

MAGELLAN HEALTH SERVICES INC  
Form DEF 14A  
March 31, 2006  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**SCHEDULE 14A**

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

Filed by the Registrant  x

Filed by a Party other than the Registrant  o

Check the appropriate box:

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

**Magellan Health Services, Inc.**

(Name of Registrant as Specified In Its Charter)

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

Payment of Filing Fee (Check the appropriate box):

- x No fee required.
- o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
  - (1) Title of each class of securities to which transaction applies:
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  - (3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
  - (4) Proposed maximum aggregate value of transaction:
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- o Fee paid previously with preliminary materials.
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**MAGELLAN HEALTH SERVICES, INC.**  
**55 Nod Road**  
**Avon, Connecticut 06001**  
[www.magellanhealth.com](http://www.magellanhealth.com)

March 31, 2006

Dear Shareholder:

You are cordially invited to attend the 2006 annual meeting of shareholders of Magellan Health Services, Inc. to be held on Tuesday, May 16, 2006 at 9:00 a.m. local time, at The Avon Old Farms Inn, 1 Nod Road, Avon, Connecticut 06001.

This year, two (2) directors are nominated for election to our board of directors. At the meeting shareholders will be asked to: (i) elect two (2) directors to serve until our 2009 annual meeting; (ii) approve the 2006 Management Incentive Plan; (iii) approve the 2006 Director Equity Compensation Plan; (iv) approve the 2006 Employee Stock Purchase Plan; and (v) ratify the appointment of Ernst & Young LLP as our independent auditors for fiscal year 2006.

The accompanying proxy statement provides a detailed description of these proposals. We urge you to read the accompanying materials so that you may be informed about the business to be addressed at our annual meeting.

It is important that your shares be represented at the annual meeting. Accordingly, we ask you, whether or not you plan to attend the annual meeting, to complete, sign and date your proxy and return it to us promptly in the enclosed envelope or to otherwise vote in accordance with the instructions on your proxy card. If you attend the meeting, you may vote in person, even if you have previously mailed in your proxy. However, if you hold your shares in a brokerage account ( *street name* ), you will need to provide a proxy form from the institution that holds your shares reflecting stock ownership as of the record date, to be able to vote by ballot at the meeting.

We look forward to seeing you at the meeting.

*IF YOU PLAN TO ATTEND THE MEETING:*

*Registration and seating will begin at 8:00 a.m. Shareholders and their guests will be asked to sign-in and may be asked to present valid picture identification. Shareholders holding stock in street name will need to obtain a proxy form from their broker or other institution that holds their shares to evidence stock ownership as of the record date.*

Sincerely,

Steven J. Shulman  
*Chairman and Chief Executive Officer*

**MAGELLAN HEALTH SERVICES, INC.**  
**55 Nod Road**  
**Avon, Connecticut 06001**

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**Notice of Annual Meeting of Shareholders**

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<b>TIME AND DATE</b>	9:00 a.m. on Tuesday, May 16, 2006
<b>PLACE</b>	The Avon Old Farms Inn, 1 Nod Road, Avon, CT 06001
<b>PURPOSE</b>	(1) To elect two (2) members of the board of directors to serve for three-year terms; (2) To approve the 2006 Management Incentive Plan; (3) To approve the 2006 Director Equity Compensation Plan; (4) To approve the 2006 Employee Stock Purchase Plan; (5) To ratify the appointment of Ernst & Young LLP as our independent auditors for the fiscal year 2006; and (6) To transact such other business as may properly come before the meeting or any adjournment or postponement thereof.
<b>RECORD DATE</b>	You can vote if you are a shareholder of record at the close of business on March 27, 2006.
<b>PROXY VOTING</b>	It is important that you vote your shares. You can vote your shares by completing and returning the proxy card sent to you. You can revoke a proxy at any time prior to its exercise at the meeting by following the instructions in the accompanying proxy statement.

DANIEL N. GREGOIRE  
*Secretary*

Avon, Connecticut  
March 31, 2006

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**MAGELLAN HEALTH SERVICES, INC.**  
**55 Nod Road**  
**Avon, Connecticut 06001**

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**Proxy Statement for Annual Meeting of Shareholders**  
**To Be Held May 16, 2006**

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**INTRODUCTION**

This proxy statement is being furnished to shareholders of Magellan Health Services, Inc., a Delaware corporation (the "company"), in connection with the solicitation of proxies by our board of directors for use at our annual meeting of shareholders to be held on Tuesday, May 16, 2006, at 9:00 a.m., local time, at The Avon Old Farms Inn, 1 Nod Road, Avon, Connecticut 06001, and any adjournment or postponement thereof. This proxy statement is dated March 31, 2006, and is first being mailed to shareholders along with the related form of proxy on or about March 31, 2006.

**ABOUT THE MEETING**

*What is the purpose of the annual meeting?*

At the annual meeting, shareholders will be asked to consider and vote upon five proposals: (i) to elect two (2) directors to serve until the 2009 annual meeting ( *Proposal Number One* ); (ii) to approve the 2006 Management Incentive Plan ( *Proposal Number Two* ); (iii) to approve the 2006 Director Equity Compensation Plan ( *Proposal Number Three* ); (iv) to approve the 2006 Employee Stock Purchase Plan ( *Proposal Number Four* ); and (v) to ratify the appointment of Ernst & Young LLP as our independent auditors for fiscal year 2006 ( *Proposal Number Five* ). In addition, management will report on our performance and respond to your questions.

*Who is entitled to vote at the meeting?*

Only shareholders of record at the close of business on March 27, 2006, the date our board of directors has fixed as the record date for determining holders of outstanding shares of our Ordinary Common Stock, par value \$.01 per share ( *common stock* ), who are entitled to notice of and to vote at the annual meeting, are entitled to vote at the meeting.

*What constitutes a quorum and why is one required?*

The presence at the meeting, in person or by proxy, of shareholders entitled to cast at least a majority of the votes which all shareholders are entitled to cast on a matter on the record date will constitute a quorum. A quorum is required by law for any action to be taken at the annual meeting. As of March 13, 2006, the approximate number of holders of record of our common stock was 327, and 36,945,150 shares of our common stock were issued and outstanding. The presence, in person or by proxy, of the holders of common stock representing at least 18,472,576 votes would be required to establish a quorum.

Abstentions and broker non-votes are counted for purposes of determining the number of shares represented at the meeting, but are deemed not to have voted on any proposal. Broker non-votes occur when a broker nominee, holding shares in street name for the beneficial owner thereof, has not received voting instructions from the beneficial owner and does not have discretionary authority to vote. Because Proposals Number Two, Three, Four and Five require the affirmative vote of the holders of a majority of the shares present or represented by proxies at the meeting, broker non-votes will have the effect of votes against those proposals.

A properly executed proxy marked **WITHHOLD AUTHORITY** with respect to the election of one or more directors will not be voted with respect to the director or directors indicated, although it will be counted for purposes of determining whether there is a quorum.

***How do I vote?***

If you complete and properly sign and return the accompanying proxy card in time for the meeting, it will be voted as you direct. If you are a registered shareholder on the record date and attend the meeting, you may deliver your completed proxy card in person. If your shares are held on the record date by a broker in street name and you wish to vote at the meeting in person or by proxy, you must obtain a proxy form from your broker to evidence your ownership and voting rights. Your votes will be counted by tellers of our transfer agent. These tellers will canvass the shareholders present at the annual meeting, count their votes and count the votes represented by proxies presented.

Unless your proxy specifies otherwise, proxies will be voted (a) FOR the election of the nominated directors; (b) FOR approval of the 2006 Management Incentive Plan; (c) FOR approval of the 2006 Director Equity Compensation Plan; (d) FOR approval of the 2006 Employee Stock Purchase Plan; (e) FOR the ratification of Ernst & Young LLP as our independent auditors for fiscal year 2006; and (f) otherwise in the discretion of the proxy holders as to any other matter that may come before the annual meeting. We expect that our current executive officers and members of our board of directors will vote their shares (representing approximately 1.3% of the shares of common stock issued and outstanding as of March 13, 2006) in favor of election of the nominee directors in Proposal Number One, in favor of Proposal Number Two, in favor of Proposal Number Three, in favor of Proposal Number Four and in favor of Proposal Number Five, as presented in this proxy statement.

***Can I change my vote?***

Any shareholder who has given a proxy has the power to revoke such proxy at any time before it is voted either: (i) by filing a written revocation or a duly executed proxy bearing a later date, by mail, with Daniel N. Gregoire, our Secretary, at Magellan Health Services, Inc., 55 Nod Road, Avon, Connecticut 06001; (ii) by appearing at the annual meeting and voting in person; or (iii) by casting another vote in the same manner as the original vote was cast. Attendance at the annual meeting will not in and of itself constitute the revocation of a proxy. Voting by those present during the conduct of the annual meeting will be by ballot.

***What vote is required to approve each proposal?***

*Election of Directors.* The affirmative vote of a plurality of the votes of the shares of common stock that are present in person or represented by proxy at the annual meeting and entitled to vote, is required to elect the directors.

*Approval of 2006 Management Incentive Plan.* The affirmative vote of the holders of a majority of the votes that are present in person or represented by proxy at the annual meeting and entitled to vote is required to approve this proposal.

*Approval of 2006 Director Equity Compensation Plan.* The affirmative vote of the holders of a majority of the votes that are present in person or represented by proxy at the annual meeting and entitled to vote is required to approve this proposal.

*Approval of 2006 Employee Stock Purchase Plan.* The affirmative vote of the holders of a majority of the votes that are present in person or represented by proxy at the annual meeting and entitled to vote is required to approve this proposal.

*Ratification of Independent Auditors.* The affirmative vote of the holders of a majority of the votes that are present in person or represented by proxy at the annual meeting and entitled to vote is required to approve this proposal.

We will post the results of the voting on our Internet site at [www.magellanhealth.com](http://www.magellanhealth.com).



**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT***Who are the largest owners of your stock?*

The following table sets forth certain information as of March 13, 2006 (except as otherwise noted) with respect to any person known by the company to be the beneficial owner of more than 5.0% of the outstanding shares of Ordinary Common Stock:

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership (1)	Percent of Class (1)
Quaker Capital Management Corporation(2) 401 Wood Street, Suite 1300 Pittsburgh, PA 15222	1,852,445	5.0 %
RS Investment Management Co. LLC(3) 388 Market Street, Suite 1700 San Francisco, CA 94111	2,740,340	7.4 %
TimesSquare Capital Management, LLC(4) Four Times Square, 25 <sup>th</sup> Floor New York, NY 10036	2,360,067	6.4 %

(1) The information regarding the beneficial ownership of common stock by such individual or entity is included herein in reliance on its reports filed with the United States Securities and Exchange Commission (the "SEC"), except that the percentage of common stock beneficially owned is based upon the company's calculations made in reliance upon the number of shares reported to be beneficially owned by such person or entity in such reports and on 36,945,150 shares of common stock issued and outstanding as of March 13, 2006.

(2) Based on information set forth in a Schedule 13G filed with the SEC on February 14, 2006. Quaker Capital Management Corporation is an investment adviser which is deemed under SEC rules to beneficially own stock owned by its investment advisory clients.

(3) Based on information set forth in Amendment No. 1 to Schedule 13G filed with the SEC on February 10, 2006. RS Investment Management Co. LLC is the general partner of RS Investment Management, L.P., which is a registered investment adviser and a managing member of registered investment advisers. George R. Hecht is a control person of both entities.

(4) Based on information set forth in Amendment No. 1 to Schedule 13G filed with the SEC on February 10, 2006. TimesSquare Capital Management, LLC is an investment adviser which is deemed under SEC rules to beneficially own stock owned by its investment advisory clients.

Prior to May 2005, the company had two outstanding classes of common stock: Ordinary Common Stock and Multiple and Variable Vote Restricted Common Stock (the "Multi-Vote Common Stock"). The shares of Multi-Vote Common Stock were entitled, in the aggregate, to the same number of votes as all of the issued and outstanding Ordinary Common Stock. The Multi-Vote Common Stock was owned by an affiliate of Onex Corporation ("Onex"). Upon a sale of any shares of Multi-Vote Common Stock to any person that is not an affiliate of Onex, such shares were automatically converted to Ordinary Common Shares. As of May 20, 2005, June 2, 2005 and November 9, 2005, Onex sold all of its shares of common stock and thus all shares outstanding are now shares of Ordinary Common Stock and there are no shares of Multi-Vote Common Stock outstanding.

**How much stock do your executive officers and directors own?**

The following table sets forth certain information regarding the beneficial ownership of our common stock as of March 13, 2006 (except as otherwise noted) by: (i) each director and nominee for director; (ii) each of the current executive officers named in the Summary Compensation Table; and (iii) the directors and all executive officers (including three executive officers who were not named in the Summary Compensation Table) as a group.

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership (1)(2)(3)	Percent of Class (4)
Steve Shulman(5)	275,281	*
René Lerer, M.D.(6)	85,440	*
Robert M. Le Blanc		
Barry M. Smith	3,000	*
Saul E. Burian	5,719	*
Michael P. Ressler	5,719	*
William J. McBride	5,719	*
Michael Diamant	5,719	*
Mark Demilio(7)	57,139	*
Daniel N. Gregoire(8)	23,902	*
All directors and executive officers as a group (12 persons)(9)	500,761	1.3 %

\* Less than 1.0% of total outstanding.

(1) Unless otherwise indicated in the footnotes to this table and subject to community property laws where applicable, the company believes that each of the stockholders named in this table has sole voting and investment power with respect to the shares indicated as beneficially owned. This table is based upon information supplied by the directors and executive officers.

(2) Includes as beneficially owned vested stock options and warrants held by such individuals which are exercisable within 60 days of March 13, 2006, in accordance with SEC Rule 13d-3.

(3) Does not include recently-granted restricted share units and options under the 2006 Management Incentive Plan, for which shareholder approval remains pending. See *Proposal Number Two Approval of the 2006 Management Incentive Plan* below.

(4) The percentage of common stock beneficially owned is based upon 36,945,150 shares of common stock issued and outstanding as of the above date.

(5) Includes 156,884 shares owned outright or as restricted stock and 118,397 shares underlying vested stock options exercisable within 60 days of March 13, 2006.

(6) Includes 14,671 shares owned outright or as restricted stock and 70,769 shares underlying vested stock options exercisable within 60 days of March 13, 2006.

(7) Includes 9,781 shares owned outright or as restricted stock and 47,358 shares underlying vested stock options exercisable within 60 days of March 13, 2006.

(8) Includes 2,390 shares owned outright or as restricted stock and 21,512 shares underlying vested stock options exercisable within 60 days of March 13, 2006.

(9) Includes 223,537 shares owned outright or as restricted stock and 277,224 shares underlying vested stock options exercisable within 60 days of March 13, 2006.

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**Equity Compensation Plan Information Table**

The following table includes the specified information as of December 31, 2005 for all of our equity compensation plans that have been approved by our shareholders and any of our equity compensation plans that have not been approved by shareholders.

<b>Plan Category</b>	<b>Number of securities to be issued upon exercise of outstanding options (a)</b>	<b>Weighted-average exercise price of outstanding options (b)</b>	<b>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)</b>
Equity compensation plans approved by security holders(1)	4,014,711	\$ 18.50	924,576 (2)
Equity compensation plans not approved by security holders(3)			
<b>Total</b>	<b>4,014,711</b>	<b>\$ 18.50</b>	<b>924,576 (2)</b>

(1) Equity compensation plans approved by our shareholders include the 2003 Management Incentive Plan (the *2003 MIP* ) and the 2005 Director Stock Compensation Plan.

(2) Includes 912,576 shares available under the 2003 MIP and 12,000 shares under the 2005 Director Stock Compensation Plan. Of the number of shares remaining available for future issuance under the 2003 MIP, the company has committed to granting 891,791 shares under options to certain employees as described under *Executive Compensation Benefit Plans 2003 Management Incentive Plan* below. In the event that less than 891,791 shares are awarded under these option commitments, the company has undertaken not to issue the awards in the amount of the shortfall as restricted stock, restricted stock units or other full-value awards. The 20,785 remaining uncommitted shares under the 2003 MIP are available for grant under the terms of the 2003 MIP.

(3) All equity compensation plans in effect as of December 31, 2005 have been approved by our shareholders.

**Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 (the *Exchange Act* ) requires our executive officers and directors, and persons who own more than 10% of our common stock, to file reports of ownership and changes in ownership of our common stock with the SEC. Executive officers, directors and greater than 10% shareholders are required by the SEC to furnish us with copies of all Section 16(a) reports that they file.

Based on our review of the copies of such reports, or written representations from certain reporting persons that no reports on Form 3, 4 or 5 were required for those persons, we believe that all reports required by Section 16(a) to be filed by our executive officers, directors and greater than 10% shareholders during 2005 were filed on a timely basis except that each of Mr. Shulman, Dr. Lerer and Mr. Demilio filed one late Form 4 and one amended Form 4 in June 2005 to report a small arithmetic error in the number of restricted shares granted to them and the exercise price of options issued to them in January 2004.

## CORPORATE GOVERNANCE AND RELATED MATTERS

### *General*

The business and affairs of the company are managed under the direction of the board of directors. The size of the board has been fixed at nine (9) directors, divided into three groups of directors who serve for staggered three-year terms. Following the resignation of Mr. Haft in October 2005, a vacancy exists in the board among the directors whose terms expire in 2008 which the board intends to fill during 2006 by appointment. The board has been structured in this fashion to provide continuity in the board's policies and to encourage members to adopt a long-term outlook in dealing with the Company's affairs.

Several provisions of the company's by-laws and the policies adopted by the board are designed to promote effective and independent governance of the company. Under the by-laws, the board is required to present to the shareholders nominees for election as director and to take other corporate actions to cause the composition of the board, and in particular its Audit and Management Compensation Committees, to meet all applicable independence requirements. As described under *Director Independence* below, the NASDAQ Stock Market ( *NASDAQ* ) listing standards require the company's board to be comprised of a majority of independent directors. Additional independence requirements under NASDAQ and SEC rules apply to the composition of the Audit and Management Compensation Committees. Our by-laws also provide for designation of a lead director to fulfill various leadership functions on behalf of the non-employee directors if, as is currently the case, the chairman of the board also serves as an officer of the company. Currently, Mr. Shulman, the company's Chairman of the Board, also serves as Chief Executive Officer. The board has also adopted corporate governance guidelines which address several issues with how the board functions; the guidelines are posted on our Internet site at [www.magellanhealth.com](http://www.magellanhealth.com).

### *Lead Director*

Currently, Mr. Le Blanc serves as the lead director of the board of directors. In that role, Mr. Le Blanc chairs the executive sessions of our outside (non-management) directors. In addition, Mr. Le Blanc has been designated the lead director for purposes of receiving communications from interested parties and from shareholders pursuant to rules of the SEC. You may express your concerns, whether such concerns relate to accounting-related matters or otherwise, by contacting the lead director through the communication channels set forth in the section entitled *Communications with Directors and Management* below.

### *Committees of the Board of Directors*

The board of directors has established an Audit Committee, a Management Compensation Committee and a Nominating Committee, each of which is comprised solely of independent directors. The standards for determining director independence are discussed under *Director Independence* below. The functions, responsibilities and members of each of the committees are also described below. Each such committee operates pursuant to a charter which is posted on our Internet site at [www.magellanhealth.com](http://www.magellanhealth.com). The Audit and Management Compensation Committees were established in connection with the consummation of the company's plan of reorganization in its bankruptcy proceedings. The Nominating Committee was established in March 2006 following the nomination of Mr. Smith and Dr. Lerer for election at the annual meeting, to identify and recommend nominees for director positions in the future. The process for selecting nominees to the board is described under *Process for Selecting Nominees to the Board* below.

*Audit Committee.* The Audit Committee has been established in accordance with Section 3(a)(58)(A) of the Exchange Act and has a written charter adopted by the board of directors. The primary function of the Audit Committee is to assist the board of directors in fulfilling its financial oversight responsibility by reviewing the Company's financial statements, the other financial information

*that is proposed to be provided to our shareholders, the periodic financial reports filed with the SEC, the system of internal controls that management and the board of directors have established, and the audit process. The Audit Committee has the power to conduct or authorize investigations into any matter within the scope of its responsibilities and has unrestricted access to management, the Company's internal audit staff and to current and former independent auditors and attorneys. The Audit Committee is responsible for selecting and engaging the independent auditors and the head of the company's internal audit functions, reviewing the scope and approach of the annual audit with the independent auditors, and pre-approving any audit and non-audit services to be performed by the independent auditors. The Audit Committee is also required to review and approve the Company's whistle blower policies and procedures for employees to report fraud, accounting irregularities or other wrongdoing. It is authorized to retain independent counsel, accountants and others to assist it at the Company's expense.*

The members of the Audit Committee are appointed annually by the board, and the Audit Committee must be composed of at least three directors, one of which is appointed chairperson. The committee is required to meet at least five times per year or more frequently as circumstances dictate. The current members of the Audit Committee are Messrs. Michael Ressner (chairman), William McBride and Michael Diament. The board of directors has determined that each of Messrs. Ressner, McBride and Diament is independent for purposes of NASDAQ listing standards. The Board has determined that Mr. Ressner is an *audit committee financial expert*, as defined by Item 401 of SEC Regulation S-K, and has financial sophistication, as required by NASDAQ listing standards. Mr. Ressner is also an independent board member, as used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act. The Board has also determined that each of Messrs. McBride and Diament is financially literate.

*Management Compensation Committee.* The Management Compensation Committee administers our equity compensation plans and bonus plans and oversees our qualified defined contribution 401(k) savings plan. The committee also reviews and recommends, from time to time, amendments to existing compensation plans and establishment and implementation of new compensation plans. The Management Compensation Committee also considers and makes recommendations with respect to the compensation of our chief executive officer and other members of senior management and makes recommendations to the board of directors generally on organization, succession, salary and incentive compensation and other grants and awards under our compensation and benefit plans. The current members of the Management Compensation Committee are Messrs. Barry Smith (chairman), William McBride and Saul Burian.

*Nominating Committee.* The Nominating Committee identifies and recommends individuals to the board for nomination as members of the board and its committees. In nominating candidates, the Committee takes into consideration the factors that it deems appropriate, including those described in the Nominating Committee Charter. As provided in the company's by-laws, candidates for election to the board may also be nominated by shareholders who meet certain requirements. The process which the Nominating Committee follows in selecting nominees is described under *Process for Selecting Nominees to the Board* below. The current members of the Nominating Committee are Messrs. Diament (chairman) and Ressner.

#### ***Number of Meetings and Attendance***

During 2005, the board of directors held six meetings, the Audit Committee held six meetings, and the Management Compensation Committee held six meetings. During 2005, each of the incumbent directors attended at least 75% of the meetings of the board of directors and 75% of the meetings of the Audit and Management Compensation Committees that occurred while such director was a member of the board and such committees, except that Mr. Diament attended two meetings of the full board of directors and two of the three meetings of the Management Compensation Committee held while he served on that committee.

While the board does not have a written policy regarding board member attendance at annual shareholders meetings, all members are encouraged to attend, and the decision to recommend an incumbent board member for re-nomination takes into account, among other criteria, the number of meetings attended and level of participation. All of the directors then serving attended the 2005 annual meeting of shareholders.

***Directors Compensation***

The board periodically reviews the components and amount of compensation to its members in relation to other similarly situated companies. In return for their services on behalf of the company as directors, the individuals who serve as members of the board of directors will receive the compensation listed below; provided however, that no compensation is paid to those members who are employees of either the company or Onex (or its affiliates):

- (a) An annual retainer of \$25,000, payable on a quarterly basis;
- (b) An additional annual payment of \$15,000, payable on a quarterly basis, to each member of the Audit Committee;
- (c) An additional annual payment of \$30,000, payable on a quarterly basis, to the Audit Committee chairman;
- (d) An annual payment of \$10,000, payable on a quarterly basis, to each member of the Management Compensation Committee;
- (e) An additional annual payment of \$10,000, payable on a quarterly basis, to the Management Compensation Committee chairman;
- (f) An additional annual payment of \$20,000, payable on a quarterly basis, to the lead director;
- (g) \$2,000 for each board meeting attended by the member in person;
- (h) \$1,000 for each board meeting attended by the member via telephone;
- (i) \$1,500 for each committee meeting attended by the member in person; and
- (j) \$1,000 for each committee meeting attended by the member via telephone.

Under the terms of the 2005 Director Stock Compensation Plan, each director who was not a member of management or affiliated with Onex received an award of 3,000 shares of restricted stock. The recipients were not entitled to sell or otherwise dispose of the shares without the prior written approval of the board prior to December 31, 2005. The shares also are subject to the registration requirements of federal and state securities laws and policies established from time to time by the board with respect to sales of shares by company directors.

The company is proposing that shareholders approve at the annual meeting the company's 2006 Director Equity Compensation Plan. Under the plan, directors who are designated by the board as *independent directors* for purposes of Article III, Section 3 of the Company's by-laws (or, although not so designated, are not an officer or employee of the company and do not otherwise participate in management and have been designated by the board to participate in the plan) and who are serving at the close of business on the date of the annual meeting of shareholders in the years 2006 or 2007, or who are elected after that date and before the next following annual meeting of shareholders and are designated by the board to participate in the plan, will receive an award of 750 restricted shares and a number of stock options, valued based on the Black-Scholes option pricing model, equal to the fair market value of 2,250 shares as of the award date. Directors whose service commences after the date of an annual meeting of

shareholders may receive an award of a lesser number of restricted shares and options as determined by the board. See *Proposal Number Three Approval of the 2006 Director Equity Compensation Plan*.

***Process for Selecting Nominees to the Board***

The board of directors until recently did not have a nominating committee. The board has operated under a Policy Regarding Director Nominations by the Board of Directors under which the independent members of the board considered and recommended nominations to the full board. The standards for determining director independence are discussed under *Director Independence* below. In addition, the board followed the practice that any incumbent director who was to be considered for re-election at a particular annual meeting did not participate in the nomination process for directors to be elected at that annual meeting. For example, Mr. Smith has not participated in the nomination process for the directors to be elected at the 2006 annual meeting.

The independent members of the board considered candidates for board membership suggested by board members, as well as by management and by our shareholders. In determining whether to recommend an incumbent board member for re-nomination, the independent board members reviewed the director's overall service to the company during the term of his or her service, including the number of meetings attended, level of participation, quality of performance, and any circumstances that presented or were expected to present a conflict of interest. Shareholders may participate in the nomination of directors by two methods: by recommending nominees to the board of directors or by directly nominating an individual to serve as a director. For further information on the nomination of directors directly by shareholders, see *Direct Shareholder Nominations* below.

The initial determination to seek a new board candidate is usually based on the need for additional board members to fill vacancies or to expand the size of the board, although the decision can also be based on the need for certain skill sets or qualifications, such as financial expertise. The independent board members' process for identifying and evaluating nominees for director was the same no matter who made the recommendation. Once the independent members determined, in consultation with other board members, that additional consideration of a candidate was warranted, the independent members might seek additional information about the prospective candidate's background, experience and independence and the other members of the board might interview the prospective candidate. The independent members then evaluated the prospective nominee against the standards and qualifications set forth below. In addition to the qualifications set forth below, the board members also considered such other relevant factors as they deemed appropriate, including the composition of the board and the candidate's personal qualities and characteristics.

Following this evaluation, if the independent members believed that the prospective candidate was qualified for nomination, they made a recommendation to the full board and the board determined whether the candidate should be nominated to the board. The Policy Regarding Director Nominations by the Board of Directors is available on the Company's Internet site at [www.magellanhealth.com](http://www.magellanhealth.com).

Mr. Smith and Dr. Lerer were nominated for reelection as directors at the annual meeting through the process described above. Following its establishment in March 2006, the Nominating Committee also reviewed and approved the nomination of Mr. Smith and Dr. Lerer for reelection at the annual meeting. In the future, the Nominating Committee will have responsibility for identifying, evaluating and recommending candidates for nomination to the board, although the shareholders will continue to have the right under the company's by-laws to directly nominate candidates for election to the board.

The Nominating Committee will take into consideration the factors that it deems appropriate, including the candidate's personal qualities and characteristics, accomplishments and reputation in the business community; the candidate's current knowledge and contacts in the communities in which the company does business and in the company's industry; the candidate's experience with businesses and



other organizations of comparable size; the candidate's ability and willingness to commit adequate time to board and committee matters; the candidate's ability to complement the skills of the other directors and potential directors in building a board that is effective, collegial and responsive to the needs of the company; and diversity of viewpoints, background, experience and other demographics. The Nominating Committee may consider candidates proposed by management, but it is not required to do so.

With respect to incumbent directors, the Nominating Committee will review the director's overall service to the company during his or her term, including the number of meetings attended, level of participation, quality of performance, and circumstances that have presented or are expected to present a conflict of interest with the company. In general, no specific search effort must be initiated to conduct a search to fill the position of an incumbent director unless and until the board has determined that such director will not be re-nominated.

The Nominating Committee will develop and recommend to the board standards to be applied in making determinations as to the absence of any material relationship between the company and a director and as to a director being otherwise considered independent under the NASDAQ rules.

The Nominating Committee will also identify board members qualified to fill vacancies on any committee of the board (including the Nominating Committee) and recommend the appointment of members to fill those vacancies. In nominating a candidate for committee membership, the Nominating Committee will take into consideration the factors set forth in the charter of the committee, if any, and any other factors it deems appropriate.

#### *Shareholder Recommendations*

Shareholders who wish to recommend a prospective nominee for the board may do so by writing to our corporate secretary at 55 Nod Road, Avon, CT 06001 along with whatever supporting material the shareholder considers appropriate. All such shareholder-recommended candidates should satisfy the following criteria for board qualification:

- The candidate should be an individual of accomplishment in his or her career.
- The candidate should be able in carrying out his or her responsibilities as a director to make independent business judgments in an analytical manner and should exhibit practical wisdom and mature judgment.
- The candidate should possess the highest personal and professional ethics, integrity and values, and should be committed to promoting the long-term interests of the company's stockholders, free of any relationship that may on a regular basis create conflict of interest between his or her directorial role and personal or other associative interests.
- The candidate should have expertise and experience in an area pertinent to the company's business, and have the time to and, by personality, be effective in providing advice and guidance to the management of the company based on that expertise and experience.

In order for shareholder-recommended candidates to be considered in an orderly manner, generally, names and other supporting materials should be submitted not later than six months prior to the anniversary of the mailing date of the Company's most recent past annual meeting proxy statement, which will be September 31, 2006 for the 2007 annual meeting. Materials in support of a shareholder-recommended candidate should include:

- All information about the candidate that is required to be disclosed in solicitations of proxies for election of directors or otherwise required under Regulation 14A under the Exchange Act, including written consent to being named in the proxy statement as a nominee and to serving as a director if elected.

- An indication of whether the candidate qualifies as *independent* under NASDAQ listing standards and securities law requirements relating to service on the Audit Committee.
- The name and address of the recommending stockholder, as they appear on the company's books, and of any beneficial owner on whose behalf the recommendation is made.
- The class and number of shares of the company's stock that are beneficially owned and held of record by such stockholder or beneficially owned by such beneficial owner.
- Information regarding whether the recommending stockholder, beneficial owner or candidate or their affiliates have any plans or proposals for the company, including for any extraordinary transaction.
- Whether the recommending stockholder, beneficial owner or candidate seeks to use the nomination to redress personal claims or grievances against the company or to further personal interests or special interests not shared by stockholders at large.

*Direct Shareholder Nominations*

Shareholders who wish to directly nominate an individual to serve as a director may do so if they are entitled to notice of and to vote at a meeting called for the election of directors, by writing to our corporate secretary at 55 Nod Road, Avon, CT 06001 together with various required materials. To be effective, the nomination must be received not later than 90 days prior to the anniversary date of the last annual meeting, provided that if the date of the annual meeting is more than 30 days before or after the anniversary date of the last annual meeting, the nomination must be received within 15 days after the public announcement by the company of the date of the annual meeting. The nomination must contain the following information to the extent known by the shareholder:

- The name, age, business address, and residence address of the proposed nominee(s) and of the notifying shareholder.
- The principal occupation of the proposed nominee.
- A representation that the notifying shareholder intends to appear in person or by proxy at the meeting to nominate the person(s) specified in the notice.
- The class and total number of shares of capital stock and other company securities that are beneficially owned by the notifying shareholder and by the proposed nominee and, if such securities are not owned solely and directly by the notifying shareholder of the proposed nominee, the manner of beneficial ownership.
- A description of all arrangements or understandings between the notifying shareholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination(s) are to be made by the notifying shareholder.
- Such other information regarding the nominee proposed by such shareholder as would be required to be included in a proxy statement filed with the SEC pursuant to Regulation 14A under the Exchange Act had the nominee been nominated, or intended to be nominated, by the board.
- The consent of the nominee to serve as a director of the company if so elected.

The company may request any proposed nominee to furnish such other information as may reasonably be required by the company to determine the qualifications of the proposed nominee to serve as a director of the company. Within 15 days after receipt by the secretary of a shareholder notice of nomination, the board must instruct the secretary to advise the notifying shareholder of any deficiencies in the notice. The notifying shareholder must cure the deficiencies within 15 days of receipt of such notice.



*Director Independence*

NASDAQ listing standards provide that a majority of the company's board of directors must be comprised of independent directors. Under NASDAQ rules, no director qualifies as independent unless the director is not an officer or employee of the company and the board determines that the director has no relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. On February 24, 2006, our board of directors undertook a review of director independence. During this review, the board considered transactions and relationships between each director or any member of his or her immediate family and the company and its subsidiaries, including those reported under *Executive Compensation Certain Relationships and Related Transactions* below. The purpose of this review was to determine whether any such relationships or transactions were inconsistent with a determination that the director is independent. In making this determination, the board applied the following standards, in addition to considering any other relevant facts and circumstances:

- A director who is, or at any time during the past three years was, employed by the company, is not considered independent.
- A director who accepted or who has a family member who accepted any payments from the company in excess of \$60,000 during any period of twelve consecutive months within the three preceding years, except compensation for board or committee service, payments arising from an investment in the company's securities and certain other payments, is not considered independent.
- A director who is a family member of an individual who is, or at any time during the past three years was, employed by the company as an executive officer, is not considered independent.
- A director who is, or has a family member who is, a partner in, or a controlling stockholder or any executive officer of, any organization to which the company made, or from which the company received, payments for property or services in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenues for that year, or \$200,000, whichever is more, other than payments arising from investments in the company's securities and certain other payments, is not considered independent.
- A director who is, or has a family member who is, employed as an executive officer of another entity where at any time during the past three years any of the executive officers of the company serve on the compensation committee of such other entity, is not considered independent.
- A director who is, or has a family member who is, a current partner of the company's outside auditor, or was a partner or employee of the company's outside auditor who worked on the company's audit at any time during any of the past three years, is not considered independent.

In addition, the NASDAQ standards impose additional independence and qualification standards on the members of our Audit Committee. Under these standards, each committee member, in addition to meeting the definition of independence applicable to all non-employee directors, is prohibited from accepting directly or indirectly any consulting, advisory or other compensatory fee from the company or from being an affiliated person of the company, and must not have participated in the preparation of the company's financial statements at any time during the past three years.

Under the standards set forth above, the board has determined that all of its members, including each of the members of our Audit Committee, Management Compensation Committee and Nominating Committee, are independent as of the date of this proxy statement, except Mr. Shulman (our chief executive officer), Dr. Lerer (our chief operating officer) and Mr. Le Blanc, due to the prior ownership of Multi-Vote Common Stock by Onex, along with other factors, and the application of certain NASDAQ three year look-back rules. Mr. Le Blanc would currently be considered independent but for the application of the NASDAQ three-year look-back rules.

### *Codes of Ethics*

The company has adopted a Code of Ethics for Directors, covering directors only, and a Code of Ethics for Covered Officers, covering senior executives and individuals reporting directly to the chief executive officer and finance department employees at a vice president level or above. In addition, the company has adopted a Corporate Compliance Handbook covering all employees. The codes and the handbook provide a framework for a comprehensive ethics and compliance process designed to ensure that we conduct our business in a legal and ethical manner. All covered persons are expected to understand and comply with the policies and obligations described in the codes and the handbook.

The Code of Ethics for Directors deals with conflicts of interest, corporate opportunities, confidentiality, fair dealing, protection and proper use of company assets, compliance with laws, insider trading and personal loans to executive officers and directors. The Code of Ethics for Covered Officers deals with good faith and fair dealing in all negotiations and transactions, actual and apparent conflicts of interest, responsible use and protection of company assets, disclosures filed with the SEC or otherwise communicated to the public, compliance with laws, prompt reporting of violations of the code of ethics and other applicable policies, and accountability with respect to compliance with the code of ethics.

The handbook, among other things, contains a whistleblower policy that sets forth steps an employee should take if he or she has a question about a legal or ethical issue related to his or her job or the company, and prohibits retribution against any person raising an issue.

The company will provide to any person without charge, upon request, copies of its Code of Ethics for Directors, Code of Ethics for Covered Officers and Corporate Compliance Handbook for all employees. Any such request should be made in writing to the Investor Relations Department, Magellan Health Services, Inc., 55 Nod Road, Avon, CT 06001. These documents are also available on our Internet site at [www.magellanhealth.com](http://www.magellanhealth.com). The company intends to disclose any future amendments to the provisions of the codes of ethics and handbook and waivers from such codes of ethics and handbook, if any, made with respect to any of its directors and executive officers on its Internet site.

### *Disclosure Controls and Procedures*

We have adopted disclosure controls and procedures that are designed to ensure that all public financial disclosures are accurate, complete and timely. We have also created a disclosure committee, which is responsible for ensuring our compliance with the disclosure controls and procedures and for the evaluation of those procedures. If you become aware that our public disclosures are not accurate, complete or timely, or become aware of a transaction or development you believe may require disclosure, you should report the matters as soon as practicable to our corporate secretary at 55 Nod Road, Avon, Connecticut 06001.

### *Communications with Directors and Management*

We have several communications channels established for employees, shareholders and other interested parties to communicate with our management and/or our board of directors or committees thereof.

*Member and Provider Communications:* Our members and providers have specific mechanisms for contacting us regarding such matters as benefits, claims or other administrative matters. Member and provider contact information is available on our Internet site at [www.magellanhealth.com](http://www.magellanhealth.com). Although our employees and members of management address most of these matters, significant issues are brought to the attention of senior management and, in certain cases, the board of directors.

*Investor Relations:* We maintain an investor relations department that is responsible for communicating with current or prospective shareholders and addressing any issues raised by them. The contact information for our investor relations department is as follows:

*E-mail:* ir@magellanhealth.com

*Post Office Address:*

Investor Relations Department

Magellan Health Services, Inc.

55 Nod Road

Avon, CT 06001

*Telephone:* (877) 645-6464

*Lead Director:* You may communicate with Mr. Le Blanc, our lead director, through the following channels:

*E-mail:* leaddirector@magellanhealth.com.

*Post Office Address:*

Communications with Lead Director

c/o Magellan Health Services, Inc.

55 Nod Road

Avon, CT 06001

All communications to the lead director will be treated confidentially. Communications should clearly identify the issue being raised, the name of the party initiating the communication and contact information for potential follow-up.

These communications will initially be received by a designee of the lead director who will log, track and summarize the matters raised in the communication. The lead director may direct that such communications be presented to the full board of directors, non-management directors, one or more board committees or management and may direct that matters raised in the communications be investigated by outside advisors or counsel or by management.

#### **PROPOSAL NUMBER ONE ELECTION OF DIRECTORS**

Our certificate of incorporation provides for a board of directors divided into three groups, each group having a different three year term of office expiring at the annual meeting of shareholders in the relevant year. Directors are elected for a term of three years except in the case of elections to fill vacancies or newly created directorships.

The board of directors currently consists of eight (8) persons: Steven J. Shulman, Barry M. Smith, Michael Diamant, William J. McBride, Robert M. Le Blanc, René Lerer, M.D., Michael P. Ressler and Saul E. Burian. A vacancy currently exists on the board due to the resignation of Robert Haft in October 2005 which the board intends to fill by appointment in 2006. The board of directors proposes that Barry M. Smith and René Lerer, M.D., who are currently serving as directors, be re-elected to serve for terms of three (3) years and until the election and qualification of their successors. The proxies cannot be voted for a greater number of persons than the two nominees named. Unless a shareholder WITHHOLDS AUTHORITY, the holders of proxies representing shares of common stock will vote FOR the election of Barry M. Smith and René Lerer, M.D. as directors. The board of directors has no reason to believe that any nominee will decline or be unable to serve as a director. However, if a nominee shall be unavailable for any reason, then the proxies may be voted for the election of such person as may be recommended by the board of directors.

Steven J. Shulman, Michael P. Ressner, Saul E. Burian and Michael Diament serve as directors whose terms expire in 2007 and William J. McBride and Robert M. Le Blanc serve as directors whose terms expire in 2008. These directors are not standing for re-election because their terms as directors extend past the annual meeting.

***Certain Information Regarding Our Directors***

The following table sets forth the age and title as of the date of this proxy statement of each nominee for director, each director continuing in office and each of our current executive officers who is a director, followed by descriptions of such person's business experience during the past five years.

**NOMINEES FOR ELECTION FOR TERMS EXPIRING IN 2009**

<b>Name</b>	<b>Age</b>	<b>Committee Membership</b>
Barry M. Smith	52	Management Compensation Committee
René Lerer, M.D.	50	

**DIRECTORS WHOSE TERMS EXPIRE IN 2007**

<b>Name</b>	<b>Age</b>	<b>Committee Membership</b>
Steven J. Shulman	54	
Michael P. Ressner	57	Audit Committee, Nominating Committee
Saul E. Burian	42	Management Compensation Committee
Michael Diament	37	Audit Committee, Nominating Committee

**DIRECTORS WHOSE TERMS EXPIRE 2008**

<b>Name</b>	<b>Age</b>	<b>Committee Membership</b>
William J. McBride	61	Management Compensation Committee, Audit Committee
Robert M. Le Blanc	39	

***Directors***

Under the company's certificate of incorporation and by-laws, the number of directors is currently fixed at nine (9). The current directors of the company were initially appointed in accordance with the company's plan of reorganization under chapter 11 of the U.S. Bankruptcy Code, which was consummated on January 5, 2004, except that Messrs. McBride and Smith were subsequently appointed to the board of directors and Mr. McBride and Mr. Le Blanc were elected by the stockholders at the 2005 annual meeting of stockholders.

The company's by-laws require a majority of directors to be independent in accordance with NASDAQ's listing standards. The company's board of directors has determined that except for those directors who are members of management of the company and Mr. Le Blanc, who is a Managing Director of Onex, all directors are independent, as that term is defined by the NASDAQ listing standards. For a discussion of these independence standards see *Corporate Governance and Related Matters Director Independence* above.

***Nominees for Election for Terms Expiring in 2009***

*Barry M. Smith* was appointed to the board on December 17, 2004. Mr. Smith replaced Mark L. Hilson, Managing Director for Onex Corporation, who resigned in December 2004. Mr. Smith is the founder, Chairman and Chief Executive Officer of Bon Travay, S.A., a charitable organization dedicated to health care and educational efforts in Third World countries. Prior to founding Bon Travay, he founded

and served as Chairman, President and CEO of Vista Care Services, a national provider of hospice services, from 1996 to 2003. Earlier in his career, Mr. Smith served as Chairman and CEO of Value Rx, Inc., then one of the country's largest pharmacy benefit management companies, and, prior to that, served as Vice President of Operations for PCS Health Systems, also a pharmacy benefit management firm. Mr. Smith serves as the Chairman of RG Capital, a financial services company, and as Chairman and Chief Executive Officer of B&J Associates, Inc. and B&J Investments, LLC. He also serves as Chairman of Eatza Pizza, Inc., a privately-held family restaurant chain, and as Chairman of iNation, Inc., a software development and services company serving financial service providers. Mr. Smith is a member of the board of the Institute of Mental Health Research, a public and private partnership sponsored by the University of Arizona, Arizona State University, the State of Arizona and Barrows Neurological Institute. Mr. Smith also serves on the boards of the Ambassador's Council of Freedom From Hunger, a leading worldwide micro-credit provider to poverty-stricken women in Third World countries, and VistaCare Foundation, an organization dedicated to advancing end of life care issues. Mr. Smith also serves on the board of directors of Inpatient Consultants, Inc., the nation's largest provider of hospitalist services delivering patient care in acute care hospitals.

*René Lerer, M.D.* has served as President and Chief Operating Officer of the company since October 2003. He previously served as Chief Operating Officer of the company since January 2003. Prior to joining the company, Dr. Lerer co-founded Internet HealthCare Group ( *IHCG* ), an early stage healthcare technology venture fund, and served as its President from 1999 to 2002. Prior to IHCG, Dr. Lerer was employed by Prudential Healthcare, Inc. as its Chief Operating Officer from 1997 to 1999. Prior thereto, Dr. Lerer was employed by Value Health, Inc., a New York Stock Exchange listed specialty managed healthcare company, and served as Senior Vice President Operations of its Pharmacy and Disease Management Group from 1995 to 1997. Prior thereto, Dr. Lerer was employed by Value Health Sciences as Senior Vice President of Corporate Development from 1992 to 1994. Dr. Lerer is a member of the board of directors of IHCG, Digital Insurance, a private employee benefits service company, and RealMed, a private insurance software company.

*Directors Whose Terms Expire in 2007*

*Steven J. Shulman* is the Chairman of the Board and Chief Executive Officer of the company. He became Chief Executive Officer of the company in December 2002 and Chairman of the Board on the effective date of the company's plan of reorganization. Prior to joining the company, Mr. Shulman founded IHCG, an early stage healthcare technology venture fund, and served as its Chairman and Chief Executive Officer from 2000 to 2002. Prior to IHCG, he was employed by Prudential Healthcare, Inc. as its Chairman, President and Chief Executive Officer from 1997 to 1999. Prior thereto, Mr. Shulman co-founded Value Health, Inc., a New York Stock Exchange listed specialty managed health care company, and served as President of its Pharmacy and Disease Management Group and director from 1991 to 1997. From 1983 to 1986, Mr. Shulman was employed by CIGNA Healthplans as President of its East Central Division. Prior thereto, he served as Director of Medical Economics for Kaiser Permanente from 1974 to 1982. Mr. Shulman is a member of the board of directors of IHCG, Digital Insurance, a private employee benefit service company, and BenefitPoint Inc., a private insurance software company.

*Michael P. Ressler* is a retired Adjunct Professor of Finance & Accounting and an adviser at North Carolina State University and is an advisor at Southeast Interactive Technology Fund. Between 1981 and 2003, he served in a variety of positions at Nortel Networks, holding leadership positions within operations and finance. Mr. Ressler currently serves on the boards of Entrust, Inc., an internet security software company, Riverstone Networks, a publicly-traded networking solutions company, Exide Technologies, a NASDAQ-listed stored electrical energy company, and Arsenal Digital Solutions, a private storage management services company.



*Saul E. Burian* is a Managing Director in the New York office of Houlihan, Lokey, Howard & Zukin ( *Houlihan* ), an investment banking and advisory firm, and splits his practice between Restructuring Advisory and Distressed M&A. Mr. Burian has served as a director of Houlihan since March 2001 and he presently manages its Distressed M&A Northeast Region. From 1988 through February 2001, Mr. Burian was a partner of the New York law firm, Kramer Levin Naftalis & Frankel LLP and specialized in the area of creditors' rights and bankruptcy. He has been a member of the Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York and has been approved by the chief bankruptcy judge of the Southern District of New York to serve as a court-certified bankruptcy mediator. Mr. Burian is a member of the City of New Rochelle Waterfront Commission, a director of the New York Chapter of the Turnaround Management Association, a director of S/A/R Academy of Riverdale and a director of Yeshiva College.

*Michael Diament* formerly served as Portfolio Manager and Director of Bankruptcies and Restructurings from January 2003 to February 2006 for Renegade Swish, LLC which, through various contractual agreements, provides personnel services to Amalgamated Gadget, LP, the investment manager for R2 Investments, LDC. From January 2001 to December 2002, Mr. Diament served as Portfolio Manager for Acme Widget, LP, which provided personnel services to Amalgamated Gadget, LP through various contractual arrangements. From February 2000 until January 2001, Mr. Diament was a Senior Research Analyst for Sandell Asset Management, an investment management firm, and served as Vice President of Havens Advisors, an investment management firm, from July 1998 to January 2000.

*Directors Whose Terms Expire in 2008*

*William J. McBride* was appointed to the board on January 21, 2004. Mr. McBride is currently retired. Prior to his retirement in 1995, Mr. McBride had been a director of Value Health, Inc., a New York Stock Exchange listed specialty managed care company which included Value Behavioral Health, one of the largest behavioral health managed care companies at the time. From 1987 to 1995, Mr. McBride served as President and Chief Operating Officer of Value Health, Inc., overseeing all operational activities of the company and its subsidiaries. Prior to his tenure at Value Health, Mr. McBride spent 15 years in a variety of positions with INA Corporation and its successor, CIGNA Corporation, including serving as President and Chief Executive Officer of CIGNA Healthplan, Inc., Vice President and Controller of INA's Life and Healthcare Group and Vice President of Finance for CIGNA's Affiliated Business Group. Mr. McBride currently serves on the board of directors of AMERIGROUP Corporation, a managed health care company focused on providing services to Medicaid recipients, Evolution Benefits, Inc., a private insurance services company, and Women's Health USA, Inc., a private healthcare services company.

*Robert M. Le Blanc*, the board's lead director, is a Managing Director for Onex Corporation. Prior to joining Onex in 1999, Mr. Le Blanc held various positions with Berkshire Hathaway for seven years. He also worked for five years at GE Capital in a variety of positions, including corporate finance and corporate strategy. Mr. Le Blanc is a director of Berkshire Hathaway Life, American Medical Response, Center for Diagnostic Imaging and ResCare, Inc., a publicly traded human service company for the disabled.

Mr. Shulman and Dr. Lerer served as employees of Healthcare Partners, Inc., which provided management services (including executive officer functions) to the company, Mr. Demilio was an executive officer of the company, and Mr. Shulman and Dr. Lerer were directors of the company, in March 2003 when it filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the Southern District of New York.

*Director Election and Terms of Office*

Mr. Smith and Dr. Lerer are currently nominated for reelection for a three-year term to extend until the 2009 annual meeting. Messrs. Shulman, Ressler, Diament and Burian are currently serving for a three-year term to extend until the 2007 annual meeting of stockholders. Messrs. McBride and Le Blanc are currently serving for a three-year term to extend until the 2008 annual meeting of stockholders. In each case, the term of office will extend until the indicated annual meeting and the election and qualification of their respective successors, or their earlier death, incapacity, resignation or removal.

*Arrangements Regarding the Nomination of Directors*

The individuals currently serving as directors of the company (other than Messrs. Smith, McBride and Le Blanc) were originally selected in accordance with provisions of the company's plan of reorganization in its Chapter 11 bankruptcy proceedings, by agreement of the parties in interest, and were approved by the bankruptcy court pursuant to the order confirming the plan of reorganization. Messrs. McBride and Le Blanc were reelected at the 2005 annual meeting of stockholders. There is no agreement or arrangement whereby any such director will be re-nominated or any other individual will be nominated or selected to serve as a director of the company. Prior to May 20, 2005, the holder of the company's Multi-Vote Common Stock, voting as a separate voting group, was entitled to elect four directors, and the holders of Multi-Vote Common Stock and Ordinary Common Stock, voting together as a voting group, were entitled to elect two directors. As of May 20, 2005, the shares of Multi-Vote Common Stock were converted in whole into shares of Ordinary Common Stock on a one-for-one basis and these special voting rights were extinguished. As a result, all directors are now elected by the holders of Ordinary Common Stock, voting as a single voting group.

Certain provisions of the company's certificate of incorporation and by-laws govern the nomination and election of the company's directors. In accordance with the company's by-laws, the board of directors is required to nominate for election at each annual meeting of shareholders candidates who, if elected, will cause a majority of the members of the board of directors of the company to be independent directors, as determined in accordance with the listing standards of NASDAQ (and to meet certain other requirements regarding independence for membership on the Audit, Management Compensation and Nominating Committees, as well as corporate governance guidelines adopted by the board). Nominations may also be made by shareholders in accordance with certain procedures established by the by-laws and nominations not made in compliance with the requirements established thereby may not be given effect.

**EXECUTIVE COMPENSATION****Summary Compensation Table**

The following table sets forth, for the fiscal year ended December 31, 2005 and the two preceding fiscal years ended December 31, 2004 and 2003, respectively, the compensation paid by the company to the company's chief executive officer and the company's four next most highly compensated executive officers serving at December 31, 2005 (collectively, the *Named Executive Officers*):

(a) <b>Name and Principal Position</b>	(b) <b>Year</b>	Annual Compensation			(e) <b>Other Annual Compensation (\$)</b>	Long Term Compensation			(i) <b>All Other Compensation (\$)</b>
		(c) <b>Salary (\$)</b>	(d) <b>Bonus (\$)(1)</b>	(f) <b>Restricted Stock Award(s) (\$)(2)</b>		(g) <b>Securities Underlying Options/SARs(#)</b>			
Steven J. Shulman(3) Chief Executive Officer and Chairman of the Board	12-05	1,030,000	1,831,440	24,432 (4)	845,271 (5)	198,250	121,114 (6)		
	12-04	992,949	2,500,000 (7)	3,079,561 (8)	2,409,738 (9)	1,445,511	116,495 (10)		
	12-03								
René Lerer, M.D.(11) President and Chief Operating Officer	12-05	618,000	824,148	8,910 (12)	507,176 (13)	118,950	75,354 (14)		
	12-04	595,769	1,050,000	698,406 (15)	1,445,849 (16)	867,307	72,150 (17)		
	12-03								
Mark S. Demilio(18) Chief Financial Officer	12-05	515,000	549,432	10,272 (19)	338,095 (20)	79,300	63,914 (21)		
	12-04	499,295	675,000	508,582 (22)	963,890 (23)	578,204	61,420 (24)		
	12-03	400,000	553,340				5,981		
Jeffrey D. Emerson(25) Former Executive Vice President	12-05	337,500	210,000		200,160 (26)	46,950	7,074 (27)		
	12-04	300,000							