Stock. The Corporation will not pay any dividend or make any distribution on shares of Common Stock held in the treasury of the Corporation.

(b) STOCK SPLITS AND REVERSE SPLITS. In case after the date of the original issuance of the Series A Preferred Stock outstanding shares of Common Stock shall be subdivided into a greater number of shares of Common Stock, the Conversion Price in effect at the opening of business on the day following the day upon which such subdivision becomes effective shall be proportionately reduced, and, conversely, in case after the original issuance of the Series A Preferred Stock outstanding shares of Common Stock shall be combined into a smaller number of shares of Common Stock, the Conversion Price
in effect at the opening of business on the day following the day upon which such combination becomes effective shall be proportionately increased, such reduction or increase, as the case may be, to become effective immediately after the opening of business on the day following the day upon which such subdivision or combination becomes effective.

(c) ISSUANCES BELOW MARKET. In case the Corporation after the date of the original issuance of the Series A Preferred Stock shall issue rights or warrants to holders of shares of Common Stock entitling them to subscribe for or purchase shares of Common Stock at a price per share less than the Closing Price per share on the record date for the determination of stockholders entitled to receive such rights or warrants, the Conversion Price in effect at the opening of business on the day following such record date shall be adjusted to a price obtained by multiplying such Conversion Price by a fraction of which (x) the numerator shall be the number of shares of Common Stock outstanding at the close of business on such record date PLUS the number of shares of Common Stock that the aggregate offering price of the total number of shares so to be offered would purchase at such Closing Price and (y) the denominator shall be the number of shares of Common Stock outstanding at the close of business on such record date PLUS the number of additional shares of Common Stock so to be offered for subscription or purchase, such adjustment to become effective immediately after the opening of business on the day following such record date; PROVIDED, HOWEVER, that no adjustment shall be made if the Corporation issues or distributes to each holder of Series B Preferred Stock the rights or warrants that each such holder would have been entitled to receive had the Series B Preferred Stock held by such holder been converted prior to such record date. For purposes of this subsection (c), the number of shares of Common Stock at any time outstanding shall not include shares held in the treasury of the Corporation but shall include shares issuable in respect of scrip certificates issued in lieu of fractions of shares of Common Stock. The Corporation shall not issue any rights or warrants in respect of shares of Common Stock held in the treasury of the Corporation. Rights or warrants issued by the Corporation to all holders of Common Stock entitling the holders thereof to subscribe for or purchase Equity Securities, which rights or warrants (i) are deemed to be transferred with such shares of Common Stock, (ii) are not exercisable and (iii) are also issued in respect of future issuances of Common Stock, including shares of Common Stock issued upon conversion of shares of Series B Preferred Stock, in each case in clauses (i) through (iii) until the occurrence of a specified event or events (a "TRIGGER EVENT"), shall for purposes of this subsection (c) not be deemed issued until the occurrence of the earliest Trigger Event.

(d) SPECIAL DIVIDENDS. In case the Corporation after the date of the original issuance of the Series A Preferred Stock shall distribute to all holders of shares of Common Stock evidences of its indebtedness or assets (excluding any regular periodic cash dividend but including any extraordinary cash dividend), Equity Securities (other than Common Stock) or rights to subscribe (excluding those referred to in subsection (c) above) for Equity Securities other than Common Stock, in each such case the Conversion Price in effect immediately prior to the close of business on the record date for the determination of stockholders entitled to receive such distribution shall be adjusted to a price obtained by multiplying such Conversion Price by a fraction of which (x) the numerator shall be the Closing Price per share of Common Stock on such record date, LESS the then-current fair market value as of such record date (as determined by the Board of Directors in its good faith judgment) of the portion of assets or evidences of indebtedness or Equity Securities or subscription rights so distributed applicable to one share of Common Stock, and (y) the denominator shall be such Closing Price, such adjustment to become effective immediately prior to the opening of business on the day following such record date; PROVIDED, HOWEVER, that no adjustment shall be made (1) if the Corporation issues or distributes to each holder of Series B Preferred Stock the subscription rights referred to above that each such holder would have been entitled to receive had the Series B Preferred Stock held by such holder been converted prior to such record date or (2) if the Corporation grants to each such holder the right to receive, upon the conversion of the Series B Preferred Stock held by such holder at any time after the distribution of the evidences of indebtedness or assets or Equity Securities referred to above, the evidences of indebtedness or assets or Equity Securities that such holder would have been entitled to receive had such Series B Preferred Stock been converted prior to
such record date. The Corporation shall provide any holder of Series B Preferred Stock, upon receipt of a written request therefor, with any indenture or other instrument defining the rights of the holders of any indebtedness, assets, subscription rights or Equity Securities referred to in this subsection (d). Rights or warrants issued by the Corporation to all holders of Common Stock entitling the holders thereof to subscribe for or purchase Equity Securities, which rights or warrants (i) are deemed to be transferred with such shares of Common Stock, (ii) are not exercisable and (iii) are also issued in respect of future issuances of Common Stock, including shares of Common Stock issued upon conversion of shares of Series B Preferred Stock, in each case in clauses (i) through (iii) until the occurrence of a Trigger Event, shall for purposes of this subsection (d) not be deemed issued until the occurrence of the earliest Trigger Event.

(e) TENDER OR EXCHANGE OFFER. In case, after the date of the original issuance of the Series A Preferred Stock, a tender or exchange offer made by the Corporation or any subsidiary of the Corporation for all or any portion of the Common Stock shall be consummated at any time after the original issuance of the Series A Preferred Stock and such tender offer shall involve an aggregate consideration having a fair market value (as determined by the Board of Directors in its good faith judgment) at the last time (the "OFFER TIME") tenders may be made pursuant to such tender or exchange offer (as it may be amended) that, together with the aggregate of the cash plus the fair market value (as determined by the Board of Directors in its good faith judgment), as of the Offer Time, of consideration payable in respect of any tender or exchange offer by the Corporation or any such subsidiary for all or any portion of the Common Stock consummated preceding the Offer Time and in respect of which no Conversion Price adjustment pursuant to this subsection (e) has been made, exceeds 5% of the product of the Closing Price of the Common Stock at the Offer Time multiplied by the number of shares of Common Stock outstanding (including any tendered shares) at the Offer Time, the Conversion Price shall be reduced so that the same shall equal the price determined by multiplying the Conversion Price in effect immediately prior to the Offer Time by a fraction of which (x) the numerator shall be (i) the product of the Closing Price of the Common Stock at the Offer Time multiplied by the number of shares of Common Stock outstanding (including any tendered shares) at the Offer Time minus (ii) the fair market value (determined as aforesaid) of the aggregate consideration payable to stockholders based on the acceptance (up to any maximum specified in the terms of the tender or exchange offer) of all shares validly tendered and not withdrawn as of the Offer Time (the shares deemed so accepted, up to any such maximum, being referred to as the "PURCHASED SHARES") and (y) the denominator shall be the product of (i) such Closing Price at the Offer Time multiplied by (ii) such number of outstanding shares at the Offer Time minus the number of Purchased Shares, such reduction to become effective immediately prior to the opening of business on the day following the Offer Time. For purposes of this subsection (e), the number of shares of Common Stock at any time outstanding shall not include shares held in the treasury of the Corporation but shall include shares issuable in respect of scrip certificates issued in lieu of fractions of shares of Common Stock.

(f) CLOSING PRICE DETERMINATION. For the purpose of any computation under subsections (c) and (d) of this Section B, the Closing Price of Common Stock on any date shall be deemed to be the average of the Closing Prices for the five consecutive Trading Days ending on the day in question (or if such day is not a Trading Day, the next preceding Trading Day), PROVIDED, HOWEVER, that (i) if the "ex" date for any event (other than the issuance or distribution requiring such computation) that requires an adjustment to the Conversion Price pursuant to this Section occurs on or after the 20th Trading Day prior to the day in question and prior to the "ex" date for the issuance or distribution requiring such computation, the Closing Price for each Trading Day prior to the "ex" date for such other event shall be adjusted by multiplying such Closing Price by the same fraction which the Conversion Price is so required to be adjusted as a result of such other event, (ii) if the "ex" date for any event (other than the issuance or distribution requiring such computation) that requires an adjustment to the Conversion Price pursuant to this Section occurs on or after the "ex" date for the issuance or distribution requiring such computation and on or prior to the day in question, the Closing Price for each Trading Day on and after the "ex" date for such other event shall
be adjusted by multiplying such Closing Price by the reciprocal of the fraction
by which the Conversion Price is so required to be adjusted as a result of such
other event, and (iii) if the "ex" date for the issuance or distribution
requiring such computation is on or prior to the day in question, after taking
into account any adjustment required pursuant to clause (ii) of this proviso,
the Closing Price for each Trading Day on or after such "ex" date shall be
adjusted by adding thereto the fair market value on the day in question (as
determined by the Board of Directors in a manner consistent with any
determination of such value for the purposes of subsection (d) of this
Section B) of the assets, evidences of indebtedness, Equity Securities or
subscription rights being distributed applicable to one share of Common Stock
as of the close of business on the day before such "ex" date. For the
purposes of any computation under subsection (e) of this Section B, the
Closing Price on any date shall be deemed to be the average of the daily
Closing Prices for the five consecutive Trading Days ending at the Offer
Time; PROVIDED, HOWEVER, that if the "ex" date for any event (other than the
tender or exchange offer requiring such computation) that requires an
adjustment to the

Conversion Price pursuant to this Section occurs on or after the date of
commencement of such tender or exchange offer and prior to the Offer Time for
such tender or exchange offer, the Closing Price for each Trading Day prior to
the "ex" date for such other event shall be adjusted by multiplying such Closing
Price by the same fraction by which the Conversion Price is so required to be
adjusted as a result of such other event. For purposes of this subsection (f),
the term "ex" date, (i) when used with respect to any issuance or distribution,
means the first date on which the Common Stock trades regular way on the NYSE or
on the relevant exchange or in the relevant market from which the Closing Price
was obtained without the right to receive such issuance or distribution, (ii)
when used with respect to any subdivision or combination of shares of Common
Stock, means the first date on which the Common Stock trades regular way on the
NYSE or such exchange or in such market after the time at which such subdivision
or combination becomes effective, and (iii) when used with respect to any tender
or exchange offer means the first date on which the Common Stock trades regular
way on the NYSE or such exchange or in such market after the Offer Time of such
tender or exchange offer.

(g) The Corporation may make such reductions in the Conversion
Price, in addition to those required by clauses (a), (b), (c), (d), (e) and (f)
of this Section B, as it considers to be advisable to avoid or diminish any
income tax to holders of Common Stock or rights to purchase Common Stock
resulting from any dividend or distribution of stock or from any event treated
as such for income tax purposes. Whenever the Conversion Price is reduced
pursuant to the preceding sentence, the Corporation shall mail to the holders of
then-outstanding shares of Series B Preferred Stock a notice of the reduction at
least fifteen (15) days prior to the date the reduced Conversion Price takes
effect, and such notice shall state the reduced Conversion Price and the period
it will be in effect.

(h) No adjustment in the Conversion Price shall be required
unless such adjustment would require an increase or decrease of at least one
percent (1%) in the Conversion Price; PROVIDED, HOWEVER, that any adjustments
which by reason of this subsection (h) are not required to be made shall be
carried forward and taken into account in any subsequent adjustment.

(i) Notwithstanding any other provision of this Section B, no
adjustment to the Conversion Price shall reduce the Conversion Price below
$0.25, and any such purported adjustment shall instead reduce the Conversion
Price to $0.25. The Corporation hereby covenants not to take any action that
would or does result in any adjustment in the Conversion Price that, if made
without giving effect to the previous sentence, would cause the Conversion Price
to be less than $0.25.

(j) Whenever the Conversion Price is adjusted as herein
provided, a notice stating that the Conversion Price has been adjusted and
setting forth the adjusted Conversion Price shall promptly be mailed by the
Corporation to the holders of the Series B Preferred Stock.

C. ORGANIC CHANGE.

(a) CORPORATION SURVIVES. Upon the consummation of an Organic
Change (other than a transaction in which the Corporation is not the surviving
modified, without payment of any additional consideration by any holder, so as to provide that upon the conversion of shares of Series B Preferred Stock following the consummation of such Organic Change, a holder of Series B Preferred Stock shall have the right to acquire and receive (in lieu of or in addition to the Conversion Shares acquirable and receivable prior to the Organic Change), without payment of additional consideration therefor (except as would otherwise have been required by the terms of the Series B Preferred Stock as in effect prior to such Organic Change), such securities, cash and other property as such holder would have received if such holder had converted such shares of Series B Preferred Stock into Common Stock immediately prior to such Organic Change. Lawful provision also shall be made as part of the terms of the Organic Change so that all other terms hereof shall remain in full force and effect following such an Organic Change. The provisions of this subsection (a) shall similarly apply to successive Organic Changes of the character described in this subsection (a).

(b) CORPORATION DOES NOT SURVIVE. The Corporation shall not enter into an Organic Change that is a transaction in which the Corporation is not the surviving entity unless lawful provision shall be made as part of the terms of such transaction whereby the surviving entity shall issue new securities (the "NEW SECURITIES") to each holder of Series B Preferred Stock, without payment of any additional consideration by such holder, with terms that provide that upon the conversion of the New Securities, the holder of such securities shall have the right to acquire and receive (in lieu of or in addition to the Conversion Shares acquirable and receivable prior to the Organic Change), without payment of additional consideration therefor (except as would otherwise have been required by the terms of the Series B Preferred Stock as in effect prior to such Organic Change), such securities, cash and other property as such holder would have received if such holder had converted such shares of Series B Preferred Stock into Common Stock immediately prior to such Organic Change. The certificate or articles of incorporation or other constituent document of the surviving entity shall provide for such adjustments which, for events subsequent to the effective date of such certificate or articles of incorporation or other constituent document, shall be equivalent to the adjustments provided for in Section B of this Article IX. All other terms of such New Securities shall be substantially equivalent to the terms provided herein. The provisions of this subsection (b) shall similarly apply to successive Organic Changes of the character described in this subsection (b).

D. CERTAIN EVENTS. If any event similar to or of the type contemplated by the provisions of Section B or Section C of this Article IX, but not expressly provided for by such provisions, occurs, then the Board of Directors of the Corporation, will make an appropriate and equitable adjustment in the Conversion Price so as to protect the rights of the holders of Series B Preferred Stock; PROVIDED, that no such adjustment will decrease the number of Conversion Shares issuable upon conversion of the Series B Preferred Stock.

E. RESTRICTION ON ACTIONS RELATING TO JUNIOR PREFERRED STOCK. No action shall be taken by the Corporation with respect to the Junior Preferred Stock, including without limitation stock splits, stock dividends, stock combinations, issuances below market and special dividends, which would require an adjustment to the Conversion Price if such action were taken with respect to the Common Stock, except pursuant to, and in accordance with, Section B or C of this Article IX.

F. NOTICE OF APPROVAL DATE. When and if the Approval Date shall occur, the Corporation shall promptly mail or cause to be mailed a notice of such occurrence to each holder of Series B Preferred Stock and Junior Preferred Stock.

X. ADDITIONAL DEFINITIONS
For the purposes of this Certificate of Designations of Series B Preferred Stock, the following terms shall have the meanings indicated:

"AFFILIATE" has the meaning set forth in Rule 12b-2 under the Exchange Act as in effect on the date of the Investment Agreement. The term "Affiliated" has a correlative meaning. Notwithstanding the foregoing, for all purposes hereof, the Investor, and each Person controlled by, controlling or under common control with the Investor (each, a "TPG PERSON"), shall not be deemed an "Affiliate" of any Designated Purchaser Person (as defined below), and no Designated Purchaser, and no Person controlled by, controlling or under common control with such Designated Purchaser (each, a "DESIGNATED PURCHASER PERSON"), shall be deemed an "Affiliate" of any TPG Person or any other Designated Purchaser Person, in any such case solely as a consequence of this Agreement or the transactions contemplated hereby.

"APPROVAL DATE" means the date, if any, on which the Corporation obtains the Series B Shareholder Approval.

"ANNIVERSARY DATE" means the date that is ninety days after the date of the original issuance of the Series B Preferred Stock.

"BENEFICIALLY OWN" with respect to any securities means having "beneficial ownership" of such securities (as determined pursuant to Rule 13d-3 under the Exchange Act as in effect on the date of the Investment Agreement, except that a Person shall be deemed to Beneficially Own all such securities that such Person has the right to acquire whether such right is exercisable immediately or after the passage of time). The terms "Beneficial Ownership" and "Beneficial Owner" have correlative meanings. Notwithstanding the foregoing, for all purposes hereof, (i) no TPG Person shall be deemed to Beneficially Own any securities that are held by any Designated Purchaser Person, and no Designated Purchaser Person shall be deemed to Beneficially Own any securities that are held by any TPG Person or any other Designated Purchaser Person, in any such case solely as a consequence of this Agreement or the transactions contemplated hereby, and (ii) no member of the Investor Group shall be deemed to Beneficially Own any Option Shares or securities issuable in respect of the Option Shares unless and until the Option is exercised.

"BUSINESS DAY" means any day, other than a Saturday, Sunday or a day on which banking institutions in the State of New York are authorized or obligated by law or executive order to close.

"BYLAWS" means the Bylaws of the Corporation, as amended from time to time.

"CHANGE OF CONTROL" shall be deemed to have occurred if (a) any person or group (within the meaning of Rule 13d-5 under the Exchange Act as in effect on February 12, 1998) shall own directly or indirectly, beneficially or of record, shares representing more than 35% of the aggregate ordinary voting power represented by the issued and outstanding Equity Securities of the Corporation, other than any Person or Group that owned at least 5% of such Equity Securities on the Closing Date (as such term is defined in the Credit Agreement as in effect on the date of the Investment Agreement); (b) a majority of the seats (other than vacant seats) on the board of directors of the Corporation shall at any time be occupied by persons who were neither (i) nominated by the board of directors of the Corporation nor (ii) appointed by directors so nominated; (c) any change in control (or similar event, however denominated) with respect to the Corporation shall occur under and as defined in any indenture or agreement in respect of Indebtedness for borrowed money in excess of the aggregate principal amount of $10,000,000 to which any Borrower (as such term is defined in the Credit Agreement as in effect on the date of the Investment Agreement) or any Guarantor (as such term is defined in the Credit Agreement as in effect on the date of the Investment Agreement) is a party, other than the Existing Parent Borrower Notes Indenture (as such term is defined in the Credit Agreement as in effect on the date of the Investment Agreement) in connection with a Permitted CBHS Sale (as such term is defined in the Credit Agreement as in effect on the date of the Investment Agreement); or (d) a "Change in Control" or "Change of Control" (or similar event) shall have occurred under the Credit Agreement or the Senior Subordinated Notes, unless, in the case of a "Change of Control" under the Indenture, the aggregate principal amount
outstanding under the Senior Subordinated Notes is less than $10,000,000. Notwithstanding the foregoing, no event described above shall constitute a "Change of Control" if such event resulted directly from any action taken by the Investor or any of its Affiliates.

"CLOSING" shall have the meaning assigned to such term in the Investment Agreement.

"CLOSING PRICE" with respect to a share of Common Stock on any day means, subject to subsection (f) of Section B of Article IX if applicable, the last reported sale price on that day or, in case no such reported sale takes place on such day, the average of the last reported bid and asked prices, regular way, on that day, in either case, as reported in the consolidated transaction reporting system with respect to securities listed on the NYSE or, if the shares of Common Stock are not listed on the NYSE, as reported in the principal consolidated transaction reporting system with respect to securities listed on the principal national securities exchange on which the shares of Common Stock are listed or, if the shares of Common Stock are not listed on NYSE and not listed on any national securities exchange, the last quoted price or, if not so quoted, the average of the high bid and low asked prices on such other nationally recognized quotation system then in use, or, if on any such day the shares of Common Stock are not quoted on any such quotation system, the average of the closing bid and asked prices as furnished by a professional market maker selected by the Board of Directors in good faith making a market in the shares of Common Stock. If the shares of Common Stock are not publicly held or so listed, quoted or publicly traded, the "Closing Price" means the fair market value of a share of Common Stock, as determined in good faith by the Board of Directors.

"COMMON SHARES" means shares of Common Stock (or any successor security) issued or issuable in respect of dividends on, or upon conversion of, shares of Series A Preferred Stock.

"CONVERSION PRICE" shall mean $9.375, as adjusted from time to time pursuant to Section B of Article IX hereof; PROVIDED, that in the event (A) the Series B Shareholder Approval is obtained by the Corporation on or prior to Anniversary Date, as of the day after the Approval Date, the Conversion Price shall equal the product of (i) the Conversion Price in effect on the Approval Date, and (ii) 1.026666666667, or (B) the Series B Shareholder Approval is not obtained by the Corporation on or prior to Anniversary Date, as of the day after the Anniversary Date, the Conversion Price shall equal the product of (i) the Conversion Price in effect on the Anniversary Date, and (ii) 0.9733333333333, in each case as adjusted from time to time pursuant to Section B of Article IX hereof. With respect to any share of Series B Preferred Stock issued after the date of the original issuance of the Series A Preferred Stock, the Conversion Price of such share shall be determined as if such share were issued on the date of the original issuance of the Series A Preferred Stock.

"CONVERSION SHARES" means (i) prior to the Approval Date, shares of Junior Preferred Stock, and (ii) on and after the Approval Date, shares of Common Stock, in each case, issued, or issuable upon, conversion of the Series B Preferred Stock.

"CREDIT AGREEMENT" means the Credit Agreement, dated as of February 12, 1998, among the Corporation, the banks and other financial institutions named therein, and The Chase Manhattan Bank, as Administrative Agent, together with all other documents entered into pursuant to or in connection with the Credit Agreement, in each case, as the same may be amended, restated, supplemented, extended, renewed or increased from time to time, replaced, substituted, refunded or refinanced or otherwise modified from time to time, in whole or in part, and any successive replacements, substitutions, refundings or refinancings.

"DESIGNATED PURCHASER" has the meaning set forth in the Investment Agreement.

"DESIGNATED PURCHASER PERSON" has the meaning set forth in the definition of "Affiliate."

"EQUITY SECURITIES" of any Person, means any and all common
stock, preferred stock and any other class of capital stock of, and any partnership or limited liability company interests in, such Person or any other similar interests of any Person that is not a corporation, partnership or limited liability company.

"EXCHANGE ACT" means the U.S. Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder, from time to time.

"45-TRADING DAY AVERAGE PRICE" means the average of the Closing Prices per share of Common Stock for the Trading Days in any period of 45 consecutive Trading Days (a "45-TRADING DAY REFERENCE PERIOD"); PROVIDED, HOWEVER, that in the event that an adjustment to the Conversion Price takes effect pursuant to Section B of Article IX hereof during the period used to compute such average, the Closing Prices used to compute such average for all Trading Days ended prior to the time such adjustment takes effect shall be similarly adjusted.

"45-TRADING DAY REFERENCE PERIOD" has the meaning set forth in the definition of "45-Trading Day Average Price."

"GOVERNMENTAL ENTITY" means any government or political subdivision or department thereof, any governmental or regulatory body, commission, board, bureau, agency or instrumentality, or any court or arbitrator or alternative dispute resolution body, in each case whether federal, state, local or foreign.

"GROUP" has the meaning set forth in Rule 13d-5 under the Exchange Act.

"GUARANTEE" means any direct or indirect obligation, contingent or otherwise, to guarantee (or having the economic effect of guaranteeing) Indebtedness in any manner, including, without limitation, any monetary obligation to purchase or pay (or advance or supply funds for the purchase or payment of) such Indebtedness (whether arising by agreement to purchase assets, goods, securities or services, to take-or-pay, or to maintain financial statement conditions or otherwise).

"INDEBTEDNESS" means, with respect to any Person, without duplication, (i) all obligations of such Person for money borrowed, (ii) all obligations of such Person evidenced by bonds, debentures, notes, or other similar instruments, (iii) all obligations of such Person upon which interest charges are customarily paid, (iv) all obligations of such Person under conditional sale or other title retention agreements relating to property or assets purchased by such Person, (v) all obligations of such Person issued or assumed as the deferred purchase price of property or services (excluding (x) trade accounts payable and accrued obligations incurred in the ordinary course of business and (y) deferred earn-out and other performance-based payment obligations incurred in connection with any Permitted Acquisition (as such term is defined in the Credit Agreement as in effect on the date of the Investment Agreement) or any similar transactions consummated prior to February 12, 1998), (vi) all Indebtedness of others secured by (or for which the holder of such Indebtedness has an existing right, contingent or otherwise, to be secured by) any Lien on property owned or acquired by such Person, whether or not the obligations secured thereby have been assumed, (vii) all Guarantees by such Person of Indebtedness of others, (viii) all capital lease obligations of such Person, (ix) all obligations (determined on the basis of actual, not notional, obligations) of such Person in respect of interest rate protection agreements, foreign currency exchange agreements or other interest or exchange rate hedging arrangements and (x) all obligations of such Person as an account party in respect of letters of credit and bankers' acceptances issued in support of obligations that constitute Indebtedness under any other clause of this definition (unless such obligations are fully cash collateralized), PROVIDED that all obligations in respect of letters of credit shall be deemed Indebtedness to the extent drawings thereunder are unreimbursed (after any applicable grace period) regardless of the purpose for which such letter of credit was issued. The Indebtedness of any Person shall include the recourse Indebtedness of any partnership in which such Person is a general partner. Notwithstanding the foregoing, no portion of Indebtedness that becomes the subject of a defeasance (whether a legal defeasance or a "covenant" or "in
"INDENTURE" means the Indenture entered into between the Corporation and the Marine Midland Bank, as Trustee, dated as of February 12, 1998, as the same may be amended, restated, supplemented, extended, renewed or increased from time to time, replaced, substituted, refunded or refinanced or otherwise modified from time to time, in whole or in part, and any successive replacements, substitutions, refundings or refinancings.

"INVESTMENT AGREEMENT" means the Investment Agreement, dated as of July 19, 1999, by and between the Investor and the Corporation, as amended, supplemented or otherwise modified from time to time.

"INVESTOR" has the meaning set forth in the Investment Agreement.

"INVESTOR GROUP" means, collectively, the Investor, the Designated Purchasers, if any, and the respective Affiliates of such Persons.

"INVESTOR NOMINEE" means a person designated for election to the Board of Directors by the Investor pursuant to the Investment Agreement.

"INVESTOR SALE PRICE" means with respect to any Investor Sale, the price per Common Share paid in such sale; PROVIDED, that in the event shares of Series A Preferred Stock are sold in such Investor Sale, the Investor Sale Price shall equal the quotient of (A) the price per share of Series A Preferred Stock paid in such Investor Sale, and (B) the number of Common Shares into which such share of Series A Preferred Stock is convertible at the time of such sale.

"LAW" means any law, treaty, statute, ordinance, code, rule, regulation, judgment, decree, order, writ, award, injunction or determination of any Governmental Entity.

"LIEN" means any mortgage, pledge, lien, security interest, claim, voting agreement, conditional sale agreement, title retention agreement, restriction, option or encumbrance of any kind, character or description whatsoever.

"MAKE-WHOLE CONVERSION SHARES" means, with respect to any Investor Sale, the Conversion Shares represented by the shares of Series B Preferred Stock and shares of Junior Preferred Stock included in such Investor Sale; PROVIDED, that aggregate number of Make-Whole Conversion Shares with respect to such Investor Sale shall not exceed the Sale Number with respect to such Investor Sale.

"NYSE" means the New York Stock Exchange, Inc.

"NYSE RULES" has the meaning set forth in the Investment Agreement.

"180-DAY AVERAGE PRICE" means the average of the Closing Prices per share of Common Stock for the Trading Days in any period of 180 consecutive calendar days (a "180-DAY REFERENCE PERIOD"); PROVIDED, however, that in the event that an adjustment to the Conversion Price takes effect pursuant to Section B of Article IX hereof during the period used to compute such average, the Closing Prices used to compute such average for all Trading Days ended prior to the time such adjustment takes effect shall be similarly adjusted.

"180-DAY REFERENCE PERIOD" has the meaning set forth in the definition of "180-Day Average Price."
"OPTION" has the meaning set forth in the Investment Agreement.

"OPTION SHARES" has the meaning set forth in the Investment Agreement.

"ORGANIC CHANGE" means, with respect to the Corporation, any transaction (including without limitation any recapitalization, capital reorganization or reclassification of any class of capital stock, any consolidation or amalgamation of the Corporation with, or merger of the Corporation into, any other Person, any merger of another Person into the Corporation (other than a merger which does not result in a reclassification, conversion, exchange or cancellation of outstanding shares of capital stock of the Corporation), any sale or transfer or lease of all or substantially all of the assets of the Corporation or any compulsory share exchange) pursuant to which any class of capital stock of the Corporation is converted into the right to receive other securities, cash or other property.

"PERSON" means any individual, corporation, company, association, partnership, limited liability company, joint venture, trust or unincorporated organization, or a government or any agency or political subdivision thereof.

"REFERENCE PERIOD" means a 45-Trading Day Reference Period or a 180-Day Reference Period, as the case may be.

"REGISTRATION RIGHTS AGREEMENT" means the Registration Rights Agreement, dated as of July 19, 1999, by and between the Investor and the Corporation, as amended, supplemented or otherwise modified from time to time.

"REGULATORY APPROVALS" means any and all certificates, permits, licenses, franchises, concessions, grants, consents, approvals, orders, registrations, authorizations, waivers, variances or clearances from, or filings or registrations with, Governmental Entities.

"SALE NUMBER" means, with respect to any Investor Sale, the aggregate number of Conversion Shares Beneficially Owned by the Selling Members prior to such Investor Sale, multiplied by a fraction, the numerator of which is the sum of (A) the aggregate number of Common Shares included in such Investor Sale, plus (B) the aggregate number of Common Shares into which the shares of Series A Preferred Stock included in such sale are convertible at the time of such sale, and the denominator is the aggregate number of Common Shares Beneficially Owned by the Selling Members prior to such Investor Sale.

"SECURITIES ACT" means the U.S. Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder, from time to time.

"SENIOR SUBORDINATED NOTES" means the Senior Subordinated Notes of the Corporation issued pursuant to the Indenture.

"SERIES B SHAREHOLDER APPROVAL" means the approval by the stockholders of the Corporation, in accordance with the General Corporation Law of the State of Delaware and in accordance with and in satisfaction of Paragraph 312.00 of the NYSE's Listed Company Manual and the related NYSE Rules and interpretations of (i) the issuance of Common Stock in respect of accrued and unpaid dividends on the Series B Preferred Stock (including upon the conversion or exchange thereof), (ii) the issuance of Common Stock upon the conversion or exchange of the Series B Preferred Stock, and (iii) the vesting of voting rights in respect of the Series B Preferred Stock, in each case in accordance with the terms hereof and the Investment Agreement.

"SUBSIDIARY" means as to any Person, any other Person of which more than 50% of the shares of the voting stock or other voting interests are owned or controlled, or the ability to select or elect more than 50% of the directors or similar managers is held, directly or indirectly, by such first Person or one or more of its Subsidiaries or by such first Person and one or more of its Subsidiaries; PROVIDED, HOWEVER, that no Joint Venture (as such term is defined in the Investment Agreement) shall be considered (i) a "Subsidiary"
of the Corporation or (ii) a "Subsidiary" of any Subsidiary of the Corporation.

"TPG PERSON" has the meaning set forth in the definition of "Affiliate."

"TRADING DAY" means any day on which the NYSE is open for trading, or if the shares of Common Stock are not quoted on the NYSE, any day on which the principal national securities exchange or national quotation system on which the shares of Common Stock are listed, admitted to trading or quoted is open for trading, or if the shares of Common Stock are not so listed, admitted to trading or quoted, any Business Day.

"TWO-WEEK AVERAGE PRICE" means the average of the Closing Prices per share of Common Stock for the Trading Days in the two-calendar week period ending on the last day of a Reference Period; PROVIDED, HOWEVER, that in the event that an adjustment to the Conversion Price takes effect pursuant to Section B of Article IX hereof during the period used to compute such average, the Closing Prices used to compute such average for all Trading Days ended prior to the time such adjustment takes effect shall be similarly adjusted.

"VOTING SECURITIES" means the shares of Common Stock and any other securities of the Corporation entitled to vote generally for the election of directors.

XI. MISCELLANEOUS

A. NOTICES. Any notice referred to herein shall be in writing and, unless first-class mail shall be specifically permitted for such notices under the terms hereof, shall be deemed to have been given upon personal delivery thereof, upon transmittal of such notice by telecopy (with confirmation of receipt by telecopy or telex) or five days after transmittal by registered or certified mail, postage prepaid, addressed as follows:

(i) if to the Corporation, to its office at 6950 Columbia Gateway Drive, Fourth Floor, Columbia, Maryland 21046 (Attention: General Counsel) or to the transfer agent for the Series B Preferred Stock;

(ii) if to a holder of the Series B Preferred Stock, to such holder at the address of such holder as listed in the stock record books of the Corporation (which may include the records of any transfer agent for the Series B Preferred Stock); or

(iii) to such other address as the Corporation or such holder, as the case may be, shall have designated by notice similarly given.

B. REACQUIRED SHARES. Any shares of Series B Preferred Stock redeemed, purchased or otherwise acquired by the Corporation, directly or indirectly, in any manner whatsoever shall be retired and canceled promptly after the acquisition thereof (and shall not be deemed to be outstanding for any purpose) and, if necessary to provide for the lawful redemption or purchase of such shares, the capital represented by such shares shall be reduced in accordance with the Delaware General Corporation Law. All such shares of Series B Preferred Stock shall upon their cancellation and upon the filing of an appropriate certificate with the Secretary of State of the State of Delaware, become authorized but unissued shares of Preferred Stock, without par value, of the Corporation and may be reissued as part of another series of Preferred Stock, without par value, of the Corporation subject to the conditions or restrictions on issuance set forth herein.

C. ENFORCEMENT. Any registered holder of shares of Series B Preferred Stock may proceed to protect and enforce its rights and the rights of such holders by any available remedy by proceeding at law or in equity to protect and enforce any such rights, whether for the specific enforcement of any provision in this Certificate of Designations or in aid of the exercise of any power granted herein, or to enforce any other proper remedy.

D. TRANSFER TAXES. Except as otherwise agreed upon pursuant to the terms of this Certificate of Designations, the Corporation shall pay any and all documentary, stamp or similar issue or transfer taxes and other governmental
charges that may be imposed under the laws of the United States of America or any political subdivision or taxing authority thereof or therein in respect of any issue or delivery of Common Stock or Debentures on conversion or exchange of, or other securities or property issued on account of, shares of Series B Preferred Stock pursuant hereto or certificates representing such shares or securities. The Corporation shall not, however, be required to pay any such tax or other charge that may be imposed in connection with any transfer involved in the issue or transfer and delivery of any certificate for Common Stock or Debentures or other securities or property in a name other than that in which the shares of Series B Preferred Stock so converted or exchanged, or on account of which such securities were issued, were registered and no such issue or delivery shall be made unless and until the Person requesting such issue has paid to the Corporation the amount of any such tax or has established to the satisfaction of the Corporation that such tax has been paid or is not payable.

E. TRANSFER AGENT. The Corporation may appoint, and from time to time discharge and change, a transfer agent for the Series B Preferred Stock. Upon any such appointment or discharge of a transfer agent, the Corporation shall send notice thereof by first-class mail, postage prepaid, to each holder of record of shares of Series B Preferred Stock.

F. RECORD DATES. In the event that the Series B Preferred Stock shall be registered under either the Securities Act or the Exchange Act, the Corporation shall establish appropriate record dates with respect to payments and other actions to be made with respect to the Series B Preferred Stock.

G. SUBORDINATION TO SENIOR SUBORDINATED NOTES. By accepting a share of Series B Preferred Stock or Debenture, the holder thereof shall be deemed to have acknowledged and agreed that (a) such holder's right to receive payments in respect of the Series B Preferred Stock or Debenture is subject and subordinated in right of payment to the payment in full and discharge of all amounts (however denominated) then due and payable under the Senior Subordinated Notes, and (b) until payment in full of all such amounts (however denominated) under the Senior Subordinated Notes has been made, no payment, whether directly or indirectly, by exercise of any right of set off or otherwise in respect of the Series B Preferred Stock or Debenture shall be made by the Corporation, and no deposit in respect of the Series B Preferred Stock or Debenture shall be made pursuant to the terms hereof. In the event that any payment by, or distribution of the assets of, the Corporation of any kind or character (whether in cash, property or securities, whether directly or indirectly, by exercise of any right of set-off or otherwise and whether as a result of a bankruptcy proceeding with respect to the Corporation or otherwise) shall be received by a holder of Series B Preferred Stock at any time when such payment is prohibited by this paragraph, such payment shall be held in trust for the benefit of, and shall be paid over to, the holders of Senior Subordinated Notes as their interests may appear. The preceding two sentences address the relative rights of holders of Series B Preferred Stock or Debentures, on the one hand, and the holders of Senior Subordinated Notes, on the other hand, and nothing in this Certificate of Designations shall impair, as between the Corporation and the holders of Series B Preferred Stock or Debentures, the obligation of the Corporation, which is absolute and unconditional, to pay amounts due in respect of the Series B Preferred Stock and Debentures in accordance with their terms. This Section G shall not be construed to limit in any manner the subordination provisions set forth in Section D of Article V hereof.

IN WITNESS WHEREOF, this Certificate of Designations is executed on behalf of the Corporation by its Chief Financial Officer and attested by its Assistant Secretary, this [__] day of [_______], 1999.
EXHIBIT C
Form of Junior Certificate of Designations

CERTIFICATE OF DESIGNATIONS

OF

SERIES C JUNIOR PARTICIPATING PREFERRED STOCK

OF

MAGELLAN HEALTH SERVICES, INC.

(PURSUANT TO SECTION 151 OF THE GENERAL CORPORATION LAW OF THE STATE OF DELAWARE)

Magellan Health Services, Inc., a corporation organized and existing under the General Corporation Law of the State of Delaware (the "CORPORATION"), hereby certifies that the following resolutions were adopted by the Board of Directors (the "BOARD OF DIRECTORS") of the Corporation as required by Section 151 of the General Corporation Law of the State of Delaware.

RESOLVED, that pursuant to the authority granted to and vested in the Board of Directors of the Corporation in accordance with the provisions of the Restated Certificate of Incorporation of the Corporation, as amended (the "CERTIFICATE OF INCORPORATION"), the Board of Directors hereby creates a series of preferred stock, without par value, of the Corporation, and hereby states the designation and number thereof, and fixes the voting powers, preferences and relative, participating, optional and other special rights, and the qualifications, limitations and restrictions thereof, as follows:

Series C Junior Participating Preferred Stock:

Section 1. DESIGNATION AND AMOUNT.

The designation of this series of shares shall be "Series C Junior Participating Preferred Stock" (the "SERIES C PREFERRED STOCK"), and the number of shares constituting such series shall be __________. The number of shares of the Series C Preferred Stock may be increased or decreased by resolution of the Board of Directors; PROVIDED, HOWEVER, that no decrease shall reduce the number of shares of Series C Preferred Stock to a number less than the aggregate number of such shares then outstanding.

Section 2. DIVIDENDS AND DISTRIBUTIONS.

(a) Subject to the rights of the holders of any shares of any series of preferred stock of the Corporation (the "PREFERRED STOCK") (or any similar stock) ranking prior and superior to the Series C Preferred Stock with respect to dividends, the holders of shares of Series C Preferred Stock, in preference to the holders of the common stock, par value $0.25 per share (the "COMMON STOCK"), of the Corporation, and of any other class of stock of the Corporation ranking
junior to the Series C Preferred Stock, shall be entitled to receive, when, as and if declared by the Board of Directors out of funds legally available for the purpose, dividends and other distributions, in an amount per share (rounded to the nearest cent) equal to, subject to the provision for adjustment hereinafter set forth, the amount of all cash dividends, and the aggregate per share amount (payable in kind) of all non-cash dividends or other distributions other than a dividend payable in shares of Common Stock, declared on the Common Stock since the immediately preceding dividend or distribution declared on the Series C Preferred Stock. In the event the Corporation shall declare or pay any dividend on Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the amount per share to which holders of shares of Series C Preferred Stock were entitled immediately prior to such event under the preceding sentence shall be adjusted by multiplying such amount by a fraction, the numerator of which shall be the number of shares of Common Stock outstanding immediately after such event and the denominator of which shall be the number of shares of Common Stock that were outstanding immediately prior to such event.

(b) The Corporation shall declare a dividend or distribution on the Series C Preferred Stock as provided in paragraph (a) of this Section 2 immediately after it declares a dividend or distribution on the Common Stock (other than a dividend payable in shares of Common Stock).

(c) The Board of Directors may fix a record date for the determination of holders of shares of Series C Preferred Stock entitled to receive payment of a dividend or distribution declared thereon, which record date shall be not more than 30 days prior to the date fixed for the payment thereof.

Section 3. VOTING RIGHTS. Except as set forth in Section 10 hereof, or as otherwise from time to time required by law, holders of Series C Preferred Stock shall have no voting rights and their consent shall not be required for taking any corporate action.

Section 4. CERTAIN RESTRICTIONS.

(a) Whenever dividends or distributions payable on the Series C Preferred Stock as provided in Section 2 are in arrears, thereafter and until all unpaid dividends and distributions, whether or not declared, on outstanding shares of Series C Preferred Stock shall have been paid in full, the Corporation shall not:

(i) declare or pay dividends, or make any other distributions, on any shares of stock ranking junior (as to dividends) to the Series C Preferred Stock;

(ii) declare or pay dividends, or make any other distributions, on any shares of stock ranking on a parity (as to dividends) with the Series C Preferred Stock, except dividends paid ratably on the Series C Preferred Stock and all such parity stock on which dividends are payable or in arrears in proportion to the total amounts to which the holders of all such shares are then entitled;

(iii) redeem or purchase or otherwise acquire for consideration shares of any stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up of the Corporation) to the Series C Preferred Stock, PROVIDED, HOWEVER, that the Corporation may at any time redeem, purchase or otherwise acquire shares of any such junior stock in exchange for shares of any stock of the Corporation ranking junior (as to dividends and upon
dissolution, liquidation or winding up of the Corporation) to
the Series C Preferred Stock or rights, warrants or options to
acquire such junior stock; or

(iv) redeem or purchase or otherwise acquire
for consideration any shares of Series C Preferred Stock, or
any shares of stock ranking on a parity (either as to
dividends or upon liquidation, dissolution or winding up of
the Corporation) with the Series C Preferred Stock, except in
accordance with a purchase offer made in writing to all
holders of such shares of Series C Preferred Stock, or shares
of Series C Preferred Stock and parity stock, as the case may
be, upon such terms as the Board of Directors, after
consideration of the respective dividend rates and other
relative rights and preferences of the respective series and
classes, shall determine in good faith will result in fair and
equitable treatment among the respective series or classes.

(b) The Corporation shall not redeem or purchase or otherwise
acquire shares of Common Stock unless, in each case, within five days of such
transaction, the Corporation makes a purchase offer in writing to all holders of
shares of Series C Preferred Stock offering to purchase a number of shares of
Series C Preferred Stock equal to the number of shares of Common Stock redeemed
or purchased or otherwise acquired in such transaction at a price per share
equal to the amount of consideration paid for one share of Common Stock in such
transaction and otherwise on terms and conditions no less favorable to the
holders of Series C Preferred Stock than those applicable in such transaction
(as determined by the Board of Directors in good faith). In the event the
Corporation shall declare or pay any dividend on Common Stock payable in shares
of Common Stock, or effect a subdivision or combination or consolidation of the
outstanding shares of Common Stock (by reclassification or otherwise than by
payment of a dividend in shares of Common Stock) into a greater or lesser number
of shares of Common Stock, then in each such case (i) the number of shares of
Series C Preferred Stock which holders thereof were entitled to have the
Corporation offer to purchase immediately prior to such event under the
preceding sentence shall be adjusted by multiplying such number by a fraction,
the numerator of which shall be the number of shares of Common Stock outstanding
immediately after such event and the denominator of which shall be the number of
shares of Series C Preferred Stock that were outstanding immediately prior to such event,
and (ii) the amount per share to which holders of shares of Series C Preferred
Stock were entitled immediately prior to such event under the preceding sentence
shall be adjusted by multiplying such amount by a fraction the numerator of
which shall be the number of shares of Common Stock outstanding immediately
immediately prior to such event and the denominator of which shall be the number of shares
of Series C Preferred Stock that were outstanding immediately after such event.

(c) The Corporation shall not, and shall not permit any
Subsidiary of the Corporation to, enter into any agreement with any Person
providing for the purchase or other acquisition by such Person (or any other
Person) of shares of Common Stock from any Person

(other than the Corporation), whether pursuant to tender offer, exchange offer
or otherwise, unless, in each case, within five days of the commencement of such
transaction, such Person promptly makes a purchase offer in writing to all
holders of shares of Series C Preferred Stock offering to purchase a number of
shares of Series C Preferred Stock equal to the number of shares of Common Stock
purchased or otherwise acquired in such transaction at a price per share equal
to the amount of consideration paid for one share of Common Stock in such
transaction and otherwise on terms and conditions no less favorable to the
holders of Series C Preferred Stock than those applicable in such transaction
(as determined by the Board of Directors in good faith). In the event the
Corporation shall declare or pay any dividend on the Common Stock payable in
shares of Common Stock, or effect a subdivision or combination or consolidation of the
outstanding shares of Common Stock (by reclassification or otherwise than by
payment of a dividend in shares of Common Stock) into a greater or lesser number
of shares of Series C Preferred Stock, then in each such case (i) the number of
shares of Series C Preferred Stock which holders thereof were entitled to have
redeemed or purchased or otherwise acquired immediately prior to such event
under the preceding sentence shall be adjusted by multiplying such number by a
fraction, the numerator of which shall be the number of shares of Common Stock
outstanding immediately after such event and the denominator of which shall be
the number of shares of Common Stock that were outstanding immediately prior to
such event, and (ii) the amount per share to which holders of shares of Series C
Preferred Stock were entitled immediately prior to such event under the
preceding sentence shall be adjusted by multiplying such amount by a fraction
the numerator of which shall be the number of shares of Common Stock outstanding
immediately prior to such event and the denominator of which shall be the number
of shares of Common Stock that were outstanding immediately after such event.

(d) The Corporation shall not permit any Subsidiary of the
Corporation to purchase or otherwise acquire for consideration any shares of
stock of the Corporation unless the Corporation could, under paragraph (a) or,
(b) or (c) of this Section 4, purchase or otherwise acquire such shares at such
time and in such manner.

(e) Notwithstanding the foregoing, this Section 4 shall not
prohibit (i) purchases of Equity Securities of the Corporation or any of its
Subsidiaries from executives and other management-level employees of the
Corporation or any of its Subsidiaries in connection with customary employment
and severance arrangements, or (ii) the acquisition, repurchase, exchange,
conversion, redemption or other retirement for value by the Corporation of any
Equity Securities of the Corporation in accordance with obligations in existence
at the time of original issuance of the Series A Preferred Stock.

Section 5. REACQUIRED SHARES. Any shares of Series C Preferred
Stock purchased or otherwise acquired by the Corporation in any manner
whatsoever shall be retired and cancelled promptly after the acquisition
thereof. All such shares shall upon their cancellation become authorized but
unissued shares of the preferred stock of the Corporation and may be reissued as
part of a new series of the preferred stock of the Corporation, subject to the
conditions and restrictions on issuance set forth herein.

Section 6. LIQUIDATION, DISSOLUTION OR WINDING UP. Upon any
liquidation, dissolution or winding up of the Corporation, no distribution shall
be made (a) to the holders of the Common Stock or of shares of any other stock
of the Corporation ranking junior, upon
Common Stock is converted, exchanged or changed. In the event the Corporation shall declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the amount set forth in the preceding sentence with respect to the conversion, exchange or change of shares of Series C Preferred Stock shall be adjusted by multiplying such amount by a fraction, the numerator of which shall be the number of shares of Common Stock outstanding immediately after such event and the denominator of which shall be the number of shares of Common Stock that were outstanding immediately prior to such event.

Section 8. NO REDEMPTION. The shares of Series C Preferred Stock shall not be redeemable by the Corporation.

Section 9. RANK. The Series C Preferred Stock shall rank, with respect to the payment of dividends and the distribution of assets upon liquidation, dissolution or winding up of the Corporation, junior to all other series of Preferred Stock (unless the terms of any such series shall provide otherwise) and senior to the Common Stock.

Section 10. AMENDMENT. Without the consent or affirmative vote of the holders of at least a majority of the outstanding shares of Series C Preferred Stock, voting separately as a class, the Corporation shall not (i) amend, alter or repeal any provision of the Certificate of Incorporation or the Bylaws, if the amendment, alteration or repeal alters or changes the powers, preferences or special rights of the Series C Preferred Stock so as to affect them adversely, or (ii) authorize or take any other action if such action alters or changes any of the rights of the Series C Preferred Stock in any respect or otherwise would be inconsistent with the provisions of this Certificate of Designations and the holders of any class or series of the capital stock of the Corporation is entitled to vote thereon.

Section 11. FRACTIONAL SHARES. Series C Preferred Stock may be issued in fractions of a share which shall entitle the holder, in proportion to such holder's fractional shares, to exercise voting rights, receive dividends, participate in distributions and to have the benefit of all other rights of holders of Series C Preferred Stock.

Section 12. DEFINITIONS. The following terms shall have the following definitions:

"EQUITY SECURITIES" of any Person, means any and all common stock, preferred stock and any other class of capital stock of, and any partnership or limited liability company interests in, such Person or any other similar interests of any Person that is not a corporation, partnership or limited liability company.

"INVESTMENT AGREEMENT" means the Investment Agreement, dated as of July 19, 1999, by and between the Investor and the Corporation, as amended, supplemented or otherwise modified from time to time.

"SERIES A PREFERRED STOCK" the Series A Cumulative Convertible Preferred Stock, without par value, of the Corporation.

"SUBSIDIARY" means as to any Person, any other Person of which more than 50% of the shares of the voting stock or other voting interests are owned or controlled, or the ability to select or elect more than 50% of the directors or similar managers is held, directly or indirectly, by such first Person or one or more of its Subsidiaries or by such first Person and one or more of its Subsidiaries; PROVIDED, HOWEVER, that no Joint Venture (as such term is defined in the Investment Agreement) shall be considered (i) a "Subsidiary" of the Corporation or (ii) a "Subsidiary" of any Subsidiary of the Corporation.

"PERSON" means any individual, corporation, company, association, partnership, limited liability company, joint venture, trust, unincorporated organization, or governmental entity.
IN WITNESS WHEREOF, this Certificate of Designations is executed on behalf of the Corporation by its Chief Financial Officer and attested by its Secretary this [ ] day of [____], 1999.

C-6

MAGELLAN HEALTH SERVICES, INC.

By:____________________________________
   Name: Cliff Donnelly
   Title: Chief Financial Officer

[Corporate Seal]

ATTEST:

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C-7
March 2, 1999

VIA FAXIMILE AND FEDERAL EXPRESS
913-685-1656

PERSONAL AND CONFIDENTIAL

Clifford W. Donnelly
6907 West 130th Street
Overland Park, KS 66209

Dear Cliff:

This letter will serve to confirm our offer of employment to you with Magellan Health Services, Inc. in the capacity of Executive Vice President and Chief Financial officer reporting directly to Henry T. Harbin, President and Chief Executive Officer.

EFFECTIVE DATE/SALARY/STOCK OPTIONS

We anticipate your start date to be March 31, 1999, at an annualized salary of $325,000. In addition, you will be entitled to a grant of 75,000 stock options. Upon relocation, your annualized base salary will be increased to $360,000 and you will receive an additional grant of 50,000 stock options.

LOCATION/TRAVEL

Your primary business office and principal place of work will be the Company's corporate offices in Columbia, Maryland. During the first four months of your employment, the Company will reimburse you for weekly air travel from your personal residence and the expense of a corporate apartment in the Columbia, Maryland area. After four months, the Company may require your relocation to the Columbia, Maryland area, expenses of which would be covered pursuant to the Company's standard relocation policy.

INCENTIVE BONUS PROGRAM

You will be eligible to participate in the 1999 corporate incentive bonus plan on a pro-rated basis which began October 1, 1998 and concludes September 30, 1999. The target for the Executive Vice President level is 35% of base salary if performance goals for the plan are met.

BENEFITS

Please see the attached Exhibit A for a summary description of benefits for which you are eligible. You will receive pro-rated PTO time for fiscal 1999. You will be eligible to participate in the next cycle of the Employee Stock Purchase Plan beginning July 1, 1999, and the Magellan Health Services Retirement Savings Plan on the first of the month after 90 days of service, as noted in the summary description.

TERM/EMPLOYMENT AGREEMENT/SEVERANCE

Your employment with the Company would be for an initial term of two years, and is subject to finalizing a standard employment agreement with you upon substantially the terms and conditions set forth above, including other customary terms and conditions such as non-competition and non-solicitation covenants. In the event of termination without cause of your employment by the Company, you would be entitled to severance for a period of one year.
addition, in the event of a change in control of the Company, you would have the right to terminate your employment for a period of 90 days and receive severance for a period of one year. Upon you relocation to Columbia, the involuntary termination and change of control severance periods would be increased to two years.

Cliff, we would be delighted to have you join the "Magellan Team".

Sincerely,

/s/ Dave Hansen

David J. Hansen
Vice President and General Counsel

Please signify your acceptance of the above terms and conditions of employment by signing below and returning the original letter to David J. Hansen, Magellan Health Services, 3414 Peachtree Road, N. E., Suite 1400, Atlanta, Georgia 30326 at your earliest convenience. (Facsimile number 404-869-5667). We will promptly forward a draft of an employment agreement for your review.

Signature /s/ Clifford W. Donnelly Date March 2, 1999

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DJH:jlm

Cc:   Henry Harbin
June 4, 1999

Mr. Mark Demilio
643 Sussex Road
Towson, Maryland 21286

Dear Mark:

This letter is to confirm our revised offer to you for the position of Executive Vice President and General Counsel for Magellan Health Services. In this position, you will report to me and receive an annualized salary of $230,000, payable semi-monthly. You will also receive a car allowance of $1000 per month payable semi-monthly.

Regarding additional executive compensation, you will participate (in accordance with plan eligibility rules) in the Magellan Health Services Short-Term Incentive (STI) Program at a target level of 40% of your base salary. Payment is based on corporate performance as well as individual performance against objectives and approved plan funding. As you are not eligible to participate in this plan for FY '99, I will consider you for a bonus in the range of $10 - 20K assuming Magellan Health Services hits all '99 STI targets. As a further statement of our confidence in you to successfully take on the challenges of this position, I am awarding you 40,000 stock options which will have a strike price based on the market value on the date of your employment with Magellan. This option grant has a three-year graduated vesting schedule.

Regarding our benefits programs, you will be eligible for enrollment in health, dental, vision, life insurance and flexible spending accounts on the first of the month following 30 days of employment. Both short-term and long-term disability programs have a six-month eligibility waiting period. These benefits are highlighted in the attached brochure. In addition to a 401(k) Plan, which is also described in the brochure, there is a 401(k) Plus program that has a company contribution target of 2% of the employee's compensation (up to the IRS limit for qualified plans) regardless of participation in the 401(k). This has a three-year cliff vesting schedule. The Employee Stock Purchase Plan, while described in the brochure, is not available to employees who report directly to me.

In addition to these benefits and the time off benefits noted for management, you will be eligible for a new executive benefit that we are currently designing for rollout later this year. This will be a 100% company contributed annual deferred compensation program. The target contribution for officers in positions equivalent to yours is projected to be in the range of 7 - 9% of base compensation. Contributions will be self-directed by the officer within an array of investment funds designated for the plan.

As discussed, we will provide you with severance protection of one year's base compensation if there is a change of control for Magellan Health Services and your employment is terminated for any reason other than "for cause". Voluntary resignation would only trigger severance in the event you resign with good cause, i.e. you resign as a result of your duties being materially reduced; your salary being reduced if the reduction is not part of a general reduction for officers in equivalent positions; your eligibility for bonus plans or benefits plans is restricted unless the restriction applies in general to officers in equivalent positions; or you are asked to relocate your office outside the greater Baltimore area. The severance arrangement would be as follows: In the event you leave the company for reasons other than voluntary resignation or dismissal for "cause", you will be eligible for twelve months of severance. "Cause" for termination includes any of the following: commission of an act of fraud or dishonestly involving his or her duties on behalf of Magellan; willful failure or refusal to faithfully and diligently perform duties as assigned or breach of material terms under any employment agreement; willful failure or refusal to abide by Magellan's policies, rules, procedures or directives; conviction of a felony or misdemeanor involving moral turpitude; or
breech of the non-competition and non-solicitation provisions in this offer letter.

As a general policy of our company, by accepting this offer, you agree that, during the tenure of your employment with the company and for a period of one year thereafter, you will not directly or indirectly (i) solicit or contact for business purposes any existing customer of the company or any prospective customer of the company with which you had contact during your employment, or (ii) offer employment to any of the company's employees, agents or consultants, or (iii) induce, or attempt to induce, any of the company's employees, agents or consultants to do anything for which you are restricted by reason of this covenant for non-Magellan business, or (iv) assist any firm, corporation or business entity as an owner, officer, director, employee, agent, security holder or creditor that engages in the managed specialty and/or behavioral health field. Also, please note that nothing in this letter is to be construed or interpreted as a promise of employment for a particular term or period of time and this letter supersedes any and all prior communications, both written and verbal, concerning your employment with the company.

We are enthused about the prospect of your acceptance of this position and would like your decision by Tuesday, June 1. If you have any questions about this offer, please talk with Chris Pettingill, our Senior Vice President of Human Resources at 410-953-1101 or me.

Sincerely,

/s/ Henry Harbin

Henry Harbin
CEO
Magellan Health Services

/s/ Mark Demilio

Accepted by Mark Demilio    Date
The following corporations are direct or indirect subsidiaries of Magellan Health Services, Inc.

<table>
<thead>
<tr>
<th>NAME</th>
<th>DOMICILE</th>
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<tr>
<td>Allied Specialty Care Services, Inc.</td>
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<td>Care Management Resources, Inc.</td>
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Green Spring of Pennsylvania, Inc.                                        Pennsylvania
Managed Care Services Mainstay of Central Pennsylvania, Inc.                                        Pennsylvania
Maryland Health Partners, LLC                                           Maryland
Maschhoff, Barr & Associates, Inc.                                      Washington
Vista Behavioral Health Plans, Inc.                                     California
Human Affairs International, Incorporated                               Utah
Human Affairs of Alaska, Inc.                                            Alaska
Human Affairs International of California                               California
Human Affairs International IPA, Inc.                                    New York
Human Affairs International of Pennsylvania, Inc.                        Pennsylvania
Magellan Behavioral Health, Inc.                                        Delaware
MCI/Magellan Partners, L.L.C.                                            Delaware
Magellan Military Health Solutions, Inc.                                Delaware
Tennessee Behavioral Health, Inc.                                        TN
Magellan Behavioral Health of Texas, Inc.                                Texas
Magellan Capital, Inc.                                                  Delaware
Magellan CMHC Holdings, Inc.                                            Delaware
Behavioral Health Systems of Indiana, Inc.                              Indiana
The Charter Behavioral Health System of Northwest Indiana, LLC          Indiana
C.A.C.O. Services, Inc.                                                 Delaware
CXM, Inc.                                                              Nevada
Charter Alvarado Behavioral Health System, Inc.                          California
Charter Asheville Behavioral Health System, Inc.                         North Carolina
Charter Bay Harbor Behavioral Health System, Inc.                       Florida
Charter Behavioral Health System of Athens, Inc.                        Georgia
Charter Behavioral Health System of California, Inc.                    California
Charter Behavioral Health System of Haywood, Inc.                       Texas
Charter Behavioral Health System of Bradenton, Inc.                     Florida
Charter Behavioral Health System at Manatee Adolescent Treatment Services, Inc.   Florida
Charter Behavioral Health System of Central Georgia, Inc.               Georgia
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<th>Company Name</th>
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Merit Behavioral Care Systems Corporation
INROADS Behavioral Health Services of Texas, L.P.
MBCS of Florida, Inc.
MBCS of North Carolina, Inc.
Merit INROADS Behavioral Health Services of Illinois, LLC
Merit Health Insurance Company
Orion Life Insurance Company
Merit Holdings Corp.
MBC National Service Corporation
Merit Behavioral Care of Arkansas, Inc.
Merit Behavioral Care of Maryland, Inc.
Merit INROADS Behavioral Health Services, LLC
Merit INROADS Behavioral Health Services of Illinois, LLC
INROADS Behavioral Health Services of Texas, L.P.
MeritChoice, Inc.
ProPsych, Inc.
PFC Group, Inc.
Merit Behavioral Care of California, Inc.
P.P.C., Inc.
Personal Performance Consultants of New York, Inc.
CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation by reference of our report dated November 30, 1999 (except with respect to the matter discussed in Note 15, as to which the date is December 15, 1999) and to all references to our firm, included in this Form 10-K, into the Company's previously filed Registration Statements on Form S-3 (File Nos. 333-53353, 333-20371, 333-01217, and 333-50423).

Arthur Andersen LLP

Baltimore, Maryland
December 23, 1999
This schedule contains summary financial information extracted from the consolidated balance sheets and consolidated statements of operations found on pages F-3 and F-4 of the company's Form 10-K for the year-to-date, and is qualified in its entirety by reference to such financial statements.

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