ZILKHA SELIM K
Form DEFC14A
May 12, 2003

SCHEDULE 14A

(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities

Exchange Act of 1934

Filed by the Registrant ¨

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Check the appropriate box:

¨ Preliminary Proxy Statement

¨ Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

x Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to Section 240.14a-11(c) or Section 240.14a-12

EL PASO CORPORATION

(Name of Registrant as Specified in Its Charter)

SELIM K. ZILKHA

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

Payment of Filing Fee (Check the appropriate box):

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

SELIM K. ZILKHA

1001 McKinney

Suite 1900

Houston, Texas 77002

May 12, 2003

To the Stockholders of El Paso Corporation

Dear Fellow Stockholders:

As one of the largest stockholders of El Paso Corporation, I have watched with great dismay the disastrous decline in the value of El Paso s securities, including the precipitous drop in its stock price and the recent series of debt ratings downgrades. I believe this drastic decline is the result of a tremendous loss of confidence in the current management and the board that supports it, and of an alarming series of errors in judgment by that group. I believe that the best way to restore confidence in El Paso and turn around its fortunes is to replace the current board with directors who have the credibility and the solid experience in the energy industry necessary to maximize the value and productivity of El Paso s employees and assets. I believe that I have assembled the right group to meet the challenges facing El Paso and urge you to support their election as directors of El Paso. In light of the serious damage done to El Paso, there can, of course, be no assurance that we will be able to restore confidence in El Paso or turn it around.

I urge you to read the enclosed Proxy Statement carefully, as it contains more detailed information about the nominees and the other proposals I will present at the Annual Meeting.

Vote for change. Vote to replace the directors who have so badly failed us. Vote FOR the election of R. Gerald Bennett, C. Robert Black, Charles H. Bowman, Ronald J. Burns, Stephen D. Chesebro , Ted Earl Davis, John J. Murphy, John V. Singleton and Selim K. Zilkha by signing the enclosed BLUE Proxy and returning it to Innisfree M&A Incorporated in the self-addressed, postage-paid envelope provided.

If you have any questions, please feel free to call Innisfree M&A Incorporated toll free at (877) 750-5837. Banks and brokers may call collect at (212) 750-5833.

Thank you for your support.

Sincerely,

Selim K. Zilkha

This Proxy Statement is dated May 12, 2003 and was first furnished to stockholders on or about May 12, 2003.

2003 Annual Meeting of Stockholders of El Paso Corporation

Proxy Statement of Selim K. Zilkha

This proxy statement (the Proxy Statement) and the enclosed **BLUE** proxy card are being furnished to you, the stockholders of El Paso Corporation, a Delaware corporation (El Paso or the Company), in connection with the solicitation of proxies by Selim K. Zilkha (the Stockholder) for use at the 2003 Annual Meeting of Stockholders of El Paso (including any adjournments, postponements, reschedulings or continuations of the meeting, the 2003 Annual Meeting).

El Paso has announced that the 2003 Annual Meeting will be held on June 17, 2003, beginning at 2:00 p.m. (Central time) at the George R. Brown Convention Center, 1001 Avenida de las Americas, Houston, Texas 77010. El Paso has announced that the record date (the Record Date) for determining stockholders entitled to notice of and to vote at the 2003 Annual Meeting is May 2, 2003.

The Stockholder believes the performance of El Paso s current Board of Directors and management has been inexcusably poor and that they should be replaced. The recent minor changes in the composition of the Board have not changed this belief. **Less than three years ago, El Paso s fully integrated core businesses of natural gas exploration combined with nationwide pipeline distribution system and its solid balance sheet made it a very successful commercial enterprise. Since that time, the current Board has led a once-proud company to the point that its very viability is being publicly questioned.** Specifically, the current Board and management have:

- presided over an enormous decline in shareholder value (over 90% by some measures, see Reasons for the Solicitation on page 4.);
- diverted management attention and focus by repeatedly changing El Paso s business strategy, including by pursuing and then abandoning high-risk ventures, such as telecommunications, energy trading, liquified natural gas (LNG) and off-balance sheet financing transactions, that proved disastrous;
- changed its business plan yet again on May 1, 2003 when it eliminated the Non-merchant Power Business from its definition of core assets. As recently as April 24, 2003, El Paso considered Non-merchant Power a core business;

incurred excessive levels of debt, including through off-balance sheet financing schemes, triggering the current liquidity crisis facing El Paso;

entered into a massive $1.7 billion settlement of claims by governmental authorities regarding energy trading which, if true, would indicate that the Board permitted, or at least failed to prevent, a corrupt culture to develop at El Paso;

signed off on financial disclosures so lacking in clarity that even a leading financial institution such as Morgan Stanley can t determine its true level of debt (but has concluded that debt is excessive); and

trumpeted a plan to sell non-core assets while in fact selling mostly core assets.

The Stockholder further believes that only immediate, fundamental change can fix El Paso s management problems, because the Board and management culture at El Paso appears too deep-rooted to be affected by incremental change. The traits that typify the current culture are:

condoning and indeed lavishly rewarding poor performance (William Wise, the CEO of El Paso until he was recently jettisoned, received compensation in excess of $37 million between 2001 and 2003, including $9.4 million in severance and a lump sum retirement benefit of $15.3 million, but not including a $9 million loan, while El Paso s stock price dropped from a high of over $75 to a low of $3.33);

insisting, without any apparent embarrassment or guilt, on retaining outrageously expensive golden parachute and related self-entrenchment devices (and apparently attempting to use the expense associated with these egregious arrangements as a means of deterring stockholders from exercising their right to elect directors);

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failing to act proactively and instead acting principally in response to outside pressure (the current Board belatedly fired Mr. Wise and added a few new directors almost immediately after Mr. Zilkha announced he would seek to replace the Board, demanded Mr. Wise be fired and criticized the Board s lack of energy industry experience); and

making excuses for poor performance, rather than taking responsibility for it.

The Stockholder is proposing to replace the incumbent Board and its troubled legacy with a talented, experienced slate of nominees that he believes offer El Paso a desperately-needed fresh start. The slate is comprised principally of industry veterans who have helped build and manage several of the most important and most complex companies in the energy industry. Importantly, several of these nominees have managed the same businesses and assets that now comprise substantial parts of El Paso s core businesses. Others within this group have managed companies that compete in the same markets as El Paso. This depth of experience and expertise is substantially greater than that of El Paso s existing Board (even with its last-minute, minor additions). Just as importantly from a stockholder perspective, the experience of this group is so directly relevant to El Paso s specific situation that the group is well-positioned to immediately and effectively take control of El Paso and to begin that process of seeking to fix it. In the Stockholder s opinion **this group will bring to El Paso key qualities business competence and discipline, focus, a commitment to transparent disclosure and credibility.**

The Stockholder has been troubled by the incumbent Board s repeated references to **a change-in-control payment obligation of at least $75 million** that El Paso apparently has undertaken and to an obligation to set aside at least $165 million (which El Paso has now changed to at least $123 million) to fund these and other severance obligations. **The Stockholder understands that, under the documents that create these obligations, no such obligations will be triggered by the election of the Stockholder Nominees if the incumbent Board acts to approve the nomination or election of the Stockholder Nominees. The Stockholder believes that under the circumstances, the incumbent Board s fiduciary duties require it to take that action, because failure to do so could inhibit the stockholders from exercising their right to select a board of their choosing and would impose a large expense on El Paso, at a time when it is desperately short of funds, without any corresponding corporate benefit (other than possibly retaining for a few months a group of executives who have brought El Paso to its**

current disastrous state). The Stockholder expects that, if the existing directors fail to take action to eliminate this change-in-control provision, the Stockholder Nominees after being elected will consider whether to take legal action against the existing directors claiming breach of fiduciary duties.

Summary of Stockholder Proposals

The Stockholder is asking you to elect to the Company s Board of Directors at the 2003 Annual Meeting Messrs. R. Gerald Bennett, C. Robert Black, Charles H. Bowman, Ronald J. Burns, Stephen D. Chesebro , Ted Earl Davis, John J. Murphy, John V. Singleton and Selim K. Zilkha (the Stockholder Nominees) and seeking your approval of the proposals described in Matters to be Considered at the 2003 Annual Meeting The Stockholder Proposals beginning on page 16 (the Stockholder Proposals).

As of the date of this Proxy Statement, the Stockholder is the beneficial owner of an aggregate of 8,909,195 shares of common stock, par value $3.00 per share, of the Company, which represent approximately 1.48% of the issued and outstanding shares of El Paso common stock (600,860,300 shares of common stock outstanding as of May 2, 2003, based on information publicly disclosed by the Company in its definitive proxy statement, filed with the Securities and Exchange Commission (the SEC) on May 9, 2003).

Additional information concerning the Stockholder and the other participants in the solicitation is set forth under the heading Information Concerning the Participants in the Solicitation beginning on page 15.

* * *

Some of the statements contained in this Proxy Statement may constitute forward-looking statements, which for this purpose includes all statements that are not of historical facts. The actual future financial

performance of El Paso could differ materially from those anticipated by these forward-looking statements. Particularly given the condition to which El Paso has been reduced under the current Board, there can be no assurance that Mr. Zilkha or the Stockholder Nominees will succeed in their efforts to turn El Paso around.

The Stockholder may quote or refer to independent industry research reports, financial analyst reports and newspaper articles in this Proxy Statement. To the extent such a quote is included in this Proxy Statement, the Stockholder has not sought or obtained the consent of the quoted source to the use of such quote as proxy soliciting material.

* * *

This solicitation is being made by Selim K. Zilkha, and not on behalf of the incumbent Board of Directors of El Paso.

Your vote at this year s annual meeting is very important, no matter how many or how few shares you own. Please sign and date the enclosed BLUE proxy card and return it in the enclosed postage-paid envelope promptly.

Please do not return any proxy card sent to you by El Paso s incumbent board of directors. Even if you may have voted on El Paso s white proxy card, you can easily change your vote and revoke that proxy by signing, dating and returning the enclosed BLUE proxy card. Only your latest dated proxy will count at the 2003 Annual Meeting.

* * *

If you have any questions concerning this Proxy Statement, would like to request additional copies of this Proxy Statement or need help voting your shares, please contact:

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Reasons for the Solicitation; Stockholder Nominees Plans for El Paso

Reasons for the Solicitation

The Stockholder decided to seek the replacement of all of El Paso s incumbent directors after concluding that, in his opinion, they cannot be relied upon to guide and oversee El Paso s management in the future. He based this conclusion particularly on the incumbent directors performance, including the following:

The price of El Paso s common stock fell by over 90% between April 1, 2002 and February 18, 2003 (the date the Stockholder formally notified El Paso of his intent to present the Stockholder Proposals at the Annual Meeting).

During that same period:

following the Board s high-risk business strategies, such as venturing into telecommunications, energy trading and LNG, as well as off-balance sheet financing transactions, and particularly because of the excessive levels of debt it authorized (see the Morgan Stanley report referenced below), El Paso s financial condition continued to decline, leading it to fall into its current severe liquidity crisis

the Board s failure to act quickly and decisively almost certainly made the liquidity crisis worse than it otherwise would have been since earlier action could have reduced El Paso s expenses and debt

instead of acknowledging responsibility for its mistakes, the Board continued to reward the management team it continued to support for example, Brent Austin, who as El Paso s Chief Financial Officer had direct responsibility for the series of financing transactions including the off-balance sheet transactions that led to El Paso s current sorry state, was promoted to President in late 2002.

This history of poor performance has been compounded by the fact that El Paso s recent public disclosures lack transparency that is, they are very difficult to understand. Recent reports published by Morgan Stanley on April 1, and April 16, 2003, discussing El Paso s most recent Annual Report on Form 10-K and conversations with management, conclude that it is not possible to determine from El Paso s SEC filings whether its total debt level is $25 billion or $29 billion.

The April 16, 2003 Morgan Stanley report concludes that the maximum prudent debt level for El Paso is $11 billion in other words, the incumbent directors have permitted El Paso to become seriously over-leveraged.

A number of securities analysts have been openly skeptical of the financial projections published by El Paso s management. An April 1, 2003 report by a Goldman Sachs analyst states: One of El Paso s key challenges is restoring management credibility (and goes on to point out that hiring a new CEO could help restore credibility).

In the Stockholder s opinion, this combination of managerial hubris, ineffectiveness and lack of transparency, and the lack of confidence those traits have caused in the financial community, cannot be repaired by the minor tinkering with Board composition that the incumbents have proposed. These problems are too deep-rooted and require radical change.

The Incumbent Board s Changing Business Plans and Poor Execution

Mr. Zilkha has noted the incumbent Board s enthusiastic promotion of its current business plan; however, he cannot overlook the series of failed plans that preceded this one. In fact, El Paso has a history of abrupt changes in strategic direction:

In 1999, El Paso announced in its annual report that it would enter the telecommunications arena in 2000, stating: Our physical footprint, risk management capabilities, and Internet trading platform provide us with a strong entry point into this business.

By the end of 2001, El Paso had stated that it would no longer participate in the telecommunications market.

In 2001, El Paso announced in its annual report: Future growth will be driven by our LNG business, increased market share in North America, expansion of our petroleum business, and the addition of selected power generation assets.

On May 2, 2002, El Paso stated during a call with analysts: The most significant development in merchant energy is our [LNG] business. The board of directors has authorized a major move by the Corporation into [LNG]. We believe we have real competitive advantage in the business and we believe it should be the largest growing subsegment of the energy sector over the next 10 years.

On May 29, 2002, El Paso implemented a restructuring plan in which its Merchant Energy Segment was reorganized so that LNG, Petroleum and Energy Trading Businesses would each report separately. El Paso s stated objective for this restructuring was to generate better and higher quality earnings, get the credit profile right.

On February 4, 2003, El Paso announced that it was exiting the LNG and Energy Trading Businesses and would seek to sell its petroleum assets.

On May 1, 2003, El Paso changed its business plan yet again when it eliminated the Non-merchant Power business from its definition of core assets. As recently as April 24, 2003, El Paso considered Non-merchant Power a core business. See Schedule II for more information.

The Stockholder believes the incumbent directors are not even following their current publicly announced business plan because contrary to their business plan, they are selling major amounts of core assets rather than non-core assets. According to El Paso s preliminary proxy statement filed on April 24, 2003, its business plan calls for preserving and enhancing the value of its core assets (which it defined as its Pipeline, Production, Midstream and Non-merchant Power Businesses) and divesting non-core businesses. The Stockholder has reviewed El Paso s announced assets sales to determine if the assets being disposed of by El Paso fall within the businesses that El Paso has defined in its public announcements as core businesses. Based upon this review, the Stockholder has concluded that El Paso s asset dispositions have been utterly inconsistent with its announced business plan because from January 1, 2002 through the date of this Proxy Statement approximately 72% by value of El Paso s asset dispositions have been in core (not non-core) areas and since January 1, 2003 over 50% by value of El Paso s asset dispositions have been in core (not non-core) areas. Remarkably, El Paso, in its May 1, 2003 revised proxy statement filing changed its definition of core business areas, by deleting Non-merchant Power businesses from the core category. The Stockholder has concluded that even under this new definition, from January 1, 2002 to the date of this Proxy Statement, approximately 65% of El Paso s asset dispositions would have been from core areas and since January 1, 2003 approximately 33% of El Paso s asset dispositions would have been from core areas. For a summary of the Stockholder s analysis, please see Schedule II.

Recent Developments

Since Mr. Zilkha first publicly announced his intent to nominate his slate of directors, the current Board has issued a barrage of self-congratulatory announcements regarding the removal of Mr. Wise, the addition of four new directors and the impending retirement of three others, and a series of financing transactions and asset sales. During this same period, El Paso filed its Annual Report on Form 10-K for the year ended December 31, 2002 with the SEC. These developments leave Mr. Zilkha more convinced than ever that the current Board must be replaced in its entirety. His reasons include:

The incumbent directors alacrity in jettisoning Mr. Wise, only weeks after confirming their unanimous support for him to Mr. Zilkha (an illustration, in Mr. Zilkha s view, of two deplorable tendencies of the current directors their tendency to constantly and abruptly change strategic direction and their tendency to be reactive rather than proactive).

Even with the addition of a few new directors, the Board remains burdened with the legacy of the past (8 of the 12 incumbent nominees have been El Paso directors since 2001).

A most notable legacy of the past is Mr. Kuehn, formerly a staunch supporter of Mr. Wise, who has replaced Mr. Wise as CEO. Mr. Kuehn s term as CEO of Sonat included a period with marked

5

similarities to Mr. Wise s last few years at El Paso. During the four year period from 1995 to 1999 Mr. Kuehn was being paid handsomely a total of $10 million as CEO of Sonat, while at the end of this period the earnings of Sonat fell drastically from earnings of over $2 per share to a loss of over $4 per share as the result of, among other things, very large write-downs taken by Sonat.

Mr. Zilkha believes the financing transactions and asset sales currently being touted by the incumbent Board are belated reactions to the El Paso liquidity crisis that one securities analyst, John Olson, in discussing the risks facing El Paso called mostly of its own making. Fixing self-created problems does not, in Mr. Zilkha s view, demonstrate competence.

Furthermore, El Paso s recent asset sales further reflect a continuing lack of focus as described above, the Stockholder has concluded that using El Paso s definition of core assets in its April 24, 2003 SEC preliminary proxy statement filing approximately 72% by value of the asset dispositions announced by El Paso from January 1, 2002 through the date of this Proxy Statement are of core (not non-core) assets. El Paso quietly that is, they failed to state that it was changed changed this definition in a May 1, 2003 SEC filing, but even under the revised definition, the Stockholder calculates that core assets accounted for approximately 65% of asset dispositions during the same period.

El Paso s Annual Report on Form 10-K for the year ended December 31, 2002, indicated two things to Mr. Zilkha first, that El Paso s condition is extremely serious and in need of immediate skillful attention; and, second, that El Paso s financial disclosure is extremely unclear and difficult to understand. When a firm such as Morgan Stanley announces in a research report that it cannot tell if El Paso s debt burden is $25 billion or $29 billion, the quality of El Paso s disclosure is clearly unacceptable.

The incumbent Board even may have bungled its termination of Mr. Wise who, according to El Paso s proxy statement, may claim even more money from El Paso than the $9.4 million severance payment, the $15.3 million lump sum retirement benefit, $97,500 per year lifetime pension and other miscellaneous benefits he already has been permitted to take from El Paso.

Stockholder Nominees Plans for El Paso

The Stockholder expects that, after the Stockholder Nominees are elected in place of the incumbent directors, they immediately will begin the process of seeking to repair the damage done to El Paso. Since the damage is extensive, this will not be an easy task. No one should expect an overnight turnaround, or that El Paso s stock price will soon return anywhere close to its former heights. The Stockholder believes, however, that by harnessing the Stockholder Nominees deep experience and expertise in the oil and gas industry and re-energizing employees, it should be possible to set a major turnaround in motion.

The Stockholder Nominees have reviewed El Paso s public disclosures about its business operations and financial condition with a view to developing a strategy for the Company. Unfortunately, El Paso s public disclosures are not clear and understandable (as noted above, a Morgan Stanley securities analyst was unable to determine from publicly available information and conversations with El Paso management if El Paso s true debt number was $24.9 billion, or $29.1 billion, or some other number). Furthermore, once elected as directors, the Stockholder Nominees will have a fiduciary obligation to act in an appropriately deliberate, fully-informed basis that they believe to be in the best interests of El Paso and its stockholders. Subject to these considerations, the Stockholder expects that, once elected as directors of El Paso, the Stockholder Nominees will:

Management Plan

Elect John J. Murphy Chairman of the Board of Directors.

Elect Stephen D. Chesebro Chief Executive Officer.

Terminate Mr. Kuehn from all management positions.

Retain all qualified members of management who are committed to rebuilding El Paso.

Build a cohesive team of employees to maximize stockholder value.

Immediately implement plans to enhance El Paso s financial and business disclosure.

Aggressively review all existing management compensation arrangements.

Business Plan

Immediately focus on core assets to maximize fundamental cash earnings and improve return on equity. Core assets for this purpose are Exploration and Production, Pipeline, and Midstream assets.

Exit non-core assets and related direct and indirect overhead costs on sound economic terms.

Aggressively reduce administrative costs to be equal to, or below, industry norms.

Set reasonable, but aggressive, operating and financial targets for each business unit, and hold them accountable. Reward exceptional performance.

Fund Exploration and Production through partnerships, farm-outs, and other financial arrangements.

Maintain adequate pipeline expenditures to ensure safe, reliable, efficient operations.

Seek to reduce El Paso s leverage.

Seek to restructure existing debt to consolidate and to extend maturities where practicable.

Corporate Governance Matters

The Stockholder expects that the Stockholder Nominees, if elected, will adopt and follow corporate governance policies that meet or exceed all of the requirements of the Sarbanes-Oxley Act of 2002, the rules and regulations of the SEC and the New York Stock Exchange listing guidelines (including the recently proposed amendments to those guidelines).

None of the Stockholder Nominees nor any of their respective immediate family members is an employee of, or a consultant to, or has any other contractual relationship with El Paso. None of the Stockholder Nominees is or has been a partner of or otherwise employed by any present or former auditor of El Paso in the past five years and none of them is an officer of a company of which any other Stockholder Nominee is also a board member. When elected, each Stockholder Nominee other than Mr. Chesebro (who is expected to be appointed Chief Executive Officer) will be independent for purposes of the New York Stock Exchange s listing requirements and guidelines, the Institutional Shareholder Services U.S. Proxy Voting Manual and the AFL-CIO Proxy Voting Guidelines.

Transition

The Stockholder believes the management transition that will occur when the Stockholder Nominees are elected will be a smooth one because, in addition to the broad energy industry expertise that exists within the slate, certain of the Stockholder Nominees have personal knowledge of significant portions of El Paso s core businesses and assets. Mr. Chesebro was CEO of Tenneco Energy, which is an important part of El Paso s natural gas transmission system. Tenneco Energy owned and operated a large portion of El Paso s current Midstream Business, was a partner with (Bear Creek Storage) and a competitor against Sonat (East Tennessee Natural Gas), was a partner (Mojave) and competitor against El Paso (California market), and was a partner (Iroquois Pipeline) and competitor against Coastal (Kern River Pipeline). Mr. Chesebro established the base for most of El Paso s international operations including Australia, Indonesia and Brazil. In addition, Mr. Chesebro managed South Texas exploration and production activities for both Tenneco Oil Company and Pennzoil. Mr. Chesebro was operations manager for Tenneco s Gulf of Mexico operations when it was the largest and most active in the industry. Mr. Murphy has worked with most, if not all of the major pipeline and Exploration and Production companies building refineries, providing pipeline components, or directly contributing to the exploration, production, and processing of oil and gas. Mr. Zilkha owned and operated a significant part of what is now El Paso s Exploration and Production Business Segment. Mr. Burns and Mr. Bennett both have extensive experience directly related to El Paso s natural gas business, including trading. Mr. Davis has extensive Exploration and Production plus Midstream experience, and along with Mr. Black and Mr. Bowman has led successful Exploration and Production organizations in the United States and worldwide.

* * *

The Stockholder urges all El Paso stockholders to vote FOR the Stockholder Nominees and FOR the adoption of each of the Stockholder Proposals by signing, dating and returning the enclosed BLUE proxy card.

The Election of Directors

The By-Laws of the Company currently provide that there will be at least one director, with the number of directors to be fixed from time to time by the Board. The Board currently consists of 12 directors. The Stockholder is asking the stockholders of the Company to approve the reduction of the size of the Board from 12 to nine and elect the nine Stockholder Nominees.

The Stockholder Nominees

The Stockholder Nominees are Messrs. R. Gerald Bennett, C. Robert Black, Charles H. Bowman, Ronald J. Burns, Stephen D. Chesebro , Ted Earl Davis, John J. Murphy, John V. Singleton and Selim K. Zilkha. The Stockholder believes the Stockholder Nominees are highly qualified individuals based on their extensive business and professional experience with requisite skills to turn the Company around as can be seen in their biographies below.

The Stockholder Nominees and certain information concerning their principal occupations or employment, beneficial ownership of El Paso s common stock as of the date of this Proxy Statement, and other matters is set forth below. This information has been furnished to the Stockholder by the respective Stockholder Nominees.

Name, Age and Business Address	**Principal Occupation and Other Selected Information Concerning Nominees for Director**
R. GERALD BENNETT Age: 61 Business Address: 11111 Wilcrest Green, Suite 300 Houston, TX 77042	Since July 2000, Mr. Bennett has been the Chairman, President and CEO of Total Safety, Inc., the principal business of which is providing safety solutions to industrial and energy markets. From January 1999 to June 2000, Mr. Bennett was involved in the operations of G&S Bennett, Ltd., the principal business of which was investments, and of which he was the owner. From 1996 to December 1998, Mr. Bennett served as a Senior Vice President of Equitable Resources, Inc. and President of that company s ERI Supply and Logistics Group, the principal business of which is natural gas distribution and production. Mr. Bennett has extensive experience in the oil and gas industry, including exploration and production, gathering, transportation and storage of natural gas, marketing and regulatory affairs. Mr. Bennett is currently a director of TransTexas Gas Corporation. Mr. Bennett was asked to serve on the TransTexas board by a number of TransTexas senior bondholders and became a director after TransTexas first filed for federal bankruptcy protection in 1999. TransTexas filed for federal bankruptcy protection again in 2002.
C. ROBERT BLACK Age: 67 Business Address: 116 Applehead Island P.O. Box 7907 Horseshoe Bay, TX 78657	Mr. Black currently serves as Chairman of the Board of Regents of Texas Tech University. He spent 41 years with Texaco, Inc., retiring in May 1999. From January 1997 to January 1998, Mr. Black served as President of the Worldwide Exploration and Production division of Texaco, the principal business of which is oil and gas exploration and production. From January 1998 to May 1, 1999, he served as Senior Vice President in the office of Chairman of Texaco. Mr. Black also served on Texaco s Executive Council, which has the responsibility for setting corporate strategies and priorities, and served as Texaco s Corporate Compliance Officer.

CHARLES H. BOWMAN Age: 67 Business Address: 13350 Hopes Creek Road College Station, TX 77845-9250	Mr. Bowman, Professor Emeritus of Petroleum Engineering at Texas A&M University, is currently retired. From July 1997 to November 2001 he served as Professor and Head of the Harold Vance Department of Petroleum Engineering at Texas A&M University. Prior to joining Texas A&M University, Mr. Bowman served as Chairman and Chief Executive Officer of BP America, Inc. from January 1994 to August 1996.

8

Name, Age and Business Address	Principal Occupation and Other Selected Information Concerning Nominees for Director
	Mr. Bowman spent 36 years in the international oil industry. From 1990 through 1993, he was the Managing Director of BP Australia Limited and Chief Executive Officer of BP Oil Australasia. He moved to Australia from London, where he was General Manager Europe for BP Oil International.
RONALD J. BURNS Age: 51 Business Address: 27890 North 100 Way Scottsdale, AZ 85262	Since 1997, Mr. Burns has been the Chairman of Burns Capital Partners LP, the principal business of which is private equity investments. From 1997 to 1998, Mr. Burns has also served as President and Chief Operating Officer of Entergy Corporation, which is an electric utility. From 1989 until 1994, Mr. Burns was Chairman and Chief Executive Officer of Enron Gas Pipeline Group and had management responsibility for all of Enron s natural gas pipeline subsidiaries. During 1994 and 1995 Mr. Burns was also the Chairman and Chief Executive Officer of Enron North America; Enron s natural gas and electricity marketing, trading and finance subsidiary. During 1995 and 1996, Mr. Burns was President and Chief Executive Officer of Union Pacific Railroad.
STEPHEN D. CHESEBRO Age: 61 Business Address: 1330 Post Oak Boulevard Suite 1600 Houston, TX 77056	Since June 2001, Mr. Chesebro has served as the non-executive Chairman of the Board of Harvest Natural Resources, Inc., the principal business of which is international oil and gas exploration and production. Mr. Chesebro served as a director of Harvest Natural Resources, Inc. from October 2000 to June 2001. From January 1999 to September 1999, Mr. Chesebro served as a director, President and Chief Executive Officer of PennzEnergy, the principal business of which was oil and gas exploration and production. From February 1997 to December 1998, Mr. Chesebro served as a director, President and Chief Operating Officer of Pennzoil Company, the principal business of which was integrated oil, including exploration, production, refining, marketing and retail services. Prior to joining Pennzoil, Mr. Chesebro served 32 years with Tenneco, Inc., where he retired in 1996 as Chairman and Chief Executive Officer of Tenneco Energy.
TED EARL DAVIS	Mr. Davis has been a consultant for the energy industry (self-employed) since July 2000. From 1997 to 2000, he served as the President, Exploration Production, for international operations of Conoco, Inc., the principal business of which is oil and gas exploration and production, in

Age: 63 Business Address: 55 Mott Lane Houston, TX 77024	Africa, Mid-East and Asia-Pacific. Mr. Davis also served as President of Conoco s Upstream North America division with responsibilities for exploration, production, natural gas and gas products, pipeline and gas processing operations, LPG supply, marketing and distribution, business development, commercial, legal, business and regulatory activities. He was also a corporate vice-president at E.I. DuPont De Nemours and Company, the principal business of which is high-performance materials and specialty chemicals, from 1986 to 1999, when E.I. DuPont De Nemours and Company was Conoco s parent corporation. Mr. Davis is currently a director of Total Safety, Inc. and TransTexas Gas Corporation. Mr. Davis was asked to serve on the TransTexas board by a number of TransTexas senior bondholders and became a director after TransTexas first filed for federal bankruptcy protection in 1999. TransTexas filed for federal bankruptcy protection again in 2002.

9

Name, Age and Business Address	Principal Occupation and Other Selected Information Concerning Nominees for Director
JOHN J. MURPHY	
Age: 71 Business Address: 5500 Preston Road Suite 210 Dallas, TX 75205	Mr. Murphy is currently retired. From 1997 to 2000, Mr. Murphy served as a Managing Director of SMG Management L.L.C., a privately owned investment group. Mr. Murphy is currently a director of CARBO Ceramics Inc., W.R. Grace & Co. and ShawCor Ltd. Mr. Murphy began his career with Dresser Industries, Inc., a provider of products and services to the energy industry, in 1952 as an engineer and he became Chairman and Chief Executive Officer in August 1983. He remained Chief Executive Officer until 1995 and Chairman of the Board until his retirement in November 1996. During his tenure with Dresser, Mr. Murphy successfully guided the company through years of both industry decline and rebirth. He negotiated a number of strategic and successful acquisitions and joint-ventures including Wheatly TXT, Baroid Corporation, M-1 Drilling Fluids Co., Western Atlas International and M.W. Kellogg, one of the major refinery construction companies in the world. At his retirement, Dresser had become one of the largest oilfield services company in the world, employing over 31,000 employees in fifty countries.
JOHN V. SINGLETON	
Age: 85 Business Address: 314 N. Post Oak Lane Houston, TX 77024	Judge Singleton is a retired United States Federal District Judge. During his tenure, Judge Singleton served as the Chief Judge of the United States District Court for the Southern District of Texas and was elected to serve as the District Judge Representative from the Fifth Circuit to the Judicial Conference of the United States by all of his fellow Judges of the Fifth Circuit. In addition, all of the District Judge Representatives elected Judge Singleton to be their Chairman during his tenure at the Judicial Conference. Judge Singleton served on the State Bar of Texas Administration of Justice Committee, served as a member of the American Arbitration Association, Large Complex Case Panel, and was an Advisory Member of the Board of Directors of the Institute for Transnational Arbitration. Judge Singleton currently does arbitration and litigation counseling.
SELIM K. ZILKHA Age: 76 Business Address:	Mr. Zilkha is a 50% owner of Zilkha Renewable Energy, L.L.C., the principal business of which is wind energy generation, located at 1001 McKinney, Suite 1740, Houston, TX 77002. Mr. Zilkha is also the owner of Laetitia Vineyard & Winery, Inc., the principal business of which is vineyards and a winery, located at 453 Laetitia Vineyard Drive, Arroyo Grande, CA 93420. He was the majority owner of Zilkha Energy Company, L.L.C. for several years prior to that company s acquisition by Sonat, Inc. Mr. Zilkha served as a director of El Paso Energy Corporation from November 1999 to February 2001, and as an advisory director from February 2001 to June 2002. From January 1998 to November 1999, Mr. Zilkha was a director of Sonat, Inc., an energy holding company whose subsidiaries operated in the oil and natural gas industries.

1001 McKinney

Suite 1740

Houston, TX 77002

10

Share Ownership of the Nominees

The following table contains a summary of the total number of shares of common stock of El Paso and shares of common stock of El Paso Energy Partners L.P.(1) beneficially owned by the Stockholder Nominees.

Title of Class	Name of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
Common Stock of El Paso Corporation	Selim K. Zilkha	8,909,195(2)	1.48%(3)
Common Stock of El Paso Corporation	Ted Earl Davis	3,000	*
Common Stock of El Paso Energy Partners, L.P.	John J. Murphy	10,000	*

(1) El Paso Corporation s annual report on Form 10-K filed with the Securities and Exchange Commission on March 15, 2002, states that a subsidiary in our Field Services segment serves as the general partner of El Paso Energy Partners and owns a one percent general partner interest and 26 percent of the partnership s common units.

(2) This number includes 4,195 shares which Mr. Zilkha owns of record, 7,400,000 shares beneficially owned indirectly through the Selim K. Zilkha Trust and 1,500,000 shares beneficially owned indirectly through the Selim K. Zilkha 2002 Trust. This number also includes the rights of Mr. Zilkha (i) under an option to acquire 3,000 shares at $42.125, which expires on October 25, 2009, and (ii) under an option to acquire 2,000 shares at $43.75, which expires on April 28, 2010.

(3) Percentage ownership is calculated based on 600,860,300 shares of common stock of the Company, which the Company reported as outstanding as of May 2, 2003 in its definitive proxy statement filed with the SEC on May 9, 2003.

* Less than 1%

The Stockholder Nominees will not receive any compensation from the Stockholder for agreeing to be nominated by the Stockholder and to serve as directors of El Paso, if elected pursuant to the Stockholder s solicitation. The Stockholder and Mr. Oscar S. Wyatt, Jr. have agreed to reimburse the Stockholder Nominees for all expenses, including legal expenses, reasonably incurred by them in connection with this proxy solicitation and any related proceedings.

It is expected that each of the Stockholder Nominees, if elected, will receive customary director s compensation from the Company.

According to the Company s definitive proxy statement, under compensation arrangements currently in effect, non-employee directors receive an annual retainer of $80,000, $20,000 of which is required to be paid in deferred shares of El Paso common stock and the remaining $60,000 of which paid at the election of the director in any combination of cash, deferred cash or deferred shares of common stock. To the extent a director receives deferred shares rather than cash, he is credited with shares with a value representing a 25% premium to the cash retainer he would otherwise have received. Accordingly, an individual director would receive $60,000 in cash and $25,000 in mandatory deferred common stock (assuming he elects not to take additional deferred common stock) and would receive $100,000 in deferred common stock (assuming he elects to take his entire retainer in deferred common stock). In the event there are not enough shares of stock available under the plan, then the deferred common stock will be in the form of deferred stock units. Each non-employee director who chairs a committee of the Board receives an additional retainer fee of $15,000, which may be paid in the same manner as the annual retainer (with a total of up to $18,750 if he elects to take his entire retainer in deferred common stock). In addition, effective in March 2003, if any committee of the Board holds a meeting other than in connection with a regularly scheduled board meeting, then each non-management committee member (other than the lead director) who attends in person will receive a meeting fee of $2,500 payable in cash. Each non-employee director also receives a retirement benefit credit in the form of deferred shares of El Paso common stock (which does not include any premium) equal to the amount of his annual retainer ($80,000). Pursuant to El Paso s 2001 Stock Option Plan for Non-Employee Directors, non-employee directors receive a grant of 5,000 stock options upon initial election to the Board of Directors, and 3,000 stock options upon each annual reelection by the

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stockholders. See El Paso s definitive proxy statement and other materials on file with the SEC for additional information regarding compensation of directors generally.

It is also expected that each of the Stockholder Nominees, if elected, will be indemnified for his services as director of the Company to the same extent indemnification is available to directors of the Company under the Company s Restated Certificate of Incorporation or otherwise provided by the Company. In addition, it is expected that, upon their election, such nominees will be covered by any officer and director liability insurance maintained by the Company.

Each of the Stockholder Nominees has consented to being nominated to the Board, being named in this Proxy Statement as a nominee, and serving as a director of El Paso, if elected pursuant to the Stockholder s solicitation. If the nomination of any individual Stockholder Nominee by the Stockholder shall be deemed to be ineffective for any reason, or if any individual Stockholder Nominee shall be unable to serve for any reason, the Stockholder reserves the right to propose a replacement Stockholder Nominee at the 2003 Annual Meeting. Shares represented by the Stockholder s **BLUE** proxy cards will be voted for any such substitute or additional nominees of the Stockholder.

If Proposal 1 is not approved at the 2003 Annual Meeting, the Board might consist of 12 directors while the Stockholder has nominated nine individuals. Under those circumstances, the Stockholder Nominees, if elected, would constitute nine of 12 directors on the Board. The Stockholder therefore urges you to vote not only **FOR** the stockholder nominees, but also **FOR** the adoption of each of Stockholder Proposals, including Proposal 1.

* * *

When you return the BLUE proxy card you will be voting for the Stockholder Nominees to serve as directors and for adoption of the Stockholder Proposals, unless you appropriately mark your card otherwise.

The Stockholder believes that it is in the best interest of stockholders to elect the stockholder nominees at the 2003 Annual Meeting, and strongly recommends a vote FOR the election of the Stockholder Nominees and FOR the adoption of each of the Stockholder Proposals.

* * *

Your vote is important regardless of the number of shares you own.

Please sign and date the BLUE proxy card and return it in the enclosed envelope whether or not you plan to attend the 2003 Annual Meeting.

12

Background to the Solicitation

The Stockholder was the majority owner of Zilkha Energy Company, L.L.C. for several years before that company was acquired by Sonat, Inc. in 1998. Sonat in turn was acquired by El Paso in 1999. As a result of these transactions, Mr. Zilkha became the holder of a substantial number of shares of El Paso s common stock. Mr. Zilkha, like many other El Paso stockholders, has suffered a tremendous decline in the value of his investment in El Paso. At January 2, 2001, based on the prices at which El Paso s common stock was traded on the New York Stock Exchange, the shares Mr. Zilkha now owns were worth approximately $626 million. As of February 18, 2003 (the date on which the Stockholder formally notified El Paso of his intent to present the Stockholder Proposals at the Annual Meeting), these shares were worth approximately $36 million. In other words, over a period of slightly more than two years, Mr. Zilkha suffered unrealized losses on his El Paso stock position of approximately $590 million. This coincided with a decline in El Paso s equity market capitalization from over $37 billion to approximately $3 billion. He has continued to hold the bulk of his position notwithstanding this loss in value because he believes that with effective new leadership and management, El Paso can again be a valuable investment.

Mr. Zilkha is a private investor. In the course of his career he has managed several large businesses, including Zilkha Energy Company, L.L.C. After the acquisition of Sonat by the Company, Mr. Zilkha served as a director of El Paso from November 1999 to February 2001, and as an advisory director from February 2001 until he resigned from that position on June 4, 2002. During the time Mr. Zilkha was a voting director, he participated in Board deliberations and periodically consulted with management regarding El Paso s business. As an advisory director, Mr. Zilkha had no vote on matters coming before the Board. Mr. Zilkha did not actively participate in the day-to-day management of El Paso at any time. A primary reason for Mr. Zilkha s resignation from his position as an advisory director was his desire to be able to more freely sell a portion of his El Paso common stock in order to satisfy some near-term liquidity requirements, including commitments made to charitable organizations. He subsequently did, in fact, sell in the aggregate 2,855,577 shares. Mr. Zilkha also donated in the aggregate an additional 933,723 shares or the proceeds generated from the sale of these shares to certain charities, primarily the Keck School of Medicine at the University of Southern California and The Hobby Center for the Performing Arts in Houston, Texas.

Around May 2002, shortly before the time Mr. Zilkha resigned as an advisory director, the trading price of El Paso s common stock began what would prove to be a precipitous decline. By September 2002 the shares, which had traded over $46.00 in the spring of 2002, had traded as low as $5.30. This decline in El Paso s share price was accompanied by a decline in Mr. Zilkha s confidence in El Paso s Board and management. Mr. Zilkha s loss of confidence was prompted by mounting evidence, appearing from mid-2002 onwards, that things were going badly at El Paso, including, among other things, increasing signs of financial distress, signs of increased scrutiny by the Securities and Exchange Commission and the Federal Energy Regulatory Commission, and class action stockholder lawsuits being filed against the Company. At various times between July 2002 and February 2003, Mr. Zilkha corresponded with members of the Company s Board regarding his increasing concerns over the strategic direction of El Paso and the quality of El Paso s management. In this correspondence, Mr. Zilkha repeatedly called for the resignation of William A. Wise from all his positions at the Company. In the same correspondence, Mr. Zilkha also made suggestions regarding candidates to replace Mr. Wise, all of which were rejected or seemingly ignored. The responses Mr. Zilkha received to his various requests and suggestions indicated to him that the Board was simply unwilling to face up to the serious reality of El Paso s deteriorating financial condition. The Board during this period appeared to ignore, or at least refuse to address, the numerous warning signs that so concerned Mr. Zilkha. Mr. Zilkha s view that the Board was in denial was reinforced when El Paso offered no response to his proposal that El Paso sell for cash the Gulfstream V jet that was provided for the use of Mr. Wise, even as El Paso s liquidity constraints became ever more acute. Mr. Zilkha was so concerned about the declining condition of El Paso and the quality of its management that at one point, Mr. Zilkha proposed that he and his son, Michael Zilkha, would be willing to assume the active management of El Paso for no compensation. This proposal was intended only as a temporary response to a situation Mr. Zilkha viewed (correctly, as it turned out) as critical for El Paso. **Neither Mr. Zilkha nor any of his immediate family members intends to accept in the future any executive management position with El Paso.**

The Company s Board responded to Mr. Zilkha s expressions of increasing concern over its failures of management with a series of overtures that apparently were intended to placate him. On January 9, 2003, Mr. Wise and two of El Paso s directors, Ron Kuehn and John Bissell, proposed to Mr. Zilkha that he be given the opportunity to nominate two directors to the Board. Mr. Zilkha rejected this proposal because by that time he had become convinced that both Mr. Wise s immediate removal and a fundamental change in the composition of the Board were required to address El Paso s problems and the proposal he rejected would have achieved neither of these objectives. Until early February 2003, the Board continued to indicate to Mr. Zilkha that it supported Mr. Wise and was not willing to remove him.

On several occasions after January 9, 2003, Mr. Zilkha suggested to Mr. Kuehn and others that along with the resignation of Mr. Wise, several of El Paso s directors should be replaced by independent directors with managerial or operating experience in the energy industry. There were several further attempts to reach a compromise agreement with Mr. Kuehn and others on a change in the composition of the Board, but each attempt failed. In these discussions, Mr. Kuehn and his colleagues continued to offer only two or three board seats and no commitment to replace Mr. Wise, while Mr. Zilkha continued to seek a substantially larger Board representation and the removal of Mr. Wise. Following these failed attempts at compromise, Mr. Zilkha concluded that real change could only be effected, and the interests of the Company s stockholders protected, through the replacement of the entire incumbent Board (including Mr. Wise) and not through the two or three Board seats being offered for him and his nominees.

On February 11, 2003, El Paso announced that Mr. Wise intended to resign his position as Chief Executive Officer and President of the Company at an unspecified future date, following the selection (with Mr. Wise s assistance) of a successor. In any event, according to the Company s announcement, Mr. Wise would continue to serve as Chairman of El Paso s Board until the end of 2003. This appeared to be an abrupt change in strategic direction on the part of the incumbent Board, **because as recently as January 17, 2003, Mr. Kuehn had advised Mr. Zilkha in an email that The Board does not believe that a change in management involving Bill Wise at this critical and challenging time in the industry is in the best interest of the shareholders and the employees. Therefore, the Board unanimously reaffirmed its support for the current senior management of the Company.** When Mr. Zilkha examined the details of El Paso s announcement regarding Mr. Wise s change in status, however, he recognized that it appeared as if Mr. Wise s active involvement in the Company s management was to continue for an indeterminate period and that Mr. Wise would continue, through his chairmanship of the Board, to exert significant influence over El Paso s corporate decision-making at least until the end of 2003. Accordingly, Mr. Zilkha determined that the Company s announcement of Mr. Wise s planned departure did not reflect the significant, immediate change in direction at El Paso that he had been looking for and, therefore, Mr. Zilkha decided to continue to press for more radical change through the replacement of the entire incumbent Board.

On February 14, 2003, one day after El Paso s common stock traded at its all-time low of $3.33, attorneys from the law firm of Fried Frank Harris Shriver & Jacobson, representing the Company and its incumbent Board, contacted lawyers at Clifford Chance who were representing Mr. Zilkha and stated that members of the Board had heard that Mr. Zilkha was planning to propose nominees for election to the Company s Board at the 2003 Annual Meeting. They said they wanted to explore a way to settle the matter, specifically by offering Mr. Zilkha the ability to nominate a minority of the Board. Mr. Zilkha s response, as communicated to the incumbent Board s attorneys, was that his concerns about El Paso s condition had become so grave that the only acceptable resolution was for the entire incumbent Board to resign.

On February 18, 2003, Mr. Zilkha sent a letter to the Board announcing his intention to seek the election of the Stockholder Nominees and the approval of the Stockholder Proposals by El Paso stockholders. In his letter Mr. Zilkha stated, among other things: As many of you know, I have long been a proponent of accountability and change at El Paso. I remain convinced that El Paso is capable of being a strong, growing enterprise. However, that turnaround can never happen under the current board and management.

Information Concerning the Participants in the Solicitation

Mr. Zilkha, Mr. Oscar S. Wyatt, Jr, and the Stockholder Nominees may be deemed participants (the Participants) in this solicitation. Mr. Wyatt is currently the Chairman and President of both NuCoastal Corporation and NuCoastal Trading Company, each of which maintain offices at 8 Greenway Plaza, Suite 930, Houston, TX 77046.

Mr. Wyatt is the beneficial owner of 4,324,368 shares of the Company s common stock, and may be deemed to be the beneficial owner of 350,689 shares of the Company s common stock owned by Mr. Wyatt s wife as to which Mr. Wyatt disclaims beneficial ownership. Of these holdings 3,861,123 shares are held of record by Mr. Wyatt. This represents less than 1% of the Company s outstanding stock as of May 2, 2003, as reported in the Company s definitive proxy statement filed on May 9, 2003. Mr. Wyatt disclaims beneficial ownership of the shares owned by his wife.

Mr. Wyatt is the named lead plaintiff in a class action suit against the Company alleging, among other things, violations of the federal securities laws. **Mr. Wyatt is not being nominated for election to the Company s Board of Directors and Mr. Wyatt has advised the Stockholder that he does not intend to seek office in the future with the Company.** If any or all of the Stockholder Nominees are elected as directors of the Company, they will be required under applicable law to act, in their capacity as directors, consistently with the best interests of the Company and its Stockholders in all matters coming before the Board, including the handling of the litigation to which Mr. Wyatt is a party. Mr. Zilkha acquired 2,095 shares of El Paso common stock during the class periods alleged in the lawsuit pursuant to stock grants made in consideration of Mr. Zilkha s service on El Paso s Board and accordingly may be entitled to participate (together with all other persons who purchased or acquired El Paso common stock during the relevant periods) in any recovery that may occur (by settlement or otherwise) under that lawsuit.

Within two days after Mr. Wyatt was appointed lead plaintiff in the class action suit, El Paso Merchant Energy-Petroleum Company (EPMA), a subsidiary of the Company, commenced a lawsuit against Mr. Wyatt alleging the breach by Mr. Wyatt of his obligations under a guaranty that Mr. Wyatt provided to Coastal Refining & Marketing, Inc., the purported predecessor of EPMA. Approximately 45 days prior to filing this suit, El Paso sent a letter to an attorney representing Mr. Wyatt seeking payment.

Mr. Wyatt owns NuCoastal Corporation. NuCoastal Corporation does not currently have any operating assets. NuCoastal Corporation has bid in the past and intends to bid for assets in the energy industry. Some of these assets may be in competition with El Paso. Mr. Wyatt also owns NuCoastal Trading Company, a small crude oil and products trading company operating primarily on the East Coast, which does not compete with El Paso.

For information relating to transactions by each of the Participants in securities of the Company over the past two years, see Schedule III hereto. For all other required information on the Participants other than Mr. Wyatt, see The Election of Directors The Stockholder Nominees beginning on page 8.

Each of the Stockholder Nominees, as well as Mr. Wyatt, may communicate with stockholders of El Paso in the manner contemplated by this Proxy Statement on behalf of the Stockholder.

Certain Transactions Involving the Participants

Mr. Zilkha received $45,000 for his services as an advisory director of El Paso in 2002.

Mr. Wyatt received $284,000 for consulting services he provided to El Paso in 2002 pursuant to a consulting agreement between Coastal Corporation and Mr. Wyatt, which was assumed by El Paso in the merger with Coastal Corporation. In addition, El Paso paid Mr. Wyatt s office rent for year of 2002 in the amount of $74,325.20 pursuant to the same consulting agreement. This consulting agreement terminated on August 31, 2002.

Except as set forth in this Proxy Statement (including the Schedules), none of the Participants nor any of their respective associates: (i) directly or indirectly beneficially owns any shares of El Paso common stock or any other securities of the Company or any of its subsidiaries; (ii) has had any relationship with the Company in any capacity other than as a stockholder, or is or has been a party to any transaction, or series of transactions, since the beginning of the Company s last fiscal year with respect to any securities of the Company; (iii) knows of any transactions since the beginning of the Company s last year, currently proposed transactions, or series of similar transactions, to which the Company or any of its subsidiaries was or is to be a party, in which the amount involved exceeds $60,000 and in which any of them had, or will have, a direct or indirect material interest; (iv) intends to seek to engage in any transaction with the Company or any of its subsidiaries in the future; or (v) has any interest in the matters to be voted on at the 2003 Annual Meeting, other than an interest, if any, as a stockholder of the Company or, with respect to the Stockholder Nominees, as a nominee for director.

In addition, other than as set forth in this Proxy Statement (including the Schedules), there are no contracts, arrangements or understandings entered into by any of the Participants or any of their respective associates within the past year with any person with respect to any of the Company s securities, including, but not limited to, joint ventures, loan or option arrangements, puts or calls, guarantees against loss or guarantees of profit, division of losses or profits, or the giving or withholding of proxies.

Except as set forth in this Proxy Statement (including the Schedules), none of the Participants nor any of their respective associates has entered into any agreement or understanding with any person with respect to (i) any future employment by the Company or its affiliates or (ii) any future transactions to which the Company or any of its affiliates will or may be a party.

Except as set forth in this Proxy Statement (including the Schedules), none of the Stockholder Nominees nor their associates has, since the beginning of the Company s last fiscal year, been indebted to the Company or any of its subsidiaries in an amount that exceeds $60,000.

Matters to Be Considered at the 2003 Annual Meeting

The Stockholder Proposals

In order to replace the current Board, the Stockholder is soliciting proxies to take the following actions at the 2003 Annual Meeting:

Proposal 1. To amend the Company s By-Laws to fix the number of directors constituting the entire Board of Directors at nine, including by appropriate amendments to Article III, Section 1 of the Company s By-Laws.

Proposal 2. To elect each of the Nominees referred to below to the Company s Board of Directors, in lieu of any persons who may be nominated by the Company s incumbent Board of Directors or by any other person.

Proposal 3. To amend the Company s By-Laws to delete any requirements for advance notice to be provided by stockholders prior to nominating persons for election to the Company s Board of Directors, including by appropriate amendment to Article III, Section 3 of the Company s By-Laws.

Proposal 4. To repeal each provision of or amendment to the Company s By-Laws (other than the provisions and amendments added or effected pursuant to Proposals 1 and 3) adopted after the version of the By-Laws, purportedly as amended through November 7, 2002, filed by the Company with the Securities and Exchange Commission as Exhibit 3.B to the Company s Quarterly Report on Form 10-Q for the period ended September 30, 2002.

Proposal 5. To require that action be taken at the Annual Meeting on proposals 1 to 4 above in the sequence indicated and before any other business is conducted.

In accordance with the By-Laws of El Paso, on February 18, 2003, the Stockholder delivered written notice to the Secretary of the Company of his intention to nominate for election to the Company s Board at the 2003 Annual Meeting Messrs. R. Gerald Bennett, C. Robert Black, Charles H. Bowman, Ronald J. Burns, Stephen D. Chesebro , Ted Earl Davis, John J. Murphy, John V. Singleton and Selim K. Zilkha and present the Proposals described above to the stockholders of the Company for their approval at the 2003 Annual Meeting. The Stockholder believes that the Stockholder Nominees are highly qualified individuals who have the credibility and the solid experience in the energy industry necessary to maximize the value and productivity of El Paso s employees and assets. For more information regarding the Stockholder Nominees, see The Election of Directors The Stockholder Nominees beginning on page 8.

Purposes of the Stockholder Proposals

The purposes of the Stockholder Proposals are as follows:

The purpose of Proposal 1 is to ensure that if all of the Stockholder Nominees are elected as directors, they will constitute the entire Board. The current Board consists of 12 directors. Therefore, in the absence of Proposal 1, the Stockholder Nominees, if elected, would constitute nine of 12 directors on the new Board, with the remaining three vacancies being filled by the nominees of the current Board. Proposal 1, if approved by the stockholders of El Paso, would prevent such a split outcome. The text of the amendment to the By-Laws to be effectuated by Proposal 1 is set forth in Schedule I. Adoption of this By-Law by stockholders will not prevent stockholders or the Board from further amending the By-Laws to again change the number of directors following the Annual Meeting. It is possible that, as the result of Proposal 1 not passing or otherwise, both Stockholder Nominees and management nominees would be elected. The Stockholder does not know if the management nominees would wish to serve under these circumstances.

The purpose of Proposal 2 is to elect the Stockholder Nominees.

Proposal 3 will allow any stockholder of the Company to nominate individuals to serve as directors without being subject to the restrictive advance notice requirements that currently are in effect. This amendment will provide El Paso stockholders with the same rights as management to nominate individuals to serve as directors. The text of the amendment to the By-Laws to be effected by Proposal 3 is set forth in Schedule I.

The purpose of Proposal 4 is to protect the transparency and fairness of the election process by ensuring that the provisions governing or related to the election of El Paso s directors, as stipulated in the latest publicly available draft of the By-Laws, remain unchanged through the time of the Annual Meeting. Proposal 4 is designed to prevent the current Board from changing the By-Laws before the Annual Meeting in ways that could limit the ability of the Company s stockholders to elect their choice of directors. El Paso has disclosed one non-substantive change to the By-Laws since November 27, 2002. After the Stockholder gave the required notice of his proposals, El Paso announced it had made some technical, previously undisclosed, amendments to its By-Laws since November 27, 2002 that would be repealed under Proposal 4.

The purpose of Proposal 5 is to ensure that action is taken at the Annual Meeting in a logical manner and to prevent results that would thwart the will of El Paso s stockholders as expressed by your votes at the 2003 Annual Meeting. If the size of the Board is reduced after the election of directors, twelve directors could be elected and the Board could then be reduced to nine. While the Stockholder believes that in that situation the three directors who received the fewest votes should be unseated, it is unclear whether this would happen if El Paso s incumbent directors were to insist on having the election of directors happen before the reduction in the size of the board. The Stockholder believes that if he and El Paso s other stockholders, together, clearly indicate through their voting that they want a board comprised of the nine Stockholder Nominees, that should be the result. Proposal 5 is intended to ensure that happens.

Management Proposals

The Company has announced that it will present the following proposals numbered 6 through 8 below at the 2003 Annual Meeting:

Proposal 6. Ratification of appointment of PricewaterhouseCoopers LLP as independent certified public accountants.

The Board is seeking stockholder ratification of the resolution appointing PricewaterhouseCoopers LLP, which has served continuously as El Paso s independent certified public accountants since 1983, as independent certified public accountants for El Paso for fiscal year 2003.

The Stockholder has no objection to the ratification of the appointment of PricewaterhouseCoopers LLP as the Company s independent certified public accountants for El Paso for fiscal year 2003. Unless you indicate otherwise on your proxy card, if you give the Stockholder the proxy he is requesting, your shares will be voted **FOR** that proposal.

Proposal 7. Amendment of Restated Certificate of Incorporation to eliminate fair price provision.

Proposal 8. Amendment of Restated Certificate of Incorporation to eliminate Series A Junior Participating Preferred Stock.

The Board is proposing amendments to eliminate the fair price provision currently contained in Article 12 of El Paso s Restated Certificate of Incorporation and the series of El Paso s preferred stock currently designated as Series A Junior Participating Preferred Stock in Article 4.2 of El Paso s Restated Certificate of Incorporation. A detailed description of these proposals and the reasons for the Board s support of the proposed amendments to El Paso s Restated Certificate of Incorporation are set forth in the Company s definitive proxy statement filed with the Securities and Exchange Commission on May 9, 2003.

The Stockholder supports both amendments to the Company s Restated Certificate of Incorporation proposed by the Board as being in the best interests of El Paso s stockholders and recommends voting **FOR** proposals 7 and 8. Unless you indicate otherwise on your proxy card, if you give the Stockholder the proxy he is requesting, your shares will be voted **FOR** proposals 7 and 8.

Additional Proposals

The Company has announced that three proposals numbered 9 through 11 below were received from various other shareholders of the Company, which intend to submit such proposals for action at the 2003 Annual Meeting:

Proposal 9. Pay disparity report

Two stockholders have indicated that they will present a proposal for action at the 2003 Annual Meeting requesting the Board s Compensation Committee to prepare and make available by January 1, 2004 a report to

requesting stockholders comparing the total compensation of the Company s top executives and its lowest paid workers both in this country and abroad on January 1, 1982, 1992 and 2002.

The Stockholder supports more transparency regarding the compensation of El Paso s top executives and believes that proposal 9 will help to insure that stockholders of the Company are fully informed about the compensation arrangements of El Paso s top executives. Accordingly, unless you indicate otherwise on your proxy card, if you give the Stockholder the proxy he is requesting, your shares will be voted **FOR** proposal 9.

Proposal 10. Indexed options for senior executives

A stockholder has indicated that it will present a proposal for action at the 2003 Annual Meeting requesting the Board to adopt an executive compensation policy that all future stock option grants to senior executives shall be performance-based, so that the options have value only to the extent that the Company s stock price performance exceeds the peer group performance level.

As stated in Reasons for the Solicitation, the Stockholder Nominees, if elected, will review the compensation arrangements of management including the use of options as a component of compensation. Currently, the Stockholder does not have a view as to proposal 10 and unless you indicate otherwise on your proxy card, if you give the Stockholder the proxy he is requesting, your shares will be voted **ABSTAIN** with respect to proposal 10.

Proposal 11. Approval of any adoption of poison pills

A stockholder indicated that he will present a proposal recommending that the Board of Directors redeem any poison pill previously issued (if applicable) and not adopt or extend any poison pill unless such adoption or extension has been submitted to a shareholder vote.

The Stockholder supports measures to limit the use of anti-takeover devices such as poison pills that tend to limit stockholder choice. Accordingly, unless you indicate otherwise on your proxy card, if you give the Stockholder the proxy he is requesting, your shares will be voted **FOR** proposal 11.

Detailed descriptions of proposals 9 to 11, supporting statements from the proponents and statements of the Board in opposition to these proposals are set forth in the Company s definitive proxy statement filed with the Securities and Exchange Commission on May 9, 2003.

If the Stockholder becomes aware of a new matter raised by the Board of Directors of El Paso after the Stockholder s proxy cards have been delivered to stockholders of El Paso, but a reasonable time before the Annual Meeting, Stockholder will either (1) include this new matter in a revised proxy card and disseminate it to stockholders with accompanying explanatory soliciting material, thus giving stockholders a meaningful opportunity to revoke any previously executed proxy granting discretionary authority or, (2) if the new matter is not so included in the card, forego the exercise of discretionary voting authority on such matter. If the Stockholder does not receive notice of a new matter a reasonable time before the Annual Meeting, the Stockholder may still exercise discretionary voting authority with respect to that matter in accordance with applicable laws and regulations.

19

Voting Procedures

2003 Annual Meeting

El Paso has announced that the 2003 Annual Meeting will be held on June 17, 2003, beginning at 2:00 p.m. (Central time) at the George R. Brown Convention Center, 1001 Avenida de las Americas, Houston, Texas 77010. El Paso has announced that the record date (the Record Date) for determining stockholders entitled to notice of and to vote at the 2003 Annual Meeting is May 2, 2003.

Voting and Revocation of Proxies

For the proxy solicited hereby to be voted, the enclosed **BLUE** proxy card must be signed, dated, and returned in the envelope enclosed, in time to be voted at the 2003 Annual Meeting. If you wish to vote **FOR** the election of the Stockholder Nominees and **FOR** the adoption of each of the Stockholder Proposals you must submit the enclosed **BLUE** proxy card and must **NOT** submit the Company s proxy card. If you have already returned the Company s proxy card, you have the right to revoke it as to all matters covered thereby and may do so by subsequently signing, dating, and mailing the enclosed **BLUE** proxy card. **Only your latest dated proxy will count at the 2003 annual meeting**. Execution of a **BLUE** proxy card will not affect your right to attend the 2003 Annual Meeting and to vote in person.

Any proxy may be revoked as to all matters covered thereby at any time prior to the time a vote is taken by (i) submitting to the Chairman of the Board or the Stockholder a later dated written revocation or duly executed proxy; or (ii) attending and voting at the 2003 Annual Meeting in person (attendance at the 2003 Annual Meeting will not in and of itself constitute a revocation).

Although a revocation will be effective only if delivered to the Company, the Stockholder requests that either the original or a copy of all revocations be mailed to Selim K. Zilkha c/o Innisfree M&A Incorporated at the address set forth on the back page of this Proxy Statement, so that the Stockholder will be aware of all revocations and can more accurately determine if and when the requisite proxies have been received. If the Stockholder receives an original copy of a revocation of a proxy furnished by El Paso s incumbent Board of Directors, he will deliver it to the Company to assure its effectiveness.

Shares of El Paso common stock represented by a valid, unrevoked **BLUE** proxy card will be voted as specified. Shares represented by a **BLUE** proxy card where no specification has been made will be voted **FOR** the election of the Stockholder Nominees, **FOR** the adoption of each of the Stockholder Proposals, **FOR** Proposals 6 through 9, and 11, and **ABSTAIN** on Proposal 10. Except as set forth in this Proxy Statement, the Stockholder is not aware of any other matter to be considered at the 2003 Annual Meeting. If you return a **BLUE** proxy card and any other matter is presented at the 2003 Annual Meeting, the persons named on the enclosed **BLUE** proxy card will vote your shares in accordance with their best judgment concerning such matter.

If any of your shares were held in the name of a brokerage firm, bank, bank nominee or other institution on the Record Date, only that institution can vote your shares and only upon its receipt of your specific instructions. Accordingly, please promptly contact the person responsible for your account at the relevant institution and instruct that person to execute and return the **BLUE** proxy card on your behalf. You should also promptly sign, date and mail the voting instruction form (or **BLUE** proxy card) that your broker or banker sends you. Please do this for each account you maintain to ensure that all of your shares are voted. If any of your shares were held in the name of a brokerage firm, bank, bank nominee or other institution on the Record Date, to revoke your proxy you will need to give appropriate instructions to the relevant institution. **If you do not give instructions to your broker or other nominee, your shares will not be voted.**

Record Date and Voting Power

Only holders of record as of the close of business on May 2, 2003, the Record Date for the 2003 Annual Meeting, will be entitled to vote at the 2003 Annual Meeting. If you were a stockholder of record on the Record

Date, you will retain your voting rights for the 2003 Annual Meeting even if you sell those shares after the Record Date. Accordingly, it is important that you vote the shares you owned on the Record Date or grant a proxy to vote those shares, even if you sell some or all of your shares after the Record Date.

The shares of common stock are the only shares of capital stock of El Paso entitled to notice of, and to vote at, the 2003 Annual Meeting. According to information publicly disclosed in El Paso s definitive proxy statement filed on May 9, 2003, there were 600,860,300 shares of El Paso common stock outstanding as of May 2, 2003, the Record Date. Every holder of shares of El Paso s common stock is entitled to one vote for each share held.

Quorum and Required Vote

In accordance with El Paso s By-Laws, at the 2003 Annual Meeting, a majority of the shares of common stock issued and outstanding and entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum.

Nominees for election as directors of El Paso pursuant to Proposal 2 will be elected by a plurality of the votes of the shares present in person or represented by proxy at the 2003 Annual Meeting and entitled to vote on the election of directors. Because directors are elected by a plurality of the votes cast at the 2003 Annual Meeting, the only effect of abstentions and broker non-votes in connection with the election of directors is to reduce the number of shares voted in favor of the nominees. Broker non-votes are shares as to which a broker indicates on a proxy that it does not have discretionary authority and has not received voting instructions from the beneficial owner on a particular matter.

The adoption of Stockholder Proposals 1, 3 and 4 will require the affirmative vote of a majority of votes cast on, and abstentions with respect to, each such proposal. Abstentions with respect to these proposals would have the effect of a vote **AGAINST** the proposals. Stockholder Proposal 5 will require for its adoption the affirmative vote of a majority of the votes cast on the proposal. Abstentions will not be counted as votes cast with respect to this proposal and therefore will not affect the outcome. In addition, with respect to each of Stockholder Proposals 1, 3, 4 and 5, broker non-votes, if any, will not be counted as votes cast or abstentions and therefore will not affect the outcome of the vote.

The affirmative vote of a majority of the votes cast on proposals 6, 9, 10 and 11 is required for approval of each of these proposals. Abstentions and broker non-votes, if any, will not be counted as votes cast and therefore will not affect the outcome of the vote.

Under El Paso s Restated Certificate of Incorporation, the adoption of the amendment proposed by the Board in proposal 7 requires the affirmative vote of holders of at least 51% of the outstanding shares of El Paso s common stock, excluding shares of common stock beneficially owned by any stockholder who is the beneficial owner of 10% or more of El Paso s common stock. Abstentions and broker non-votes, if any, will have the effect of a vote **AGAINST** the adoption of the amendment proposed by the Board in proposal 7.

The adoption of the amendment proposed by the Board in proposal 8 requires the affirmative vote of holders of at least a majority of the outstanding shares of El Paso s common stock. Abstentions and broker non-votes, if any, will have the effect of a vote **AGAINST** the adoption of the amendment proposed by the Board in proposal 8.

Subject to Delaware law, inspectors of election that are appointed by the Board or, if no such appointment is made or such inspectors fail to appear or act, by the Chairman of the 2003 Annual Meeting (appointed in accordance with the By-Laws of the Company), will determine the validity of proxies and receive, inspect, count and report to the meeting in writing the votes cast at the 2003 Annual Meeting.

Stockholder Proposals for 2004 Annual Meeting

According to El Paso, if you want to submit a proposal for possible inclusion in next year s proxy statement, you must submit it in writing to the Corporate Secretary, El Paso Corporation, 1001 Louisiana Street, Houston, Texas 77002, telephone (713) 420-6195 and facsimile (713) 420-4099. El Paso must receive your proposal on or before January 13, 2004. Additionally, under El Paso s By-law provisions, a stockholder who desires to bring any matter before the Annual Meeting that is not included in the 2004 Proxy Statement must send written notice to the foregoing address not less than 90 days nor more than 120 days prior to the first anniversary of the 2003 Annual Meeting. Under these criteria, stockholders must provide us with notice of a matter to be brought before the 2004 Annual Meeting between February 18, 2004 and March 19, 2004. If the 2004 Annual Meeting is to be held more than 30 days before or 60 days after June 17, 2004, for a stockholder to bring any matter before the 2004 Annual Meeting, the stockholder s written notice must be received not less than 90 days nor more than 120 days before the date of the 2004 Annual Meeting or by the tenth day after we publicly announce the date of the 2004 Annual Meeting, if that would result in a later deadline.

No Appraisal Rights

Stockholders of the Company do not have dissenter s rights of appraisal as a result of this solicitation or the adoption of any of the proposals included in this Proxy Statement.

Where To Get Help

If you have questions, or need further assistance, please contact Innisfree M&A Incorporated toll free at (877) 750-5837 or if you are a bank or broker please call collect at (212) 750-5833.

Solicitation of Proxies; Expenses

In connection with the Stockholder s solicitation of proxies for use at the 2003 Annual Meeting, proxies may be solicited by mail, courier service, advertisement, telephone, facsimile, telegraph, electronic mail, internet, television, radio, and in person. Solicitations may be made, in the manner set forth in this Proxy Statement, by the Stockholders, Mr. Wyatt, and by the Stockholder Nominees, none of whom will receive additional compensation for such solicitations. The Stockholder may request banks, brokerage firms, and other custodians, nominees and fiduciaries to forward all of the solicitation materials to the beneficial owners of the shares of El Paso common stock they hold of record. The Stockholder will reimburse these record holders for customary clerical and mailing expenses incurred by them in forwarding these materials to their customers.

The Stockholder has retained Innisfree M&A Incorporated for solicitation and advisory services in connection with the solicitation of proxies for a fee of up to $300,000, together with reimbursement for its reasonable out-of-pocket expenses. The Stockholder has also agreed to indemnify Innisfree M&A Incorporated against certain liabilities and expenses (including under federal securities laws). Innisfree has informed the Stockholder that it would employ up to approximately 100 persons to solicit proxies for use at the 2003 Annual Meeting.

All expenses associated with any solicitation of proxies by the Stockholder in connection with the 2003 Annual Meeting will be borne directly by Selim K. Zilkha and Oscar S. Wyatt, Jr. pro rata based upon the number of El Paso shares held by each of them respectively pursuant to an agreement between them (67.3% by Mr. Zilkha and 32.7% by Mr. Wyatt). There are no commitments or arrangements relating to Mr. Wyatt s litigation in this agreement or otherwise. The Stockholder and Mr. Wyatt further have agreed to seek reimbursement from the Company upon completion of the solicitation of all expenses incurred by them in connection with the nomination of the Stockholder Nominees, the submission of the Stockholder Proposals and this solicitation. The Stockholder does not intend to seek the approval of El Paso s stockholders for that reimbursement. If the Stockholder and Mr. Wyatt seek reimbursement of the costs of this solicitation from the Company, the decision whether or not to submit the question of reimbursement to a stockholder vote will be made by the Board. The Stockholder estimates that the costs incidental to his solicitation of proxies, including expenditures for advertising, printing, postage, legal and related expenses will be approximately $5.9 million. Total costs incurred to the date of this Proxy Statement by the Stockholder and Mr. Wyatt have been approximately $1.8 million.

Annual Report and Proxy Statement of the Company

An annual report to stockholders covering the Company s fiscal year ended December 31, 2002, including financial statements, is required to be furnished to stockholders by the Company in connection with the Company s solicitation of proxies for the 2003 Annual Meeting. That annual report is not required to be provided by the Stockholder and does not form any part of the material being distributed by the Stockholder for the solicitation of proxies.

The Company s incumbent Board also will solicit proxies for use at the 2003 Annual Meeting and has furnished or will shortly furnish a proxy statement in connection with that solicitation. Neither the Stockholder, the Participants nor any of their respective affiliates or associates is presently an officer or director of, or otherwise engaged in the management of, the Company. Consequently, the Stockholder does not have current information concerning the common stock of the Company, other information concerning the Company s management, the procedures for submitting proposals for consideration at the next annual meeting of the Company s stockholders or certain other matters regarding the Company and the 2003 Annual Meeting. Accordingly, reference for that information is made to management s definitive proxy statement filed with the Securities and Exchange Commission on May 9, 2003.

Under the federal securities laws, the Stockholder is required to disclose certain information as to the security ownership of the Company s management, its current directors and the holders of significant amounts of El Paso s common stock. That information, which has been obtained from El Paso s definitive proxy statement with the Securities and Exchange Commission, on May 9, 2003 is provided in Schedule IV.

* * *

If you have any questions concerning this Proxy Statement, would like to request additional copies of this Proxy Statement or need help voting your shares, please contact:

INNISFREE M&A INCORPORATED

501 Madison Avenue, 20th floor

New York, NY 10022

Call toll free: (877) 750-5837

Banks and Brokers, call collect: (212) 750-5833

For more information, please visit www.saveelpasonow.com

23

SCHEDULE I

PROPOSED BY-LAW AMENDMENTS

Following is the text to the amendments to the Company s By-Laws set forth in the Stockholder s Proposals 1 and 3:

Proposal 1. Delete Article III, Section 1 of the Company s By-Laws in its entirety and replace it with the following:

Section 1. Number, Qualification and Term of Office. The number of directors which shall constitute the whole Board shall be nine. At each annual meeting of the stockholders a Board shall be elected by the stockholders for a term of one year. Each Director shall serve until his successor is duly elected and shall qualify.

Proposal 2. Delete Section 3 of Article III of the Company s By-Laws in its entirety and replace it with the following:

Section 3. Nomination of Directors. Nominations of persons for election to the Board may be made at any time prior to or at an annual meeting of stockholders or special meeting of stockholders called by the Board for the purpose of electing Directors (i) by or at the direction of the Board or (ii) by any stockholder of the corporation entitled to vote for the election of directors at such meeting.

SCHEDULE II

	As defined in April 24, 2003 Preliminary Proxy Statement filed by El Paso[1] ($ millions)	
	Core Assets	**Non-core Assets**
2002 as reported in Annual Report on Form 10-K for the year ended December 31, 2002 (p. 23)		
Cove Point LNG contract		210
2002 as reported in Annual Report on Form 10-K for the year ended December 31, 2002 (p. 107)		
Pipeline Segment:[3]	303	
Natural gas and oil properties located in Texas, Kansas and Oklahoma and their related contracts		
Typhoon natural gas pipeline		
12.3% equity interest in Alliance Pipeline and related assets		

Production Segment:[4]	1,297	
Natural gas and oil properties located in east and south Texas, Colorado, southeast Texas, Utah and western Canada		
Field Services Segment:[5]	1,513	
Texas and New Mexico midstream assets		
Dragon Trail processing plant		
San Juan Basin gathering, treating and processing assets		
14.4 % equity interest in Aux Sable NGL plant		
Gathering facilities located in Utah		
50% interest in Blacks Fork facility		
Merchant Energy Segment:[6]		161
50% equity interest in petroleum products terminal		
NGL pipelines and fractionation facilities		
14.4% equity interest in Alliance Canada Marketing L.P.		
Typhoon oil pipelines		
40% equity interest in Samalayuca Power II power project in Mexico		
Corporate and Other:		57
Coal reserves and properties in West Virginia, Virginia and Kentucky		
Total 2002	**3,113**	**428**
2003 as reported in Annual Report on Form 10-K for the year ended December 31, 2002 (p. 108)		
Pipeline Segment:	43	
Panhandle gathering system located in Texas		
2.1% equity interest in Alliance pipeline and related assets		
Production Segment:	687	
Natural gas and oil properties located in western Canada, Oklahoma, New Mexico and offshore		
Field Services Segment:	35	
Gathering systems located in Wyoming		
Merchant Energy Segment:		813
50% equity interest in CE Generation L.L.C. power investment (including the rights to a 50% interest in a geothermal development Project)		
Mt. Carmel power plant		
Kladno power project		
Corpus Christi refinery		
Florida petroleum terminals and tug and barge operations		
Petroleum asphalt operations		
Enerplus Global Energy Management Company		
Corporate and Other:		89
Remaining coal reserves and properties in West Virginia, Virginia and Kentucky		
Aircraft		

	As defined in April 24, 2003 Preliminary Proxy Statement filed by El Paso[1]	
	($ millions)	
	Core Assets	**Non-core Assets**
2003 as reported in El Paso s Definitive Proxy Statement filed on May 9, 2003 (p. 2-3)		
European natural gas trading book[7]		82
Other, including ECK generating project in Prague, Czech Republic		78
Other, including Enerplus Global Energy Management Company[8]		65
East Coast Power L.L.C.[9]	456	
North Louisiana and Mid-Continent field service[10]	120	
Unspecified additional asset sales[11]		79
Eagle Point refinery and related pipeline assets[12]		130[13]
Total 2003	**1,341**	**1,336**
Total 2002 and 2003	**4,454**	**1,764**
Percentage of Total 2002 and 2003	72%	28%

1

In its April 24, 2003 preliminary proxy statement, El Paso states that its business plan includes [p]reserving and enhancing the value of our core pipeline, production, midstream and non-merchant power businesses. In its May 1, 2003 preliminary proxy statement and subsequent filings, El Paso changed its business plan yet again when it eliminated Non-merchant Power from its definition of core businesses. Under the latest definition, the sale of East Coast Power L.L.C. would be classified as non-core. Under the latest definition of core businesses, the total core and non-core sales in 2002 and 2003 would be $3.998 billion (64%) and $2.220 billion (36%), respectively, and in 2003 would be $885 million (33%) and $1.792 billion (67%), respectively.

[2] For some reason, in its May 1, 2003 preliminary proxy statement and subsequent filings, El Paso removed Non-merchant Power from its core business. El Paso s February 5, 2003 press release states that its Non-merchant Power business consists of plants with long-term sales agreements.

[3] According to El Paso s Annual Report on Form 10-K for the year ended December 31, 2002, this segment is defined as interstate natural gas pipelines.

[4] According to El Paso s Annual Report on Form 10-K for the year ended December 31, 2002, this segment conducts [El Paso s] natural gas and oil exploration and production activities.

[5] According to El Paso s Annual Report on Form 10-K for the year ended December 31, 2002, this segment conducts [El Paso s] midstream activities.

[6] According to El Paso s Annual Report on Form 10-K for the year ended December 31, 2002, this segment consists of three primary divisions: global power, petroleum and energy trading.

[7] The Stockholder characterized this sale under El Paso s energy trading division of its Merchant Energy Segment.

[8] The Stockholder characterized the $35 million sale of Enerplus Global Energy Management Company under El Paso s trading division of its Merchant Energy Segment.

[9] The Stockholder characterized this sale under El Paso s Non-merchant Power Business.

[10] The Stockholder characterized this sale under El Paso s Field Services (or Midstream) Segment.

[11] Although these additional asset sales are unspecified in the proxy statement, the Stockholder has listed them as non-core.

[12] No agreement has been signed for this sale, although El Paso has signed a letter of intent. This sale is characterized as a sale under El Paso s petroleum division of its Merchant Energy Segment.

[13] The letter of intent states that the sale is for $130 million plus the fair market value of inventory on hand.

SCHEDULE III

PARTICIPANT INFORMATION

TRADING ACTIVITY OF THE NOMINEES

The following table contains a summary description of all purchases and sales of the common stock of El Paso effected within the past two years by the Participants:

Shares of El Paso Corporation

	Participant	Common Stock	Action	Date	
I.					
	Stephen D. Chesebro		20,026,000		19,577,000
Diluted		20,199,000		19,743,000	

See accompanying notes to consolidated financial statements.

CORVEL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS – UNAUDITED

	Six Months Ended September 30, 2015	2016
Cash flows from Operating Activities		
NET INCOME	$15,167,000	$14,443,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,916,000	10,410,000
Loss (gain) on disposal of assets	(5,000)	8,000
Stock compensation expense	1,104,000	1,128,000
Write-off of uncollectible accounts	897,000	1,080,000
Deferred income tax	(399,000)	(427,000)
Changes in operating assets and liabilities		
Accounts receivable	(2,585,000)	(1,779,000)
Customer deposits	(7,403,000)	(5,540,000)
Prepaid taxes and expenses	5,205,000	(1,268,000)
Other assets	(571,000)	(213,000)
Accounts and taxes payable	(271,000)	(552,000)
Accrued liabilities	3,535,000	3,257,000
Net cash provided by operating activities	24,590,000	20,547,000
Cash Flows from Investing Activities		
Investment in private equity	(600,000)	(250,000)
Purchase of property and equipment	(8,025,000)	(10,843,000)
Net cash (used in) investing activities	(8,625,000)	(11,093,000)
Cash Flows from Financing Activities		
Purchase of treasury stock	(18,775,000)	(4,199,000)
Tax effect of stock option exercises	475,000	869,000
Exercise of common stock options	1,525,000	1,758,000
Exercise of employee stock purchase options	181,000	201,000
Net cash (used in) financing activities	(16,594,000)	(1,371,000)
(Decrease) Increase in cash and cash equivalents	(629,000)	8,083,000
Cash and cash equivalents at beginning of period	25,516,000	32,779,000
Cash and cash equivalents at end of period	$24,887,000	$40,862,000
Supplemental Cash Flow Information:		
Income taxes paid	$6,946,000	$9,502,000
Purchase of software license under finance agreement	$—	$3,492,000

See accompanying notes to consolidated financial statements.

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2016

Note A — Basis of Presentation and Summary of Significant Accounting Policies

The unaudited financial statements herein have been prepared by the Company pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”). The accompanying interim financial statements have been prepared under the presumption that users of the interim financial information have either read or have access to the audited financial statements for the latest fiscal year ended March 31, 2016. Accordingly, note disclosures which would substantially duplicate the disclosures contained in the March 31, 2016 audited financial statements have been omitted from these interim financial statements.

The Company evaluated all subsequent events or transactions through the date of filing this report. During the period subsequent to the quarter ended September 30, 2016, the Company repurchased 61,880 shares of common stock for $2,197,000 at an average of $35.51 per share of common stock. These shares of common stock were repurchased under the Company’s ongoing share repurchase program described in Note C.

Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three and six months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2017. For further information, refer to the consolidated financial statements and notes for the fiscal year ended March 31, 2016 included in the Company's Annual Report on Form 10-K filed with the SEC on June 10, 2016.

Basis of Presentation: The consolidated financial statements include the accounts of CorVel and its subsidiaries. Significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates: The preparation of financial statements in compliance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements. Actual results could differ from those estimates. Significant estimates include the values assigned to intangible assets, capitalized software development, the allowance for doubtful accounts, accruals for income taxes, share-based payments related to performance-based awards, loss contingencies, estimated claims for claims administration revenue recognition, estimates used in stock option valuations, and accruals for self-insurance reserves.

Cash and Cash Equivalents: Cash and cash equivalents consist of short-term, highly-liquid, investment-grade, interest-bearing securities with maturities of 90 days or less when purchased. Customer deposits represent cash that is expected to be returned or applied towards payment within one year through our provider reimbursement services.

Fair Value of Financial Instruments: The Company applies Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 820, “Fair Value Measurements and Disclosures,” which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements with respect to fair value measurements of (a) nonfinancial assets and liabilities that are recognized or disclosed at fair value in the Company’s Consolidated Financial Statements on a recurring basis (at least annually) and (b) all financial assets and liabilities. ASC 820 prioritizes the inputs used in measuring fair value into the following hierarchy:

Level 1- Quoted market prices in active markets for identical assets or liabilities;

Level 2- Observable inputs other than those included in Level 1 (for example, quoted prices for similar assets in active markets or quoted prices for identical assets in inactive markets); and

Level 3- Unobservable inputs reflecting management’s own assumptions about the inputs used in estimating the value of the asset.

The carrying amount of the Company’s financial instruments (i.e. cash equivalents, accounts receivable, accounts payable) are all Level 1 and approximate their fair values at March 31, 2016 and September 30, 2016. The Company has no Level 2 or Level 3 financial instruments.

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2016

Note A — Basis of Presentation and Summary of Significant Accounting Policies (continued)

Investment in Private Equity: The Company has made an investment of $2,250,000 into a private equity limited partnership (the "partnership") that invests in start-up companies primarily in the data analytics industry. The Company accounts for the investment on the cost method and will periodically review the investment for possible impairment. There was no impairment on the investment for the year ended March 31, 2016 and for the six months ended September 30, 2016. The investment is recorded in other assets on the accompanying consolidated balance sheets. Management has not identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment, and in accordance with ASC 825-10-50-16 through 50-19, it is not practicable to estimate the fair value of the investment due to the fact the investment is in a diversified portfolio of companies whose shares are not traded on the open market.

Goodwill: The Company accounts for its business combinations in accordance with the FASB ASC 805-10 through ASC 805-50, "Business Combinations," which requires that the purchase method of accounting be applied to all business combinations and addresses the criteria for initial recognition of intangible assets and goodwill. In accordance with FASB ASC 350-10 through ASC 350-30, goodwill and other intangible assets with indefinite lives are not amortized but are tested for impairment annually, or more frequently if circumstances indicate the possibility of impairment. If the carrying value of goodwill or an intangible asset exceeds its fair value, an impairment loss shall be recognized.

Revenue Recognition: The Company recognizes revenue when there is persuasive evidence of an arrangement, the services have been provided to the customer, the sales price is fixed or determinable, and collectability is reasonably assured. For the Company's services, as the Company's professional staff performs work, they are contractually permitted to bill for fees earned in fraction of an hour increments worked or by units of production. The Company recognizes revenue as the time is worked or as units of production are completed, which is when the revenue is earned and realized. Labor costs are recognized as the costs are incurred. The Company derives its revenue from the sale of network solutions and patient management services. Network solutions and patient management services may be sold individually or combined. When a sale combines multiple elements, the Company accounts for multiple element arrangements in accordance with the guidance included in ASC 605-25.

The multiple-deliverable arrangements consist of bundled managed care services, which includes various units of accounting such as network solutions, and patient management which includes claims administration. Such elements are considered separate units of accounting due to each element having value to the customer on a stand-alone basis. The selling price for each unit of accounting is determined using contract price and management estimates. When the Company's customers purchase several products, the pricing of the products sold is generally the same as if the products were sold on an individual basis. Revenue is recognized as the work is performed in accordance with the Company's customer contracts. Based upon the nature of the Company's products, bundled managed care elements are generally delivered in the same accounting period. The Company recognizes revenue for patient management claims administration services over the life of the customer contract. The Company estimates, based upon prior experience in managing claims, the deferral amount from when the claim is received to when the customer contract expires.

Recent Accounting Pronouncements: On May 28, 2014, the FASB issued ASU 2014-09 regarding ASC Topic 606, Revenue from Contracts with Customers. This standard provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. In July 2015, the FASB approved a one-year delay of the effective date of this new revenue recognition standard. The guidance will now be effective for our fiscal year beginning April 1, 2018. We are currently evaluating the accounting, transition, and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

On November 20, 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes. ASU 2015-17 alters the presentation of deferred tax items on a classified balance sheet requiring companies to unify previously separated current and noncurrent items and present them as a single noncurrent amount. We have elected to early adopt this standard as of March 31, 2016 and have retrospectively applied the amendments to all periods presented.

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2016

Note A — Basis of Presentation and Summary of Significant Accounting Policies (continued)

In January 2016, the FASB issued ASU 2016-01 regarding Subtopic 825-10, Financials Instruments — Overall: Recognition and Measurements of Financial Assets and Financial Liabilities. The standard addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. It requires that most equity investments be measured at fair value, with subsequent changes in fair value recognized in net income. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. We are currently evaluating the accounting, transition, and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

In February 2016, the FASB issued ASU No. 2016-02, Leases, which lays out the principles for the recognition, measurement, presentation, and disclosure of leases for both parties to a contract (i.e. lessees and lessors). The standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases. This classification will determine whether the lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. The standard is effective April 1, 2019, with early adoption permitted. The standard is to be applied using a modified retrospective transition method. We are in the process of determining the effect on our consolidated financial position, results of operations and cash flows.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification on the statement of cash flows. For public companies, the new guidance is effective for annual reporting periods (including interim periods within those periods) beginning after December 15, 2016, with early adoption permitted. We are in the process of evaluating the impact of adoption of this guidance on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows, which reduces diversity in practice in how certain transactions are classified in the statement of cash flows. The new guidance is effective for annual reporting periods beginning after December 15, 2017, with early adoption permitted. The adoption of this guidance will not have a material impact on the Company's consolidated financial statements.

Accounts Receivable: The majority of the Company's accounts receivable is due from companies in the property and casualty insurance industries, self-insured employers, and government entities. Accounts receivable are generally due within 30 days and are stated as amounts due from customers net of an allowance for doubtful accounts. Those accounts outstanding longer than the contractual payment terms are considered past due. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company and the condition of the general economy and the industry as a whole. No one customer accounted for 10% or more of accounts receivable at either March 31, 2016 or September 30, 2016. No one customer accounted for 10% or more of revenue during the three and six months ended September 30, 2015 and 2016.

Property and Equipment: Additions to property and equipment are recorded at cost. Depreciation and amortization are provided using the straight-line method over the estimated useful lives of the related assets, which range from two to seven years or the life of the lease. The Company accounts for internally developed software costs in accordance with FASB ASC 350-40, “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use”, which allows for the capitalization of software developed for internal use. These costs are included in computer software in property and equipment and are amortized over a period of five years.

Long-Lived Assets: The carrying amount of all long-lived assets is evaluated periodically to determine if adjustment to the depreciation and amortization period or to the unamortized balance is warranted. Such evaluation is based principally on the expected utilization of the long-lived assets and the projected, undiscounted cash flows of the operations in which the long-lived assets are deployed.

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2016

Note A — Basis of Presentation and Summary of Significant Accounting Policies (continued)

Income Taxes: The Company provides for income taxes in accordance with provisions specified in ASC 740, “Accounting for Income Taxes”. Accordingly, deferred income tax assets and liabilities are computed for differences between the financial statement and tax bases of assets and liabilities. These differences will result in taxable or deductible amounts in the future, based on tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which temporary differences become deductible. In making an assessment regarding the probability of realizing a benefit from these deductible differences, management considers the Company’s current and past performance, the market environment in which the Company operates, tax-planning strategies and the length of carry-forward periods for loss carry-forwards, if any. Valuation allowances are established when necessary to reduce deferred tax assets to amounts that are more likely than not to be realized. Further, the Company provides for income tax issues not yet resolved with federal, state and local tax authorities.

Earnings Per Share: Earnings per common share-basic is based on the weighted average number of common shares outstanding during the period. Earnings per common share-diluted is based on the weighted average number of common shares and common share equivalents outstanding during the period. In calculating earnings per share, earnings are the same for the basic and diluted calculations. Weighted average shares outstanding decreased in the September 2016 quarter compared to the same quarter of the prior year primarily due to repurchases of shares under the Company’s share repurchase program. See also Note D.

Note B — Stock-Based Compensation and Stock Options

Under the Company’s Restated Omnibus Incentive Plan (formerly the Restated 1988 Executive Stock Option Plan) (“the Plan”) as in effect at September 30, 2016, options exercisable for up to 19,365,000 shares of the Company’s common stock may be granted over the life of the Plan to key employees, non-employee directors, and consultants at exercise prices not less than the fair market value of the stock at the date of grant. Options granted under the Plan are non-statutory stock options and generally vest 25% one year from date of grant and the remaining 75% vesting ratably each month for the next 36 months. The options granted to employees and the board of directors expire at the end of five years and ten years from date of grant, respectively.

The Company records compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model with the assumptions included in the table below. The Company uses historical data among other factors to estimate the expected volatility, the expected option life, and the expected forfeiture rate. The risk-free rate is based on the interest rate paid on a U.S. Treasury issue with a term similar to the estimated life of the option. Based upon the historical experience of options cancellations, the Company has estimated an annualized forfeiture rate of 12.28% and 13.16% for the three months ended September 30, 2015 and 2016, respectively. Forfeiture rates will be adjusted over the requisite service period when actual forfeitures differ, or are expected to differ, from the estimate. The following assumptions were used to estimate the fair value of options granted during the three months ended September 30, 2015 and 2016 using the Black-Scholes option-pricing model:

	Three Months Ended September 30,	
	2015	2016
Risk-free interest rate	1.61%	1.03
Expected volatility	44%	42%
Expected dividend yield	0.00%	0.00%
Expected forfeiture rate	12.28%	13.16%
Expected weighted average life of option in years	4.4 years	4.4 years

All options granted in the six months ended September 30, 2015 and 2016 were granted with an exercise price equal to the fair value of the Company’s common stock on the grant date and are non-statutory stock options.

For the three months ended September 30, 2015 and 2016, the Company recorded share-based compensation expense of $488,000 and $612,000, respectively. For the six months ended September 30, 2015 and 2016, the Company recorded share-based compensation expense of $1,104,000 and $1,128,000, respectively. The table below shows the amounts recognized in the consolidated financial statements for stock compensation expense for time-based options and performance-based options during the three and six months ended September 30, 2015 and 2016, respectively.

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2016

Note B — Stock-Based Compensation and Stock Options (continued)

	Three Months Ended	
	September 30, 2015	September 30, 2016
Cost of revenues	$321,000	$ 395,000
General and administrative	167,000	217,000
Total cost of stock-based compensation included in income before income tax provision	488,000	612,000
Amount of income tax benefit recognized	(188,000)	(234,000)
Amount charged against net income	$300,000	$ 378,000
Effect on basic earnings per share	$(0.02)	$ (0.02)
Effect on diluted earnings per share	$(0.01)	$ (0.02)

	Six Months Ended	
	September 30, 2015	September 30, 2016
Cost of revenues	$633,000	$ 732,000
General and administrative	471,000	396,000
Total cost of stock-based compensation included in income before income tax provision	1,104,000	1,128,000
Amount of income tax benefit recognized	(425,000)	(432,000)
Amount charged against net income	$679,000	$ 696,000
Effect on basic net income per share	$(0.03)	$ (0.04)
Effect on diluted net income per share	$(0.03)	$ (0.04)

Summarized information for all stock options for the three and six months ended September 30, 2015 and 2016 follows:

	Three Months Ended September 30, 2015		Three Months Ended September 30, 2016	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price

Options outstanding, beginning	1,167,042	$ 28.15	1,074,521	$ 31.56
Options granted	47,300	33.15	45,600	43.32
Options exercised	(59,804)	16.91	(14,593)	20.61
Options cancelled/forfeited	(18,952)	36.25	(2,609)	39.33
Options outstanding, ending	1,135,586	$ 28.81	1,102,919	$ 32.17

	Six Months Ended September 30, 2015		Six Months Ended September 30, 2016	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding, beginning	1,163,179	$ 27.65	1,115,465	$ 28.81
Options granted	87,000	33.85	90,500	44.52
Options exercised	(95,641)	17.75	(91,216)	21.87
Options cancelled/forfeited	(18,952)	36.25	(11,830)	36.36
Options outstanding, ending	1,135,586	$ 28.81	1,102,919	$ 32.17

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2016

Note B — Stock-Based Compensation and Stock Options (continued)

The following table summarizes the status of stock options outstanding and exercisable at September 30, 2016:

Range of Exercise Price	Number of Outstanding Options	Weighted Average Remaining Contractual Life	Outstanding Options – Weighted Average Exercise Price	Exercisable Options – Number of Exercisable Options	Exercisable Options – Weighted Average Exercise Price
$12.71 to $23.10	335,209	2.51	$ 20.45	304,139	$ 20.19
$23.11 to $34.77	190,134	2.86	$ 30.75	118,443	$ 28.96
$34.78 to $35.76	233,099	3.75	$ 34.78	8,390	$ 34.78
$35.77 to $46.20	344,477	3.72	$ 43.50	103,684	$ 43.26
Total	1,102,919	3.21	$ 32.17	534,656	$ 26.69

A summary of the status for all outstanding options at September 30, 2016, and changes during the three months then ended, is presented in the table below:

	Number of Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value as of September 30, 2016
Options outstanding at July 1, 2016	1,074,521	$ 31.56		
Granted	45,600	43.32		

Exercised	(14,593)	20.61		
Cancelled – forfeited	(2,110)	39.21		
Cancelled – expired	(499)	39.82		
Ending outstanding	1,102,919	$ 32.17	3.21	$8,387,418
Ending vested and expected to vest	971,976	$ 31.50	3.09	$8,045,668
Ending exercisable at September 30, 2016	534,656	$ 26.69	2.55	$6,712,666

The weighted-average grant-date fair value of options granted during the three months ended September 30, 2015 and 2016, was $12.53 and $14.78, respectively.

Included in the above-noted stock option grants and stock compensation expense are performance-based stock options under which vesting occurs only upon the Company achieving certain revenue or earnings per shares targets on a calendar year basis as determined by the Company's Board of Directors. These options were valued in the same manner as the time-vesting options. However, the Company only recognizes stock compensation to the extent that the probable targets are determined to be achieved which allow the performance options to vest. The Company recognized ($63,000) and ($31,000) of stock compensation expense for the three months ended September 30, 2015 and 2016, respectively, for performance-based stock options.

Note C — Treasury Stock and Subsequent Event

The Company's Board of Directors initially approved the commencement of a share repurchase program in the fall of 1996. In November 2015, the Company's Board of Directors approved a 1,000,000 share expansion to its existing stock repurchase plan, increasing the total number of shares of the Company's common stock approved for repurchase over the life of the program to 35,000,000 shares of the Company's common stock from the previous limit of 34,000,000 shares of the Company's common stock. Since the commencement of the share repurchase program, the Company has spent $396 million to repurchase 33,988,013 shares of its common stock, equal to 63% of the outstanding common stock had there been no repurchases. The average price of these repurchases was $11.65 per share. These repurchases were funded primarily from the net earnings of the Company, along with the proceeds from the exercise of common stock options. During the three and six months ended September 30, 2016, the Company repurchased 63,594 shares of the Company's common stock for $2.6 million at an average price of $40.12 per share of common stock and 101,754 shares of the Company's common stock for $4.2 million at an average price of $41.27 per share of common stock, respectively. The Company had 19,552,218 shares of common stock outstanding as of September 30, 2016, net of the 33,988,013 shares in treasury. During the period subsequent to the quarter ended September 30, 2016, the Company repurchased 61,880 shares of common stock for $2,197,000 at an average price of $35.51 per share of common stock.

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2016

Note D — Weighted Average Shares and Net Income Per Share

Weighted average basic common shares decreased from 19,902,000 for the quarter ended September 30, 2015 to 19,581,000 for the quarter ended September 30, 2016. Weighted average diluted common and common equivalent shares decreased from 20,063,000 for the quarter ended September 30, 2015 to 19,733,000 for the quarter ended September 30, 2016. The net decrease in both of these weighted share calculations is due to the repurchase of common stock as noted above, offset by an increase in shares outstanding due to the exercise of stock options under the Company's employee stock option plan.

Net income per common and common equivalent shares was computed by dividing net income by the weighted average number of common and common stock equivalents outstanding during the quarter. The calculations of the basic and diluted weighted shares for the three and six months ended September 30, 2015 and 2016, are as follows:

	Three Months Ended September 30, 2016	
	2015	2016
Net Income	$8,267,000	$6,952,000
Basic:		
Weighted average common shares outstanding	19,902,000	19,581,000
Net Income per share	$0.42	$0.36
Diluted:		
Weighted average common shares outstanding	19,902,000	19,581,000
Treasury stock impact of stock options	161,000	152,000
Total common and common equivalent shares	20,063,000	19,733,000
Net Income per share	$0.41	$0.35

	Six Months Ended September 30, 2016	
	2015	2016
Net Income	$15,167,000	$14,443,000
Basic:		
Weighted average common shares outstanding	20,026,000	19,577,000
Net Income per share	$0.76	$0.74
Diluted:		
Weighted average common shares outstanding	20,026,000	19,577,000
Treasury stock impact of stock options	173,000	166,000
Total common and common equivalent shares	20,199,000	19,743,000
Net Income per share	$0.75	$0.73

Note E — Shareholder Rights Plan

During fiscal year 1997, the Company's Board of Directors approved the adoption of a Shareholder Rights Plan. The Shareholder Rights Plan provides for a dividend distribution to CorVel stockholders of one preferred stock purchase right for each outstanding share of CorVel's common stock under certain circumstances. In November 2008, the Company's Board of Directors approved an amendment to the Shareholder Rights Plan to extend the expiration date of the rights to February 10, 2022.

The rights are designed to assure that all shareholders receive fair and equal treatment in the event of any proposed takeover of the Company and to encourage a potential acquirer to negotiate with the Company's Board of Directors prior to attempting a takeover. The rights have an exercise price of $118 per right, subject to subsequent adjustment. The rights trade with the Company's common stock and will not be exercisable until the occurrence of certain takeover-related events.

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2016

Note E — Shareholder Rights Plan (continued)

Generally, the Shareholder Rights Plan provides that if a person or group acquires 15% or more of the Company's common stock without the approval of the Board, subject to certain exceptions, the holders of the rights, other than the acquiring person or group, would, under certain circumstances, have the right to purchase additional shares of the Company's common stock having a market value equal to two times the then-current exercise price of the right.

In addition, if the Company is thereafter merged into another entity, or if 50% or more of the Company's consolidated assets or earning power are sold, then the right will entitle its holder to buy common shares of the acquiring entity having a market value equal to two times the then-current exercise price of the right. The Company's Board of Directors may exchange or redeem the rights under certain conditions.

Note F — Other Intangible Assets

Other intangible assets consisted of the following at March 31, 2016:

Item	Life	Cost	Fiscal 2016 Amortization Expense	Accumulated Amortization at March 31, 2016	Cost, Net of Accumulated Amortization at March 31, 2016
Covenants Not to Compete	5 Years	$775,000	$ 13,000	$ 775,000	$ —
Customer Relationships	18-20 Years	7,922,000	423,000	3,721,000	4,201,000
TPA Licenses	15 Years	204,000	14,000	118,000	86,000
Total		$8,901,000	$ 450,000	$ 4,614,000	$ 4,287,000

Other intangible assets consisted of the following at September 30, 2016:

Item	Life	Cost	Six Months Ended September 30, 2016 Amortization Expense	Accumulated Amortization at September 30, 2016	Cost, Net of Accumulated Amortization at September 30, 2016

Covenants Not to Compete	5 Years	$775,000	$ —	$ 775,000	$ —
Customer Relationships	18-20 Years	7,922,000	211,000	3,933,000	3,989,000
TPA Licenses	15 Years	204,000	7,000	124,000	80,000
Total		$8,901,000	$ 218,000	$ 4,832,000	$ 4,069,000

Note G — Line of Credit

In September 2016, the Company renewed a line of credit agreement. The line is with a financial institution to provide a revolving credit facility with borrowing capacity of up to $10 million. Borrowings under this agreement, as amended, bear interest, at the Company's option, at a fixed LIBOR-based rate plus 1.50% or at a fluctuating rate determined by the financial institution to be 1.0% above the daily one-month LIBOR rate. The loan covenants require the Company to maintain the current assets to liabilities ratio of at least 1.25:1, debt to tangible net worth not greater than 1.25:1 and have positive net income. The Company is in compliance with all the covenants. There were no outstanding revolving loans as of September 30, 2016, but letters of credit in the aggregate amount of $4.5 million have been issued separate from the line of credit and therefore do not reduce the amount of borrowings available under the revolving credit facility. The renewed credit agreement expires in September 2017.

Note H — Contingencies and Legal Proceedings

The Company is involved in litigation arising in the normal course of business. Management believes that resolution of these matters will not result in any payment that, individually or in the aggregate, would be material to the consolidated financial position or results of the operations of the Company.

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2016

Note I — Accounts and Taxes Payable and Accrued Liabilities

Accounts payable, income taxes payable and accrued liabilities consisted of the following at March 31, 2016 and September 30, 2016:

	March 31, 2016	September 30, 2016
Accounts payable	$11,191,000	$14,130,000
Income taxes payable and uncertain tax positions	2,042,000	2,042,000
Total accounts and taxes payable	$13,233,000	$16,172,000

	March 31, 2016	September 30, 2016
Payroll, payroll taxes and employee benefits	$18,003,000	$15,827,000
Customer deposits	25,649,000	31,189,000
Accrued professional service fees	4,692,000	4,895,000
Self-insurance accruals	3,095,000	2,845,000
Deferred revenue	7,821,000	8,623,000
Accrued rent	4,907,000	4,598,000
Other	3,015,000	2,462,000
Total accrued liabilities	$67,182,000	$70,439,000

Item 2 - MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This report may include certain forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including (without limitation) statements with respect to anticipated future operating and financial performance, growth and acquisition opportunities and other similar forecasts and statements of expectation. Words such as “expects,” “anticipates,” “intends,” “plans,” “predicts,” “believes,” “seeks,” “estimates,” “potential,” “continue,” “strive,” “ongoing,” “may,” “will,” “would,” “co variations of these words and similar expressions, are intended to identify these forward-looking statements. Forward-looking statements made by the Company and its management are based on estimates, projections, beliefs, and assumptions of management at the time of such statements and are not guarantees of future performance.

The Company disclaims any obligations to update or revise any forward-looking statement based on the occurrence of future events, the receipt of new information or otherwise, except as required by law. Actual future performance, outcomes and results may differ materially from those expressed in forward-looking statements made by the Company and its management as a result of a number of risks, uncertainties, and assumptions. Representative examples of these factors include (without limitation) general industry and economic conditions, including a decreasing number of national claims due to decreasing number of injured workers; cost of capital and capital requirements; existing and possible litigation and legal liability in the course of operations and the Company’s ability to resolve such litigation; competition from other managed care companies; the ability to expand certain areas of the Company’s business; shifts in customer demands; the ability of the Company to produce market-competitive software; changes in operating expenses including employee wages, benefits and medical inflation; governmental and public policy changes, including but not limited to legislative and administrative law and rule implementation or change; and dependence on key personnel.

Overview

CorVel Corporation is an independent nationwide provider of medical cost containment and managed care services designed to address the escalating medical costs of workers’ compensation and auto claims. The Company’s services are provided to insurance companies, third party administrators (“TPA’s”), governmental entities, and self-administered employers to assist them in managing the medical costs and monitoring the quality of care associated with healthcare claims. There is a decrease in the occupational injury and illness incidence rates as released from the United States Department of Labor in October 2016. This is a continuance of a long term trend of a decrease in the injury rates in the United States.

Network Solutions Services

The Company’s network solutions services are designed to reduce the price paid by its customers for medical services rendered in workers’ compensation cases, auto policies, and group health policies. The network solutions offered by the Company include automated medical fee auditing, preferred provider services, retrospective utilization review, independent medical examinations, and inpatient bill review. Network solutions services also includes revenue from the Company’s directed care network (CareIQ), including imaging and physical therapy.

Patient Management Services

In addition to its network solutions services, the Company also operates as a TPA offering a range of patient management services, which involve working on a one-on-one basis with injured employees and their various healthcare professionals, employers, and insurance company adjusters. The services are designed to monitor the medical necessity and appropriateness of healthcare services provided to workers’ compensation and other healthcare claimants and to expedite return to work. The Company offers these services on a stand-alone basis, or as an integrated component of its medical cost containment services. Patient management services include the processing of claims for self-insured payors to property and casualty insurance.

Seasonality

While we are not directly impacted by seasonal shifts, we are affected by the change in working days in a given quarter. There are generally fewer working days for our employees to generate revenue in the third fiscal quarter as we experience vacations, inclement weather, and holidays.

Organizational Structure

The Company’s management is structured geographically with regional vice-presidents who report to the Chief Executive Officer of the Company. Each of these regional vice-presidents is responsible for all services provided by the Company in his or her particular region and for the operating results of the Company in multiple states. These regional vice-presidents have area and district managers who are also responsible for all services provided by the Company in their given area and district.

Business Enterprise Segments

The Company operates in one reportable operating segment, managed care. The Company's services are delivered to its customers through its local offices in each region and financial information for the Company's operations follows this service delivery model. All regions provide the Company's patient management and network solutions services. FASB ASC 280-10 establishes standards for the way that public business enterprises report information about operating segments in annual and interim consolidated financial statements. The Company’s internal financial reporting is segmented geographically, as discussed above, and managed on a geographic rather than service line basis, with virtually all of the Company’s operating revenue generated within the United States.

Under FASB ASC 280-10, two or more operating segments may be aggregated into a single operating segment for financial reporting purposes if aggregation is consistent with the objective and basic principles, if the segments have similar economic characteristics, and if the segments are similar in each of the following areas: 1) the nature of products and services; 2) the nature of the production processes; 3) the type or class of customer for their products and services; and 4) the methods used to distribute their products or provide their services. The Company believes each of its regions meet these criteria as each provides similar services and products to similar customers using similar methods of productions and similar methods to distribute the services and products.

Summary of Quarterly Results

The Company generated revenues of $128.2 million for the quarter ended September 30, 2016, an increase of $3.8 million, or 3.0%, compared to revenues of $124.5 million for the quarter ended September 30, 2015. This increase was due to an increase in patient management services, which was due to an increase in TPA services offset by a decrease in case management services.

Cost of revenues increased by $4.5 million, from $97.8 million in the September 30, 2015 quarter to $102.3 million in the September 30, 2016 quarter, an increase of 4.6%. The increase in cost of revenues was due to an increase in revenues. Additionally, the increase in cost of revenues was primarily due to an increase in salaries, directed network costs, and temporary help expenses.

General and administrative expense increased by $1.4 million, from $13.2 million in the September 30, 2015 quarter to $14.6 million in the September 30, 2016 quarter, an increase of 10.9%. This increase was primarily due to an increase in spending in legal, information systems, and marketing expenses.

Income tax expense decreased by $0.9 million, or 17.1%, from $5.2 million, in the September 30, 2015 quarter to $4.3 million in the September 30, 2016 quarter. The decrease in income tax expense was primarily due to a decrease in pretax income from the prior year.

Weighted diluted shares decreased from 20.1 million shares in the September 30, 2015 quarter to 19.7 million shares in the September 30, 2016 quarter, a decrease of 330,000 shares, or 1.6%. This decrease was primarily due to the repurchase of 435,823 shares of common stock in the twelve months ended September 30, 2016 under our stock repurchase program.

Diluted earnings per share decreased from $0.41 in the September 30, 2015 quarter to $0.35 in the September 30, 2016 quarter, a decrease of $0.06 per share, or 14.5%. The decrease in diluted earnings per share was primarily due to a decrease in net income.

Results of Operations for the three months ended September 30, 2015 and 2016

The Company derives its revenues from providing patient management and network solutions services to payers of workers' compensation benefits, auto insurance claims, and health insurance benefits. Patient management services include claims management and all services sold to claims management customers, case management, 24/7 nurse triage, utilization management, vocational rehabilitation, and life care planning. Network solutions services include medical bill review, PPO management, facility claim review, provider reimbursement, professional review, pharmacy services, directed care services, Medicare solutions, and clearinghouse services. The percentages of total revenues attributable to patient management and network solutions services for the quarters ended September 30, 2015 and September 30, 2016 are as follows:

	September 30, 2015		September 30, 2016	
Patient management services	54.7	%	56.1	%
Network solutions services	45.3	%	43.9	%

The following table sets forth, for the periods indicated, the dollar amounts, dollar and percent changes, share changes, and the percentage of revenues represented by certain items reflected in the Company’s consolidated income statements for the three months ended September 30, 2015 and September 30, 2016. The Company’s past operating results are not necessarily indicative of future operating results.

	Three Months Ended September 30, 2015	Three Months Ended September 30, 2016	Change	Percentage Change
Revenue	$124,460,000	$128,219,000	$3,759,000	3.0%
Cost of revenues	97,776,000	102,307,000	4,531,000	4.6%
Gross profit	26,684,000	25,912,000	(772,000)	(2.9%)
Gross profit as percentage of revenue	21.4%	20.2%		
General and administrative	13,209,000	14,644,000	1,435,000	10.9%
General and administrative as percentage of revenue	10.6%	11.4%		
Income before income tax provision	13,475,000	11,268,000	(2,207,000)	(16.4%)
Income before income tax provision as percentage of revenue	10.8%	8.8%		
Income tax provision	5,208,000	4,316,000	(892,000)	(17.1%)
Net income	$8,267,000	$6,952,000	$(1,315,000)	(15.9%)
Weighted Shares				
Basic	19,902,000	19,581,000	(321,000)	(1.6%)
Diluted	20,063,000	19,733,000	(330,000)	(1.6%)
Earnings Per Share				
Basic	$0.42	$0.36	$(0.06)	(14.3%)
Diluted	$0.41	$0.35	$(0.06)	(14.6%)

Revenues

Change in revenue from the quarter ended September 30, 2015 to the quarter ended September 30, 2016

Revenues increased from $124.5 million for the three months ended September 30, 2015 to $128.2 million for the three months ended September 30, 2016, an increase of $3.8 million, or 3.0%. The increase in revenues was due to an increase in patient management services, which increased by 5.6%, from $68.1 million to $71.9 million. The increase in patient management services was due to an increase in TPA services partially offset by a decrease in case management services.

Cost of Revenues

The Company’s cost of revenues consists of direct expenses, costs directly attributable to the generation of revenue, and field indirect costs which are incurred in the field to support the operations in the field offices which generate the revenue. Direct costs are primarily case manager salaries, bill review analysts, related payroll taxes and fringe benefits, costs for independent medical examination (IME), prescription drugs, and MRI providers. Most of the

Company's revenues are generated in offices which provide both patient management services and network solutions services. The largest of the field indirect costs are manager salaries and bonuses, account executive base pay and commissions, administrative and clerical support, field systems personnel, PPO network developers, related payroll taxes and fringe benefits, office rent, and telephone expenses. Approximately 32% of the costs incurred in the field are field indirect costs which support both the patient management services and network solutions operations of the Company's field operations.

Change in cost of revenues from the quarter ended September 30, 2015 to the quarter ended September 30, 2016

Cost of revenues increased from $97.8 million in the three months ended September 30, 2015 to $102.3 million in the three months ended September 30, 2016, an increase of $4.5 million or 4.6%. The increase in cost of revenues was primarily due to revenue increasing in lower margin TPA services and a decrease in case management margins. Additionally, there was an increase in salaries, directed network costs, and temporary help expenses.

General and Administrative Expense

For the quarter ended September 30, 2016, general and administrative expense consisted of approximately 56% of corporate systems costs, which include corporate systems support, implementation and training, rules engine development, national information technology (IT) strategy and planning, amortization of software development costs, depreciation of the hardware costs in the Company's national systems, the Company's national wide area network, and other systems related costs. The remaining 44% of the general and administrative expense consisted of national marketing, national sales support, corporate legal, corporate insurance, human resources, accounting, product management, new business development, and other general corporate matters.

Change in general and administrative expense from the quarter ended September 30, 2015 to the quarter ended September 30, 2016

General and administrative expense increased from $13.2 million in the quarter ended September 30, 2015 to $14.6 million in the quarter ended September 30, 2016, an increase of $1.4 million, or 10.9%. Approximately half of this increase was primarily due to an increase in legal costs related to mediation and employment litigations. The increase in IT expenses was due to software depreciation.

Income Tax Provision

Change in income tax expense from the quarter ended September 30, 2015 to the quarter ended September 30, 2016

Income tax expense decreased by $0.9 million, or 17.1%, from $5.2 million for the quarter ended September 30, 2015 to $4.3 million for the quarter ended September 30, 2016 due to the decrease in pretax income. The income tax expense as a percentage of income before income taxes, also known as the effective tax rate, was 38.6% for the quarter ended September 30, 2015 and 38.3% for the quarter ended September 30, 2016.

Results of Operations for the six months ended September 30, 2015 and the six months ended September 30, 2016

The following table sets forth, for the periods indicated, the dollar amounts, dollar and percent changes, share changes, and the percentage of revenues represented by certain items reflected in the Company's consolidated income statements for the six months ended September 30, 2015 and September 30, 2016. The Company's past operating results are not necessarily indicative of future operating results.

	Six Months Ended September 30, 2015	Six Months Ended September 30, 2016	Change	Percentage Change
Revenue	$251,399,000	$256,678,000	$5,279,000	2.1 %
Cost of revenues	198,532,000	205,184,000	6,652,000	3.4 %
Gross profit	52,867,000	51,494,000	(1,373,000)	(2.6 %)
Gross profit as percentage of revenue	21.0 %	20.1 %		
General and administrative	28,171,000	28,105,000	(66,000)	(0.2 %)
General and administrative as percentage of revenue	11.2 %	10.9 %		
Income before income tax provision	24,696,000	23,389,000	(1,307,000)	(5.3 %)
Income before income tax provision as percentage of	9.8 %	9.1 %		

revenue				
Income tax provision	9,529,000	8,946,000	(583,000)	(6.1%)
Net income	$15,167,000	$14,443,000	$(724,000)	(4.8%)
Weighted Shares				
Basic	20,026,000	19,577,000	(449,000)	(2.2%)
Diluted	20,199,000	19,743,000	(456,000)	(2.3%)
Earnings Per Share				
Basic	$0.76	$0.74	$(0.02)	(2.6%)
Diluted	$0.75	$0.73	$(0.02)	(2.7%)

Revenues

Change in revenue from the six months ended September 30, 2015 to the six months ended September 30, 2016

Revenues increased from $251.4 million for the six months ended September 30, 2015 to $256.7 million for the six months ended September 30, 2016, an increase of $5.3 million, or 2.1%. The increase in revenues was due to an increase in patient management services, which increased by 2.8%, from $139.3 million to $143.3 million, along with a lesser increase in network solutions, which increased by 1.2%, from $112.1 million to $113.4 million. Within patient management services, most of the increase was related to TPA services, which was offset by a decrease in case management services.

Cost of Revenues

Change in cost of revenues from the six months ended September 30, 2015 to the six months ended September 30, 2016

Cost of revenues increased from $198.5 million in the six months ended September 30, 2015 to $205.2 million in the six months ended September 30, 2016, an increase of $6.7 million or 3.4%. The increase in cost of revenues was primarily due to revenue increasing in lower margin TPA services, a decrease in case management margins, which was slightly offset by an increase in higher margin network solutions revenue. Additionally, there was an increase in salaries, directed network costs, and temporary help expenses.

General and Administrative Expense

Change in general and administrative expense from the six months ended September 30, 2015 to the six months ended September 30, 2016

General and administrative expense decreased from $28.2 million in the six months ended September 30, 2015 to $28.1 million in the six months ended September 30, 2016, a decrease of $0.1 million, or 0.2%. This decrease was primarily due to a decrease in IT costs.

Income Tax Provision

Change in income tax expense from the six months ended September 30, 2015 to the six months ended September 30, 2016

Income tax expense decreased by $0.6 million, or 6.1%, from $9.5 million for the six months ended September 30, 2015 to $8.9 million for the six months ended September 30, 2016 due to the decrease in pretax income. The income tax expense as a percentage of income before income taxes, also known as the effective tax rate, was 38.6% for the six months ended September 30, 2015 and 38.2% for the six months ended September 30, 2016.

Liquidity and Capital Resources

The Company has historically funded its operations and capital expenditures primarily from cash flow from operations, and to a lesser extent, proceeds from stock option exercises. Working capital increased $9.4 million, from $42.7 million as of March 31, 2016 to $52.1 million as of September 30, 2016. Cash and cash equivalents increased from $32.8 million as of March 31, 2016 to $40.9 million as of September 30, 2016, an increase of $8.1 million. This is primarily due to the Company’s decision to reduce its stock repurchase program activity.

The Company believes that cash from operations and funds from exercises of stock options granted to employees are adequate to fund existing obligations, repurchase shares of the Company's common stock under its current stock repurchase program, introduce new services, and continue to develop healthcare related services for at least the next twelve months. The Company regularly evaluates cash requirements for current operations, commitments, capital acquisitions, and other strategic transactions. The Company may elect to raise additional funds for these purposes, through debt or equity financings or otherwise, as appropriate. Additional equity or debt financing may not be available when needed, on terms favorable to the Company or at all.

As of September 30, 2016, the Company had $40.9 million in cash and cash equivalents, invested primarily in short-term, interest-bearing, highly liquid investment-grade securities with maturities of 90 days or less.

In September 2016, the Company renewed a line of credit agreement. The line is with a financial institution to provide a revolving credit facility with borrowing capacity of up to $10 million. Borrowings under this agreement, as amended, bear interest, at the Company's option, at a fixed LIBOR-based rate plus 1.50% or at a fluctuating rate determined by the financial institution to be 1.0% above the daily one-month LIBOR rate. The loan covenants require the Company to maintain the current assets to liabilities ratio of at least 1.25:1, debt to tangible net worth not greater than 1.25:1 and have positive net income. The Company is in compliance with all the covenants. There were no outstanding revolving loans as of September 30, 2016, but letters of credit in the aggregate amount of $4.5 million have been issued separate from the line of credit and therefore do not reduce the amount of borrowings available under the revolving credit facility. The renewed credit agreement expires in September 2017.

The Company believes that the cash balance at September 30, 2016, along with anticipated internally generated funds and the credit facility, will be sufficient to meet the Company's expected cash requirements for at least the next twelve months.

Operating Cash Flows

Six months ended September 30, 2015 compared to six months ended September 30, 2016

Net cash provided by operating activities decreased from $24.6 million in the six months ended September 30, 2015 to $20.5 million in the six months ended September 30, 2016, a decrease of $4.0 million. The decrease in cash flow from operating activities was primarily due to a change in prepaid taxes and expenses.

Investing Activities

Six months ended September 30, 2015 compared to six months ended September 30, 2016

Net cash flow used in investing activities was $8.6 million in the six months ended September 30, 2015 and $11.1 million in the six months ended September 30, 2016. Capital purchases were $8.0 million for the six months ended September 30, 2015 and $10.8 million for the six months ended September 30, 2016. This increase was due to the renewal of software licenses.

Financing Activities

Six months ended September 30, 2015 compared to six months ended September 30, 2016

Net cash flow used in financing activities was $16.6 million for the six months ended September 30, 2015 and $1.4 million for the six months ended September 30, 2016, a decrease of $15.2 million. The change is primarily due to the Company's decision to reduce its stock repurchase program activity.

Contractual Obligations

The following table summarizes the Company's contractual obligations outstanding as of September 30, 2016:

	Payments Due by Period				
	Total	Within One Year	Between One and Three Years	Between Three and Five Years	More than Five Years
Operating leases	$49,846,000	$13,013,000	$ 18,698,000	$ 11,829,000	$6,306,000
Uncertain tax positions	$2,206,000	$2,206,000	—	—	—
Software licenses	$3,492,000	$1,746,000	1,746,000	—	—
Total	$55,544,000	$16,965,000	$ 20,444,000	$ 11,829,000	$6,306,000

Operating leases are rents paid for the Company’s physical locations.

Litigation

The Company is involved in litigation arising in the normal course of business. Management believes that resolution of these matters will not result in any payment that, individually or in the aggregate, would be material to the financial position or results of the operations of the Company.

Inflation

The Company is impacted by rising costs for certain inflation-sensitive operating expenses such as labor and employee benefits, and facility leases. However, the Company generally does not believe these impacts are material to its revenues or net income.

Off-Balance Sheet Arrangements

The Company is not a party to off-balance sheet arrangements as defined by the rules of the SEC. However, from time to time the Company enters into certain types of contracts that contingently require the Company to indemnify parties against third-party claims. The contracts primarily relate to: (i) certain contracts to perform services, under which the Company may provide customary indemnification to the purchases of such services; (ii) certain real estate leases, under which the Company may be required to indemnify property owners for environmental and other liabilities, and other claims arising from the Company's use of the applicable premises; and (iii) certain agreements with the Company's officers, directors and employees, under which the Company may be required to indemnify such persons for liabilities arising out of their relationship with the Company.

The terms of such obligations vary by contract and in most instances a specific or maximum dollar amount is not explicitly stated therein. Generally, amounts under these contracts cannot be reasonably estimated until a specific claim is asserted. Consequently, no material liabilities have been recorded for these obligations on the Company's balance sheets for any of the periods presented.

Critical Accounting Policies

The SEC defines critical accounting policies as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

The following is not intended to be a comprehensive list of our accounting policies. The Company's significant accounting policies are more fully described in Note A to the Consolidated Financial Statements. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States of America, with no need for management's judgment in their application. There are also areas in which management's judgment in selecting an available alternative would not produce a materially different result.

We have identified the following accounting policies as critical to us: 1) revenue recognition, 2) allowance for uncollectible accounts, 3) goodwill and long-lived assets, 4) accrual for self-insured costs, 5) accounting for income taxes, 6) legal and other contingencies, 7) share-based compensation, and 8) software development costs.

Revenue Recognition: The Company recognizes revenue when there is persuasive evidence of an arrangement, the services have been provided to the customer, the sales price is fixed or determinable, and collectability is reasonably assured. For the Company's services, as the Company's professional staff performs work, they are contractually permitted to bill for fees earned in fraction of an hour increments worked or by units of production. The Company recognizes revenue as the time is worked or as units of production are completed, which is when the revenue is earned and realized. Labor costs are recognized as the costs are incurred. The Company derives the majority of its revenue from the sale of network solutions and patient management services. Network solutions and patient management services may be sold individually or combined with any of the services the Company provides. When a sale combines multiple elements, the Company accounts for multiple element arrangements in accordance with the guidance included in Accounting Standard Codification ("ASC") 605-25.

The multiple-deliverable arrangements consist of bundled managed care which included various units of accounting such as network solutions, and patient management which includes claims administration. Such elements are considered separate units of accounting as each element has value to the customer on a stand-alone basis. The selling price for each unit of accounting is determined using the contract price and management estimates. When the Company's customers purchase several products, the pricing of the products sold is generally the same as if the products were sold on an individual basis. Revenue is recognized as the work is performed in accordance with the Company's customer contracts. Based upon the nature of the Company's products, bundled managed care elements are generally delivered in the same accounting period. The Company recognizes revenue for patient management claims administration services over the life of the customer contract. The Company estimates, based upon prior experience in managing claims, the deferral amount from when the claim is received to when the customer contract expires.

Allowance for Uncollectible Accounts: The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customers' current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes off accounts receivable when they become uncollectible.

The Company must make significant judgments and estimates in determining contractual and bad debt allowances in any accounting period. One significant uncertainty inherent in the Company's analysis is whether its past experience will be indicative of future periods. Although the Company considers future projections when estimating contractual and bad debt allowances, the Company ultimately makes its decisions based on the best information available to it at that time. Adverse changes in general economic conditions or trends in reimbursement amounts for the Company's services could affect the Company's contractual and bad debt allowance estimates, collection of accounts receivable, cash flows, and results of operations. No one customer accounted for 10% or more of accounts receivable at March 31, 2016 or September 30, 2016.

Goodwill and Long-Lived Assets: Goodwill arising from business combinations represents the excess of the purchase price over the estimated fair value of the net assets of the acquired business. Pursuant to ASC 350-10 through ASC 350-30, “Goodwill and Other Intangible Assets,” goodwill is tested annually for impairment or more frequently if circumstances indicate the potential for impairment. Also, management tests for impairment of its amortizable intangible assets and long-lived assets annually and whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company’s impairment is conducted at a regional level. The measurement of fair value is based on an evaluation of market capitalization and is further tested using a multiple of earnings approach. In projecting the Company’s cash flows, management considers industry growth rates and trends and cost structure changes. Based on management’s evaluations, no indicators of impairment of its goodwill, intangible assets or other long-lived assets existed at September 30, 2016. However, future events or changes in current circumstances could affect the recoverability of the carrying value of goodwill and long-lived assets. Should an asset be deemed impaired, an impairment loss would be recognized to the extent the carrying value of the asset exceeded its estimated fair market value.

Accrual for Self-insurance Costs: The Company accrues for the group medical costs and workers’ compensation costs of its employees based on claims filed and an estimate of claims incurred but not reported as of each balance sheet date. The Company purchases stop loss insurance for large claims. The Company determines its estimated self-insurance reserves based upon historical trends along with outstanding claims information provided by its claims paying agents. However, it is possible that recorded accruals may not be adequate to cover the future payment of claims. Adjustments, if any, to estimated accruals resulting from ultimate claim payments will be reflected in earnings during the periods in which such adjustments are determined. The Company’s self-insured liabilities contain uncertainties since management is required to make assumptions and apply judgment to estimate the ultimate cost to settle reported claims and claims incurred but not reported at the balance sheet date.

The Company does not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions used to calculate its self-insured liabilities. However, if actual results are not consistent with these estimates or assumptions, the Company may be exposed to losses or gains that could be material.

Accounting for Income Taxes: The Company records a tax provision for the anticipated tax consequences of the reported results of operations. The provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carry-forwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company records a valuation allowance, if necessary, to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

The Company recognizes tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with future reversals of existing taxable temporary differences, will be sufficient to fully recover the deferred tax assets. In the event that the Company determines all or part of the net deferred tax assets are not realizable in the future, the Company will make an adjustment to the valuation allowance that would be charged to earnings in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of GAAP and complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on the Company's financial condition and operating results. The significant assumptions and estimates described above are important contributors to our ultimate effective tax rate in each year.

Legal and Other Contingencies: As discussed in Part II, Item 1 of this report under the heading "Legal Proceedings" and in Note H, "Contingencies and Legal Proceedings" in the Notes to Consolidated Financial Statements, the Company is subject to various legal proceedings and claims that arise in the ordinary course of business. The Company records a liability when it is probable that a loss has been incurred and the amount is reasonably estimable. There is significant judgment required in both the probability determination and as to whether an exposure can be reasonably estimated. In the opinion of management, there was not at least a reasonable possibility the Company may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies. However, the outcome of legal proceedings and claims brought against the Company are subject to significant uncertainty.

Share-Based Compensation: The Company accounts for share-based compensation in accordance with the provisions of ASC Topic 718 “Compensation – Stock Compensation”. Under ASC 718, share-based compensation cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the employee’s requisite service period (generally the vesting period of the equity grant). Share-based compensation expense is recognized based on awards ultimately expected to vest; therefore, it has been reduced for estimated forfeitures. ASC Topic 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company estimates the fair value of stock options using the Black-Scholes valuation model. Key input assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, the expected volatility of the Company’s stock over the option’s expected term, the risk-free interest rate over the option’s term, and the Company’s expected annual dividend yield. The Company’s management believes that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of the Company’s granted stock options. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

The Company does not believe there is a reasonable likelihood there will be a material change in the future estimates or assumptions used to determine stock-based compensation expense. However, if actual results are not consistent with these estimates or assumptions, the Company may be exposed to changes in stock-based compensation expense that could be material.

Software Development Costs: Development costs incurred in the research and development of new software products and enhancements to existing software products for internal use are expensed as incurred until technological feasibility has been established. After technological feasibility is established, any additional external and internal software development costs are capitalized and amortized on a straight-line basis over the estimated economic life of the related product, which is typically five years. The Company performs an annual review of the estimated economic life and the recoverability of such capitalized software costs. If a determination is made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software, any remaining capitalized amounts are written off.

Recent Accounting Standards Update

On May 28, 2014, the FASB issued ASU 2014-09 regarding ASC Topic 606, Revenue from Contracts with Customers. The standard provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. In July 2015, the FASB approved a one-year delay of the effective date of this new revenue recognition standard. The guidance will now be effective for our fiscal year beginning April 1, 2018. We are currently evaluating the accounting, transition and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

On November 20, 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes. ASU 2015-17 alters the presentation of deferred tax items on a classified balance sheet requiring companies to unify previously separated current and noncurrent items and present them as a single noncurrent amount. We have elected to early adopt this standard as of March 31, 2016 and have retrospectively applied the amendments to all periods presented.

In January 2016, the FASB issued ASU 2016-01 regarding Subtopic 825-10, Financials Instruments — Overall: Recognition and Measurements of Financial Assets and Financial Liabilities. The standard addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. It requires that most equity investments be measured at fair value, with subsequent changes in fair value recognized in net income. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. We are currently evaluating the accounting, transition, and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

In February 2016, the FASB issued ASU No. 2016-02, Leases, which sets out the principles for the recognition, measurement, presentation, and disclosure of leases for both parties to a contract (i.e. lessees and lessors). The standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases. This classification will determine whether the lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. The standard is effective April 1, 2019, with early adoption permitted. The standard is to be applied using a modified retrospective transition method. We are in the process of determining the effect on our consolidated financial position, results of operations and cash flows.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification on the statement of cash flows. For public companies, the new guidance is effective for annual reporting periods (including interim periods within those periods) beginning after December 15, 2016, with early adoption permitted. We are in the process of evaluating the impact of adoption of this guidance on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows, which reduces diversity in practice in how certain transactions are classified in the statement of cash flows. The new guidance is effective for annual reporting periods beginning after December 15, 2017, with early adoption permitted. The adoption of this guidance will not have a material impact on the Company's consolidated financial statements.

Item 3 – Quantitative and Qualitative Disclosures About Market Risk

As of September 30, 2016, the Company held no market risk sensitive instruments for trading purposes, and the Company did not employ any derivative financial instruments, other financial instruments, or derivative commodity instruments to hedge any market risk. The Company had no debt outstanding as of September 30, 2016, and therefore, had no market risk related to debt.

Item 4 – Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of September 30, 2016, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC and (ii) accumulated and communicated to our management, including our principal executive and principal accounting officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the three months ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1 – Legal Proceedings

The Company is involved in litigation arising in the normal course of business. Management believes that resolution of these matters will not result in any payment that, individually or in the aggregate, would be material to the consolidated financial position or results of the operations of the Company.

Item 1A – Risk Factors.

A restated description of the risk factors associated with our business is set forth below. This description includes any and all changes (whether or not material) to, and supersedes, the description of the risk factors associated with our business previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended March 31, 2016.

Past financial performance is not necessarily a reliable indicator of future performance and investors in our common stock should not use historical performance to anticipate results or future period trends. Investing in our common stock involves a high degree of risk. Investors should consider carefully the following risk factors, as well as the other information in this report and our other filings with the Securities and Exchange Commission, including our consolidated financial statements and the related notes, before deciding whether to invest or maintain an investment in shares of our common stock. If any of the following risks actually occurs, our business, financial condition and results of operations would suffer. In this case, the trading price of our common stock would likely decline. The risks described below are not the only ones we face. Additional risks that we currently do not know about or that we currently believe to be immaterial also may impair our business operations.

If we fail to grow our business internally or through strategic acquisitions we may be unable to execute our business plan, maintain high levels of service or adequately address competitive challenges.

Our strategy is to continue internal growth and, as strategic opportunities arise in the workers' compensation managed care industry, to consider acquisitions of, or relationships with, other companies in related lines of business. As a result, we are subject to certain growth-related risks, including the risk that we will be unable to retain personnel or acquire other resources necessary to service such growth adequately. Expenses arising from our efforts to increase our market penetration may have a negative impact on operating results. In addition, there can be no assurance that any suitable opportunities for strategic acquisitions or relationships will arise or, if they do arise, that the transactions contemplated could be completed. If such a transaction does occur, there can be no assurance that we will be able to integrate effectively any acquired business. In addition, any such transaction would be subject to various risks associated with the acquisition of businesses, including, but not limited to, the following:

- an acquisition may negatively impact our results of operations as it may require incurring large one-time charges, substantial debt or liabilities; it may require the amortization or write down of amounts related to deferred compensation, goodwill and other intangible assets; or it may cause adverse tax consequences, substantial depreciation or deferred compensation charges;
- we may encounter difficulties in assimilating and integrating the business, technologies, products, services, personnel or operations of companies that are acquired, particularly if key personnel of the acquired company decide not to work for us;
- an acquisition may disrupt ongoing business, divert resources, increase expenses and distract management;
- the acquired businesses, products, services or technologies may not generate sufficient revenue to offset acquisition costs;
- we may have to issue equity or debt securities to complete an acquisition, which would dilute the position of stockholders and could adversely affect the market price of our common stock; and
- the acquisitions may involve the entry into a geographic or business market in which we have little or no prior experience.

There can be no assurance that we will be able to identify or consummate any future acquisitions or other strategic relationships on favorable terms, or at all, or that any future acquisition or other strategic relationship will not have an adverse impact on our business or results of operations. If suitable opportunities arise, we may finance such transactions, as well as internal growth, through debt or equity financing. There can be no assurance, however, that such debt or equity financing would be available to us on acceptable terms when, and if, suitable strategic opportunities arise.

If we are unable to increase our market share among national and regional insurance carriers and large, self-funded employers, our results may be adversely affected.

Our business strategy and future success depend in part on our ability to capture market share with our cost containment services as national and regional insurance carriers and large, self-funded employers look for ways to achieve cost savings. There can be no assurance that we will successfully market our services to these insurance carriers and employers or that they will not resort to other means to achieve cost savings. Additionally, our ability to capture additional market share may be adversely affected by the decision of potential customers to perform services internally instead of outsourcing the provision of such services to us. Furthermore, we may not be able to demonstrate sufficient cost savings to potential or current customers to induce them not to provide comparable services internally or to accelerate efforts to provide such services internally.

If competition increases, our growth and profits may decline.

The markets for our network services and patient management services are also fragmented and competitive. Our competitors include national managed care providers, preferred provider networks, smaller independent providers, and insurance companies. Companies that offer one or more workers' compensation managed care services on a national basis are our primary competitors. We also compete with many smaller vendors who generally provide unbundled services on a local level, particularly companies with an established relationship with a local insurance company adjuster. In addition, several large workers' compensation insurance carriers offer managed care services for their customers, either by performance of the services in-house or by outsourcing to organizations like ours. If these carriers increase their performance of these services in-house, our business may be adversely affected. In addition, consolidation in the industry may result in carriers performing more of such services in-house.

Our sequential revenue may not increase and may decline. As a result, we may fail to meet or exceed the expectations of investors or analysts which could cause our common stock price to decline.

Our sequential revenue growth may not increase and may decline in the future as a result of a variety of factors, many of which are outside of our control. If changes in our sequential revenue fall below the expectations of investors or analysts, the price of our common stock could decline substantially. Fluctuations or declines in sequential revenue growth may be due to a number of factors, including, but not limited to, those listed below and identified throughout this “Risk Factors” section: the decline in manufacturing employment, the decline in workers’ compensation claims, the decline in healthcare expenditures, the considerable price competition in a flat-to-declining workers’ compensation market, litigation, the increase in competition, and the changes and potential changes in state workers’ compensation and automobile-managed care laws which can reduce demand for our services. These factors create an environment where revenue and margin growth are more difficult to attain and where revenue growth is less certain than historically experienced. Additionally, our technology and preferred provider network face competition from companies that have more resources available to them than we do. Also, some customers may handle their managed care services in-house and may reduce the amount of services which are outsourced to managed care companies such as CorVel. These factors could cause the market price of our common stock to fluctuate substantially. There can be no assurance that our growth rate in the future, if any, will be at or near historical levels.

In addition, the stock market has in the past experienced price and volume fluctuations that have particularly affected companies in the healthcare and managed care markets resulting in changes in the market price of the stock of many companies, which may not have been directly related to the operating performance of those companies.

Due to the foregoing factors and the other risks discussed in this report, investors should not rely on period-to-period comparisons of our results of operations as an indication of our future performance.

The market price and trading volume of our common stock may be volatile, which could result in rapid and substantial losses for our stockholders.

The market price of our common stock may be highly volatile and could be subject to wide fluctuations. In addition, the trading volume in our common stock may fluctuate and cause significant price variations to occur. The stock market has, in the past, experienced price and volume fluctuations that have particularly affected companies in the healthcare and managed care markets resulting in changes in the market price of the stock of many companies, which may not have been directly related to the operating performance of those companies. There can be no assurance that the market price of our common stock will not fluctuate or decline significantly in the future.

We cannot assure our stockholders that our stock repurchase program will enhance long-term stockholder value and stock repurchases, if any, could increase the volatility of the price of our common stock and will diminish our cash reserves.

In 1996, our Board of Directors authorized a stock repurchase program and has periodically increased the number of shares authorized for repurchase under the repurchase program. In November 2015, the Company’s Board of Directors approved a 1,000,000 share expansion to its existing stock repurchase plan, increasing the total number of shares approved for repurchase over the life of the program to 35,000,000 shares from the previous limit of 34,000,000 shares. There is no expiration date for the repurchase program. The timing and actual number of shares repurchased, if any, depend on a variety of factors including the timing of open trading windows, price, corporate and regulatory requirements, and other market conditions. The program may be suspended or discontinued at any time without prior notice. Repurchases pursuant to our stock repurchase program could affect our stock price and increase its volatility. The existence of a stock repurchase program could also cause our stock price to be higher than it would be in the absence of such a program and could potentially reduce the market liquidity for our stock. Additionally, repurchases under our stock repurchase program will diminish our cash reserves, which could impact our ability to pursue possible future strategic opportunities and acquisitions and could result in lower overall returns on our cash balances. There can be no assurance that any further stock repurchases will enhance stockholder value as the market price of our common stock may decline below the levels at which we repurchased shares of stock. Although our stock repurchase program is intended to enhance long-term stockholder value, short-term stock price fluctuations could reduce the program’s effectiveness.

If the referrals for our patient management services decline, our business, financial condition and results of operations would be materially adversely affected.

In some years, we have experienced a general decline in the revenue and operating performance of patient management services. We believe that the performance decline has been due to the following factors: the decrease of the number of workplace injuries that have become longer-term disability cases; increased regional and local competition from providers of managed care services; a possible reduction by insurers on the types of services provided by our patient management business; the closure of offices and continuing consolidation of our patient management operations; and employee turnover, including management personnel, in our patient management business. In the past, these factors have all contributed to the lowering of our long-term outlook for our patient management services. If some or all of these conditions continue, we believe that the performance of our patient management revenues could decrease.

Declines in workers' compensation claims may materially harm our results of operations.

Within the past few years, the economy has performed below historical averages which leads to fewer workers on a national level and could lead to fewer work-related injuries. If declines in workers' compensation costs occur in many states and persist over the long-term, it would have a material adverse impact on our business, financial condition, and results of operations.

We provide an outsource service to payors of workers' compensation and auto healthcare benefits. These payors include insurance companies, TPAs, municipalities, state funds, and self-insured and self-administered employers. If these payors reduce the amount of work they outsource, our results of operations would be materially adversely affected.

Healthcare providers are becoming increasingly resistant to the application of certain healthcare cost containment techniques; this may cause revenue from our cost containment operations to decrease.

Healthcare providers have become more active in their efforts to minimize the use of certain cost containment techniques and are engaging in litigation to avoid application of certain cost containment practices. Recent litigation between healthcare providers and insurers has challenged certain insurers' claims adjudication and reimbursement decisions. Although these lawsuits do not directly involve us or any services we provide, these cases may affect the use by insurers of certain cost containment services that we provide and may result in a decrease in revenue from our cost containment business.

Our failure to compete successfully could make it difficult for us to add and retain customers and could reduce or impede the growth of our business.

We face competition from PPOs, TPAs and other managed healthcare companies. We believe that as managed care techniques continue to gain acceptance in the workers' compensation marketplace, our competitors will increasingly consist of nationally-focused workers' compensation managed care service companies, insurance companies, HMOs and other significant providers of managed care products. Legislative reform in some states has been considered, but not enacted to permit employers to designate health plans such as HMOs and PPOs to cover workers' compensation claimants. Because many health plans have the ability to manage medical costs for workers' compensation claimants, such legislation may intensify competition in the markets served by us. Many of our current and potential competitors are significantly larger and have greater financial and marketing resources than we do, and there can be no assurance that we will continue to maintain our existing customers, our past level of operating performance or be successful with any new products or in any new geographical markets we may enter.

A breach of security may cause our customers to curtail or stop using our services.

We rely largely on our own security systems, confidentiality procedures and employee nondisclosure agreements to maintain the privacy and security of our Company's and our customers' proprietary information. Accidental or willful security breaches or other unauthorized access by third parties to our information systems or the existence of computer viruses in our data or software and misappropriation of our proprietary information could expose us to a risk of information loss, litigation and other possible liabilities which may have a material adverse effect on our business, financial condition and results of operations. If security measures are breached due to third-party action, employee error, malfeasance or otherwise, or if design flaws in our software are exposed and exploited, and, as a result, a third party obtains unauthorized access to any customer data, our relationships with our customers and our reputation will be damaged, our business may suffer and we could incur significant liability. We may be unable to anticipate these techniques or to implement adequate preventative measures because techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until launched against a target.

Exposure to possible litigation and legal liability may adversely affect our business, financial condition and results of operations.

We, through our utilization management services, make recommendations concerning the appropriateness of providers' medical treatment plans of patients throughout the country, and as a result, could be exposed to claims for adverse medical consequences. We do not grant or deny claims for payment of benefits and we do not believe that we engage in the practice of medicine or the delivery of medical services. There can be no assurance, however, that we will not be subject to claims or litigation related to the authorization or denial of claims for payment of benefits or allegations that we engage in the practice of medicine or the delivery of medical services.

In addition, there can be no assurance that we will not be subject to other litigation that may adversely affect our business, financial condition or results of operations, including but not limited to being joined in litigation brought against our customers in the managed care industry. We maintain professional liability insurance and such other coverages as we believe are reasonable in light of our experience to date. If such insurance is insufficient or unavailable in the future at a reasonable cost to protect us from liability, our business, financial condition or results of operations could be adversely affected.

If lawsuits against us are successful, we may incur significant liabilities.

We provide to insurers and other payors of healthcare costs managed care programs that utilize preferred provider organizations and computerized bill review programs. Healthcare providers have brought, against us and our customers, individual and class action lawsuits challenging such programs. If such lawsuits are successful, we may incur significant liabilities.

We make recommendations about the appropriateness of providers' proposed medical treatment plans for patients throughout the country. As a result, we could be subject to claims arising from any adverse medical consequences. Although plaintiffs have not to date subjected us to any claims or litigation relating to the granting or denial of claims for payment of benefits or allegations that we engage in the practice of medicine or the delivery of medical services, there can be no assurance that plaintiffs will not make such claims in future litigation. There also can be no assurance that our insurance will provide sufficient coverage or that insurance companies will make insurance available at a reasonable cost to protect us from significant future liability.

If the utilization by healthcare payors of early intervention services continues to increase, the revenue from our later-stage network and healthcare management services could be negatively affected.

The performance of early intervention services, including injury occupational healthcare, first notice of loss, and telephonic case management services, often result in a decrease in the average length of, and the total costs associated with, a healthcare claim. By successfully intervening at an early stage in a claim, the need for additional cost containment services for that claim often can be reduced or even eliminated. As healthcare payors continue to increase their utilization of early intervention services, the revenue from our later stage network and healthcare management services will decrease.

An interruption in our ability to access critical data may cause customers to cancel their service and/or may reduce our ability to effectively compete.

Certain aspects of our business are dependent upon our ability to store, retrieve, process and manage data and to maintain and upgrade our data processing capabilities. Interruption of data processing capabilities for any extended length of time, loss of stored data, programming errors or other system failures could cause customers to cancel their service and could have a material adverse effect on our business and results of operations.

In addition, we expect that a considerable amount of our future growth will depend on our ability to process and manage claims data more efficiently and to provide more meaningful healthcare information to customers and payors of healthcare. There can be no assurance that our current data processing capabilities will be adequate for our future growth, that we will be able to efficiently upgrade our systems to meet future demands, or that we will be able to develop, license or otherwise acquire software to address these market demands as well or as timely as our competitors.

We face competition for staffing, which may increase our labor costs and reduce profitability.

We compete with other healthcare providers in recruiting qualified management and staff personnel for the day-to-day operations of our business, including nurses and other case management professionals. In some markets, the scarcity of nurses and other medical support personnel has become a significant operating issue to healthcare providers. This shortage may require us to enhance wages to recruit and retain qualified nurses and other healthcare professionals. Our failure to recruit and retain qualified management, nurses and other healthcare professionals, or to control labor costs could have a material adverse effect on profitability.

The increased costs of professional and general liability insurance may have an adverse effect on our profitability.

The cost of commercial professional and general liability insurance coverage has risen significantly in the past several years, and this trend may continue. In addition, if we were to suffer a material loss, our costs may increase over and above the general increases in the industry. If the costs associated with insuring our business continue to increase, it may adversely affect our business. We believe our current level of insurance coverage is adequate for a company of our size engaged in our business.

Changes in government regulations could increase our costs of operations and/or reduce the demand for our services.

Many states, including a number of those in which we transact business, have licensing and other regulatory requirements applicable to our business. Approximately half of the states have enacted laws that require licensing of businesses which provide medical review services such as ours. Some of these laws apply to medical review of care covered by workers’ compensation. These laws typically establish minimum standards for qualifications of personnel, confidentiality, internal quality control and dispute resolution procedures. These regulatory programs may result in increased costs of operation for us, which may have an adverse impact upon our ability to compete with other available alternatives for healthcare cost control. In addition, new laws regulating the operation of managed care provider networks have been adopted by a number of states. These laws may apply to managed care provider networks having contracts with us or to provider networks which we may organize. To the extent we are governed by these regulations, we may be subject to additional licensing requirements, financial and operational oversight, and procedural standards for beneficiaries and providers.

Regulation in the healthcare and workers’ compensation fields is constantly evolving. We are unable to predict what additional government initiatives, if any, affecting our business may be promulgated in the future. Our business may be adversely affected by failure to comply with existing laws and regulations, failure to obtain necessary licenses and government approvals or failure to adapt to new or modified regulatory requirements. Proposals for healthcare legislative reforms are regularly considered at the federal and state levels. To the extent that such proposals affect workers’ compensation, such proposals may adversely affect our business, financial condition and results of operations.

In addition, changes in workers’ compensation, auto and managed healthcare laws or regulations may reduce demand for our services, require us to develop new or modified services to meet the demands of the marketplace or reduce the fees that we may charge for our services.

The introduction of software products incorporating new technologies and the emergence of new industry standards could render our existing software products less competitive, obsolete or unmarketable.

There can be no assurance that we will be successful in developing and marketing new software products that respond to technological changes or evolving industry standards. If we are unable, for technological or other reasons, to develop and introduce new software products cost-effectively, in a timely manner and in response to changing market conditions or customer requirements, our business, results of operations and financial condition may be adversely affected.

Developing or implementing new or updated software products and services may take longer and cost more than expected. We rely on a combination of internal development, strategic relationships, licensing and acquisitions to develop our software products and services. The cost of developing new healthcare information services and technology solutions is inherently difficult to estimate. Our development and implementation of proposed software products and services may take longer than originally expected, require more testing than originally anticipated and require the acquisition of additional personnel and other resources. If we are unable to develop new or updated software products and services cost-effectively on a timely basis and implement them without significant disruptions to the existing systems and processes of our customers, we may lose potential sales and harm our relationships with current or potential customers.

The failure to attract and retain qualified or key personnel may prevent us from effectively developing, marketing, selling, integrating and supporting our services.

We are dependent, to a substantial extent, upon the continuing efforts and abilities of certain key management personnel. In addition, we face competition for experienced employees with professional expertise in the workers' compensation managed care area. The loss of key personnel, especially V. Gordon Clemons, Chairman, President, and Chief Executive Officer, or the inability to attract qualified employees, could have a material unfavorable effect on our business and results of operations.

If we lose several customers in a short period, our results may be materially adversely affected.

Our results may decline if we lose several customers during a short period. Most of our customer contracts permit either party to terminate without cause. If several customers terminate, or do not renew or extend their contracts with us, our results could be materially and adversely affected. Many organizations in the insurance industry have consolidated and this could result in the loss of one or more of our customers through a merger or acquisition. Additionally, we could lose customers due to competitive pricing pressures or for other reasons.

We are subject to risks associated with acquisitions of intangible assets.

Our acquisition of other businesses may result in significant increases in our intangible assets and goodwill. We regularly evaluate whether events and circumstances have occurred indicating that any portion of our intangible assets and goodwill may not be recoverable. When factors indicate that intangible assets and goodwill should be evaluated for possible impairment, we may be required to reduce the carrying value of these assets. We cannot currently estimate the timing and amount of any such charges.

If we are unable to leverage our information systems to enhance our outcome-driven service model, our results may be adversely affected.

To leverage our knowledge of workplace injuries, treatment protocols, outcomes data, and complex regulatory provisions related to the workers' compensation market, we must continue to implement and enhance information systems that can analyze our data related to the workers' compensation industry. We frequently upgrade existing operating systems and are updating other information systems that we rely upon in providing our services and financial reporting. We have detailed implementation schedules for these projects that require extensive involvement from our operational, technological and financial personnel. Delays or other problems we might encounter in implementing these projects could adversely affect our ability to deliver streamlined patient care and outcome reporting to our customers.

Our Internet-based services are dependent on the development and maintenance of the Internet infrastructure.

The Internet has experienced a variety of outages and other delays as a result of damages to portions of its infrastructure, and it could face outages and delays in the future. These outages and delays could reduce the level of Internet usage, as well as the availability of the Internet to us for delivery of our Internet-based services. In addition, our customers who use our Web-based services depend on Internet service providers, online service providers and other website operators for access to our website. All of these providers have experienced significant outages in the past and could experience outages, delays and other difficulties in the future due to system failures unrelated to our systems. Any significant interruptions in our services or increases in response time could result in a loss of potential or existing users, and, if sustained or repeated, could reduce the attractiveness of our services.

We are sensitive to regional weather conditions that may adversely affect our operations.

Our operations are directly affected in the short term by the weather conditions in certain regions of operation. Therefore our business is sensitive to the weather conditions of these regions. Unusually inclement weather, including significant rain, snow, sleet, freezing rain or ice can temporarily affect our operations if clients are forced to close operational centers. Accordingly, our operating results may vary from quarter to quarter, depending on the impact of these weather conditions.

Natural and other disasters may adversely affect our business.

We may be vulnerable to damage from severe weather conditions or natural disasters, including hurricanes, fires, floods, earthquakes, power loss, communications failures and similar events, including the effects of war or acts of terrorism. If a disaster were to occur, our ability to operate our business could be seriously or completely impaired or destroyed. The insurance we maintain may not be adequate to cover our losses resulting from disasters or other business interruptions.

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

There were no sales of unregistered securities during the period covered by this report. The following table shows the repurchases of the Company's common stock made by or on behalf of the Company in open-market transactions for the quarter ended September 30, 2016 pursuant to a publicly announced plan.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares that may yet be Purchased Under the Program
July 1 to July 31, 2016	6,651	$ 44.18	6,651	1,068,930
August 1 to August 31, 2016	26,837	40.97	26,837	1,042,093
September 1 to September 30, 2016	30,106	38.47	30,106	1,011,987
Total	63,594	$ 40.12	63,594	1,011,987

In 1996, the Company's Board of Directors authorized a stock repurchase program for up to 900,000 shares of the Company's common stock. The Company's Board of Directors has periodically increased the number of shares authorized for repurchase under the repurchase program. In November 2015, the Company's Board of Directors approved a 1,000,000 share expansion to its existing stock repurchase plan, increasing the total number of shares approved for repurchase over the life of the program to 35,000,000 shares from the previous limit of 34,000,000 shares. There is no expiration date for the repurchase program. As of September 30, 2016, the Company had repurchased 33,988,013 shares of its common stock over the life of the program.

Item 3 – Defaults Upon Senior Securities – None.

Item 4 – Mine Safety Disclosures – Not applicable.

Item 5 – Other Information – None.

Item 6 – Exhibits

3.1 Amended and Restated Certificate of Incorporation of the Company. Incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the SEC on August 10, 2011 (File No. 000-19291).

3.2 Amended and Restated Bylaws of the Company. Incorporated herein by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006 filed with the SEC on August 14, 2006 (File No. 000-19291).

3.3 Certification of Designation Increasing the Number of Shares of Series A Junior Participating Preferred Stock. Incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the SEC on November 24, 2008 (File No. 000-19291).

10.1 Seventh Amendment to Credit Agreement dated September 1, 2016 by and between CorVel Corporation and Wells Fargo Bank, National Association. Incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on September 2, 2016 (File No. 000-19291).

10.2 Revolving Line of Credit Note dated September 1, 2016 by CorVel Corporation in favor of Wells Fargo Bank, National Association. Incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on September 2, 2016 (File No. 000-19291).

31.1 Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

32.2 Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

101.0 The following materials from the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2016, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets as of September 30, 2016 and March 31, 2016; (ii) Consolidated Statements of Income for the three and six months ended September 30, 2015 and 2016; (iii) Consolidated Statements of Cash Flows for the six months ended September 30, 2015 and 2016; and (iv) Notes to Consolidated Financial Statements.

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 hereunto duly authorized.

CORVEL CORPORATION

By: /s/ V. Gordon Clemons, Sr.
V. Gordon Clemons, Sr.,
Chairman of the Board,

President and Chief Executive Officer

By: /s/ Richard J. Schweppe
Richard J. Schweppe,
Chief Financial Officer

November 4, 2016