

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1994-05-13** | Period of Report: **1994-03-31**
SEC Accession No. **0000793499-94-000026**

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FILER

FHP INTERNATIONAL CORP

CIK: **793499** | IRS No.: **330072502** | State of Incorporation: **DE** | Fiscal Year End: **0630**
Type: **10-Q** | Act: **34** | File No.: **001-11329** | Film No.: **94528344**
SIC: **8011** Offices & clinics of doctors of medicine

Business Address
9900 TALBERT AVE
C/O FHP INTERNATIONAL
CORP
FOUNTAIN VALLEY CA 92708
7149637233

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

(Mark One)

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

For the quarterly period ended March 31, 1994

OR

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

For the transition period from _____ to _____

Commission file number 0-14796

FHP INTERNATIONAL CORPORATION
a Delaware Corporation
I.R.S. Employer Identification No. 33-0072502

9900 Talbert Avenue, Fountain Valley, CA 92708-8000
(Address of principal executive offices) (Zip Code)
(714) 963-7233
(Registrant's telephone number, including area code)

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 No .

The registrant had 33,158,269 shares of common stock, par value \$0.05 per share, outstanding at May 10, 1994.

The Exhibit Index Appears on Page 19

PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements

FHP INTERNATIONAL CORPORATION
CONSOLIDATED BALANCE SHEETS
(unaudited)

ASSETS

(amounts in thousands, except share data)	March 31, 1994	June 30, 1993
	_____	_____
Cash and cash equivalents	\$ 194,884	\$ 2,700
Short-term investments	172,733	174,057
Accounts receivable (net of allowance for doubtful accounts of \$11,792 and \$7,147 at March 31, 1994 and June 30, 1993, respectively)	70,761	56,288
Inventories	12,566	11,658
Other current assets	30,312	22,167
	_____	_____
Total current assets	481,256	266,870
	_____	_____
Property and equipment	506,811	455,915
Less accumulated depreciation and amortization	138,154	109,607
	_____	_____
Property and equipment, net	368,657	346,308
	_____	_____
Long-term investments	78,629	38,723
Restricted investments	75,418	67,025
Other assets (Note 7)	34,535	26,758
	_____	_____
Total assets	\$1,038,495	\$745,684
	=====	=====

See accompanying notes to consolidated financial statements.

FHP INTERNATIONAL CORPORATION
CONSOLIDATED BALANCE SHEETS
(unaudited)

LIABILITIES AND STOCKHOLDERS' EQUITY

(amounts in thousands, except share data)	March 31, 1994	June 30, 1993
Current portion of long-term obligations	\$ 150	\$ 2,474
Accounts payable	35,411	39,935
Medical claims payable	170,968	149,060
Accrued salaries and employee benefits	79,030	69,940
Deferred premiums	146,017	17,678
Other current liabilities	16,839	16,817
	448,415	295,904
Total current liabilities		
Long-term obligations	103,025	20,802
Other liabilities	81,958	64,556
	633,398	381,262
Total liabilities		
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock, \$0.05 par value; 5,000,000 shares authorized; none outstanding		
Common stock, \$0.05 par value; 70,000,000 shares authorized; 33,152,619 and 32,836,079 shares issued at March 31, 1994 and June 30, 1993, respectively	1,658	1,642
Paid-in capital	224,722	222,375
Retained earnings	178,717	140,405
	405,097	364,422
Total stockholders' equity		
Total liabilities and stockholders' equity	\$1,038,495	\$745,684

See accompanying notes to consolidated financial statements.

FHP INTERNATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

(amounts in thousands, except per share data)	For The Three Months Ended March 31,	
	1994	1993
Revenue	\$622,461	\$535,775
Expenses:		
Primary health care	494,484	422,521
Other health care	23,803	22,255
General, administrative and marketing	79,818	71,951
Total expenses	598,105	516,727
Operating income	24,356	19,048
Interest income, net (Note 5)	3,342	3,848
Income before income taxes	27,698	22,896
Provision for income taxes	10,885	8,448
Net income	\$ 16,813	\$ 14,448

	=====	=====
Earnings per share (Note 2)	\$ 0.50	\$ 0.43
	=====	=====
Weighted average number of common shares and common share equivalents	33,840	33,384
	=====	=====

See accompanying notes to consolidated financial statements.

FHP INTERNATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

	For The Nine Months Ended March 31,	
(amounts in thousands, except per share data)		
	1994	1993
	-----	-----
Revenue	\$1,789,947	\$1,444,451
	-----	-----
Expenses:		
Primary health care	1,428,703	1,153,712
Other health care	69,634	63,762
General, administrative and marketing	240,086	195,403
	-----	-----
Total expenses	1,738,423	1,412,877
	-----	-----
Operating income	51,524	31,574
Interest income, net (Note 5)	10,673	11,148

Income before income taxes	62,197	42,722
Provision for income taxes	23,885	15,679
Net income	\$ 38,312 =====	\$ 27,043 =====
Earnings per share (Note 2)	\$ 1.14 =====	\$ 0.82 =====
Weighted average number of common shares and common share equivalents	33,659 =====	33,159 =====

See accompanying notes to consolidated financial statements.

FHP INTERNATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

(amounts in thousands)	For The Nine Months Ended March 31,	
	1994	1993
Operating Activities		
Net income	\$ 38,312	\$ 27,043
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	32,494	21,886
Loss on disposal of equipment	1,420	1,189
Amortization of restricted stock awards		220
Deferred income taxes	(1,042)	(111)
Effect on cash of changes in operating assets and liabilities,		

net of effects of purchase of Colorado
health maintenance organization (HMO) (1994)
(Note 7) and Great States Financial
Corporation (1993):

Accounts receivable, net	(14,332)	(5,296)
Inventories	(908)	(1,792)
Other current assets	(8,336)	(3,209)
Other assets	(4,934)	(11,692)
Accounts payable	(4,877)	3,385
Medical claims payable	20,137	15,773
Accrued salaries and employee benefits	9,090	(711)
Deferred premiums	128,189	4,224
Other liabilities	17,397	5,309
	<hr/>	<hr/>
Net cash provided by operating activities	212,610	56,218
	<hr/>	<hr/>
Investing Activities		
Decrease (increase) in short-term investments	5,153	(5,164)
Purchases of property and equipment	(56,278)	(61,196)
Increase in long-term and restricted investments	(48,144)	(25,502)
Purchase of Colorado HMO (net of cash acquired)	(3,419)	
Purchase of Great States Financial Corporation, net of cash acquired		(21,706)
Payments received on notes receivable from Employee Stock Ownership Trust		4,150
	<hr/>	<hr/>
Net cash used in investing activities	(102,688)	(109,418)
	<hr/>	<hr/>

FHP INTERNATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(unaudited)

(amounts in thousands)

For The
Nine Months Ended
March 31,

<hr/>	<hr/>
1994	1993
<hr/>	<hr/>

Financing Activities

Issuance of common stock	\$ 16	\$ 19
Proceeds from issuance of Senior Notes	100,000	
Payments on long-term obligations	(20,101)	(1,953)
Proceeds from exercise of stock options	2,347	1,971
	<hr/>	<hr/>
Net cash provided by financing activities	82,262	37
	<hr/>	<hr/>
Increase (decrease) in cash and cash equivalents	192,184	(53,163)
Cash and cash equivalents at beginning of period	2,700	73,560
	<hr/>	<hr/>
Cash and cash equivalents at end of period	\$194,884 =====	\$ 20,397 =====
Supplemental cash flow information:		
Interest payments (net of portion capitalized)	\$ 4,292	\$ 1,678
Income tax payments (net of refunds)	\$ 25,566	\$ 17,851

Note: Certain amounts previously classified as property, plant and equipment of \$3,039 were reclassified to other assets during the nine months ended March 31, 1994.

See accompanying notes to consolidated financial statements.

FHP INTERNATIONAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1. Accounting Policies

Interim periods are viewed as an integral part of the annual period of FHP International Corporation and subsidiaries (the "Company"). Accordingly, the results for the interim periods reported are based on the accounting principles and practices followed by the Company as presented in its Annual Report on Form 10-K for the year ended June 30, 1993. In the opinion of management, all adjustments necessary to fairly present the

financial position and the results of operations for the three and nine months ended March 31, 1994 and 1993 are included in these consolidated financial statements.

NOTE 2. Earnings Per Share

Earnings per share for the three and nine months ended March 31, 1994 and 1993 are computed by dividing net income by the weighted average number of common shares and dilutive common stock options, which are considered common share equivalents, outstanding during the periods.

NOTE 3. Reclassifications

Certain prior period amounts have been reclassified to conform to the current period financial statement presentation.

NOTE 4. Income Taxes

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes, effective as of July 1, 1993. This Statement supersedes Accounting Principles Board (APB) Opinion No. 11, Accounting for Income Taxes. Under SFAS No. 109, income taxes are recognized for (a) the amount of taxes payable or refundable for the current year, and (b) deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. The effects of income taxes are measured based on enacted tax law and rates. No cumulative effect of the accounting change was recorded because the amount of deferred tax assets and liabilities computed under the new method is not significantly different from the amount recorded under the former method using APB Opinion No. 11.

FHP INTERNATIONAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(unaudited)

NOTE 5. Capitalized Interest

The Company capitalizes interest costs as part of the cost of constructing major facilities. Interest costs of \$100,000 and \$588,000 were capitalized during the three months ended March 31, 1994 and 1993, respectively. Interest costs of \$596,000 and \$2,009,000 were capitalized during the nine months ended March 31, 1994 and 1993 respectively.

NOTE 6. Commitments and Contingencies

During the ordinary course of business, the Company and its subsidiaries have become party to pending and threatened legal actions and proceedings, a significant portion of which involve alleged claims of medical malpractice. Management is of the opinion that the outcome of such legal actions and proceedings will not have a material effect on the consolidated financial statements of the Company and its subsidiaries.

NOTE 7. Acquisition

In October 1993, the Company acquired a health maintenance organization based in Denver, Colorado for approximately \$3.5 million. The acquisition, which has been accounted for as a purchase, was financed through cash generated from operations of the Company. As a result of the purchase, the Company recorded costs in excess of net assets acquired of approximately \$1,000,000. The Company also obtained a covenant not to compete for which it paid \$500,000.

NOTE 8. Proposed Acquisition

On March 4, 1994, the Company and TakeCare, Inc. ("TakeCare") jointly announced the execution of a definitive merger agreement. TakeCare is a health maintenance organization serving approximately 788,000 commercial members in California, Colorado, Illinois and Ohio. The definitive merger agreement calls for aggregate consideration of more than \$1 billion or approximately \$80 per share of TakeCare common stock.

The merger is subject to the approval of the shareholders of both the Company and TakeCare. Shareholder meetings are scheduled for both companies on June 10, 1994. The merger is also subject to the approval of regulatory agencies in California, Colorado, Arizona, Illinois and Ohio. If all requisite government agency and shareholder approvals are received in time, the merger is expected to close late in the fourth quarter of fiscal 1994.

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

Three Months Ended March 31, 1994 Compared to
the Three Months Ended March 31, 1993

Revenue

Substantially all of the Company's revenue is generated by premiums received for health care services provided to its HMO members. Revenue for the three months ended March 31, 1994 totaled \$622.5 million, increasing 16.2% over revenue of \$535.8 million for the same period in the

previous fiscal year.

Approximately 4.4% of the Company's revenue for the three months ended March 31, 1994 was derived from its subsidiaries' indemnity health and life insurance and workers' compensation insurance products. This compares to 4.2% for the same period during the previous fiscal year.

Commercial HMO revenue growth for the three months ended March 31, 1993 was generated by membership increases and premium rate increases. Commercial per member per month revenue on average increased approximately 3.0% over the same period during the prior fiscal year, and is expected to average approximately the same over the remainder of calendar 1994. The Company's ability to increase commercial HMO premiums continues to be impacted by increasing competition among HMOs and insurers in the Company's service areas and by pressure from some large employers and other groups to minimize rate increases or even reduce existing rates. The Company expects to mitigate this impact by restructuring HMO benefits, and offering additional managed care products and services.

Senior Plan revenue growth for the three months ended March 31, 1994 was generated by membership increases and rate increases on premiums paid to the Company by the Health Care Financing Administration ("HCFA") for its Senior Plan members (individuals eligible for benefits under the federal Medicare program). Revenue per Senior Plan member is substantially higher than revenue per commercial plan member because Senior Plan members use substantially more health care services.

The Company receives Senior Plan premium rate increases on January 1 of each year. The Company received an average 2.0% rate increase effective January 1, 1994 compared to 11.6% for the previous year. The Company believes the impact of this increase has largely been offset by its cost sharing arrangements with contract providers. Contract providers serve over 80% of Senior Plan members.

HMO Membership

The Company experienced a 10.5% growth in total HMO membership to 906,000 members at March 31, 1994 from 820,000 members at March 31, 1993. Senior Plan membership increased by 12.8% to 325,000 from 288,000, primarily in the Company's IPA and mixed model operations in California, Arizona and Nevada. Commercial plan membership increased by 9.2% to 581,000 from 532,000, primarily in the Company's IPA and mixed model operations in California and Nevada, in the staff model in Utah and due to the addition of approximately 6,000 members enrolled in the recently acquired Colorado HMO. Total staff model membership grew 2.1% to 346,000 at March 31, 1994 from 339,000 at March 31, 1993. Total IPA and mixed model membership grew 16.4% to 560,000 at March 31, 1994 from 481,000 at March 31, 1993.

During the last four fiscal quarters, the Company has experienced

declining membership in certain staff model medical centers in Southern California. The decline has been primarily among commercial members and management believes this has been caused by increased competition, the economic recession and substantial employment reductions in several industry sectors. The Company also experienced a slight decrease in California Senior Plan staff model enrollment compared to the third quarter of fiscal 1993. In Arizona, commercial enrollment growth slowed to approximately 5.7% over the year ended March 31, 1994, due primarily to aggressive pricing by major competitors. The Company's Senior Plan growth in Arizona has been constrained by a HCFA rule that Senior Plan membership may not exceed commercial membership. At March 31, 1994, commercial membership exceeded Senior Plan membership in Arizona by approximately 2,100 members.

Cost of Health Care

Health care costs increased 16.5% to \$518.3 million for the three months ended March 31, 1994 from \$444.8 million for the three months ended March 31, 1993. Health care costs increased as a percent of revenue to 83.3% in the current period from 83.0% in the same period of the last fiscal year. The increase as a percent of revenue reflected lower premium rate increases in the Medicare risk and commercial businesses. In addition, higher hospital costs in the Company's Utah, Arizona and Nevada regions as well as higher contract physician costs in all regions except the California IPA operations contributed to this increase. The higher hospital costs in the Utah region are expected to continue during the fourth quarter as the region transitions from utilization of contract hospitals to the FHP owned hospital opened in August 1993. The increases noted were offset partially by cost decreases as a percentage of revenue in health care operations and ancillary health care services. Although the Company's California staff model operations continued to be unfavorably impacted by fixed operating and delivery system costs in certain medical centers, health care costs as a percentage of revenue remained the same as the prior fiscal year period.

The January 1994 earthquake in Southern California did not significantly impact the Company's consolidated financial position. Although there was temporary loss of contract provider and hospital capacity and an increase in emergency room usage in Los Angeles County and an overall slowdown in the enrollment process during January, the Company's cost of health care in Southern California (staff and IPA combined) improved as a percentage of revenue compared to the prior year period.

General, Administrative and Marketing Costs

General, administrative and marketing ("G & A") expenses increased 10.9% to \$79.8 million for the third quarter of fiscal 1994 from \$72.0 million for the third quarter of fiscal 1993. The increase resulted primarily from growth in the Company's operations, increased advertising expenses, and the inclusion of G & A costs for Great States Insurance

Company ("GSIC") which was acquired in March 1993. G & A expenses for the three months ended March 31, 1994 decreased as a percentage of revenue to 12.8% from 13.4% for the same period in the prior fiscal year in part reflecting the benefit of the Company's second quarter of fiscal 1994 reduction in force which slowed the growth of G & A expenses.

Nine Months Ended March 31, 1994
Compared to the Nine Months Ended March 31, 1993

Revenue

Revenue for the nine months ended March 31, 1994 totaled \$1,789.9 million, increasing 23.9% over revenue of \$1,444.5 million for the same period in the previous year. Approximately 4.5% of the revenue for the nine months ended March 31, 1994, was related to the Company's indemnity health and life insurance and workers' compensation insurance products.

Cost of Health Care

Health care costs increased 23.1% to \$1,498.3 million for the nine months ended March 31, 1994, from \$1,217.5 million for the comparable nine months ended March 31, 1993. Health care costs during the nine month period decreased to 83.7% of total revenue from 84.3% of total revenue in the same period last year primarily as a result of lower health care operations costs offset by an increase in contract physician costs. Although the Company's California staff model operations continued to be unfavorably impacted by fixed operating and delivery system costs in certain medical centers, its health care costs as a percentage of revenue improved over the prior year period. The Company's Utah operations incurred higher health care costs as a percentage of revenue primarily due to the continuing transition from contract hospitals to the FHP owned hospital opened in August 1993.

General, Administrative and Marketing Costs

G & A expenses increased 22.9% to \$240.1 million from \$195.4 million in the previous year, due to continuing expansion of the Company's operations. G & A expenses were 13.4% of total revenue for the nine months ended March 31, 1994 versus 13.5% of total revenue for the comparable period in the previous year. The decrease resulted primarily from a reduction in sales expenditures as a percentage of revenue and the Company's second quarter of fiscal 1994 reduction in force.

Interest Income

Net interest income was \$10.7 million for the nine months ended March 31, 1994 as compared to \$11.1 million for the same period in the previous year. Net interest income decreased primarily as the result of the interest expense of the \$100 million of 7% senior 10-year notes (the "Notes") issued in September 1993 offset by higher average invested cash

balances during the period. Also, capitalized interest decreased approximately \$1.4 million year-over-year, due to the completion of several major construction projects.

Liquidity and Capital Resources

The Company's cash, cash equivalents and short-term investments increased by \$190.8 million to \$367.6 million at March 31, 1994 from \$176.8 million at June 30, 1993. This increase reflects the receipt in March 1994 of \$131.0 million in premiums from HCFA due on April 1, 1994 for medical services to be provided to Senior Plan members in April 1994. Other major sources of cash during the nine months ended March 31, 1994, included cash generated from operations of \$81.6 million (net of the early receipt of the HCFA premium of \$131.0 million) and net proceeds from the Notes in September 1993. Major uses of cash during the period included \$56.3 million for capital expenditures and \$48.1 million in transfers to long-term and restricted investments.

The net proceeds from the sale of the Notes were used to repay, in full, certain outstanding indebtedness of approximately \$21 million. The Company has used \$25 million of the remaining net proceeds to increase the net surplus of an indirect insurance subsidiary of the Company, with the balance available for general corporate purposes, including possible acquisitions.

The Company generally receives premiums on a prepaid basis and therefore operates with relatively large cash balances. The Company believes that the cash flow generated by its operations, current cash balances and short-term investments will be sufficient to fund continuing operations during the remaining quarter of fiscal 1994.

In March 1994, the Company entered into a \$350 million Credit Agreement with several banks in connection with the TakeCare merger. The Company intends to fund the cash portion of the merger with \$100 million of internally generated funds and by drawings under the Credit Agreement. The Credit Agreement provides for a \$250 million five-year term loan facility and a \$100 million five-year revolving credit facility. The Credit Agreement contains financial and other covenants, including limitations on indebtedness, liens, dividends, sale and lease-back transactions and certain other transactions.

Effects of Regulatory Changes and Inflation

Effective January 1, 1994, the Company received an average annual premium rate increase of approximately 2.0% for its Senior Plan members. Over calendar years 1992 and 1993, average annual Senior Plan premium increases granted by HCFA were approximately 5.0% and 11.6%, respectively. The Company periodically evaluates the effects of HCFA premium adjustments on its liquidity and capital resources, and incorporates the actual and anticipated impact of such adjustments into its planning process.

Item 1. Legal Proceedings.

Information relating to certain litigation as set forth in Note 6 of Notes to Consolidated Financial Statements in Part I of this report is incorporated herein by this reference.

Item 2. Changes in Securities.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

On March 3, 1994, the Company, its wholly-owned subsidiary, FHP Sub, Inc. ("FHP Sub") and TakeCare executed an Agreement and Plan of Merger (the "Merger Agreement"), pursuant to which (i) TakeCare will be merged with and into FHP Sub (the "Merger"); (ii) the name of FHP Sub will be changed to TakeCare, Inc.; and (iii) each outstanding share of common stock of TakeCare will be converted into the right to receive merger consideration composed of a combination of the Company's common stock, its Series A cumulative convertible preferred stock (the "Convertible Merger Preferred Stock") and either cash or the Company's Series B adjustable rate cumulative preferred stock (the "Non-Convertible Merger Preferred Stock").

Pursuant to the Merger Agreement and to facilitate the payment of the cash portion of the merger consideration contemplated thereunder, the Company entered into a Credit Agreement, dated as of March 24, 1994 (the "Credit Agreement") among the Company, the lenders named therein (the "Lenders") and Chemical Bank, as Administrative Agent ("Chemical"). The Company will not borrow under the Credit Agreement until the Merger becomes effective (the "Effective Time").

The Credit Agreement provides for a \$250 million five-year term loan facility and a \$100 million five-year revolving credit facility. Term loans may be borrowed from the Effective Time to December 31, 1994. The aggregate amount of the term loans outstanding on December 31, 1994 will

be amortized in equal semi-annual installments, which amortization will be at the rate of \$50 million a year if the aggregate amount of term loans outstanding on such date is \$250 million. Revolving loans may be made at any time up to the fifth anniversary of the Effective Time, on which date all revolving loans, term loans and other amounts owed under the Credit Agreement must be paid in full.

At the Company's election, revolving loans and terms loans may bear interest at a rate determined by reference to Chemical's Alternate Base Rate (as described below) or the Eurodollar Rate (as described below), plus, in the case of loans based on the Eurodollar Rate, an incremental per annum charge that varies based on the rating of the Company's unsecured, long-term debt. Such rating is presently BBB- from Standard & Poor's Corporation and Baa3 from Moody's Investor Service, Inc. Based on the present rating, the incremental per annum charge would be 0.375% for revolving loans and 0.600% for term loans. Chemical's Alternate Base Rate is equal to or greater than Chemical's prime rate. The Eurodollar Rate is based on the average of rates at which certain Lenders are offered dollar deposits in applicable interbank Eurodollar markets. Additionally, the Company may request that the Lenders submit interest rate bids for revolving loans. These bids will be based on either the LIBOR rate or a fixed rate, at the Company's election. It is anticipated that the bids received will result in lower interest rates than the interest rates at which all lenders are contractually obligated to lend.

Additionally, the Company is required to pay each Lender a facility fee and a commitment fee, both of which vary based on the Company's unsecured, long-term debt rating. The Company is also obligated to pay certain amounts to Chemical for its services in syndicating the credit facilities and for its services as administrative agent.

The Credit Agreement contains financial and other covenants, including limitations on indebtedness, liens, dividends, sale and lease-back transactions and certain other transactions. Dividends are permitted to be paid on the Convertible Merger Preferred Stock and the Non-Convertible Merger Preferred Stock, and redemptions are permitted to be made in respect of the Non-Convertible Merger Preferred Stock, in each case so long as no event of default exists under the Credit Agreement at the time of such payment or redemption, or occurs as a result of such payment or redemption. In addition, so long as no event of default exists under the Credit Agreement at the time of such payment or redemption, or occurs as a result of such payment or redemption, the Company may pay dividends on, or may redeem, the Company's Common Stock and the Company's Preferred Stock if the total cash amount of all such dividends and redemptions in any fiscal quarter does not exceed (i) 50% of the consolidated net income of the Company and its consolidated subsidiaries for the period of four consecutive fiscal quarters immediately preceding such fiscal quarter less (ii) the cash amount of all dividends paid and redemptions made by the Company (including dividends and redemption described in the immediately preceding sentence) during such four consecutive fiscal quarters in respect of the Company's Common Stock and

the Company's Preferred Stock. Additionally, the Credit Agreement requires that the Company repay the loans thereunder with the net proceeds of asset sales, if any, in excess of \$75 million per year. The Credit Agreement contains representations and warranties, events of defaults and conditions to lending considered by the Company to be typical for financing mergers of companies with credit standings comparable to those of the Company and TakeCare.

Additional information relating to the proposed acquisition of TakeCare is set forth in Note 8 of Notes to Consolidated Financial Statements in Part I of this report and incorporated herein by this reference.

Item 6. Exhibits and Reports on Form 8-K.

- (a) Exhibits. See Index to Exhibits at page 19 of this report.
- (b) Reports on Form 8-K. A current report on Form 8-K was filed on April 5, 1994 describing the amendment and restatement of the Company's Rights Agreement.

Signatures

Pursuant to the requirements 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.

FHP INTERNATIONAL CORPORATION

Dated: May 13, 1994

By: /s/ KENNETH S. ORD

Kenneth S. Ord, Senior Vice
President and Chief (Principal)
Financial Officer

INDEX TO EXHIBITS

Exhibit
Number

- *4.1 Specimen Common Stock Certificate (Exhibit 4.1 to Form S-3 Registration Statement No. 33-39984).
- 4.2 Registrant agrees to furnish to the Commission upon request a copy of each instrument with respect to issues of long-term debt of the Registrant, the authorized principal amount of which does not exceed 10% of total assets of Registrant.
- *10.1 Credit Agreement dated as of March 24, 1994, among the Company, the Lenders named therein and Chemical Bank as Administrative Agent (Exhibit 10.1 to Form 8-A filed May 9, 1994).
- 10.2 Form of Employment Agreement dated as of March 12, 1994 by and between the Company and 11 key executives.
- 11.1 Statement Re: Computation of Earnings Per Share.

* Document has previously been filed with the Commission and is incorporated by reference and made a part hereof.

EMPLOYMENT AGREEMENT

AGREEMENT by and between FHP International Corporation, a Delaware corporation (the "Company") and (the "Executive"), dated as of the 12th day of March, 1994.

The Board of Directors of the Company (the "Board"), has determined that it is in the best interests of the Company and its shareholders to assure that the Company will have the continued dedication of the Executive, notwithstanding the possibility, threat or occurrence of a Change of Control (as defined below) of the Company. The Board believes it is imperative to diminish the inevitable distraction of the Executive by virtue of the personal uncertainties and risks created by a pending or threatened Change of Control and to encourage the Executive's full attention and dedication to the Company currently and in the event of any threatened or pending Change of Control, and to provide the Executive with compensation and benefits arrangements upon a Change of Control which ensure that the compensation and benefits expectations of the Executive will be satisfied and which are competitive with those of other corporations. Therefore, in order to accomplish these objectives, the Board has caused the Company to enter into this Agreement.

NOW, THEREFORE, IT IS HEREBY AGREED AS FOLLOWS:

1. Certain Definitions. (a) The "Effective Date" shall mean the first date during the Change of Control Period (as defined in Section 1(b)) on which a Change of Control (as defined in Section 2) occurs. Anything in this Agreement to the contrary notwithstanding, if a Change of Control occurs and if the Executive's employment with the Company is terminated prior to the date on which the Change of Control occurs, and if it is reasonably demonstrated by the Executive that such termination of employment (i) was at the request of a third party who has taken steps reasonably calculated to effect a Change of Control or (ii) otherwise arose in connection with or anticipation of a Change of Control, then for all purposes of this Agreement the "Effective Date" shall mean the date immediately prior to the date of such termination of employment.

(b) The "Change of Control Period" shall mean the

period commencing on the date hereof and ending on the third anniversary of the date hereof; provided, however, that commencing on the date one year after the date hereof, and on each annual anniversary of such date (such date and each annual anniversary thereof shall be hereinafter referred to as the "Renewal Date"), unless previously terminated, the Change of Control Period shall be automatically extended so as to terminate three years from such Renewal Date, unless at least 60 days prior to the Renewal Date the Company shall give notice to the Executive that the Change of Control Period shall not be so extended.

2. Change of Control. For the purpose of this Agreement, a "Change of Control" shall mean:

(a) The acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) (a "Person") of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (i) the then outstanding shares of common stock of the Company (the "Outstanding Company Common Stock") or (ii) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities"); provided, however, that for purposes of this subsection (a), the following acquisitions shall not constitute a Change of Control: (i) any acquisition directly from the Company, (ii) any acquisition by the Company, (iii) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company or (iv) any acquisition by any corporation pursuant to a transaction which complies with clauses (i), (ii) and (iii) of subsection (c) of this Section 2; or

(b) Individuals who, as of the date hereof, constitute the Board (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or

(c) Consummation of a reorganization, merger or consolidation or sale or other disposition of all or substantially all of the assets of the Company (a "Business Combination"), in each case, unless, following such Business Combination, (i) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 70% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock and Outstanding Company Voting Securities, as the case may be, (ii) no Person (excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 20% or more of, respectively, the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination and (iii) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

(d) Approval by the shareholders of the Company of a complete liquidation or dissolution of the Company.

3. Employment Period. The Company hereby agrees to continue the Executive in its employ, and the Executive hereby agrees to remain in the employ of the Company subject to the terms and conditions of this Agreement, for the period commencing on the Effective Date and ending on the third anniversary of such date (the "Employment Period").

4. Terms of Employment. (a) Position and Duties. (i) During the Employment Period, (A) the Executive's position (including status, offices, titles and reporting requirements), authority, duties and responsibilities shall be

at least commensurate in all material respects with the most significant of those held, exercised and assigned at any time during the 120-day period immediately preceding the Effective Date and (B) the Executive's services shall be performed at the location where the Executive was employed immediately preceding the Effective Date or any office or location less than 35 miles from such location.

(ii) During the Employment Period, and excluding any periods of vacation and sick leave to which the Executive is entitled, the Executive agrees to devote reasonable attention and time during normal business hours to the business and affairs of the Company and, to the extent necessary to discharge the responsibilities assigned to the Executive hereunder, to use the Executive's reasonable best efforts to perform faithfully and efficiently such responsibilities. During the Employment Period it shall not be a violation of this Agreement for the Executive to (A) serve on corporate, civic or charitable boards or committees, (B) deliver lectures, fulfill speaking engagements or teach at educational institutions and (C) manage personal investments, so long as such activities do not significantly interfere with the performance of the Executive's responsibilities as an employee of the Company in accordance with this Agreement. It is expressly understood and agreed that to the extent that any such activities have been conducted by the Executive prior to the Effective Date, the continued conduct of such activities (or the conduct of activities similar in nature and scope thereto) subsequent to the Effective Date shall not thereafter be deemed to interfere with the performance of the Executive's responsibilities to the Company.

(b) Compensation. (i) Base Salary. During the Employment Period, the Executive shall receive an annual base salary ("Annual Base Salary"), which shall be paid at a monthly rate, at least equal to twelve times the highest monthly base salary paid or payable, including any base salary which has been earned but deferred, to the Executive by the Company and its affiliated companies in respect of the twelve-month period immediately preceding the month in which the Effective Date occurs. During the Employment Period, the Annual Base Salary shall be reviewed no more than 12 months after the last salary increase awarded to the Executive prior to the Effective Date and thereafter at least annually. Any increase in Annual Base Salary shall not serve to limit or reduce any other obligation to the Executive under this Agreement. Annual Base Salary shall not be reduced after any such increase and the term Annual Base Salary as utilized in this Agreement shall refer to Annual Base Salary as so increased. As used in this

Agreement, the term "affiliated companies" shall include any company controlled by, controlling or under common control with the Company.

(ii) Annual Bonus. In addition to Annual Base Salary, the Executive shall be awarded, for each fiscal year ending during the Employment Period, an annual bonus (the "Annual Bonus") in cash at least equal to the Executive's highest bonus under the Company's Management Incentive Plan, or any comparable bonus under any predecessor or successor plan, for the last three full fiscal years prior to the Effective Date (annualized in the event that the Executive was not employed by the Company for the whole of such fiscal year) (the "Recent Annual Bonus"). Each such Annual Bonus shall be paid no later than the end of the third month of the fiscal year next following the fiscal year for which the Annual Bonus is awarded, unless the Executive shall elect to defer the receipt of such Annual Bonus.

(iii) Incentive, Savings and Retirement Plans. During the Employment Period, the Executive shall be entitled to participate in all incentive, savings and retirement plans, practices, policies and programs applicable generally to other peer executives of the Company and its affiliated companies, but in no event shall such plans, practices, policies and programs provide the Executive with incentive opportunities (measured with respect to both regular and special incentive opportunities, to the extent, if any, that such distinction is applicable), savings opportunities and retirement benefit opportunities, in each case, less favorable, in the aggregate, than the most favorable of those provided by the Company and its affiliated companies for the Executive under such plans, practices, policies and programs as in effect at any time during the 120-day period immediately preceding the Effective Date or if more favorable to the Executive, those provided generally at any time after the Effective Date to other peer executives of the Company and its affiliated companies.

(iv) Welfare Benefit Plans. During the Employment Period, the Executive and/or the Executive's family, as the case may be, shall be eligible for participation in and shall receive all benefits under welfare benefit plans, practices, policies and programs provided by the Company and its affiliated companies (including, without limitation, medical, prescription, dental, disability, salary continuance, employee life, group life, accidental death and travel accident insurance plans and programs) to the extent applicable generally to other peer executives of

the Company and its affiliated companies, but in no event shall such plans, practices, policies and programs provide the Executive with benefits which are less favorable, in the aggregate, than the most favorable of such plans, practices, policies and programs in effect for the Executive at any time during the 120-day period immediately preceding the Effective Date or, if more favorable to the Executive, those provided generally at any time after the Effective Date to other peer executives of the Company and its affiliated companies.

(v) Expenses. During the Employment Period, the Executive shall be entitled to receive prompt reimbursement for all reasonable expenses incurred by the Executive in accordance with the most favorable policies, practices and procedures of the Company and its affiliated companies in effect for the Executive at any time during the 120-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect generally at any time thereafter with respect to other peer executives of the Company and its affiliated companies.

(vi) Fringe Benefits. During the Employment Period, the Executive shall be entitled to fringe benefits, including, without limitation, tax and financial planning services, payment of club dues, and, if applicable, use of an automobile and payment of related expenses, in accordance with the most favorable plans, practices, programs and policies of the Company and its affiliated companies in effect for the Executive at any time during the 120-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect generally at any time thereafter with respect to other peer executives of the Company and its affiliated companies.

(vii) Office and Support Staff. During the Employment Period, the Executive shall be entitled to an office or offices of a size and with furnishings and other appointments, and to exclusive personal secretarial and other assistance, at least equal to the most favorable of the foregoing provided to the Executive by the Company and its affiliated companies at any time during the 120-day period immediately preceding the Effective Date or, if more favorable to the Executive, as provided generally at any time thereafter with respect to other peer executives of the Company and its affiliated companies.

(viii) Vacation. During the Employment Period, the Executive shall be entitled to paid vacation in accordance with the most favorable plans, policies, programs and practices of the Company and its affiliated companies as

in effect for the Executive at any time during the 120-day period immediately preceding the Effective Date or, if more favorable to the Executive, as in effect generally at any time thereafter with respect to other peer executives of the Company and its affiliated companies.

5. Termination of Employment. (a) Death or Disability. The Executive's employment shall terminate automatically upon the Executive's death during the Employment Period. If the Company determines in good faith that the Disability of the Executive has occurred during the Employment Period (pursuant to the definition of Disability set forth below), it may give to the Executive written notice in accordance with Section 12(b) of this Agreement of its intention to terminate the Executive's employment. In such event, the Executive's employment with the Company shall terminate effective on the 30th day after receipt of such notice by the Executive (the "Disability Effective Date"), provided that, within the 30 days after such receipt, the Executive shall not have returned to full-time performance of the Executive's duties. For purposes of this Agreement, "Disability" shall mean the absence of the Executive from the Executive's duties with the Company on a full-time basis for 180 consecutive business days as a result of incapacity due to mental or physical illness which is determined to be total and permanent by a physician selected by the Company or its insurers and acceptable to the Executive or the Executive's legal representative.

(b) Cause. The Company may terminate the Executive's employment during the Employment Period for Cause. For purposes of this Agreement, "Cause" shall mean:

(i) the willful and continued failure of the Executive to perform substantially the Executive's duties with the Company or one of its affiliates (other than any such failure resulting from incapacity due to physical or mental illness), after a written demand for substantial performance is delivered to the Executive by the Board or the Chief Executive Officer of the Company which specifically identifies the manner in which the Board or Chief Executive Officer believes that the Executive has not substantially performed the Executive's duties, or

(ii) the willful engaging by the Executive in illegal conduct or gross misconduct which is materially and demonstrably injurious to the Company.

For purposes of this provision, no act or failure to act, on the part of the Executive, shall be considered "willful" un-

less it is done, or omitted to be done, by the Executive in bad faith or without reasonable belief that the Executive's action or omission was in the best interests of the Company. Any act, or failure to act, based upon authority given pursuant to a resolution duly adopted by the Board or upon the instructions of the Chief Executive Officer or a senior officer of the Company or based upon the advice of counsel for the Company shall be conclusively presumed to be done, or omitted to be done, by the Executive in good faith and in the best interests of the Company. The cessation of employment of the Executive shall not be deemed to be for Cause unless and until there shall have been delivered to the Executive a copy of a resolution duly adopted by the affirmative vote of not less than three-quarters of the entire membership of the Board at a meeting of the Board called and held for such purpose (after reasonable notice is provided to the Executive and the Executive is given an opportunity, together with counsel, to be heard before the Board), finding that, in the good faith opinion of the Board, the Executive is guilty of the conduct described in subparagraph (i) or (ii) above, and specifying the particulars thereof in detail.

(c) Good Reason. The Executive's employment may be terminated by the Executive for Good Reason. For purposes of this Agreement, "Good Reason" shall mean:

(i) the assignment to the Executive of any duties inconsistent in any respect with the Executive's position (including status, offices, titles and reporting requirements), authority, duties or responsibilities as contemplated by Section 4(a) of this Agreement, or any other action by the Company which results in a diminution in such position, authority, duties or responsibilities, excluding for this purpose an isolated, insubstantial and inadvertent action not taken in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by the Executive;

(ii) any failure by the Company to comply with any of the provisions of Section 4(b) of this Agreement, other than an isolated, insubstantial and inadvertent failure not occurring in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by the Executive;

(iii) the Company's requiring the Executive to be based at any office or location other than as provided in Section 4(a) (i) (B) hereof or the Company's requiring the Executive to travel on Company business to a

substantially greater extent than required immediately prior to the Effective Date;

(iv) any purported termination by the Company of the Executive's employment otherwise than as expressly permitted by this Agreement; or

(v) any failure by the Company to comply with and satisfy Section 11(c) of this Agreement.

For purposes of this Section 5(c), any good faith determination of "Good Reason" made by the Executive shall be conclusive. Anything in this Agreement to the contrary notwithstanding, a termination by the Executive for any reason during the 30-day period immediately following the first anniversary of the Effective Date shall be deemed to be a termination for Good Reason for all purposes of this Agreement.

(d) Notice of Termination. Any termination by the Company for Cause, or by the Executive for Good Reason, shall be communicated by Notice of Termination to the other party hereto given in accordance with Section 12(b) of this Agreement. For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) to the extent applicable, sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of the Executive's employment under the provision so indicated and (iii) if the Date of Termination (as defined below) is other than the date of receipt of such notice, specifies the termination date (which date shall be not more than thirty days after the giving of such notice). The failure by the Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of Good Reason or Cause shall not waive any right of the Executive or the Company, respectively, hereunder or preclude the Executive or the Company, respectively, from asserting such fact or circumstance in enforcing the Executive's or the Company's rights hereunder.

(e) Date of Termination. "Date of Termination" means (i) if the Executive's employment is terminated by the Company for Cause, or by the Executive for Good Reason, the date of receipt of the Notice of Termination or any later date specified therein, as the case may be, (ii) if the Executive's employment is terminated by the Company other than for Cause or Disability, the Date of Termination shall be the date on which the Company notifies the Executive of such termination and (iii) if the Executive's employment is terminated by reason of death or Disability, the Date of

Termination shall be the date of death of the Executive or the Disability Effective Date, as the case may be.

6. Obligations of the Company upon Termination.

(a) Good Reason; Other Than for Cause, Death or Disability. If, during the Employment Period, the Company shall terminate the Executive's employment other than for Cause or Disability or the Executive shall terminate employment for Good Reason:

(i) the Company shall pay to the Executive in a lump sum in cash within 30 days after the Date of Termination the aggregate of the following amounts:

A. the sum of (1) the Executive's Annual Base Salary through the Date of Termination to the extent not theretofore paid, (2) the product of (x) the higher of (I) the Recent Annual Bonus and (II) the Annual Bonus paid or payable, including any bonus or portion thereof which has been earned but deferred (and annualized for any fiscal year consisting of less than twelve full months or during which the Executive was employed for less than twelve full months), for the most recently completed fiscal year during the Employment Period, if any (such higher amount being referred to as the "Highest Annual Bonus") and (y) a fraction, the numerator of which is the number of days in the current fiscal year through the Date of Termination, and the denominator of which is 365 and (3) any compensation previously deferred by the Executive (together with any accrued interest or earnings thereon) and any accrued vacation pay, in each case to the extent not theretofore paid (the sum of the amounts described in clauses (1), (2), and (3) shall be hereinafter referred to as the "Accrued Obligations"); and

B. the amount equal to the product of (1) three and (2) the sum of (x) the Executive's Annual Base Salary and (y) the Highest Annual Bonus; and

C. an amount equal to the excess of (a) the actuarial equivalent of the benefit under the Company's qualified defined benefit retirement plan (the "Retirement Plan") (utilizing actuarial assumptions no less favorable to the Executive than those in effect under the Company's Retirement Plan immediately prior to the Effective Date), and any excess or supplemental retirement plan in which the Executive participates (together, the "SERP") which

the Executive would receive if the Executive's employment continued for three years after the Date of Termination assuming for this purpose that all accrued benefits are fully vested, and, assuming that the Executive's compensation in each of the three years is that required by Section 4(b)(i) and Section 4(b)(ii), over (b) the actuarial equivalent of the Executive's actual benefit (paid or payable), if any, under the Retirement Plan and the SERP as of the Date of Termination;

(ii) for three years after the Executive's Date of Termination, or such longer period as may be provided by the terms of the appropriate plan, program, practice or policy, the Company shall continue benefits to the Executive and/or the Executive's family at least equal to those which would have been provided to them in accordance with the plans, programs, practices and policies described in Section 4(b)(iv) of this Agreement if the Executive's employment had not been terminated or, if more favorable to the Executive, as in effect generally at any time thereafter with respect to other peer executives of the Company and its affiliated companies and their families, provided, however, that if the Executive becomes reemployed with another employer and is eligible to receive medical or other welfare benefits under another employer provided plan, the medical and other welfare benefits described herein shall be secondary to those provided under such other plan during such applicable period of eligibility. For purposes of determining eligibility (but not the time of commencement of benefits) of the Executive for retiree benefits pursuant to such plans, practices, programs and policies, the Executive shall be considered to have remained employed until three years after the Date of Termination and to have retired on the last day of such period;

(iii) the Company shall, at its sole expense as incurred, provide the Executive with outplacement services the scope and provider of which shall be selected by the Executive in his sole discretion; and

(iv) to the extent not theretofore paid or provided, the Company shall timely pay or provide to the Executive any other amounts or benefits required to be paid or provided or which the Executive is eligible to receive under any plan, program, policy or practice or contract or agreement of the Company and its affiliated companies (such other amounts and benefits shall be hereinafter referred to as the "Other Benefits").

(b) Death. If the Executive's employment is terminated by reason of the Executive's death during the Employment Period, this Agreement shall terminate without further obligations to the Executive's legal representatives under this Agreement, other than for payment of Accrued Obligations and the timely payment or provision of Other Benefits. Accrued Obligations shall be paid to the Executive's estate or beneficiary, as applicable, in a lump sum in cash within 30 days of the Date of Termination. With respect to the provision of Other Benefits, the term Other Benefits as utilized in this Section 6(b) shall include, without limitation, and the Executive's estate and/or beneficiaries shall be entitled to receive, benefits at least equal to the most favorable benefits provided by the Company and affiliated companies to the estates and beneficiaries of peer executives of the Company and such affiliated companies under such plans, programs, practices and policies relating to death benefits, if any, as in effect with respect to other peer executives and their beneficiaries at any time during the 120-day period immediately preceding the Effective Date or, if more favorable to the Executive's estate and/or the Executive's beneficiaries, as in effect on the date of the Executive's death with respect to other peer executives of the Company and its affiliated companies and their beneficiaries.

(c) Disability. If the Executive's employment is terminated by reason of the Executive's Disability during the Employment Period, this Agreement shall terminate without further obligations to the Executive, other than for payment of Accrued Obligations and the timely payment or provision of Other Benefits. Accrued Obligations shall be paid to the Executive in a lump sum in cash within 30 days of the Date of Termination. With respect to the provision of Other Benefits, the term Other Benefits as utilized in this Section 6(c) shall include, and the Executive shall be entitled after the Disability Effective Date to receive, disability and other benefits at least equal to the most favorable of those generally provided by the Company and its affiliated companies to disabled executives and/or their families in accordance with such plans, programs, practices and policies relating to disability, if any, as in effect generally with respect to other peer executives and their families at any time during the 120-day period immediately preceding the Effective Date or, if more favorable to the Executive and/or the Executive's family, as in effect at any time thereafter generally with respect to other peer executives of the Company and its affiliated companies and their families.

(d) Cause; Other than for Good Reason. If the Executive's employment shall be terminated for Cause during the Employment Period, this Agreement shall terminate without further obligations to the Executive other than the obligation to pay to the Executive (x) his Annual Base Salary through the Date of Termination, (y) the amount of any compensation previously deferred by the Executive, and (z) Other Benefits, in each case to the extent theretofore unpaid. If the Executive voluntarily terminates employment during the Employment Period, excluding a termination for Good Reason, this Agreement shall terminate without further obligations to the Executive, other than for Accrued Obligations and the timely payment or provision of Other Benefits. In such case, all Accrued Obligations shall be paid to the Executive in a lump sum in cash within 30 days of the Date of Termination.

7. Non-exclusivity of Rights. Nothing in this Agreement shall prevent or limit the Executive's continuing or future participation in any plan, program, policy or practice provided by the Company or any of its affiliated companies and for which the Executive may qualify, nor, subject to Section 12(f), shall anything herein limit or otherwise affect such rights as the Executive may have under any contract or agreement with the Company or any of its affiliated companies. Amounts which are vested benefits or which the Executive is otherwise entitled to receive under any plan, policy, practice or program of or any contract or agreement with the Company or any of its affiliated companies at or subsequent to the Date of Termination shall be payable in accordance with such plan, policy, practice or program or contract or agreement except as explicitly modified by this Agreement.

8. Full Settlement. The Company's obligation to make the payments provided for in this Agreement and otherwise to perform its obligations hereunder shall not be affected by any set-off, counterclaim, recoupment, defense or other claim, right or action which the Company may have against the Executive or others. In no event shall the Executive be obligated to seek other employment or take any other action by way of mitigation of the amounts payable to the Executive under any of the provisions of this Agreement and such amounts shall not be reduced whether or not the Executive obtains other employment. The Company agrees to pay as incurred, to the full extent permitted by law, all legal fees and expenses which the Executive may reasonably incur as a result of any contest (regardless of the outcome thereof) by the Company, the Executive or others of the validity or enforceability of, or liability under, any provision of this Agreement or any guarantee of performance

thereof (including as a result of any contest by the Executive about the amount of any payment pursuant to this Agreement), plus in each case interest on any delayed payment at the applicable Federal rate provided for in Section 7872(f)(2)(A) of the Internal Revenue Code of 1986, as amended (the "Code").

9. Certain Additional Payments by the Company.

(a) Anything in this Agreement to the contrary notwithstanding but subject to the provisions of this Section 9(a), in the event it shall be determined that any payment or distribution by the Company to or for the benefit of the Executive (whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise, but determined without regard to any additional payments required under this Section 9) (a "Payment") would be subject to the excise tax imposed by Section 4999 of the Code or any interest or penalties are incurred by the Executive with respect to such excise tax (such excise tax, together with any such interest and penalties, are hereinafter collectively referred to as the "Excise Tax"), then the Executive shall be entitled to receive an additional payment (a "Gross-Up Payment") in an amount such that after payment by the Executive of all taxes (including any interest or penalties imposed with respect to such taxes), including, without limitation, any income taxes (and any interest and penalties imposed with respect thereto) and Excise Tax imposed upon the Gross-Up Payment, the Executive retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payments. Notwithstanding the foregoing provisions of this Section 9(a), if it shall be determined that the Executive is entitled to a Gross-Up Payment, but that the Executive, after taking into account the Payments and the Gross-Up Payment, would not receive a net after-tax benefit of at least \$50,000 (taking into account both income taxes and any Excise Tax) as compared to the net after-tax proceeds to the Executive resulting from an elimination of the Gross-Up Payment and a reduction of the Payments, in the aggregate, to an amount (the "Reduced Amount") such that the receipt of Payments would not give rise to any Excise Tax, then no Gross-Up Payment shall be made to the Executive and the Payments, in the aggregate, shall be reduced to the Reduced Amount.

(b) Subject to the provisions of Section 9(c), all determinations required to be made under this Section 9, including whether and when a Gross-Up Payment is required and the amount of such Gross-Up Payment and the assumptions to be utilized in arriving at such determination, shall be made by Deloitte & Touche or such other certified public ac-

counting firm as may be designated by the Executive (the "Accounting Firm") which shall provide detailed supporting calculations both to the Company and the Executive within 15 business days of the receipt of notice from the Executive that there has been a Payment, or such earlier time as is requested by the Company. In the event that the Accounting Firm is serving as accountant or auditor for the individual, entity or group effecting the Change of Control, the Executive shall appoint another nationally recognized accounting firm to make the determinations required hereunder (which accounting firm shall then be referred to as the Accounting Firm hereunder). All fees and expenses of the Accounting Firm shall be borne solely by the Company. Any Gross-Up Payment, as determined pursuant to this Section 9, shall be paid by the Company to the Executive within five days of the receipt of the Accounting Firm's determination. Any determination by the Accounting Firm shall be binding upon the Company and the Executive. As a result of the uncertainty in the application of Section 4999 of the Code at the time of the initial determination by the Accounting Firm hereunder, it is possible that Gross-Up Payments which will not have been made by the Company should have been made ("Underpayment"), consistent with the calculations required to be made hereunder. In the event that the Company exhausts its remedies pursuant to Section 9(c) and the Executive thereafter is required to make a payment of any Excise Tax, the Accounting Firm shall determine the amount of the Underpayment that has occurred and any such Underpayment shall be promptly paid by the Company to or for the benefit of the Executive.

(c) The Executive shall notify the Company in writing of any claim by the Internal Revenue Service that, if successful, would require the payment by the Company of the Gross-Up Payment. Such notification shall be given as soon as practicable but no later than ten business days after the Executive is informed in writing of such claim and shall apprise the Company of the nature of such claim and the date on which such claim is requested to be paid. The Executive shall not pay such claim prior to the expiration of the 30-day period following the date on which it gives such notice to the Company (or such shorter period ending on the date that any payment of taxes with respect to such claim is due). If the Company notifies the Executive in writing prior to the expiration of such period that it desires to contest such claim, the Executive shall:

- (i) give the Company any information reasonably requested by the Company relating to such claim,
- (ii) take such action in connection with contesting

such claim as the Company shall reasonably request in writing from time to time, including, without limitation, accepting legal representation with respect to such claim by an attorney reasonably selected by the Company,

(iii) cooperate with the Company in good faith in order effectively to contest such claim, and

(iv) permit the Company to participate in any proceedings relating to such claim;

provided, however, that the Company shall bear and pay directly all costs and expenses (including additional interest and penalties) incurred in connection with such contest and shall indemnify and hold the Executive harmless, on an after-tax basis, for any Excise Tax or income tax (including interest and penalties with respect thereto) imposed as a result of such representation and payment of costs and expenses. Without limitation on the foregoing provisions of this Section 9(c), the Company shall control all proceedings taken in connection with such contest and, at its sole option, may pursue or forgo any and all administrative appeals, proceedings, hearings and conferences with the taxing authority in respect of such claim and may, at its sole option, either direct the Executive to pay the tax claimed and sue for a refund or contest the claim in any permissible manner, and the Executive agrees to prosecute such contest to a determination before any administrative tribunal, in a court of initial jurisdiction and in one or more appellate courts, as the Company shall determine; provided, however, that if the Company directs the Executive to pay such claim and sue for a refund, the Company shall advance the amount of such payment to the Executive, on an interest-free basis and shall indemnify and hold the Executive harmless, on an after-tax basis, from any Excise Tax or income tax (including interest or penalties with respect thereto) imposed with respect to such advance or with respect to any imputed income with respect to such advance; and further provided that any extension of the statute of limitations relating to payment of taxes for the taxable year of the Executive with respect to which such contested amount is claimed to be due is limited solely to such contested amount. Furthermore, the Company's control of the contest shall be limited to issues with respect to which a Gross-Up Payment would be payable hereunder and the Executive shall be entitled to settle or contest, as the case may be, any other issue raised by the Internal Revenue Service or any other taxing authority.

(d) If, after the receipt by the Executive of an

amount advanced by the Company pursuant to Section 9(c), the Executive becomes entitled to receive any refund with respect to such claim, the Executive shall (subject to the Company's complying with the requirements of Section 9(c)) promptly pay to the Company the amount of such refund (together with any interest paid or credited thereon after taxes applicable thereto). If, after the receipt by the Executive of an amount advanced by the Company pursuant to Section 9(c), a determination is made that the Executive shall not be entitled to any refund with respect to such claim and the Company does not notify the Executive in writing of its intent to contest such denial of refund prior to the expiration of 30 days after such determination, then such advance shall be forgiven and shall not be required to be repaid and the amount of such advance shall offset, to the extent thereof, the amount of Gross-Up Payment required to be paid.

10. Confidential Information. The Executive shall hold in a fiduciary capacity for the benefit of the Company all secret or confidential information, knowledge or data relating to the Company or any of its affiliated companies, and their respective businesses, which shall have been obtained by the Executive during the Executive's employment by the Company or any of its affiliated companies and which shall not be or become public knowledge (other than by acts by the Executive or representatives of the Executive in violation of this Agreement). After termination of the Executive's employment with the Company, the Executive shall not, without the prior written consent of the Company or as may otherwise be required by law or legal process, communicate or divulge any such information, knowledge or data to anyone other than the Company and those designated by it. In no event shall an asserted violation of the provisions of this Section 10 constitute a basis for deferring or withholding any amounts otherwise payable to the Executive under this Agreement.

11. Successors. (a) This Agreement is personal to the Executive and without the prior written consent of the Company shall not be assignable by the Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by the Executive's legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.

(c) The Company will require any successor (whether direct or indirect, by purchase, merger,

consolidation or otherwise) to all or substantially all of the business and/or assets of the Company to assume expressly and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place. As used in this Agreement, "Company" shall mean the Company as hereinbefore defined and any successor to its business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

12. Miscellaneous. (a) This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware, without reference to principles of conflict of laws. The captions of this Agreement are not part of the provisions hereof and shall have no force or effect. This Agreement may not be amended or modified otherwise than by a written agreement executed by the parties hereto or their respective successors and legal representatives.

(b) All notices and other communications hereunder shall be in writing and shall be given by hand delivery to the other party or by registered or certified mail, return receipt requested, postage prepaid, addressed as follows:

If to the Executive:

If to the Company:

FHP International Corporation
9900 Talbert Avenue
Fountain Valley, California 92708
Attention: General Counsel

or to such other address as either party shall have furnished to the other in writing in accordance herewith. Notice and communications shall be effective when actually received by the addressee.

(c) The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision of this Agreement.

(d) The Company may withhold from any amounts payable under this Agreement such Federal, state, local or for-

eign taxes as shall be required to be withheld pursuant to any applicable law or regulation.

(e) The Executive's or the Company's failure to insist upon strict compliance with any provision of this Agreement or the failure to assert any right the Executive or the Company may have hereunder, including, without limitation, the right of the Executive to terminate employment for Good Reason pursuant to Section 5(c)(i)-(v) of this Agreement, shall not be deemed to be a waiver of such provision or right or any other provision or right of this Agreement.

(f) The Executive and the Company acknowledge that, except as may otherwise be provided under any other written agreement between the Executive and the Company, the employment of the Executive by the Company is "at will" and, subject to Section 1(a) hereof, prior to the Effective Date, the Executive's employment and/or this Agreement may be terminated by either the Executive or the Company at any time prior to the Effective Date, in which case the Executive shall have no further rights under this Agreement.

(g) From and after the Effective Date, this Agreement shall supersede any other agreement between the parties with respect to the subject matter hereof entered into prior to the date hereof.

IN WITNESS WHEREOF, the Executive has hereunto set the Executive's hand and, pursuant to the authorization from its Board of Directors, the Company has caused these presents to be executed in its name on its behalf, all as of the day and year first above written.

FHP INTERNATIONAL CORPORATION

By

Westcott W. Price III
President and Chief
Executive Officer

A:\form

Exhibit 11.1

FHP INTERNATIONAL CORPORATION
 STATEMENT RE: COMPUTATION OF EARNINGS PER SHARE
 (unaudited)

(amounts in thousands, except per share data)	For The Three Months Ended March 31,		For The Nine Months Ended March 31,	
	1994	1993	1994	1993
	-----	-----	-----	-----
Primary earnings per share:				
Net income	\$16,813	\$14,448	\$38,312	\$27,043
	=====	=====	=====	=====
Weighted average number of common shares and common share equivalents:				
Common stock	33,131	32,725	32,994	32,594
Assumed exercise of options	709	659	665	565
	-----	-----	-----	-----
Total shares	33,840	33,384	33,659	33,159
	=====	=====	=====	=====
Primary earnings per share	\$ 0.50	\$ 0.43	\$ 1.14	\$ 0.82
	=====	=====	=====	=====
Fully diluted earnings per share:				
Net income	\$16,813	\$14,448	\$38,312	\$27,043
	=====	=====	=====	=====
Weighted average number of common shares and common share equivalents:				
Common stock	33,131	32,725	32,994	32,594
Assumed exercise of options	709	764	665	761
	-----	-----	-----	-----
Total shares, assuming				

full dilution	33,840 =====	33,489 =====	33,659 =====	33,355 =====
Fully diluted earnings per share	\$ 0.50 =====	\$ 0.43 =====	\$ 1.14 =====	\$ 0.81 =====