
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: June 30, 2008

or

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

For the transition period from _____ to _____

Commission File Number: 1-12718

HEALTH NET, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

95-4288333
(I.R.S. Employer
Identification No.)

21650 Oxnard Street, Woodland Hills, CA
(Address of principal executive offices)

91367
(Zip Code)

(818) 676-6000

(Registrant's telephone number, including area code)
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

The number of shares outstanding of the registrant's Common Stock as of August 1, 2008 was 107,326,977 (excluding 36,391,798 shares held as treasury stock).

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

HEALTH NET, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
REVENUES				
Health plan services premiums	\$3,114,168	\$2,811,186	\$6,237,156	\$5,588,445
Government contracts	694,885	613,865	1,359,334	1,221,860
Net investment income	20,931	27,884	56,302	59,248
Administrative services fees and other income	11,516	11,243	25,464	23,537
Total revenues	<u>3,841,500</u>	<u>3,464,178</u>	<u>7,678,256</u>	<u>6,893,090</u>
EXPENSES				
Health plan services (excluding depreciation and amortization)	2,655,066	2,381,279	5,443,469	4,722,353
Government contracts	658,255	570,518	1,295,832	1,137,617
General and administrative	297,475	270,003	649,753	561,288
Selling	88,243	76,842	174,835	145,971
Depreciation and amortization	13,073	9,013	25,352	16,646
Interest	11,316	7,824	21,973	17,384
Total expenses	<u>3,723,428</u>	<u>3,315,479</u>	<u>7,611,214</u>	<u>6,601,259</u>
Income from operations before income taxes	118,072	148,699	67,042	291,831
Income tax provision	41,394	56,669	26,044	111,216
Net income	<u>\$ 76,678</u>	<u>\$ 92,030</u>	<u>\$ 40,998</u>	<u>\$ 180,615</u>
Net income per share:				
Basic	\$ 0.71	\$ 0.82	\$ 0.38	\$ 1.61
Diluted	\$ 0.71	\$ 0.80	\$ 0.37	\$ 1.57
Weighted average shares outstanding:				
Basic	107,308	112,122	108,276	112,047
Diluted	108,338	114,808	109,772	114,785

See accompanying condensed notes to consolidated financial statements.

HEALTH NET, INC.
CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except per share data)

	<u>June 30, 2008</u>	<u>December 31, 2007</u>
	<u>(Unaudited)</u>	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 760,648	\$ 1,007,017
Investments—available for sale (amortized cost: 2008—\$1,532,362; 2007— \$1,557,411)	1,514,421	1,557,278
Premiums receivable, net of allowance for doubtful accounts (2008—\$10,093; 2007—\$6,724)	400,918	264,691
Amounts receivable under government contracts	262,877	189,976
Incurred but not reported (IBNR) health care costs receivable under TRICARE North contract	280,801	266,767
Other receivables	92,310	72,518
Deferred taxes	107,478	132,818
Other assets	223,326	210,039
Total current assets	3,642,779	3,701,104
Property and equipment, net	234,423	178,758
Goodwill	751,949	751,949
Other intangible assets, net	101,216	109,386
Deferred taxes	55,096	47,765
Other noncurrent assets	135,896	144,093
Total Assets	<u>\$ 4,921,359</u>	<u>\$ 4,933,055</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Reserves for claims and other settlements	\$ 1,357,756	\$ 1,300,432
Health care and other costs payable under government contracts	78,341	69,014
IBNR health care costs payable under TRICARE North contract	280,801	266,767
Unearned premiums	190,204	176,981
Borrowings under amortizing financing facility	26,028	35,000
Accounts payable and other liabilities	327,782	463,823
Total current liabilities	2,260,912	2,312,017
Senior notes payable	398,173	398,071
Borrowings under amortizing financing facility	117,984	112,363
Borrowings under revolving credit facility	145,000	—
Other noncurrent liabilities	215,199	235,022
Total Liabilities	<u>3,137,268</u>	<u>3,057,473</u>
Commitments and contingencies		
Stockholders' Equity:		
Preferred stock (\$0.001 par value, 10,000 shares authorized, none issued and outstanding)	—	—
Common stock (\$0.001 par value, 350,000 shares authorized; issued 2008—143,717 shares; 2007—143,477 shares)	144	144
Additional paid-in capital	1,172,988	1,151,251
Treasury common stock, at cost (2008—36,390 shares of common stock; 2007— 33,178 shares of common stock)	(1,267,192)	(1,123,750)
Retained earnings	1,890,095	1,849,097
Accumulated other comprehensive loss	(11,944)	(1,160)
Total Stockholders' Equity	<u>1,784,091</u>	<u>1,875,582</u>
Total Liabilities and Stockholders' Equity	<u>\$ 4,921,359</u>	<u>\$ 4,933,055</u>

See accompanying condensed notes to consolidated financial statements.

HEALTH NET, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Amounts in thousands)
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Common Stock Held in Treasury Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance as of January 1, 2007	140,690	\$140	\$1,027,878	(28,815)	\$ (891,294)	\$1,653,478	\$(11,237)	\$1,778,965
Implementation of FIN 48						1,922		1,922
Adjusted balance as of January 1, 2007	140,690	\$140	\$1,027,878	(28,815)	\$ (891,294)	\$1,655,400	\$(11,237)	\$1,780,887
Comprehensive income:								
Net income						180,615		180,615
Change in unrealized loss on investments, net of tax impact of \$5,900							(9,091)	(9,091)
Defined benefit pension plans:								
Prior service cost and net loss							174	174
Total comprehensive income								
Exercise of stock options and issuance of shares	1,669	3	42,646					171,698
Share-based compensation expense			11,764					42,649
Tax benefit related to equity compensation plans			18,314					11,764
Repurchases of common stock and accelerated stock repurchase settlement	133		(125)	(1,400)	(75,397)			18,314
Forfeiture of restricted stock	(3)		(88)					(75,522)
Amortization of restricted stock grants			91					(88)
Balance as of June 30, 2007	142,489	\$143	\$1,100,480	(30,215)	\$ (966,691)	\$1,836,015	\$(20,154)	\$1,949,793
Balance as of January 1, 2008	143,477	\$144	\$1,151,251	(33,178)	\$(1,123,750)	\$1,849,097	\$ (1,160)	\$1,875,582
Comprehensive income:								
Net income						40,998		40,998
Change in unrealized loss on investments, net of tax impact of \$6,878							(10,931)	(10,931)
Defined benefit pension plans:								
Prior service cost and net loss							147	147
Total comprehensive income								
Exercise of stock options and issuance of shares	240		6,445					30,214
Share-based compensation expense			14,558					6,445
Tax benefit related to equity compensation plans			732					14,558
Repurchases of common stock and accelerated stock repurchase settlement				(3,212)	(143,442)			732
Amortization of restricted stock grants								(143,442)
Balance as of June 30, 2008	143,717	\$144	\$1,172,988	(36,390)	\$(1,267,192)	\$1,890,095	\$(11,944)	\$1,784,091

See accompanying condensed notes to consolidated financial statements.

HEALTH NET, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)
(Unaudited)

	Six Months Ended June 30,	
	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 40,998	\$ 180,615
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Amortization and depreciation	25,352	16,646
Share-based compensation expense	14,555	11,769
Deferred income taxes	(24,887)	67,758
Excess tax benefit on share-based compensation	(780)	(14,188)
Other changes	521	(4,577)
Changes in assets and liabilities, net of effects of dispositions or acquisitions:		
Premiums receivable and unearned premiums	(123,004)	222,269
Other current assets, receivables and noncurrent assets	18,987	4,659
Amounts receivable/payable under government contracts	(63,574)	(28,421)
Reserves for claims and other settlements	57,324	35,665
Accounts payable and other liabilities	(143,317)	(12,512)
Net cash (used in) provided by operating activities	(197,825)	479,683
CASH FLOWS FROM INVESTING ACTIVITIES:		
Sales of investments	550,766	470,546
Maturities of investments	136,632	106,734
Purchases of investments	(674,626)	(610,045)
Sales of property and equipment	4	96,748
Purchases of property and equipment	(74,843)	(33,023)
Cash paid related to the acquisition of assets and businesses	—	(80,277)
Sales and purchases of restricted investments and other	13,109	(39,562)
Net cash used in investing activities	(48,958)	(88,879)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options and employee stock purchases	6,401	42,601
Excess tax benefit on share-based compensation	780	14,188
Repurchases of common stock	(143,045)	(69,784)
Proceeds from issuance of senior notes	—	393,535
Borrowings under revolving credit facility	145,000	100,000
Repayment of borrowings	(8,722)	(600,000)
Net cash provided by (used in) financing activities	414	(119,460)
Net (decrease) increase in cash and cash equivalents	(246,369)	271,344
Cash and cash equivalents, beginning of year	1,007,017	704,806
Cash and cash equivalents, end of period	\$ 760,648	\$ 976,150
SUPPLEMENTAL CASH FLOWS DISCLOSURE:		
Interest paid	\$ 15,277	\$ 25,836
Income taxes paid	56,416	70,208

See accompanying condensed notes to consolidated financial statements.

HEALTH NET, INC.
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

Health Net, Inc. (referred to herein as Health Net, the Company, we, us or our) prepared the accompanying unaudited consolidated financial statements following the rules and regulations of the Securities and Exchange Commission (SEC) for interim reporting. As permitted under those rules and regulations, certain notes or other financial information that are normally required by accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted if they substantially duplicate the disclosures contained in the annual audited financial statements. The accompanying unaudited consolidated financial statements should be read together with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2007 (Form 10-K).

We are responsible for the accompanying unaudited consolidated financial statements. These consolidated financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of our financial position and operating results in accordance with GAAP. In accordance with GAAP, we make certain estimates and assumptions that affect the reported amounts. Actual results could differ from those estimates and assumptions.

Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be indicative of those for the full year.

Certain items presented in the operating cash flow section of the consolidated statements of cash flows for the six months ended June 30, 2007 have been reclassified within the operating cash flow section. This reclassification had no impact on our operating cash flows, net earnings or balance sheets as previously reported.

2. SIGNIFICANT ACCOUNTING POLICIES

Comprehensive Income

Our comprehensive income is as follows:

	<u>Three Months Ended</u> <u>June 30,</u>		<u>Six Months Ended</u> <u>June 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	(Dollars in millions)			
Net income	\$ 76.7	\$92.0	\$ 41.0	\$180.6
Other comprehensive income, net of tax:				
Net change in unrealized depreciation on investments available for sale	(12.6)	(8.8)	(10.9)	(9.1)
Defined benefit pension plans: Prior service cost and net loss amortization	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.2</u>
Comprehensive income	<u>\$ 64.2</u>	<u>\$83.3</u>	<u>\$ 30.2</u>	<u>\$171.7</u>

Earnings Per Share

Basic earnings per share excludes dilution and reflects net income divided by the weighted average shares of common stock outstanding during the periods presented. Diluted earnings per share is based upon the weighted average shares of common stock and dilutive common stock equivalents (this reflects the potential dilution that could occur if stock options were exercised and restricted stock units (RSUs) and restricted shares were vested) outstanding during the periods presented.

Common stock equivalents arising from dilutive stock options, restricted common stock and RSUs are computed using the treasury stock method. For the three and six months ended June 30, 2008, these amounted to 1,030,000 and 1,496,000 shares, respectively, which included 239,000 and 286,000 common stock equivalents from dilutive RSUs and restricted common stock. There were 2,686,000 and 2,738,000 shares of common stock equivalents, including 225,000 and 191,000 RSUs and restricted common stock equivalents, for the three and six months ended June 30, 2007, respectively.

Options to purchase an aggregate of 3,120,000 and 1,573,000 shares of common stock, during the three and six months ended June 30, 2008, respectively, and 726,000 and 1,255,000, during the three and six months ended June 30, 2007, respectively, were considered anti-dilutive and were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common stock for each respective period. These options expire at various times through June 2018.

We are authorized to repurchase our common stock under a \$700 million stock repurchase program authorized by our Board of Directors. The remaining authorization under our stock repurchase program as of June 30, 2008 was \$203.3 million (see Note 5).

Goodwill and Other Intangible Assets

The carrying amount of goodwill by reporting unit is as follows:

	<u>Health Plan Services</u>	<u>Total</u>
	(Dollars in millions)	
Balance as of June 30, 2008 and December 31, 2007	<u>\$752.0</u>	<u>\$752.0</u>

The intangible assets that continue to be subject to amortization using the straight-line method over their estimated lives are as follows:

	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net Balance</u>	<u>Weighted Average Life (in years)</u>
	(Dollars in millions)			
As of June 30, 2008:				
Provider networks	\$ 40.5	\$(29.0)	\$ 11.5	19.4
Employer groups	76.8	(12.3)	64.5	6.5
Customer relationships and other	29.5	(6.2)	23.3	11.1
Trade name	3.1	(2.2)	0.9	1.5
Covenant not-to-compete	2.2	(1.2)	1.0	2.0
	<u>\$152.1</u>	<u>\$(50.9)</u>	<u>\$101.2</u>	
As of December 31, 2007:				
Provider networks	\$ 40.5	\$(27.7)	\$ 12.8	19.4
Employer groups	75.0	(6.5)	68.5	6.5
Customer relationships and other	29.5	(4.9)	24.6	11.1
Trade name	3.1	(1.2)	1.9	1.5
Covenant not-to-compete	2.2	(0.6)	1.6	2.0
	<u>\$150.3</u>	<u>\$(40.9)</u>	<u>\$109.4</u>	

We performed our annual impairment test on our goodwill and other intangible assets as of June 30, 2008 for our health plan services reporting unit and also re-evaluated the useful lives of our other intangible assets. No

goodwill impairment was identified in our health plan services reporting unit. We also determined that the estimated useful lives of our other intangible assets properly reflected the current estimated useful lives.

Estimated annual pretax amortization expense for other intangible assets for the current year and each of the next four years ending December 31 are as follows (dollars in millions):

<u>Year</u>	<u>Amount</u>
2008	\$19.3
2009	16.8
2010	16.3
2011	16.0
2012	15.6

Restricted Assets

We and our consolidated subsidiaries are required to set aside certain funds which may only be used for certain purposes pursuant to state regulatory requirements. We have discretion as to whether we invest such funds in cash and cash equivalents or other investments. As of June 30, 2008 and December 31, 2007, our restricted cash and cash equivalents balances totaled \$51.1 million and \$30.5 million, respectively, and are included in other noncurrent assets. Investment securities held by trustees or agencies were \$68.0 million and \$79.3 million as of June 30, 2008 and December 31, 2007, respectively, and are included in investments available-for-sale.

In connection with our purchase of The Guardian Life Insurance Company of America's interest in the HealthCare Solutions business in 2007, we established escrowed funds to secure the payment of projected run-out claims for the purchased block of business. As of June 30, 2008 and December 31, 2007, this restricted cash balance amounted to \$16.9 million and \$37.0 million, respectively, and is included in other noncurrent assets on the accompanying consolidated balance sheets.

Interest Rate Swap Contracts

On December 19, 2007, we entered into a five-year, \$175 million amortizing financing facility with a non-U.S. lender (see Note 6). In connection with the financing facility, we entered into an interest rate swap agreement under which we pay an amount equal to LIBOR times a notional principal amount and receive in return an amount equal to 4.3% times the same notional principal amount. The interest rate swap does not qualify for hedge accounting. Accordingly, the interest rate swap is reflected at positive fair value of \$1.6 million in our consolidated balance sheet with an offset to net investment income in our consolidated statement of operations for the change in fair value during the three and six months ended June 30, 2008.

CMS Risk Factor Adjustments

We have an arrangement with the Centers for Medicare & Medicaid Services (CMS) for certain of our Medicare products whereby periodic changes in our risk factor adjustment scores for certain diagnostic codes result in changes to our health plan services premium revenues. We recognize such changes when the amounts become determinable and supportable and collectibility is reasonably assured.

We recognized \$48.4 million and \$89.3 million of favorable Medicare risk factor estimates, most of which were for the 2008 payment years in our health plan services premium revenues for the three and six months ended June 30, 2008, respectively. We also recognized \$10.9 million and \$23.5 million of capitation expense related to the Medicare risk factor estimates, most of which were for the 2008 payment years in our health plan services costs for the three and six months ended June 30, 2008, respectively.

We recognized \$22.7 million and \$49.2 million of favorable Medicare risk factor estimates in our health plan services premium revenues for the three and six months ended June 30, 2007, respectively. Of these amounts, \$3.8 million and \$13.6 million for the three and six months ended June 30, 2007, respectively, were for 2006 and prior payment years. We also recognized \$6.4 million and \$15.0 million of capitation expense related to the Medicare risk factor estimates in our health plan services costs for the three and six months ended June 30, 2007, respectively. Of these amounts, \$1.4 million and \$4.7 million for the three and six months ended June 30, 2007, respectively, were for 2006 and prior payment years.

TRICARE Contract Target Costs

Our TRICARE contract for the North Region includes a target cost and price for reimbursed health care costs which is negotiated annually during the term of the contract, with underruns and overruns of our target cost borne 80% by the government and 20% by us. In the normal course of contracting with the federal government, we recognize changes in our estimate for the target cost underruns and overruns when the amounts become determinable, supportable and the collectibility is reasonably assured. During the three and six months ended June 30, 2008, we recognized increases in the revenue estimate of \$4.2 million and \$0.2 million and in the cost estimate an increase of \$5.2 million and decrease of \$0.3 million, respectively. During the three and six months ended June 30, 2007, we recognized decreases in the revenue estimate of \$19 million and \$62 million and decreases in the cost estimate of \$24 million and \$78 million, respectively.

Recently Issued Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 161, *Disclosures about Derivative Instruments and Hedging Activities-an amendment of SFAS No. 133* (SFAS No. 161). This statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. This statement requires that objectives for using derivative instruments be disclosed in terms of underlying risks and accounting designation. Fair values of derivatives and their gains and losses are required to be disclosed in a tabular format. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We do not expect the adoption of SFAS No. 161 as of January 1, 2009 to have a material impact on our financial statements.

3. SEGMENT INFORMATION

We operate within two reportable segments: Health Plan Services and Government Contracts. Our Health Plan Services reportable segment includes the operations of our commercial, Medicare (including Part D) and Medicaid health plans, the operations of our health and life insurance companies and our behavioral health and pharmaceutical services subsidiaries. Our Government Contracts reportable segment includes government-sponsored managed care plans through the TRICARE program and other health care-related government contracts. Our Government Contracts segment administers one large, multi-year managed health care government contract and other health care related government contracts.

We evaluate performance and allocate resources based on segment pretax income. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies in Note 2 to the consolidated financial statements included in our Form 10-K, except that intersegment transactions are not eliminated. We include investment income, administrative services fees and other income and expenses associated with our corporate shared services and other costs in determining our Health Plan Services segment's pretax income to reflect the fact that these revenues and expenses are primarily used to support our Health Plan Services reportable segment.

Our segment information is as follows:

	<u>Health Plan Services</u>	<u>Government Contracts</u>	<u>Eliminations</u>	<u>Total</u>
	(Dollars in millions)			
Three Months Ended June 30, 2008				
Revenues from external sources	\$3,114.2	\$ 694.9	\$ —	\$3,809.1
Intersegment revenues	12.9	—	(12.9)	—
Segment pretax income	81.5	36.6	—	118.1
Three Months Ended June 30, 2007				
Revenues from external sources	\$2,811.2	\$ 613.9	\$ —	\$3,425.1
Intersegment revenues	2.3	—	(2.3)	—
Segment pretax income	105.4	43.3	—	148.7
Six Months Ended June 30, 2008				
Revenues from external sources	\$6,237.2	\$1,359.3	\$ —	\$7,596.5
Intersegment revenues	28.2	—	(28.2)	—
Segment pretax income	3.5	63.5	—	67.0
Six Months Ended June 30, 2007				
Revenues from external sources	\$5,588.4	\$1,221.9	\$ —	\$6,810.3
Intersegment revenues	4.5	—	(4.5)	—
Segment pretax income	207.6	84.2	—	291.8

Our health plan services premium revenue by line of business is as follows:

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	(Dollars in millions)			
Commercial premium revenue	\$1,950.8	\$1,820.0	\$3,922.3	\$3,597.5
Medicare premium revenue	899.5	693.4	1,792.2	1,398.2
Medicaid premium revenue	263.9	297.8	522.7	592.7
Total Health Plan Services premiums	<u>\$3,114.2</u>	<u>\$2,811.2</u>	<u>\$6,237.2</u>	<u>\$5,588.4</u>

4. PURCHASE OF PROPERTY AND EQUIPMENT

On June 30, 2005, we entered into a sale-leaseback transaction with an independent third party. Pursuant to the terms of the agreement, we sold certain of our non-real estate fixed assets with a net book value of \$76.5 million as of June 30, 2005 for the sale price of \$80 million (less approximately \$1.0 million in certain costs and expenses) and simultaneously leased such assets under an operating lease for a term of three years. On June 30, 2008, at the expiration of the operating lease, we elected to purchase the leased assets for the purchase price of \$46.4 million, which are included as part of property and equipment on our consolidated balance sheet as of June 30, 2008.

5. STOCK REPURCHASE PROGRAM

On October 26, 2007, our Board of Directors increased the size of our stock repurchase program by \$250 million, bringing the total amount of the program to \$700 million. Subject to Board approval, additional amounts are added to the repurchase program from time to time based on exercise proceeds and tax benefits the Company receives from employee stock options. We repurchased 3,199,100 shares during the three months ended March 31, 2008 for aggregate consideration of approximately \$143 million. We did not repurchase any shares under the stock repurchase program during the three months ended June 30, 2008.

The remaining authorization under our stock repurchase program as of June 30, 2008 was \$203.3 million. As of June 30, 2008, we had repurchased a cumulative aggregate of 32,970,852 shares of our common stock under our stock repurchase program at an average price of \$35.18 for aggregate consideration of \$1,159.8 million (which amount includes exercise proceeds and tax benefits the Company had received from the exercise of employee stock options). We used net free cash available to fund the share repurchases.

6. FINANCING ARRANGEMENTS

Amortizing Financing Facility

On December 19, 2007, we entered into a five-year, non-interest bearing, \$175 million amortizing financing facility with a non-U.S. lender, and on April 29, 2008, we entered into an amendment to the financing facility, which was administrative in nature. In connection with the financing facility, we entered into an interest rate swap agreement (see Note 2). Under the interest rate swap agreement, we pay an amount equal to LIBOR times a notional principal amount and receive in return an amount equal to 4.3% times the same notional principal amount. The financing facility requires one of our subsidiaries to pay semi-annual distributions, in the amount of \$17.5 million, to a participant in the financing facility. Unless terminated earlier, the final payment under the facility is scheduled to be made on December 19, 2012. The financing facility also provides that the financing facility may be terminated through a series of put and call transactions: (1) at the option of one of our wholly-owned subsidiaries at any time after December 20, 2009, or (2) upon the occurrence of certain defined acceleration events.

The financing facility includes limitations (subject to specified exclusions) on our and certain of our subsidiaries' ability to incur debt; create liens; engage in certain mergers, consolidations and acquisitions; engage in transactions with affiliates; enter into agreements which will restrict the ability to pay dividends or other distributions with respect to any shares of capital stock or the ability to make or repay loans or advances; make dividends; and alter the character of the business we and our subsidiaries conducted on the closing date of the financing facility. In addition, the financing facility also requires that we maintain a specified consolidated leverage ratio and consolidated fixed charge coverage ratio throughout the term of the financing facility. As of June 30, 2008, we were in compliance with all of the covenants under the financing facility.

Senior Notes

On May 18, 2007, we issued \$300 million in aggregate principal amount of 6.375% Senior Notes due 2017. On May 31, 2007, we issued an additional \$100 million of 6.375% Senior Notes due 2017 which were consolidated with, and constitute the same series as, the Senior Notes issued on May 18, 2007 (collectively, Senior Notes). The aggregate net proceeds from the issuance of the Senior Notes were \$393.5 million and were used to repay outstanding debt.

The indenture governing the Senior Notes limits our ability to incur certain liens, or consolidate, merge or sell all or substantially all of our assets. In the event of the occurrence of both (1) a change of control of Health Net, Inc. and (2) a below investment grade rating by any two of Fitch, Inc., Moody's Investors Service, Inc. and Standard & Poor's Ratings Services within a specified period, we will be required to make an offer to purchase the Senior Notes at a price equal to 101% of the principal amount of the Senior Notes plus accrued and unpaid interest to the date of repurchase. As of June 30, 2008, no default or event of default had occurred under the indenture governing the Senior Notes.

The Senior Notes may be redeemed in whole at any time or in part from time to time, prior to maturity at our option, at a redemption price equal to the greater of:

- 100% of the principal amount of the Senior Notes then outstanding to be redeemed; or
- the sum of the present values of the remaining scheduled payments of principal and interest on the Senior Notes to be redeemed (not including any portion of such payments of interest accrued to the date of redemption) discounted to the date of redemption on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the applicable treasury rate plus 30 basis points

plus, in each case, accrued and unpaid interest on the principal amount being redeemed to the redemption date.

Each of the following will be an Event of Default under the indenture governing the Senior Notes:

- failure to pay interest for 30 days after the date payment is due and payable, provided that an extension of an interest payment period by us in accordance with the terms of the Senior Notes shall not constitute a failure to pay interest;
- failure to pay principal or premium, if any, on any note when due, either at maturity, upon any redemption, by declaration or otherwise;
- failure to perform any other covenant or agreement in the notes or indenture for a period of 60 days after notice that performance was required;
- (A) our failure or the failure of any of our subsidiaries to pay indebtedness for money we borrowed or any of our subsidiaries borrowed in an aggregate principal amount of at least \$50,000,000, at the later of final maturity and the expiration of any related applicable grace period and such defaulted payment shall not have been made, waived or extended within 30 days after notice or (B) acceleration of the maturity of indebtedness for money we borrowed or any of our subsidiaries borrowed in an aggregate principal amount of at least \$50,000,000, if that acceleration results from a default under the instrument giving rise to or securing such indebtedness for money borrowed and such indebtedness has not been discharged in full or such acceleration has not been rescinded or annulled within 30 days after notice; or
- events in bankruptcy, insolvency or reorganization of our Company.

Revolving Credit Facility

On June 25, 2007, we entered into a \$900 million five-year revolving credit facility with Bank of America, N.A. as Administrative Agent, Swingline Lender, and L/C Issuer, and the other lenders party thereto. We entered into an amendment to the credit facility on April 29, 2008, which was administrative in nature. As of June 30, 2008, the maximum amount available for borrowing under the revolving credit facility was \$629.9 million (see “—Letters of Credit” below).

Amounts outstanding under our revolving credit facility will bear interest, at our option, at (a) the base rate, which is a rate per annum equal to the greater of (i) the federal funds rate plus one-half of one percent and (ii) Bank of America’s prime rate (as such term is defined in the facility), (b) a competitive bid rate solicited from the syndicate of banks, or (c) the British Bankers Association LIBOR rate (as such term is defined in the facility), plus an applicable margin, which is initially 70 basis points per annum and is subject to adjustment according to our credit ratings, as specified in the facility.

Our revolving credit facility includes, among other customary terms and conditions, limitations (subject to specified exclusions) on our and our subsidiaries’ ability to incur debt; create liens; engage in certain mergers, consolidations and acquisitions; sell or transfer assets; enter into agreements which restrict the ability to pay dividends or make or repay loans or advances; make investments, loans, and advances; engage in transactions with affiliates; and make dividends. In addition, we are required to maintain a specified consolidated leverage ratio and consolidated fixed charge coverage ratio throughout the term of the revolving credit facility.

Our revolving credit facility contains customary events of default, including nonpayment of principal or other amounts when due; breach of covenants; inaccuracy of representations and warranties; cross-default and/or cross-acceleration to other indebtedness of the Company or our subsidiaries in excess of \$50 million; certain ERISA-related events; noncompliance by us or any of our subsidiaries with any material term or provision of the HMO Regulations or Insurance Regulations (as each such term is defined in the facility); certain voluntary and involuntary bankruptcy events; inability to pay debts; undischarged, uninsured judgments greater than \$50 million against us and/or our subsidiaries; actual or asserted invalidity of any loan document; and a change of control. If an event of default occurs and is continuing under the credit facility, the lenders thereunder may, among other things, terminate their obligations under the facility and require us to repay all amounts owed thereunder.

Letters of Credit

We can obtain letters of credit in an aggregate amount of \$400 million under our revolving credit facility. The maximum amount available for borrowing under our revolving credit facility is reduced by the dollar amount of any outstanding letters of credit. As of June 30, 2008 and December 31, 2007, we had outstanding letters of credit for \$125.1 million and \$120.8 million, respectively, resulting in the maximum amount available for borrowing under the revolving credit facility of \$629.9 million and \$779.2 million, respectively. As of June 30, 2008 and December 31, 2007, no amounts have been drawn on any of these letters of credit.

7. FAIR VALUE MEASUREMENTS

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which we adopted on January 1, 2008. SFAS No. 157 does not require any new fair value measurements, but it defines fair value, establishes a framework for measuring fair value in accordance with existing GAAP, and expands disclosures about fair value measurements. Assets and liabilities recorded at fair value in the consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value and the level of market price observability.

Investments measured and reported at fair value using Level inputs, as defined by SFAS No. 157, are classified and disclosed in one of the following categories:

Level 1—Quoted prices are available in active markets for identical investments as of the reporting date. The type of investments included in Level I include U.S. treasury securities and listed equities. As required by SFAS No. 157, we do not adjust the quoted price for these investments, even in situations where we hold a large position and a sale could reasonably impact the quoted price.

Level 2—Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies. Investments that are generally included in this category include asset-backed securities, corporate bonds and loans, municipal bonds, auction rate securities and interest rate swap asset.

Level 3—Pricing inputs are unobservable for the investment and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require significant management judgment or estimation.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the investment.

The following table presents information about our assets and liabilities measured at fair value on a recurring basis at June 30, 2008, and indicate the fair value hierarchy of the valuation techniques utilized by us to determine such fair value.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	(Dollars in millions)			
Assets:				
Investments—available for sale				
Asset-backed securities	—	\$ 621.5	—	\$ 621.5
U.S. government and agencies	\$47.1	43.3	—	90.4
Obligations of states and other political subdivisions	—	511.8	\$10.3	522.1
Corporate debt securities	—	278.5	—	278.5
Other securities	1.9	—	—	1.9
	<u>\$49.0</u>	<u>\$1,455.1</u>	<u>\$10.3</u>	<u>\$1,514.4</u>
Interest rate swap asset	—	1.6	—	1.6
Total assets at fair value	<u>\$49.0</u>	<u>\$1,456.7</u>	<u>\$10.3</u>	<u>\$1,516.0</u>

The changes in the balances of Level 3 financial assets for the three and six months ended June 30, 2008 were as follows (dollars in millions):

	Three Months Ended	Six Months Ended
	<u>June 30, 2008</u>	
Beginning balance	\$ 21.8	\$ —
Total gains and losses		
Realized in net income	—	—
Unrealized in accumulated other comprehensive income	—	—
Purchases, sales, issuances and settlements	(11.5)	(11.5)
Transfers into Level 3	—	21.8
Ending balance at June 30, 2008	<u>\$ 10.3</u>	<u>\$ 10.3</u>
Change in unrealized gains (losses) included in net income related to assets still held	\$ —	\$ —

During the six months ended June 30, 2008, certain auction rate securities experienced “failed” auctions. As a result, these securities’ fair value could not be estimated based on observable market prices and unobservable inputs were used.

8. LEGAL PROCEEDINGS

Class Action Litigation

McCoy v. Health Net, Inc. et al, Wachtel v. Health Net, Inc., et al and Scharfman, et al v. Health Net, Inc., et al.

These three lawsuits are styled as nationwide class actions. *McCoy* and *Wachtel* were pending in the United States District Court for the District of New Jersey on behalf of a class of subscribers in a number of our large and small employer group plans. The *Wachtel* complaint initially was filed as a single plaintiff case in New Jersey State court on July 23, 2001. Subsequently, we removed the *Wachtel* complaint to federal court, and plaintiffs amended their complaint to assert claims on behalf of a class of subscribers in small employer group plans in New Jersey on December 4, 2001. The *McCoy* complaint was filed on April 23, 2003 and asserted claims on behalf of a nationwide class of Health Net subscribers. These two cases were consolidated for purposes of trial. Plaintiffs alleged that Health Net, Inc., Health Net of the Northeast, Inc. and Health Net of New Jersey, Inc. violated the Employee Retirement Income Security Act of 1974 (ERISA) in connection with various practices related to the reimbursement of claims for services provided by out-of-network (ONET) providers. Plaintiffs sought relief in the form of payment of additional benefits, injunctive and other equitable relief, and attorneys’ fees.

In September 2006, the District Court in *McCoy/Wachtel* certified two nationwide classes of Health Net subscribers who received medical services or supplies from an out-of-network provider and to whom the defendants paid less than the providers billed charges from 1995 through August 31, 2004. Class notices were mailed and published in various newspapers at the beginning of July 2007.

On January 13, 2005, counsel for the plaintiffs in the *McCoy/Wachtel* actions filed a separate class action against Health Net, Inc., Health Net of the Northeast, Inc., Health Net of New York, Inc. and Health Net Life Insurance Co. captioned *Scharfman, et al. v. Health Net, Inc., et al.*, 05-CV-00301 (FSH)(PS) (United States District Court for the District of New Jersey). On March 12, 2007, the *Scharfman* complaint was amended to add *McCoy* and *Wachtel* as named plaintiffs and to add a non-ERISA claim. The *Scharfman* complaint alleged both ERISA and Racketeer Influenced and Corrupt Organizations Act (RICO) claims based on conduct similar to that alleged in *McCoy/Wachtel*. The alleged claims in *Scharfman* ran from September 1, 2004 until the present.

Plaintiffs in the *Scharfman* action sought relief in the form of payment of additional benefits, civil penalties, restitution, compensatory, and consequential damages, treble damages, prejudgment interest and costs, attorney's fees and injunctive and other equitable relief.

In August 2007, we engaged in mediation with the plaintiffs resulting in an agreement in principle to settle *McCoy, Wachtel and Scharfman*. A final settlement agreement was signed with the plaintiffs on March 13, 2008. The material terms of our settlement agreement with the plaintiffs are as follows: (1) Health Net established a \$175 million cash settlement fund which will be utilized to pay class members, plaintiffs' attorneys' fees and expenses and regulatory remediation of claims up to \$15 million paid by Health Net to members in New Jersey relating to Health Net's failure to comply with specific New Jersey state laws relating to ONET and certain other claims payment practices; (2) Health Net established a \$40 million prove-up fund to compensate eligible class members who can prove that they paid out of pocket for certain ONET claims or who have received balance bills for such services after May 5, 2005; and (3) Health Net will implement various business practice changes relating to its handling of ONET claims, including changes designed to enhance information provided to its members on ONET reimbursements and enhanced reimbursement for certain ONET services. These amounts were accrued for in our consolidated statements of operations for the year ended December 31, 2007, and on January 28, 2008, we deposited \$160 million into an escrow fund to be used, together with interest accrued thereon, as the cash settlement fund referenced above.

On April 24, 2008, the District Court conducted a preliminary fairness hearing and subsequently signed an order on that date preliminarily approving the settlement agreement. Notice of the settlement agreement's terms, as well as class members' rights to opt out of the settlement or object to the settlement, was provided to class members in May 2008. On July 24, 2008, the District Court conducted a final fairness hearing, at which objections to the settlement agreement were presented by certain class members. Immediately following the hearing, the District Court entered an order granting final approval of the settlement agreement.

It is not known at this time whether any appeals of the final approval will be filed. As a result, the settlement of these proceedings is not final and continues to be subject to change until the period for filing timely appeals of the order expires, or such time when any appeals that are filed are exhausted. If any appeals are timely filed, they will be considered by the U.S. Court of Appeals for the Third Circuit. In the event that the Third Circuit were to reverse the District Court's order granting final approval, the parties would attempt to renegotiate the portion(s) of the settlement agreement that were not acceptable to the Third Circuit. If we were unable to reach an agreement that is acceptable to all parties, the District Court and the Third Circuit, these proceedings would continue and the \$160 million in escrowed funds, together with accrued interest, would be returned to us. If the proceedings were to continue, we would continue to defend ourselves vigorously in this litigation. Given the complexity and scope of this litigation it is possible that, if these proceedings were to continue, an unfavorable resolution could have a material adverse effect on our results of operations and/or financial condition, depending, in part, upon our results of operations or cash flow at that time. In addition, the amount involved could be greater than the settlement amount currently agreed to by the parties and approved by the District Court.

Litigation Related to the Sale of Businesses

AmCareco Litigation

We are a defendant in two related litigation matters pending in Louisiana and Texas state courts, both of which relate to claims asserted by three separate state receivers overseeing the liquidation of three health plans in Louisiana, Texas and Oklahoma that were previously owned by our former subsidiary, Foundation Health Corporation (FHC), which merged into Health Net, Inc. in January 2001. In 1999, FHC sold its interest in these plans to AmCareco, Inc. (AmCareco). We retained a minority interest in the three plans after the sale. Thereafter, the three plans became known as AmCare of Louisiana (AmCare-LA), AmCare of Oklahoma (AmCare-OK) and AmCare of Texas (AmCare-TX). In 2002, three years after the sale of the plans to AmCareco, each of the AmCare plans was placed under state oversight and ultimately into receivership. The receivers for each of the

AmCare plans later filed suit against certain of AmCareco's officers, directors and investors, AmCareco's independent auditors and its outside counsel in connection with the failure of the three plans. The three receivers also filed suit against us contending that, among other things, we were responsible as a "controlling shareholder" of AmCareco following the sale of the plans for post-acquisition misconduct by AmCareco and others that caused the three health plans to fail and ultimately be placed into receivership.

The action brought against us by the receiver for AmCare-LA action originally was filed in Louisiana on June 30, 2003. That original action sought only to enforce a parental guarantee that FHC had issued in 1996. The AmCare-LA receiver alleged that the parental guarantee obligated FHC to contribute sufficient capital to the Louisiana health plan to enable the plan to maintain statutory minimum capital requirements. The original action also alleged that the parental guarantee was not terminated by virtue of the 1999 sale of the Louisiana plan. The actions brought against us by AmCare-TX and AmCare-OK originally were filed in Texas state court on June 7, 2004 and included allegations that after the sale to AmCareco we were nevertheless responsible for the mismanagement of the three plans by AmCareco and that the three plans were insolvent at the time of the sale to AmCareco. On September 30, 2004 and October 15, 2004, respectively, the AmCare-TX receiver and the AmCare-OK receiver intervened in the pending AmCare-LA litigation in Louisiana. Thereafter, all three receivers amended their complaints to assert essentially the same claims against us and successfully moved to consolidate their three actions in the Louisiana state court proceeding. The Texas state court ultimately stayed the Texas action and ordered that the parties submit quarterly reports to the Texas court regarding the status of the consolidated Louisiana litigation.

On June 16, 2005, a consolidated trial of the claims asserted against us by the three receivers commenced in state court in Baton Rouge, Louisiana. The claims of the receiver for AmCare-TX were tried before a jury and the claims of the receivers for the AmCare-LA and AmCare-OK were tried before the judge in the same proceeding. On June 30, 2005, the jury considering the claims of the receiver for AmCare-TX returned a verdict against us in the amount of \$117.4 million, consisting of \$52.4 million in compensatory damages and \$65 million in punitive damages. The Court later reduced the compensatory and punitive damages awards to \$36.7 million and \$45.5 million, respectively and entered judgments in those amounts on November 3, 2005. We thereafter filed a motion for suspensive appeal and posted the required security as required by law.

The proceedings regarding the claims of the receivers for AmCare-LA and AmCare-OK concluded on July 8, 2005. On November 4, 2005, the Court issued separate judgments on those claims that awarded \$9.5 million in compensatory damages to AmCare-LA and \$17 million in compensatory damages to AmCare-OK, respectively. The Court later denied requests by AmCare-LA and AmCare-OK for attorneys' fees and punitive damages. We thereafter filed motions for suspensive appeals in connection with both judgments and posted the required security as required by law, and the receivers for AmCare-LA and AmCare-OK each appealed the orders denying them attorneys' fees and punitive damages. Our appeals of the judgments in all three cases have been consolidated in the Louisiana Court of Appeal. On January 17, 2007, the Court of Appeal vacated on procedural grounds the trial court's judgments denying the AmCare-LA and AmCare-OK claims for attorney fees and punitive damages, and referred those issues instead to be considered with the merits of the main appeal pending before it. The Court of Appeal also has considered and ruled on various other preliminary procedural issues related to the main appeal. Oral argument on the appeals was held on October 4, 2007. We are currently waiting on decisions to be rendered by the Court on the various appeals.

On November 3, 2006, we filed a complaint in the U.S. District Court for the Middle District of Louisiana and simultaneously filed an identical suit in the 19th Judicial District Court in East Baton Rouge Parish seeking to nullify the three judgments that were rendered against us on the grounds of ill practice which resulted in the judgments entered. We have alleged that the judgments and other prejudicial rulings rendered in these cases were the result of impermissible ex parte contacts between the receivers, their counsel and the trial court during the course of the litigation. Preliminary motions and exceptions have been filed by the receivers for AmCare-TX, AmCare-OK and AmCare-LA seeking dismissal of our claim for nullification on various grounds. The federal magistrate, after considering the briefs of the parties, found that Health Net had a reasonable basis to infer

possible impropriety based on the facts alleged, but also found that the federal court lacked jurisdiction to hear the nullity action and recommended that the suit be dismissed. The federal judge dismissed Health Net's federal complaint and Health Net appealed to the U.S. Fifth Circuit Court of Appeals. On July 8, the Fifth Circuit issued an opinion affirming the district court's dismissal of the federal complaint, albeit on different legal grounds from those relied upon by the district court. We are presently evaluating what actions to take in response to the Fifth Circuit's ruling. The state court nullity action has been stayed pending the resolution of Health Net's jurisdictional appeal in the federal action.

We have vigorously contested all of the claims asserted against us by the plaintiffs in the consolidated Louisiana actions since they were first filed. We intend to vigorously pursue all avenues of redress in these cases, including the actions for nullification, post-trial motions and appeals, and the prosecution of our pending but stayed cross-claims against other parties. During the three months ended June 30, 2005, we recorded a pretax charge of \$15.9 million representing the estimated legal defense costs for this litigation.

These proceedings are subject to many uncertainties, and, given their complexity and scope, their outcome, including the outcome of any appeal, cannot be predicted at this time. It is possible that in a particular quarter or annual period our results of operations, cash flow and/or liquidity could be materially affected by an ultimate unfavorable resolution of these proceedings depending, in part, upon the results of operations or cash flow for such period. However, at this time, management believes that the ultimate outcome of these proceedings should not have a material adverse effect on our financial condition.

Litigation Relating to Rescission of Policies

In recent years, there has been growing public attention in California to the practices of health plans and health insurers involving the rescission of members' policies for misrepresenting their health status on applications for coverage. On October 23, 2007, the California Department of Managed Health Care (DMHC) and the California Department of Insurance (DOI) announced their intention to issue joint regulations limiting the rights of health plans and insurers to rescind coverage. In addition, effective January 1, 2008, newly enacted legislation in California requires health plans and insurers to pay health care providers who, under certain circumstances, have rendered services to members whose policies are subsequently rescinded. The issue of rescissions has also attracted increasing media attention, and both the DMHC and the DOI have been conducting surveys of the rescission practices of health plans, including ours. Other government agencies, including the Attorney General of California, have indicated that they are investigating, or may be interested in investigating, rescissions and related activities.

On February 20, 2008, the Los Angeles City Attorney filed a complaint against Health Net in the Los Angeles Superior Court relating to our underwriting practices and rescission of certain individual policies. The complaint seeks equitable relief and civil penalties for, among other things, alleged false advertising, violations of unfair competition laws and violations of the California Penal Code.

We are party to arbitrations and litigation, including a putative class action lawsuit filed in April 2008 in Los Angeles Superior Court, in which rescinded members allege that we unlawfully rescinded their coverage. The lawsuits generally seek to recover the cost of medical services that were not paid for as a result of the rescission, and in some cases they also seek damages for emotional distress, attorney fees and punitive damages. On February 21, 2008, we received an arbitration decision in a case involving the rescission of an individual insurance policy. The arbitration decision ordered us to pay approximately \$9.4 million in medical service costs, emotional distress and punitive damages together with attorney's fees in an amount to be awarded at a later date. In the three months ended June 30, 2008, we paid \$9.5 million to the plaintiff, including attorney fees.

We intend to defend ourselves vigorously in each of the cases involving rescission. The cases are subject to many uncertainties, and, given their complexity and scope, their final outcome cannot be predicted at this time. It is possible that in a particular quarter or annual period our results of operations, financial condition and/or liquidity could be materially and adversely affected by an ultimate unfavorable resolution of these cases.

Miscellaneous Proceedings

We have been the subject of a regulatory investigation in New Jersey related principally to the timeliness and accuracy of our claims payment practices for services rendered by out-of-network providers. The regulatory investigation included an audit of our claims payment practices for services rendered by out-of-network providers for 1996 through 2005 in New Jersey. The New Jersey Department of Banking and Insurance (DOBI) informed us that, based on the results of the audit, it would require us to remediate certain claims payments for this period and would assess a regulatory fine against us. In July 2008, we reached an agreement with DOBI regarding most of the claims that would require remediation and had preliminary discussions with DOBI regarding the fine that it expects to impose. We completed remediation of the claims as of August 1, 2008. We expect to reach an agreement on the fine to be assessed and enter into a consent order in the near future. At this time, management believes that the ultimate outcome of this regulatory investigation should not have a material adverse effect on our financial condition and liquidity.

On February 13, 2008, the New York Attorney General (NYAG) announced that his office was conducting an industry-wide investigation into the manner in which health insurers calculate “usual, customary and reasonable” charges for purposes of reimbursing members for out-of-network medical services. The NYAG’s office issued subpoenas to 16 health insurance companies, including us, in connection with this investigation. As described by the NYAG in a press conference on February 13, 2008, the threatened claims appear to be similar in part to those asserted by the plaintiffs in the *McCoy*, *Wachtel* and *Scharfman* cases described above. We responded to the subpoena and are cooperating with the NYAG as appropriate in his investigation. On March 28, 2008, we received a request for voluntary production from the Connecticut Attorney General that sought information similar to that subpoenaed by the NYAG. We responded to the request and are cooperating with the Connecticut Attorney General as appropriate in his investigation.

On September 12, 2007, Health Net of New Jersey (HNNJ) received notification from the New Jersey Division of Medical Assistance and Health Services (NJDMAHS) of its Intent to Impose Liquidated Damages for Provider Network Deficiencies as of September 24, 2007 and that NJDMAHS might impose a daily penalty for each network deficiency (originally \$250/day, potentially to increase to \$500/day). On April 17, 2008, NJDMAHS notified HNNJ that it was withdrawing the Notice of Intent to Impose Liquidated Damages for Provider Network Deficiencies. On November 29, 2007, HNNJ received notification from NJDMAHS of its Intent to Impose Liquidated Damages for Continuity of Care in Lead Case Management and Care Management as of August 15, 2007 in the amount of \$250/day. On December 12, 2007, NJDMAHS notified HNNJ that it was increasing the liquidated damages amount from \$250/day to \$500/day as of December 14, 2007 and until HNNJ had demonstrated that its continuity of care for care management of certain of its populations was in compliance with contractual requirements. On June 2, 2008, HNNJ received notice from NJDMAHS that it had successfully remediated the outstanding identified deficiencies and that the daily penalties would no longer continue to accrue effective as of April 25, 2008.

In the ordinary course of our business operations, we are also subject to periodic reviews by various regulatory agencies with respect to our compliance with a wide variety of rules and regulations applicable to our business, including, without limitation, rules relating to pre-authorization penalties, payment of out-of-network claims and timely review of grievances and appeals, which may result in remediation of certain claims and the assessment of regulatory fines or penalties.

In addition, in the ordinary course of our business operations, we are also party to various other legal proceedings, including, without limitation, litigation arising out of our general business activities, such as contract disputes, employment litigation, wage and hour claims, real estate and intellectual property claims, claims brought by members seeking coverage or additional reimbursement for services allegedly rendered to our members, but which allegedly were either denied, underpaid or not paid, and claims arising out of the acquisition or divestiture of various business units or other assets. We are also subject to claims relating to the performance of contractual obligations to providers, members, employer groups and others, including the alleged failure to

properly pay claims and challenges to the manner in which we process claims. In addition, we are subject to claims relating to the insurance industry in general, such as claims relating to reinsurance agreements and rescission of coverage and other types of insurance coverage obligations.

These other regulatory and legal proceedings are subject to many uncertainties, and, given their complexity and scope, their final outcome cannot be predicted at this time. It is possible that in a particular quarter or annual period our results of operations and cash flow could be materially affected by an ultimate unfavorable resolution of any or all of these other regulatory and legal proceedings depending, in part, upon the results of operations or cash flow for such period. However, at this time, management believes that the ultimate outcome of all of these other regulatory and legal proceedings that are pending, after consideration of applicable reserves and potentially available insurance coverage benefits, should not have a material adverse effect on our financial condition and liquidity.

Potential Settlements

We regularly evaluate litigation matters pending against us, including those described above, to determine if settlement of such matters would be in the best interests of the Company and its stockholders. The costs associated with any such settlement could be substantial and, in certain cases, could result in a significant earnings charge in any particular quarter in which we enter into a settlement agreement. We have recorded reserves and accrued costs for future legal costs for certain significant matters described above. These reserves and accrued costs represent our best estimate of probable loss, including related future legal costs for such matters, both known and incurred but not reported, although our recorded amounts might ultimately be inadequate to cover such costs. Therefore, the costs associated with the various litigation matters to which we are subject and any earnings charge recorded in connection with a settlement agreement could have a material adverse effect on our financial condition or results of operations.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

CAUTIONARY STATEMENTS

The following discussion and other portions of this Quarterly Report on Form 10-Q contain “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (Exchange Act), and Section 27A of the Securities Act of 1933, as amended, regarding our business, financial condition and results of operations. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and we are including this statement for purposes of complying with these safe-harbor provisions. These forward-looking statements involve risks and uncertainties. All statements other than statements of historical information provided or incorporated by reference herein may be deemed to be forward-looking statements. Without limiting the foregoing, the words “believes,” “anticipates,” “plans,” “expects,” “may,” “should,” “could,” “estimate” and “intend” and other similar expressions are intended to identify forward-looking statements. Managed health care companies operate in a highly competitive, constantly changing environment that is significantly influenced by, among other things, aggressive marketing and pricing practices of competitors and regulatory oversight. Factors that could cause our actual results to differ materially from those reflected in forward-looking statements include, but are not limited to, the factors set forth under the heading “Risk Factors” in our Form 10-K and the risks discussed in our other filings from time to time with the SEC.

Any or all forward-looking statements in this Form 10-Q and in any other public filings or statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many of the factors discussed in our filings with the SEC will be important in determining future results. These factors should be considered in conjunction with any discussion of operations or results by us or our representatives, including any forward-looking discussion, as well as comments contained in press releases, presentations to securities analysts or investors or other communications by us. You should not place undue reliance on any forward-looking statements, which reflect management’s analysis, judgment, belief or expectation only as of the date thereof. Except as may be required by law, we undertake no obligation to publicly update or revise any forward-looking statements to reflect events or circumstances that arise after the date of this report.

This Management’s Discussion and Analysis of Financial Condition and Results of Operations should be read in its entirety since it contains detailed information that is important to understanding Health Net, Inc. and its subsidiaries’ results of operations and financial condition.

OVERVIEW

General

We are an integrated managed care organization that delivers managed health care services through health plans and government sponsored managed care plans. We are among the nation’s largest publicly traded managed health care companies. Our mission is to help people be healthy, secure and comfortable. We provide health benefits to approximately 6.7 million individuals across the country through group, individual, Medicare (including the Medicare prescription drug benefit commonly referred to as “Part D”), Medicaid, TRICARE and Veterans Affairs programs. Our behavioral health services subsidiary, MHN, provides behavioral health, substance abuse and employee assistance programs to approximately 6.9 million individuals, including our own health plan members. Our subsidiaries also offer managed health care products related to prescription drugs, and offer managed health care product coordination for multi-region employers and administrative services for medical groups and self-funded benefits programs.

Summary of Key Financial Results

Our total health plan membership increased by 60,000, or 2%, from June 30, 2007 to June 30, 2008. The increase in membership was primarily driven by the addition of 178,000 Medicare Part D stand-alone plan (Medicare Part D) members and 49,000 Medicare Advantage members, and was partially offset by a decline of 58,000 Medicaid members, 57,000 commercial members and 52,000 administrative services only (ASO) members.

Total revenues increased by \$377.3 million, or 11%, in the three months ended June 30, 2008 and by \$785.2 million, or 11%, in the six months ended June 30, 2008 as compared to the same periods in 2007. These increases were primarily driven by an average 7% increase in our health plan services premiums on a per member per month (PMPM) basis and a 13% increase in our government contracts revenue from our TRICARE contract. The increases in the revenues of our operating segments were partially offset by decreases in our net investment income in the second quarter of 2008.

Our diluted earnings per share for the three and six months ended June 30, 2008 were \$0.71 and \$0.37, respectively, compared with \$0.80 and \$1.57, respectively, for the same periods in 2007. Our pretax margin declined in the three months ended June 30, 2008 to 3.1% from 4.3% for the same period in 2007. This decline was primarily due to a 320 basis point increase in the Medicare medical care ratio (MCR) as a result of higher hospital and pharmacy costs and increased utilization. This decline was partially offset by improvements in our commercial and Medicaid MCRs. In the three months ended June 30, 2008, we also recorded a pretax charge of \$13.0 million related to our previously announced operations strategy. Our pretax margin declined in the six months ended June 30, 2008 to 0.9% from 4.2% for the same period in 2007. This decline was primarily due to pretax charges of \$95.5 million recorded in the six months ended June 30, 2008 related to litigation and regulatory matters and our operations strategy. In addition to these charges, during the six months ended June 30, 2008 our operating results were unfavorably impacted by unusual seasonal physician and hospital utilization patterns that occurred primarily in the fourth quarter of 2007, resulting in \$50 million pretax of adverse prior period development; higher than expected utilization in both Medicare Advantage and Medicare Part D plans resulting in a \$24 million pretax impact in the first quarter of 2008; and an unusually active flu season during the first quarter of 2008 resulting in a \$20 million pretax impact on earnings.

Our cash flows from operations decreased to a negative \$(197.8) million for the six months ended June 30, 2008 from a positive \$479.7 million for the same period in 2007. This decrease of \$677.5 million in operating cash flow is primarily as a result of an extra CMS payment received in June 2007 combined with timing of collecting our premiums receivable, including amounts due from CMS for Medicare Part D, and payments related to our operations strategy, legal and regulatory related matters and the other factors discussed above.

How We Report Our Results

We currently operate within two reportable segments, Health Plan Services and Government Contracts, each of which is described below.

Our Health Plan Services reportable segment includes the operations of our commercial, Medicare (including the Medicare prescription drug benefit commonly referred to as “Part D”) and Medicaid health plans, the operations of our health and life insurance companies, and our behavioral health and pharmaceutical services subsidiaries. We have approximately 3.8 million members, including Medicare Part D members and ASO members in our Health Plan Services segment.

Our Government Contracts segment includes our government-sponsored managed care federal contract with the U.S. Department of Defense (the Department of Defense) under the TRICARE program in the North Region and other health care related government contracts that we administer for the Department of Defense. Under the TRICARE contract for the North Region, we provide health care services to approximately 3.0 million Military Health System (MHS) eligible beneficiaries (active duty personnel and TRICARE/Medicare dual eligible beneficiaries), including 1.8 million TRICARE eligibles for whom we provide health care and administrative services and 1.2 million other MHS-eligible beneficiaries for whom we provide ASO.

How We Measure Our Profitability

Our profitability depends in large part on our ability to, among other things, effectively price our health care products; manage health care costs, including reserve estimates and pharmacy costs; contract with health care providers; attract and retain members; and manage our general and administrative (G&A) and selling expenses. In addition, factors such as regulation, competition and general economic conditions affect our operations and profitability. The potential effect of escalating health care costs, as well as any changes in our ability to negotiate competitive rates with our providers, may impose further risks to our ability to profitably underwrite our business, and may have a material impact on our business, financial condition or results of operations.

We measure our Health Plan Services segment profitability based on MCR and pretax income. The MCR is calculated as health plan services expense (excluding depreciation and amortization) divided by health plan services premiums. The pretax income is calculated as health plan services premiums and administrative services fees and other income less health plan services expense and G&A and other net expenses. See “—Results of Operations—Table of Summary Financial Information” for a calculation of our MCR and “—Results of Operations—Health Plan Services Segment Results” for a calculation of our pretax income.

Health plan services premiums include HMO, POS and PPO premiums from employer groups and individuals and from Medicare recipients who have purchased supplemental benefit coverage (which premiums are based on a predetermined prepaid fee), Medicaid revenues based on multi-year contracts to provide care to Medicaid recipients, and revenue under Medicare risk contracts, including Medicare Part D, to provide care to enrolled Medicare recipients. Medicare revenue can also include amounts for risk factor adjustments (see Note 2 to our consolidated financial statements). The amount of premiums we earn in a given year is driven by the rates we charge and enrollment levels. Administrative services fees and other income primarily include revenue for administrative services such as claims processing, customer service, medical management, provider network access and other administrative services. Health plan services expense includes medical and related costs for health services provided to our members, including physician services, hospital and related professional services, outpatient care, and pharmacy benefit costs. These expenses are impacted by unit costs and utilization rates. Unit costs represent the health care cost per visit, and the utilization rates represent the volume of health care consumption by our members.

G&A expenses include those costs related to employees and benefits, consulting and professional fees, marketing, premium taxes and assessments, occupancy costs and litigation and regulatory-related costs. Such costs are driven by membership levels, introduction of new products, system consolidations and compliance requirements for changing regulations. These expenses also include expenses associated with corporate shared services and other costs to reflect the fact that such expenses are incurred primarily to support the Health Plan Services segment. Selling expenses consist of external broker commission expenses and generally vary with premium volume.

We measure our Government Contracts segment profitability based on government contracts cost ratio and pretax income. The government contracts cost ratio is calculated as government contracts cost divided by government contracts revenue. The pretax income is calculated as government contracts revenue less government contracts cost. See “—Results of Operations—Table of Summary Financial Information” for a calculation of our government contracts cost ratio and “—Results of Operations—Government Contracts Segment Results” for a calculation of our pretax income.

Government Contracts revenue is made up of two major components: health care and administrative services. The health care component includes revenue recorded for health care costs for the provision of services to our members, including paid claims and estimated incurred but not reported claims (IBNR) expenses for which we are at risk, and underwriting fees earned for providing the health care and assuming underwriting risk in the delivery of care. The administrative services component encompasses fees received for all other services provided to both the government customer and to beneficiaries, including services such as medical management, claims processing, enrollment, customer services and other services unique to the managed care support contract with the government. Government Contracts revenue and expenses include the impact from underruns and overruns relative to our target cost under the applicable contracts (see Note 2 to our consolidated financial statements).

RESULTS OF OPERATIONS

Table of Summary Financial Information

The table below and the discussion that follows summarize our results of operations for the three and six months ended June 30, 2008 and 2007.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
(Dollars in thousands, except per share and PMPM data)				
REVENUES				
Health plan services premiums	\$3,114,168	\$2,811,186	\$6,237,156	\$5,588,445
Government contracts	694,885	613,865	1,359,334	1,221,860
Net investment income	20,931	27,884	56,302	59,248
Administrative services fees and other income	11,516	11,243	25,464	23,537
Total revenues	<u>3,841,500</u>	<u>3,464,178</u>	<u>7,678,256</u>	<u>6,893,090</u>
EXPENSES				
Health plan services (excluding depreciation and amortization)	2,655,066	2,381,279	5,443,469	4,722,353
Government contracts	658,255	570,518	1,295,832	1,137,617
General and administrative	297,475	270,003	649,753	561,288
Selling	88,243	76,842	174,835	145,971
Depreciation	8,328	6,969	15,886	13,510
Amortization	4,745	2,044	9,466	3,136
Interest	11,316	7,824	21,973	17,384
Total expenses	<u>3,723,428</u>	<u>3,315,479</u>	<u>7,611,214</u>	<u>6,601,259</u>
Income from operations before income taxes	118,072	148,699	67,042	291,831
Income tax provision	41,394	56,669	26,044	111,216
Net income	<u>\$ 76,678</u>	<u>\$ 92,030</u>	<u>\$ 40,998</u>	<u>\$ 180,615</u>
Net income per share:				
Basic	\$ 0.71	\$ 0.82	\$ 0.38	\$ 1.61
Diluted	\$ 0.71	\$ 0.80	\$ 0.37	\$ 1.57
Pretax margin	3.1%	4.3%	0.9%	4.2%
Health plan services medical care ratio (MCR) (a)	85.3%	84.7%	87.3%	84.5%
Government contracts cost ratio (b)	94.7%	92.9%	95.3%	93.1%
G&A expense ratio (c)	9.5%	9.6%	10.4%	10.0%
Selling costs ratio (d)	2.8%	2.7%	2.8%	2.6%
Health plan services premiums per member per month (PMPM) (e)	\$ 278.25	\$ 260.18	\$ 277.71	\$ 259.76
Health plan services costs PMPM (e)	\$ 237.23	\$ 220.39	\$ 242.37	\$ 219.51

- (a) MCR is calculated as health plan services cost divided by health plan services premiums revenue.
- (b) Government contracts cost ratio is calculated as government contracts cost divided by government contracts revenue.
- (c) The G&A expense ratio is computed as G&A expenses divided by the sum of health plan services premiums and administrative services fees and other income.
- (d) The selling costs ratio is computed as selling expenses divided by health plan services premium revenues.
- (e) PMPM is calculated based on total at-risk member months and excludes ASO member months.

Consolidated Segment Results

The following table summarizes the operating results of our reportable segments for the three and six months ended June 30, 2008 and 2007:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars in millions)			
Pretax income:				
Health Plan Services segment	\$ 81.5	\$105.4	\$ 3.5	\$207.6
Government Contracts segment	36.6	43.3	63.5	84.2
Income from operations before income taxes	<u>\$118.1</u>	<u>\$148.7</u>	<u>\$67.0</u>	<u>\$291.8</u>

Health Plan Services Segment Membership

The following table below summarizes our health plan membership information by program and by state at June 30, 2008 and 2007:

	Commercial		ASO		Medicare		Medicaid		Health Plan Total	
	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
	(Membership in thousands)									
Arizona	138	133	—	—	64	48	—	—	202	181
California	1,424	1,438	5	5	126	112	737	708	2,292	2,263
Connecticut	149	169	25	58	57	43	—	85	231	355
New Jersey	78	94	3	18	—	—	44	46	125	158
New York	213	233	11	15	6	9	—	—	230	257
Oregon	139	131	—	—	22	20	—	—	161	151
Other states	—	—	—	—	10	4	—	—	10	4
	<u>2,141</u>	<u>2,198</u>	<u>44</u>	<u>96</u>	<u>285</u>	<u>236</u>	<u>781</u>	<u>839</u>	<u>3,251</u>	<u>3,369</u>
Medicare Part D	—	—	—	—	526	348	—	—	526	348
Total	<u>2,141</u>	<u>2,198</u>	<u>44</u>	<u>96</u>	<u>811</u>	<u>584</u>	<u>781</u>	<u>839</u>	<u>3,777</u>	<u>3,717</u>

Our total health plan membership increased by 60,000, or 2%, from June 30, 2007 to June 30, 2008. The increase in membership was primarily driven by the addition of 178,000 Medicare Part D members and 49,000 Medicare Advantage members, partially offset by a decline of 58,000 Medicaid members, 57,000 commercial members and 52,000 ASO members.

Membership in our commercial health plans decreased by 57,000 members, or 3%, at June 30, 2008 compared to June 30, 2007. This decrease was primarily attributable to our Northeast plans, which experienced a decline of 56,000 commercial members, mostly in the large group. This decrease was partially offset by an increase in our Arizona and Oregon commercial large group membership of 5,000 and 8,000 members, respectively. Our California plan experienced a loss of 42,000 large group members, partially offset by a gain of 28,000 small group and individual members. Our ASO enrollment declined by 52,000 members or 54% at June 30, 2008 compared to June 30, 2007 due to membership losses in our Northeast plans.

Membership in our Medicare Advantage program increased by 49,000 members, or 21%, at June 30, 2008 compared to June 30, 2007, due to membership growth primarily in Arizona of 16,000 members, California of 14,000 members and Connecticut of 14,000 members. Our Medicare Part D membership increased by 178,000 members, or 51%, at June 30, 2008 compared to June 30, 2007.

We participate in state Medicaid programs in California and New Jersey. California membership, where the program is known as Medi-Cal, represents 94% of our Medicaid membership at June 30, 2008. Membership in our Medicaid programs decreased by 58,000 members at June 30, 2008 compared to June 30, 2007 due to our withdrawal from the Connecticut Medicaid Program, which had 85,000 members at June 30, 2007, partially offset by a gain of 29,000 members in California due to higher enrollment in the Fresno and San Diego areas and in the Healthy Families program. During the first quarter of 2008, we provided administrative services only to Connecticut Medicaid members and we withdrew from the Connecticut Medicaid program in April 2008.

Health Plan Services Segment Results

The following table summarizes the operating results for our health plan services segment for the three and six months ended June 30, 2008 and June 30, 2007, respectively. Effective May 31, 2007, we purchased a 50% interest in the Healthcare Solutions (HCS) business from the Guardian Life Insurance Company of America. As a result, our health plan services premium revenue, health plan services costs and G&A expenses, and related metrics, for the three and six months ended June 30, 2008 include 100% contribution from the HCS business.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars in millions, except PMPM data)			
Health Plan Services segment:				
Commercial premium revenue	\$ 1,950.8	\$ 1,820.0	\$ 3,922.3	\$ 3,597.5
Medicare premium revenue	899.5	693.4	1,792.2	1,398.2
Medicaid premium revenue	263.9	297.8	522.7	592.7
Health plan services premium revenues	\$ 3,114.2	\$ 2,811.2	\$ 6,237.2	\$ 5,588.4
Health plan services costs	(2,655.1)	(2,381.3)	(5,443.5)	(4,722.3)
Net investment income	20.9	27.9	56.3	59.3
Administrative services fees and other income	11.5	11.2	25.5	23.5
G&A	(297.5)	(270.0)	(649.8)	(561.3)
Selling	(88.2)	(76.8)	(174.8)	(146.0)
Amortization and depreciation	(13.0)	(9.0)	(25.4)	(16.6)
Interest	(11.3)	(7.8)	(22.0)	(17.4)
Pretax income	\$ 81.5	\$ 105.4	\$ 3.5	\$ 207.6
MCR:	85.3%	84.7%	87.3%	84.5%
Commercial	84.2%	84.5%	86.3%	83.8%
Medicare	89.0%	85.8%	90.7%	86.7%
Medicaid	80.5%	83.5%	82.6%	83.4%
Health plan services premium PMPM	\$ 278.25	\$ 260.18	\$ 277.71	\$ 259.76
Health plan services costs PMPM	\$ 237.23	\$ 220.39	\$ 242.37	\$ 219.51
G&A expense ratio	9.5%	9.6%	10.4%	10.0%
Selling costs ratio	2.8%	2.7%	2.8%	2.6%

Health Plan Services Premiums

Total health plan services premiums increased by \$303.0 million, or 11%, for the three months ended June 30, 2008 and by \$648.8 million, or 12%, for the six months ended June 30, 2008 as compared to the same periods in 2007. On a PMPM basis, premiums increased by 7% in each of the three and six months ended June 30, 2008, as compared to the same periods in 2007.

Commercial premium revenues increased by \$130.8 million, or 7%, for the three months ended June 30, 2008 and by \$324.8 million, or 9%, for the six months ended June 30, 2008 as compared to the same periods in 2007. The commercial premium PMPM increased by 9% and 10% for the three and six months ended June 30, 2008, respectively, as compared to the same periods in 2007. These increases were primarily attributable to the impact of the HCS business and our ongoing pricing discipline and premium rate increases, partially offset by decreases in our membership.

Medicare premiums increased by \$206.1 million, or 30%, for the three months ended June 30, 2008 and by \$394.0 million, or 28%, for the six months ended June 30, 2008 as compared to the same periods in 2007. These increases were primarily due to an increase in members participating in the Medicare Advantage and Medicare Part D prescription drug program. In addition, we recognized \$48.4 million and \$22.7 million of Medicare risk factor estimates in our health plan services premium revenues in the three months ended June 30, 2008 and 2007, respectively, and \$89.3 million and \$49.2 million of Medicare risk factor estimates in our health plan services premium revenues in the six months ended June 30, 2008 and 2007, respectively.

Medicaid premiums decreased by \$33.9 million, or 11%, for the three months ended June 30, 2008 and by \$70.0 million, or 12%, for the six months ended June 30, 2008 as compared to the same periods in 2007. These decreases were primarily due to a decrease in Connecticut Medicaid membership. We served the Connecticut Medicaid members on an ASO basis through the end of the first quarter of 2008, and we completed our exit from the Connecticut Medicaid program in April 2008. We recognized approximately \$48.7 million and \$95.1 million of premium revenue from our Connecticut Medicaid program during the three and six months ended June 30, 2007, respectively.

Health Plan Services Costs

Health plan services costs increased by \$273.8 million, or 11%, for the three months ended June 30, 2008 and by \$721.2 million, or 15%, for the six months ended June 30, 2008 as compared to the same periods in 2007. Health plan MCR was 85.3% for the three months ended June 30, 2008 and 87.3% for the six months ended June 30, 2008 as compared to 84.7% and 84.5% for the same periods in 2007, respectively. On a PMPM basis, health care costs increased by 8% for the three months ended June 30, 2008 and 10% for the six months ended June 30, 2008 as compared to the same periods in 2007.

Our commercial MCR for the three months ended June 30, 2008 decreased to 84.2% from 84.5% for the same period in 2007, primarily due to the increase in the premium yield outpacing the increase in the health care cost trend. Our commercial MCR increased to 86.3% from 83.8% for the six months ended June 30, 2008 compared to the same period in 2007. This increase was primarily attributable to a \$43.2 million charge recorded in health care costs in connection with litigation and regulatory matters, as well as \$40 million of unfavorable prior period reserve development recorded in the three months ended March 31, 2008. The increase in the commercial health care cost trend on a PMPM basis was 9% and 13% for the three and six months ended June 30, 2008, respectively, over the same periods in 2007. On a PMPM basis, physician and hospital costs rose 6% and 10%, respectively, and pharmacy costs rose 11% for the three months ended June 30, 2008 over the same period in 2007. Physician and hospital costs each rose 13%, and pharmacy costs rose 12% for the six months ended June 30, 2008 over the same period in 2007.

Our Medicare MCR, including Medicare Advantage and Part D, increased to 89.0% and to 90.7% for the three and six months ended June 30, 2008, respectively, from 85.8% and 86.7% for the three and six months ended June 30, 2007, respectively. These increases were primarily driven by higher inpatient and outpatient hospital and pharmacy costs in the three months ended June 30, 2008 and higher than expected utilization in both Medicare Advantage and Medicare Part D and an unusually active flu season in the three months ended March 31, 2008. Medicare Advantage health care cost PMPM increased by 8% and 7% for the three and six months ended June 30, 2008, respectively, as compared to the same periods in 2007. Part D health care cost PMPM increased by 6% for the three months ended June 30, 2008 compared to the same period in 2007, and decreased by 3% for the six months ended June 30, 2008 compared to the same period in 2007. We also recognized \$10.9 million and \$6.4 million of capitation expense related to the Medicare risk factor estimates in our health plan services costs in the three months ended June 30, 2008 and 2007, respectively, and \$23.5 million and \$15.0 million of capitation expense in the six months ended June 30, 2008 and 2007, respectively.

Our Medicaid MCR decreased to 80.5% and 82.6% for the three and six months ended June 30, 2008, respectively, from 83.5% and 83.4% for the three and six months ended June 30, 2007, respectively. The

decrease in the Medicaid health care cost PMPM was 8% and 5% for the three and six months ended June 30, 2008, respectively, over the same periods in 2007 primarily due to the conversion of our Connecticut Medicaid contract, which had an MCR of 97.5%, to the ASO funding type during the three months ended March 31, 2008 and our ultimate exit from the Connecticut Medicaid program in April 2008.

Administrative Services Fees and Other Income

Administrative services fees and other income increased by \$0.3 million, or 2%, for the three months ended June 30, 2008 and by \$2.0 million, or 8%, for the six months ended June 30, 2008 as compared to the same periods in 2007. The increase in the six months ended June 30, 2008 was primarily due to \$5.4 million in amortization of participation fees related to our amortizing financing facility, partially offset by a \$3.4 million asset impairment related to a small, non-core subsidiary.

Net Investment Income

Net investment income decreased by \$7.0 million, or 25%, for the three months ended June 30, 2008 as compared to the same period in 2007. This decrease was primarily due to the \$3.6 million decrease in the valuation of the interest rate swap in connection with our financing facility coupled with lower overall yields on our cash portfolio. Net investment income decreased by \$3.0 million, or 5%, for the six months ended June 30, 2008 as compared to the same period in 2007, primarily due to a lower interest rate environment.

General, Administrative and Other Costs

G&A expense increased by \$27.5 million, or 10%, for the three months ended June 30, 2008 and by \$88.5 million, or 16%, for the six months ended June 30, 2008 as compared to the same periods in 2007. The increases in the G&A expense were primarily driven by litigation and operations strategy-related charges of \$13 million and \$49 million recorded in the three and six months ended June 30, 2008, respectively, payroll and employee benefit expenses and regulatory assessment fees. Our G&A expense ratio decreased to 9.5% from 9.6% for the three months ended June 30, 2008 compared to the same period in 2007, and increased to 10.4% from 10.0% for the six months ended June 30, 2008 compared to the same period in 2007.

The selling costs ratio increased to 2.8% and 2.8% for the three and six months ended June 30, 2008, respectively, from 2.7% and 2.6% for the same periods in 2007 as a result of an increase in individual, small and mid-size group members, which generally have higher broker and sales commissions.

Amortization and depreciation expense increased by \$4.0 million and by \$8.8 million for the three and six months ended June 30, 2008, respectively, as compared to the same periods in 2007. The increases were primarily due to the addition of new assets placed in production related to various information technology system projects and the amortization of intangible assets from the purchase of the HCS business.

Interest expense increased by \$3.5 million, or 45%, for the three months ended June 30, 2008 and by \$4.6 million, or 26%, for the six months ended June 30, 2008 as compared to the same periods in 2007. The increases were primarily due to increased borrowings on our revolving credit facility and amortization of the discount on our amortizing financing facility completed in December 2007, partially offset by interest on our bridge loan paid off in March 2007 and term loan paid off in May 2007.

Government Contracts Segment Membership

Under our TRICARE contract for the North Region, we provided health care services to approximately 3.0 million eligible beneficiaries in the Military Health System (MHS) as of June 30, 2008, and approximately 2.9 million eligible beneficiaries as of June 30, 2007. Included in the 3.0 million eligibles as of June 30, 2008 were 1.8 million TRICARE eligibles for whom we provide health care and administrative services and 1.2 million other

MHS-eligible beneficiaries for whom we provide administrative services only. As of June 30, 2008, there were approximately 1.5 million TRICARE eligibles enrolled in TRICARE Prime under our North Region contract.

In addition to the 3.0 million eligible beneficiaries that we service under the TRICARE contract for the North Region, we administer contracts with the U.S. Department of Veterans Affairs to manage community based outpatient clinics in nine states covering approximately 24,000 enrollees.

Government Contracts Segment Results

The following table summarizes the operating results for the Government Contracts segment for the three and six months ended June 30, 2008 and 2007:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars in millions)			
Government Contracts segment:				
Revenues	\$694.9	\$613.9	\$1,359.3	\$1,221.9
Costs	658.3	570.6	1,295.8	1,137.7
Pretax income	\$ 36.6	\$ 43.3	\$ 63.5	\$ 84.2
Government Contracts Ratio	94.7%	92.9%	95.3%	93.1%

Government Contracts revenues increased by \$81.0 million, or 13%, for the three months ended June 30, 2008 and by \$137.4 million, or 11%, for the six months ended June 30, 2008 as compared to the same periods in 2007. Government Contracts costs increased by \$87.7 million, or 15%, for the three months ended June 30, 2008 and by \$158.1 million, or 14%, for the six months ended June 30, 2008 as compared to the same periods in 2007. For the three months ended June 30, 2008, these increases were primarily due to an increase in health care cost trends for Option Period 5 as compared to the trends for Option Periods 3 and 4.

Our TRICARE contract for the North Region includes a target cost and price for reimbursed health care costs, which is negotiated annually during the term of the contract with underruns and overruns of our target cost borne 80% by the government and 20% by us. In the normal course of contracting with the federal government, we recognize changes in our estimate for the target cost underruns and overruns when the amounts become determinable, supportable, and the collectibility is reasonably assured. During the three and six months ended June 30, 2008, we recognized increases in the revenue estimate of \$4.2 million and \$0.2 million, respectively, and in the cost estimate an increase of \$5.2 million and a decrease of \$0.3 million, respectively. During the three and six months ended June 30, 2007, we recognized decreases in the revenue estimate of \$19 million and \$62 million, respectively, and decreases in the cost estimate of \$24 million and \$78 million, respectively.

The Government contracts ratio increased by 180 basis points for the three months ended June 30, 2008 as compared to the same periods in 2007. The Government contracts ratio increased by 220 basis points for the six months ended June 30, 2008 as compared to the same period in 2007. These increases were primarily due to favorable Option Period 3 health care costs that impacted 2007.

Income Tax Provision

Our income tax expense and the effective income tax rate for the three and six months ended June 30, 2008 and 2007 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars in millions)			
Income tax expense	\$41.4	\$56.7	\$26.0	\$111.2
Effective income tax rate	35.1%	38.1%	38.8%	38.1%

The effective income tax rate differs from the statutory federal tax rate of 35% in each period due primarily to state income taxes, tax-exempt investment income, and interest on uncertain tax positions. Additionally, the three months ended June 30, 2008 included a favorable tax impact of expenses associated with litigation matters. The effective income tax rate for the three months ended June 30, 2008 is lower compared to the same period in 2007 due primarily to a favorable tax impact of expenses associated with litigation matters. The effective income tax rate for the six months ended June 30, 2008 is higher compared to the same period in 2007 due primarily to an increase in state income taxes related to changes in income earned in high tax jurisdictions.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

We believe that cash flow from operating activities, existing working capital, lines of credit and cash reserves are adequate to allow us to fund existing obligations, repurchase shares under our stock repurchase program, introduce new products and services, and continue to develop health care-related businesses. We regularly evaluate cash requirements for current operations and commitments, and for capital acquisitions and other strategic transactions. We may elect to raise additional funds for these purposes, either through issuance of debt or equity, the sale of investment securities or otherwise, as appropriate.

Our cash flow from operating activities is impacted by, among other things, the timing of collections on our amounts receivable from our TRICARE contract for the North Region. Health care receivables related to TRICARE are best estimates of payments that are ultimately collectible or payable. The timing of collection of such receivables is impacted by government audit and negotiation and can extend for periods beyond a year. Amounts receivable under government contracts were \$262.9 million and \$190.0 million as of June 30, 2008 and December 31, 2007, respectively.

Our cash flow from operating activities is also impacted by the timing of collections on our amounts receivable from CMS. Our receivable related to our Medicare business was \$267.0 million and \$103.6 million as of June 30, 2008 and December 31, 2007, respectively.

Our cash flow from investing activities is primarily impacted by the sales, maturities and purchases of our available-for-sale investment securities and restricted investments. Our investment objective is to maintain safety and preservation of principal by investing in a diversified mix of high-quality, investment grade securities while maintaining liquidity in each portfolio sufficient to meet our cash flow requirements and attaining the highest total return on invested funds. We do not own any investments that have direct subprime mortgage exposure.

Our investment portfolio includes \$621.5 million, or 41% of our portfolio holdings, of mortgage-backed and asset-backed securities. The majority of our mortgage-backed securities are Fannie Mae, Freddie Mac and Ginnie Mae issues, and the average rating of our asset-backed securities is AA+/Aa1. As of June 30, 2008 and December 31, 2007, our asset-backed and mortgage-backed securities had gross unrealized holding losses of \$8.7 million and \$3.1 million, respectively. We have the intent and ability to hold our debt investments for a sufficient period of time to allow for recovery of the principal amounts invested. However, any failure by Fannie Mae or Freddie Mac to honor the obligations under the securities they have issued or guaranteed could cause a significant decline in the value or cash flow of our mortgage-backed securities.

Our investment portfolio also includes \$20.4 million, or 1.3% of our portfolio holdings, of auction rate securities (ARS). These ARS have long-term nominal maturities for which the interest rates are reset through a dutch auction process every 7, 28 or 35 days. At June 30, 2008, \$10.3 million of the ARS had at one point or are continuing to experience "failed" auctions. These securities are entirely municipal issues and rates are set at the maximum allowable rate as stipulated in the applicable bond indentures. We continue to receive income on all ARS. If all or any portion of the ARS continue to experience failed auctions, it could take an extended amount of time for us to realize our investments' recorded value.

Based on the composition and quality of our investment portfolio, our ability to liquidate our investment portfolio as needed, and our expected operating and financing cash flows, we do not anticipate any liquidity constraints as a result of the current credit environment.

Operating Cash Flows

Our net cash flow (used in) provided by operating activities for the six months ended June 30, 2008 compared to the same period in 2007 is as follows:

	<u>June 30, 2008</u>	<u>June 30, 2007</u>	<u>Change 2008 over 2007</u>
	(Dollars in millions)		
Net cash (used in) provided by operating activities	\$(197.8)	\$479.7	\$(677.5)

This decrease of \$677.5 million in operating cash flow is primarily a result of an extra CMS payment of \$304 million received in June 2007 combined with the timing of collecting our premiums receivable, including amounts due from CMS for Medicare Part D, as well as payments related to our operations strategy and payments for legal and regulatory related matters.

Investing Activities

Our net cash flow used in investing activities for the six months ended June 30, 2008 compared to the same period in 2007 is as follows:

	<u>June 30, 2008</u>	<u>June 30, 2007</u>	<u>Change 2008 over 2007</u>
	(Dollars in millions)		
Net cash used in investing activities	\$(49.0)	\$(88.9)	\$39.9

Net cash used in investing activities decreased primarily due to an increase in net sales and maturities of investments of \$98 million, partially offset by a decrease in net cash received from the purchase/sale of assets and buildings of \$58 million.

Financing Activities

Our net cash flow provided by (used in) financing activities for the six months ended June 30, 2008 compared to the same period in 2007 is as follows:

	<u>June 30, 2008</u>	<u>June 30, 2007</u>	<u>Change 2008 over 2007</u>
	(Dollars in millions)		
Net cash provided by (used in) financing activities	\$0.4	\$(119.5)	\$119.9

Net cash provided by financing activities increased during the six months ended June 30, 2008, primarily due to an increase in net borrowings of \$243 million, partially offset by a decrease in proceeds from the exercise of stock options and tax benefits from share-based compensation of \$50 million and share repurchases of \$73 million.

Capital Structure

Share Repurchases. On October 26, 2007, our Board of Directors increased the size of our stock repurchase program by \$250 million, bringing the total amount of the program to \$700 million. Subject to Board approval, additional amounts are added to the repurchase program from time to time based on exercise proceeds and tax benefits the Company receives from the employee stock options. We repurchased 3,199,100 shares

during the three months ended March 31, 2008 for aggregate consideration of approximately \$143 million. We did not repurchase any shares during the three months ended June 30, 2008 under the our stock repurchase program. We used net free cash available to fund the share repurchases. As of June 30, 2008, the remaining authorization under our stock repurchase program was \$203.3 million.

Under the Company's various stock option and long term incentive plans, employees and non-employee directors may elect for the Company to withhold shares to satisfy minimum statutory federal, state and local tax withholding and exercise price obligations arising from the vesting and/or exercise of stock options and other equity awards. These repurchases were not part of our stock repurchase program.

The following table presents monthly information related to repurchases of our common stock, including shares withheld by the Company to satisfy tax withholdings and exercise price obligations in 2008, as of June 30, 2008:

<u>Period</u>	<u>Total Number of Shares Purchased (a)</u>	<u>Average Price Paid per Share</u>	<u>Total Average Price Paid</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Programs (b)(c)</u>	<u>Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Programs (c)(d)</u>
January 1—January 31	—	—	—	—	\$346,159,116
February 1—February 29 (e)	1,904,010	\$46.78	\$ 89,064,600	1,895,300	\$257,491,899
March 1—March 31 (e)	1,306,123	41.51	54,214,053	1,303,800	\$203,349,454
April 1—April 30	—	—	—	—	\$203,349,454
May 1—May 31	—	—	—	—	\$203,349,454
June 1—June 30 (e)	2,236	30.21	67,550	—	\$203,349,454
	<u>3,212,369(e)</u>	<u>\$44.62</u>	<u>\$143,346,203</u>	<u>3,199,100</u>	

- (a) We did not repurchase any shares of our common stock during the three months ended June 30, 2008 outside our publicly announced stock repurchase program, except shares withheld in connection with our various stock option and long-term incentive plans.
- (b) Our stock repurchase program was announced in April 2002. We announced additional repurchase authorization in August 2003, October 2006 and October 2007.
- (c) A total of \$700 million of our common stock may be repurchased under our stock repurchase program. Additional amounts may be added to the program based on exercise proceeds and tax benefits the Company receives from the exercise of employee stock options, but only upon further approval by the Board of Directors. The remaining authority under our repurchase program includes proceeds received from option exercises and tax benefits the Company received from exercise of employee stock options which have been approved for inclusion in the program by the Board.
- (d) Our stock repurchase program does not have an expiration date. During the six months ended June 30, 2008, we did not have any repurchase program that expired, and we did not terminate any repurchase program prior to its expiration date.
- (e) Includes 8,710, 2,323 and 2,236 shares withheld by the Company to satisfy tax withholdings and exercise price obligations arising from the vesting and/or exercise of stock options and other equity awards in February, March and June 2008, respectively.

Amortizing Financing Facility. On December 19, 2007, we entered into a five-year, non-interest bearing, \$175 million amortizing financing facility with a non-U.S. lender. We entered into an amendment to the financing facility on April 29, 2008, which was administrative in nature. For financial reporting purposes, this financing facility will have an effective interest rate of zero as a result of imputed interest being offset by other income related to the financing facility. The proceeds from the financing facility were used for general corporate purposes.

The financing facility requires one of our subsidiaries to pay semi-annual distributions, in the amount of \$17.5 million to a participant in the financing facility. Unless terminated earlier, the final payment under the facility is scheduled to be made on December 19, 2012.

The financing facility includes limitations (subject to specified exclusions) on our and certain of our subsidiaries' ability to incur debt; create liens; engage in certain mergers, consolidations and acquisitions; engage in transactions with affiliates; enter into agreements which will restrict the ability to pay dividends or other distributions with respect to any shares of capital stock or the ability to make or repay loans or advances; make dividends; and alter the character of ours or their business conducted on the closing date of the financing facility. In addition, the financing facility also requires that we maintain a specified consolidated leverage ratio and consolidated fixed charge coverage ratio throughout the term of the financing facility. As of June 30, 2008, we were in compliance with all of the covenants under the financing facility.

The financing facility provides that it may be terminated through a series of put and call transactions (1) at the option of one of our wholly-owned subsidiaries at any time after December 20, 2009, or (2) upon the occurrence of certain defined acceleration events. These acceleration events, include, but are not limited to:

- nonpayment of certain amounts due by us or certain of our subsidiaries under the financing facility (if not cured within the related time period set forth therein);
- a change of control (as defined in the financing facility);
- our failure to maintain the following ratings on our senior indebtedness by any two of the following three rating agencies: (A) a rating of at least BB by Standard & Poor's Ratings Services, (B) a rating of at least BB by Fitch, Inc., and (C) a rating of at least Ba2 by Moody's Investors Service, Inc.;
- cross-acceleration to other indebtedness of our Company in excess of \$50 million;
- certain ERISA-related events;
- noncompliance by Health Net with any material term or provision of the HMO Regulations or Insurance Regulations (as each such term is defined in the financing facility);
- events in bankruptcy, insolvency or reorganization of our Company;
- undischarged, uninsured judgments in the amount of \$50 million or more against our Company; or
- certain changes in law that could adversely affect a participant in the financing facility.

In addition, in connection with the financing facility, we entered into a guaranty which will require us to guarantee the payment of the semi-annual distributions and any other amounts payable by one of our subsidiaries to the financing facility participants under certain circumstances provided under the financing facility. Also in connection with the financing facility, we entered into an interest rate swap agreement with a non-U.S. bank affiliated with one of the financing facility participants. Under the interest rate swap agreement, we pay a floating payment in an amount equal to LIBOR times a notional principal amount and receive a fixed payment in an amount equal to 4.3% times the same notional principal amount from the non-U.S. bank counterparty in return in accordance with a schedule set forth in the interest rate swap agreement.

Senior Notes. On May 18, 2007, we issued \$300 million in aggregate principal amount of 6.375% Senior Notes due 2017. On May 31, 2007, we issued an additional \$100 million of 6.375% Senior Notes due 2017 which were consolidated with, and constitute the same series as, the Senior Notes issued on May 18, 2007 (collectively, the Senior Notes). The aggregate net proceeds from the issuance of the Senior Notes were \$393.5 million and were used to repay outstanding debt.

The indenture governing the Senior Notes limits our ability to incur certain liens, or consolidate, merge or sell all or substantially all of our assets. In the event of the occurrence of both (1) a change of control of Health Net, Inc. and (2) a below investment grade rating by any two of Fitch, Inc., Moody's Investors Service, Inc. and

Standard & Poor's Ratings Services within a specified period, we will be required to make an offer to purchase the Senior Notes at a price equal to 101% of the principal amount of the Senior Notes plus accrued and unpaid interest to the date of repurchase. As of June 30, 2008, no default or event of default had occurred under the indenture governing the Senior Notes.

The Senior Notes may be redeemed in whole at any time or in part from time to time, prior to maturity at our option, at a redemption price equal to the greater of:

- 100% of the principal amount of the Senior Notes then outstanding to be redeemed; or
- the sum of the present values of the remaining scheduled payments of principal and interest on the Senior Notes to be redeemed (not including any portion of such payments of interest accrued to the date of redemption) discounted to the date of redemption on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the applicable treasury rate plus 30 basis points

plus, in each case, accrued and unpaid interest on the principal amount being redeemed to the redemption date.

Each of the following will be an Event of Default under the indenture governing the Senior Notes:

- failure to pay interest for 30 days after the date payment is due and payable; provided that an extension of an interest payment period by us in accordance with the terms of the Senior Notes shall not constitute a failure to pay interest;
- failure to pay principal or premium, if any, on any note when due, either at maturity, upon any redemption, by declaration or otherwise;
- failure to perform any other covenant or agreement in the notes or indenture for a period of 60 days after notice that performance was required;
- (A) our failure or the failure of any of our subsidiaries to pay indebtedness for money we borrowed or any of our subsidiaries borrowed in an aggregate principal amount of at least \$50,000,000, at the later of final maturity and the expiration of any related applicable grace period and such defaulted payment shall not have been made, waived or extended within 30 days after notice or (B) acceleration of the maturity of indebtedness for money we borrowed or any of our subsidiaries borrowed in an aggregate principal amount of at least \$50,000,000, if that acceleration results from a default under the instrument giving rise to or securing such indebtedness for money borrowed and such indebtedness has not been discharged in full or such acceleration has not been rescinded or annulled within 30 days after notice; or
- events in bankruptcy, insolvency or reorganization of our Company.

Revolving Credit Facility. On June 25, 2007, we entered into a \$900 million five-year revolving credit facility with Bank of America, N.A. as Administrative Agent, Swingline Lender, and L/C Issuer, and the other lenders party thereto. We entered into an amendment to the credit facility on April 29, 2008, which was administrative in nature. Our revolving credit facility provides for aggregate borrowings in the amount of \$900 million, which includes a \$400 million sub-limit for the issuance of standby letters of credit and a \$50 million sub-limit for swing line loans. In addition, we have the ability from time to time to increase the facility by up to an additional \$250 million in the aggregate, subject to the receipt of additional commitments. The revolving credit facility matures on June 25, 2012.

Amounts outstanding under the revolving credit facility will bear interest, at our option, at (a) the base rate, which is a rate per annum equal to the greater of (i) the federal funds rate plus one-half of one percent and (ii) Bank of America's prime rate (as such term is defined in the facility), (b) a competitive bid rate solicited from the syndicate of banks, or (c) the British Bankers Association LIBOR rate (as such term is defined in the facility), plus an applicable margin, which is initially 70 basis points per annum and is subject to adjustment according to the our credit ratings, as specified in the facility.

Our revolving credit facility includes, among other customary terms and conditions, limitations (subject to specified exclusions) on our and our subsidiaries' ability to incur debt; create liens; engage in certain mergers, consolidations and acquisitions; sell or transfer assets; enter into agreements which restrict the ability to pay dividends or make or repay loans or advances; make investments, loans, and advances; engage in transactions with affiliates; and make dividends. In addition, we are required to maintain a specified consolidated leverage ratio and consolidated fixed charge coverage ratio throughout the term of the revolving credit facility.

Our revolving credit facility contains customary events of default, including nonpayment of principal or other amounts when due; breach of covenants; inaccuracy of representations and warranties; cross-default and/or cross-acceleration to other indebtedness of the Company or our subsidiaries in excess of \$50 million; certain ERISA-related events; noncompliance by us or any of our subsidiaries with any material term or provision of the HMO Regulations or Insurance Regulations (as each such term is defined in the credit facility); certain voluntary and involuntary bankruptcy events; inability to pay debts; undischarged, uninsured judgments greater than \$50 million against us and/or our subsidiaries; actual or asserted invalidity of any loan document; and a change of control. If an event of default occurs and is continuing under the facility, the lenders thereunder may, among other things, terminate their obligations under the facility and require us to repay all amounts owed thereunder.

As of June 30, 2008, we were in compliance with all covenants under our revolving credit facility.

As of June 30, 2008, we had outstanding an aggregate of \$125.1 million in letters of credit and outstanding borrowings under the revolving credit facility of \$145 million. As a result, as of June 30, 2008, the maximum amount available for borrowing under our credit facility was \$629.9 million, and no amounts had been drawn on the letters of credit.

Statutory Capital Requirements

Certain of our subsidiaries must comply with minimum capital and surplus requirements under applicable state laws and regulations, and must have adequate reserves for claims. Management believes that as of June 30, 2008, all of our health plans and insurance subsidiaries met their respective regulatory requirements in all material respects.

By law, regulation and governmental policy, our health plan and insurance subsidiaries, which we refer to as our regulated subsidiaries, are required to maintain minimum levels of statutory net worth. The minimum statutory net worth requirements differ by state and are generally based on balances established by statute, a percentage of annualized premium revenue, a percentage of annualized health care costs, or risk-based capital (RBC) requirements. The RBC requirements are based on guidelines established by the National Association of Insurance Commissioners. The RBC formula, which calculates asset risk, underwriting risk, credit risk, business risk and other factors, generates the authorized control level (ACL), which represents the minimum amount of net worth believed to be required to support the regulated entity's business. For states in which the RBC requirements have been adopted, the regulated entity typically must maintain the greater of the Company Action Level RBC, calculated as 200% of the ACL, or the minimum statutory net worth requirement calculated pursuant to pre-RBC guidelines. Because our regulated subsidiaries are also subject to their state regulators' overall oversight authority, some of our subsidiaries are required to maintain minimum capital and surplus in excess of the RBC requirement, even though RBC has been adopted in their states of domicile. We generally manage our aggregate regulated subsidiary capital above 300% of ACL, although RBC standards are not yet applicable to all of our regulated subsidiaries. At June 30, 2008, we had sufficient capital to exceed the applicable RBC levels. In addition to the foregoing requirements, our regulated subsidiaries are subject to restrictions on their ability to make dividend payments, loans and other transfers of cash or other assets to the parent company.

As necessary, we make contributions to, and issue standby letters of credit on behalf of, our subsidiaries to meet RBC or other statutory capital requirements under state laws and regulations. During the six months ended June 30, 2008, we made capital contributions of \$13 million to certain of our subsidiaries in order to meet RBC or other statutory capital requirements. Health Net, Inc. did not make any capital contributions to its subsidiaries to meet RBC or other statutory capital requirements under state laws and regulations thereafter through August 8, 2008.

Legislation has been or may be enacted in certain states in which our subsidiaries operate imposing substantially increased minimum capital and/or statutory deposit requirements for HMOs in such states. Such statutory deposits may only be drawn upon under limited circumstances relating to the protection of policyholders.

As a result of the above requirements and other regulatory requirements, certain subsidiaries are subject to restrictions on their ability to make dividend payments, loans or other transfers of cash to their parent companies. Such restrictions, unless amended or waived, or unless regulatory approval is granted, limit the use of any cash generated by these subsidiaries to pay our obligations. The maximum amount of dividends, that can be paid by our insurance company subsidiaries without prior approval of the applicable state insurance departments, is subject to restrictions relating to statutory surplus, statutory income and unassigned surplus.

CONTRACTUAL OBLIGATIONS

Pursuant to Item 303(a)(5) of Regulation S-K, we identified our known contractual obligations as of December 31, 2007 in our Form 10-K. Significant changes to our contractual obligations as previously disclosed in our Form 10-K are as follows:

	Between July 1, 2008 and December 31, 2008	2009	2010	2011	2012	Thereafter	Total
	<small>(Amounts in millions)</small>						
Draw on revolving credit facility (1)	\$145.0	\$—	\$—	\$—	\$—	\$—	\$145.0

(1) See Note 6 to the consolidated financial statements.

OFF-BALANCE SHEET ARRANGEMENTS

As of June 30, 2008, we did not have any off-balance sheet arrangements as defined under Item 303(a)(4) of Regulation S-K.

CRITICAL ACCOUNTING ESTIMATES

In our Form 10-K, we identified the critical accounting policies which affect the more significant estimates and assumptions used in preparing our consolidated financial statements. Those policies include revenue recognition, health plan services, reserves for contingent liabilities, amounts receivable or payable under government contracts, goodwill and recoverability of long-lived assets and investments. We have not changed these policies from those previously disclosed in our Form 10-K. Our critical accounting policy on estimating reserves for claims and other settlements and the quantification of the sensitivity of financial results to reasonably possible changes in the underlying assumptions used in such estimation as of June 30, 2008 is discussed below. There were no other significant changes to the critical accounting estimates as disclosed in our Form 10-K.

Reserves for claims and other settlements include reserves for claims (incurred but not reported claims (IBNR) and received but unprocessed claims), and other liabilities including capitation payable, shared risk settlements, provider disputes, provider incentives and other reserves for our Health Plan Services reporting segment.

We estimate the amount of our reserves for claims primarily by using standard actuarial developmental methodologies. This method is also known as the chain-ladder or completion factor method. The developmental method estimates reserves for claims based upon the historical lag between the month when services are rendered and the month claims are paid while taking into consideration, among other things, expected medical cost

inflation, seasonal patterns, product mix, benefit plan changes and changes in membership. A key component of the developmental method is the completion factor which is a measure of how complete the claims paid to date are relative to the estimate of the claims for services rendered for a given period. While the completion factors are reliable and robust for older service periods, they are more volatile and less reliable for more recent periods since a large portion of health care claims are not submitted to us until several months after services have been rendered. Accordingly, for the most recent months, the incurred claims are estimated from a trend analysis based on per member per month claims trends developed from the experience in preceding months. This method is applied consistently year over year while assumptions may be adjusted to reflect changes in medical cost inflation, seasonal patterns, product mix, benefit plan changes and changes in membership.

An extensive degree of actuarial judgment is used in this estimation process, considerable variability is inherent in such estimates, and the estimates are highly sensitive to changes in medical claims submission and payment patterns and medical cost trends. As such, the completion factors and the claims per member per month trend factor are the most significant factors used in estimating our reserves for claims. Since a large portion of the reserves for claims is attributed to the most recent months, the estimated reserves for claims are highly sensitive to these factors. The following table illustrates the sensitivity of these factors and the estimated potential impact on our operating results caused by these factors:

Completion Factor (a) Percentage-point Increase (Decrease) in Factor	Health Plan Services (Increase) Decrease in Reserves for Claims
2%	\$ (57.2) million
1%	\$ (29.1) million
(1)%	\$ 30.2 million
(2)%	\$ 61.4 million
Medical Cost Trend (b) Percentage-point Increase (Decrease) in Factor	Health Plan Services Increase (Decrease) in Reserves for Claims
2%	\$ 29.4 million
1%	\$ 14.7 million
(1)%	\$ (14.7) million
(2)%	\$ (29.4) million

- (a) Impact due to change in completion factor for the most recent three months. Completion factors indicate how complete claims paid to date are in relation to the estimate of total claims for a given period. Therefore, an increase in the completion factor percent results in a decrease in the remaining estimated reserves for claims.
- (b) Impact due to change in annualized medical cost trend used to estimate the per member per month cost for the most recent three months.

Other relevant factors include exceptional situations that might require judgmental adjustments in setting the reserves for claims, such as system conversions, processing interruptions or changes, environmental changes or other factors. All of these factors are used in estimating reserves for claims and are important to our reserve methodology in trending the claims per member per month for purposes of estimating the reserves for the most recent months. In developing our best estimate of reserves for claims, we consistently apply the principles and methodology described above from year to year, while also giving due consideration to the potential variability of these factors. Because reserves for claims include various actuarially developed estimates, our actual health care services expense may be more or less than our previously developed estimates. Claims processing expenses are also accrued based on an estimate of expenses necessary to process such claims. Such reserves are continually monitored and reviewed, with any adjustments reflected in current operations.

Item 3. Quantitative And Qualitative Disclosures About Market Risk.

We are exposed to interest rate and market risk primarily due to our investing and borrowing activities. Market risk generally represents the risk of loss that may result from the potential change in the value of a financial instrument as a result of fluctuations in interest rates and/or market conditions and in equity prices. Interest rate risk is a consequence of maintaining variable interest rate earning investments and fixed rate liabilities or fixed income investments and variable rate liabilities. We are exposed to interest rate risks arising from changes in the level or volatility of interest rates, prepayment speeds and/or the shape and slope of the yield curve. In addition, we are exposed to the risk of loss related to changes in credit spreads. Credit spread risk arises from the potential that changes in an issuer's credit rating or credit perception may affect the value of financial instruments. No material changes to any of these risks have occurred since December 31, 2007.

For a more detailed discussion of our market risks relating to these activities, refer to Item 7A, Quantitative and Qualitative Disclosures about Market Risk, included in our Form 10-K.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that are designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) under the Exchange Act, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based upon the evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of the end of such period.

Changes in Internal Control Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the six months ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

A description of the legal proceedings to which the Company and its subsidiaries are a party is contained in Note 8 to the consolidated financial statements included in Part I of this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors.

The risk factors set forth below update, and should be read together with, the risk factors disclosed in Part I Item 1A of the Company's Form 10-K.

Our efforts to capitalize on Medicare business opportunities could prove to be unsuccessful.

Medicare programs represent a significant portion of our business, accounting for approximately 20% of our total revenue in 2007 and an expected 23% in 2008. Over the last several years we have significantly expanded our Medicare health plans and restructured our Medicare program management team and operations to enhance our ability to pursue business opportunities presented by the MMA and the Medicare program generally. For example, in 2007 we introduced private fee-for-service (PFFS) Medicare Advantage plans, expanded our Medicare Part D prescription drug benefits plans to all 50 states, and we are in the process of enhancing our HMO/PPO product offerings. This growth requires substantial administrative and operational capabilities, which we have developed or for which we have contracted. For example, we use third party vendors to administer the enrollment, claims and billing functions for stand-alone PDP and PFFS. If the execution of these key operational functions is not successful, or we are unable to develop administrative capabilities to address the additional needs of our growing Medicare programs, it could have a material adverse effect on our Medicare business. In January 2008, we were directed by the CMS to suspend the marketing of and enrollment into our stand-alone PDP products due to certain administrative deficiencies relating to our ability to timely process stand-alone PDP enrollment applications. On March 18, 2008, CMS lifted this suspension based on its acceptance of our Corrective Action Plan and our demonstrated correction of the deficiencies. The Corrective Action Plan will remain in place until we demonstrate continued fulfillment of the Corrective Action Plan requirements for a two-month period. This temporary suspension did not have a material adverse effect on our Medicare business. If CMS were to suspend the marketing of and enrollment into our stand-alone PDP products for a significant period of time in the future, it could have a material adverse effect on our Medicare business.

Particular risks associated with our providing Medicare Part D prescription drug benefits under the MMA include potential uncollectibility of receivables, inadequacy of pricing assumptions, inability to receive and process information and increased pharmaceutical costs, as well as the underlying seasonality of this business, and extended settlement periods for claims submissions. In addition, in connection with our participation in the Medicare Advantage and Part D programs, we regularly record revenues associated with the risk adjustment reimbursement mechanism employed by CMS. This mechanism is designed to appropriately reimburse health plans for the relative health care cost risk of its Medicare enrollees. While we have historically recorded revenue and received payment for risk adjustment reimbursement settlements, there can be no assurance that we will receive payment from CMS for the levels of the risk adjustment premium revenue recorded in any given quarter.

On July 15, 2008, the Medicare Improvement for Patients and Providers Act of 2008 (the Medicare Improvement Act) became law. Beginning in 2010, the Medicare Improvement Act will, among other things, significantly reduce funding for Medicare Advantage programs.

If the cost and complexity of the recent Medicare changes exceed our expectations or prevent effective program implementation; if the government alters or further reduces funding of Medicare programs; if we fail to design and maintain programs that are attractive to Medicare participants; or if we are not successful in winning

contract renewals or new contracts under the MMA's competitive bidding process, our current Medicare business and our ability to expand our Medicare operations could be materially and adversely affected, and we may not be able to realize any return on our investments in Medicare initiatives.

A significant reduction in revenues from the government programs in which we participate could have an adverse effect on our business, financial condition or results of operations.

Approximately 48% of our annual revenues relate to federal, state and local government health care coverage programs, such as Medicare, Medicaid and TRICARE. All of the revenues in our Government Contracts segment come from the federal government. Under government-funded health programs, the government payor typically determines premium and reimbursement levels. If the government payor reduces premium or reimbursement levels or increases them by less than our costs increase, and we are unable to make offsetting adjustments through supplemental premiums and changes in benefit plans, we could be adversely affected. Contracts under these programs are generally subject to frequent change, including changes that may reduce the number of persons enrolled or eligible, reduce the revenue received by us or increase our administrative or health care costs under such programs. Changes of this nature could have a material adverse effect on our business, financial condition or results of operations. Changes to government health care coverage programs in the future may also affect our willingness to participate in these programs.

States periodically consider reducing or reallocating the amount of money they spend for Medicaid. Currently, many states are experiencing budget deficits, and some states have reduced or have begun to reduce, or have proposed reductions in, payments to Medicaid managed care providers. For example, the State of California recently announced a proposal to cut reimbursement rates for the state's Medi-Cal program by 10%. This rate reduction was implemented on July 1, 2008 and is expected to have an adverse impact on our pretax income for 2008. This rate reduction was one of the factors contributing to our announcement in April 2008 that we were lowering our full-year earnings per share guidance for 2008. Any additional significant reduction in payments received in connection with Medicaid could adversely affect our business, financial condition or results of operations.

In addition, states can impose requirements on Medicaid programs that make continued operations not feasible. For example, in early 2008 we completed our transition out of the Medicaid program in Connecticut due to the state requiring Medicaid contractors to publicly disclose certain proprietary and trade secret information and persistent underfunding of the program.

The amount of government receivables set forth in our consolidated financial statements represents our best estimate of the government's liability to us under TRICARE and other federal government contracts. In general, government receivables are estimates and subject to government audit and negotiation. In addition, inherent in government contracts are an uncertainty of and vulnerability to disagreements with the government. Final amounts we ultimately receive under government contracts may be significantly greater or less than the amounts we initially recognize on our financial statements.

Health care operations under our TRICARE North contract are scheduled to conclude on March 31, 2009. In the first quarter of 2008, the Department of Defense released a formal Request for Proposal for the next generation of TRICARE contracts. We submitted our proposal to the Department of Defense on June 27, 2008, in advance of the June 30, 2008 due date. Contracts are expected to be awarded on or before May 2009, with implementation of the new contracts scheduled to begin on April 1, 2010. Given the effective date of the new contracts, we currently believe that the Department of Defense will extend our current TRICARE North contract for one year. If the contract is not extended, and we are not awarded a new TRICARE contract, or if the terms and conditions of a new contract were significantly changed, it could have a material adverse effect on our business, results of operation and financial condition.

Regulatory activities and litigation relating to the rescission of coverage, if resolved unfavorably, could adversely affect us.

In our individual business in certain states, persons applying for insurance policies are required to provide information about their medical history as well as that of family members for whom they are seeking coverage. These applications are subjected to a formal underwriting process to determine whether the applicants present an acceptable risk. If coverage is issued and the health plan or insurer subsequently discovers that the applicant materially misrepresented their or their family members' medical history, the health plan or insurer has the legal right to rescind the policy in accordance with applicable legal standards. Although rescission has long been a legally authorized practice, the decisions of health plans to rescind coverage and decline payment to treating providers, as well as the procedures used to do so, have recently generated public attention, particularly in California. As a result, there has been both legislative and regulatory action, as well as significant litigation, in connection with this issue.

As of January 1, 2008, health plans and insurers in California, under certain defined circumstances, are obligated to pay providers for services they have rendered despite the rescission of a member's policy. On October 23, 2007, the California Department of Managed Health Care (DMHC) and the California Department of Insurance (DOI) announced that they would be issuing joint regulations that would restrict the ability of health plans and insurers to rescind a member's coverage and deny payment to treating providers. The DMHC has issued draft proposed regulations and it is expected that the DOI will do so as well in the near future. The DOI commenced an audit of Health Net Life Insurance Company on April 7, 2008 relating to our rescission practices. This audit is ongoing.

On October 16, 2007, the DMHC initiated a survey of Health Net of California's activities regarding the rescission of policies for the period 2004 through 2006. This survey is similar to ones the DMHC has already conducted of other health plans in California, which have resulted in administrative penalties. The results of the survey are expected to be made public some time in 2008. During the course of the survey, the DMHC alleged that Health Net of California had failed to timely provide information to the DMHC's survey team. As a result of this allegation, the DMHC required Health Net of California to pay an administrative penalty of \$1 million. Following completion of the survey, on May 15, 2008, Health Net of California entered into a settlement agreement with the DMHC. The settlement agreement requires Health Net of California to (1) pay a \$300,000 administrative fine, (2) offer future coverage to all 85 HMO enrollees who had coverage rescinded from 2004 and later, (3) offer those enrollees an opportunity to participate in an expedited review process where the enrollee could seek to resolve claims for out of pocket medical expenses and other damages incurred as a result of the rescission, and (4) file a corrective action plan for various internal procedural changes by June 30, 2008. Health Net of California filed the corrective action plan by the due date. Failure to substantially implement the actions set forth in the corrective action plan will subject Health Net of California to a potential additional penalty of up to \$3 million.

We are also party to arbitrations and litigation, including a putative class action, in which rescinded members allege that we unlawfully rescinded their coverage. The lawsuits generally seek reimbursement for the cost of medical services that were not paid as a result of the rescission, and also seek to recover for emotional distress, attorneys' fees and punitive damages. One of these arbitrations was decided on February 21, 2008, and resulted in an award paid to the claimant of approximately \$9.4 million. Recent court of appeal decisions in California adverse to health plans and insurers have increased the risks associated with rescissions of policies based on applications containing material misrepresentations of medical history, and may make it more difficult to rescind policies in the future. Additionally, the Los Angeles City Attorney recently filed a complaint against us relating to our underwriting practices and rescission of certain individual policies. The complaint seeks equitable relief and civil penalties for, among other things, alleged false advertising, violations of unfair competition laws and violations of the California Penal Code. Other government agencies, including the Attorney General of California, have indicated that they are investigating, or may be interested in investigating, rescissions and related activities. These developments, together with increased media scrutiny of health plans' and insurers' rescission practices, may also increase the risk of additional litigation in this area.

We cannot predict the outcome of the anticipated regulatory proposals described above, nor the extent to which we may be affected by the enactment of those or other regulatory or legislative activities relating to rescissions. Such legislation or regulation, including measures that would cause us to change our current manner of operation or increase our exposure to liability, could have a material adverse effect on our results of operations, financial condition and ability to compete in our industry. Similarly, given the complexity and scope of rescission lawsuits, their final outcome cannot be predicted with any certainty. It is possible that in a particular quarter or annual period our results of operations, financial condition and/or liquidity could be materially and adversely affected by an ultimate unfavorable resolution of these cases.

We face risks related to litigation, which, if resolved unfavorably, could result in substantial penalties and/or monetary damages, including punitive damages. In addition, we incur material expenses in the defense of litigation and our results of operations or financial condition could be adversely affected if we fail to accurately project litigation expenses.

We are subject to a variety of legal actions to which any corporation may be subject, including employment and employment discrimination-related suits, employee benefit claims, wage and hour claims, breach of contract actions, tort claims, fraud and misrepresentation claims, shareholder suits, including suits for securities fraud, and intellectual property and real estate related disputes. In addition, we incur and likely will continue to incur potential liability for claims related to the insurance industry in general and our business in particular, such as claims by members alleging failure to pay for or provide health care, poor outcomes for care delivered or arranged, improper rescission, termination or non-renewal of coverage and insufficient payments for out-of-network services; claims by employer groups for return of premiums; and claims by providers, including claims for withheld or otherwise insufficient compensation or reimbursement, claims related to self-funded business, and claims related to reinsurance matters. Such actions can also include allegations of fraud, misrepresentation, and unfair or improper business practices and can include claims for punitive damages. Also, there are currently, and may be in the future, attempts to bring class action lawsuits against various managed care organizations, including us. In some of the cases pending against us, substantial non-economic or punitive damages are also being sought.

For example in the *McCoy*, *Wachtel*, and *Scharfman* cases described in Note 8 to our consolidated financial statements, the plaintiffs alleged that the manner in which our various subsidiaries paid member claims for out-of-network services was improper. On March 13, 2008 we executed a final settlement agreement with the plaintiffs in *McCoy*, *Wachtel* and *Scharfman* to settle those cases and on April 24, 2008 the court preliminarily approved the settlement agreement. On July 24, 2008, the court entered an order granting final approval of the settlement agreement. See Note 8 to our consolidated financial statements and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for additional information regarding these matters and the expenses we have incurred in connection with these matters.

We cannot predict the outcome of any lawsuit with certainty, and we are incurring material expenses in the defense of litigation matters, including without limitation, substantial discovery costs. While we currently have insurance policies that may provide coverage for some of the potential liabilities relating to litigation matters, there can be no assurance that coverage will be available for any particular case or liability. Insurers could dispute coverage or the amount of insurance could not be sufficient to cover the damages awarded. In addition, certain liabilities such as punitive damages, may not be covered by insurance. Insurance coverage for all or certain types of liability may become unavailable or prohibitively expensive in the future or the deductible on any such insurance coverage could be set at a level that would result in us effectively self-insuring cases against us. The deductible on our errors and omissions (E&O) insurance has reached such a level. Given the amount of the deductible, the only cases which would be covered by our E&O insurance are those involving claims that substantially exceed our average claim values and otherwise qualify for coverage under the terms of the insurance policy.

Recent court decisions and legislative activity may increase our exposure for any of the types of claims we face. There is a risk that we could incur substantial legal fees and expenses, including discovery expenses, in any of the actions we defend in excess of amounts budgeted for defense. Plaintiffs' attorneys have increasingly used expansive electronic discovery requests as a litigation tactic. Responding to these requests, the scope of which may exceed the normal capacity of our historical systems for archiving and organizing electronic documents, may require application of significant resources and impose significant costs on us. In certain cases, we could also be subject to awards of substantial legal fees and costs to plaintiffs' counsel.

We regularly evaluate litigation matters pending against us, including those described in Note 8 to our consolidated financial statements, to determine if settlement of such matters would be in the best interests of the Company and its stockholders. The costs associated with any such settlement could be substantial and, in certain cases, could result in an earnings charge in any particular quarter in which we enter into a settlement agreement. Although we have recorded litigation reserves which represent our best estimate on probable losses, both known and incurred but not reported, our recorded reserves might prove to be inadequate to cover an adverse result or settlement for extraordinary matters, such as the matters described in Note 8. Therefore, costs associated with the various litigation matters to which we are subject and any earnings charge recorded in connection with a settlement agreement could have a material adverse effect on our financial condition or results of operations.

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

(c) Purchases of Equity Securities by the Issuer

Our Board of Directors has authorized a \$700 million stock repurchase program. As of June 30, 2008, the remaining authorization under our stock repurchase program was \$203.3 million.

Under the Company's various stock option and long term incentive plans, employees and non-employee directors may elect for the Company to withhold shares to satisfy minimum statutory federal, state and local tax withholding and exercise price obligations arising from the vesting and/or exercise of stock options and other equity awards.

A description of the Company's stock repurchase program and tabular disclosure of the information required under this Item 2 is contained in Part I—"Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Structure—Share Repurchases."

Item 3. Defaults Upon Senior Securities.

None.

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

On May 8, 2008, we held our 2008 Annual Meeting of Stockholders (Annual Meeting). At the Annual Meeting, our stockholders voted upon proposals to (i) elect nine directors to serve for a term of one year or until the 2009 Annual Meeting of Stockholders (Proposal 1) and (ii) ratify the Board's selection of Deloitte & Touche LLP as the Company's independent registered public accountants for 2008 (Proposal 2).

The following provides voting information for all matters voted upon at the Annual Meeting, and includes a separate tabulation with respect to each nominee for director:

Proposal 1

<u>Election of Directors:</u>	<u>Votes For:</u>	<u>Votes Against:</u>	<u>Votes Withheld:</u>	<u>Broker Non Votes:</u>
Theodore F. Craver, Jr.	87,987,656	0	7,112,729	0
Vicki B. Escarra	87,785,905	0	7,314,480	0
Thomas T. Farley	87,714,695	0	7,385,690	0
Gale S. Fitzgerald	87,785,602	0	7,314,783	0
Patrick Foley	87,514,553	0	7,585,832	0
Jay M. Gellert	87,732,672	0	7,367,713	0
Roger F. Greaves	87,731,144	0	7,369,241	0
Bruce G. Willison	83,259,213	0	11,841,172	0
Frederick C. Yeager	87,787,764	0	7,312,621	0

Since each of the nominees received a plurality of the votes cast, each of the nominees was elected as a director for an additional term at the Annual Meeting.

Proposal 2

With respect to the ratification of the selection of Deloitte & Touche LLP as our independent registered public accountants for the year ending December 31, 2008, 93,057,070 votes were cast for and 1,970,768 votes were cast against and there were 72,547 abstentions and no broker non-votes. Since Proposal 2 received the affirmative vote of a majority of the votes cast on that proposal, the selection of Deloitte & Touche LLP as our independent registered public accountants for the year ending December 31, 2008 was ratified.

Item 5. Other Information.

None.

Item 6. Exhibits.

The following exhibits are filed as part of this Quarterly Report on Form 10-Q:

<u>Exhibit Number</u>	<u>Description</u>
10.1	Amended and Restated Employment Agreement, dated as of May 23, 2008, by and between Health Net, Inc. and Patricia T. Clarey
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

HEALTH NET, INC.
(REGISTRANT)

Date: August 8, 2008

By: /s/ JOSEPH C. CAPEZZA
Joseph C. Capezza
Chief Financial Officer

Date: August 8, 2008

By: /s/ BRET A. MORRIS
Bret A. Morris
Senior Vice President and Corporate Controller
(Principal Accounting Officer)

EXHIBIT INDEX

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**PATRICIA T. CLAREY
AMENDED AND RESTATED EMPLOYMENT AGREEMENT**

This AMENDED AND RESTATED EMPLOYMENT AGREEMENT (this "Agreement") is made and entered into as of May 23, 2008 (the "Effective Date"), by and between Health Net, Inc., a Delaware corporation (the "Company"), with its principal place of business located at 21650 Oxnard Street, Woodland Hills, California 91367, and Patricia T. Clarey ("Executive").

RECITALS

WHEREAS, the Company and Executive are party to an Employment Letter Agreement, dated March 23, 2006, (the "Prior Agreement");

WHEREAS, the Company and Executive desire to amend and restate the Prior Agreement to reflect Executive's new role with the Company as Senior Vice President and Chief Regulatory and External Relations Officer and to make certain changes to the Prior Agreement as a result of Executive's new role; and

WHEREAS, the Company and Executive are entering into this Agreement to establish the terms and conditions of the employment relationship.

NOW, THEREFORE, in consideration of the following covenants, conditions and promises contained herein, and other good and valuable consideration, the Company and Executive hereby agree as follows:

1. Duties and Salary.

A. Duties. Executive's title will be Senior Vice President and Chief Regulatory and External Relations Officer, but may be changed at the discretion of the Company to a title that reflects a similarly situated senior executive position. Executive shall report directly to Jay Gellert, President and Chief Executive Officer of the Company, but Executive's reporting relationship may be changed from time to time at the discretion of the Company. Executive's duties and responsibilities include (i) responsibility for policy and execution of the Company's regulatory, public, communications and legislative activities including Medicare and Medicaid to insure consistency of message, approach, execution and compliance and (ii) provision of staff support to President and Chief Executive Officer in all legislative, congressional, industry group, community activities and strategic Company initiatives, as assigned, but the Company reserves the right to assign Executive other duties as needed and to change Executive's duties from time to time on reasonable notice, based on Executive's skills and the needs of the Company.

B. Salary. Executive will be paid a base salary at the annual rate of \$397,254, which salary will be paid on a pro-rated bi-weekly basis, less applicable withholdings ("Base Salary"), covering all hours worked. Generally, Executive's Base Salary will be

reviewed annually, but the Company reserves the right to change Executive's compensation from time-to-time. Pursuant to the charter of the Compensation Committee of the Company's Board of Directors (the "Committee"), any adjustment to Executive's compensation must be made with the approval of the Committee and, in the event that Executive constitutes one of the top two (2) highest paid executive officers of the Company, with the ratification of the Company's Board of Directors.

C. Disclosure of Personal Compensation Information. As an "executive officer" of the Company (as such term is defined in the rules and regulations of the Securities and Exchange Commission ("SEC")), information regarding Executive's employment arrangements with the Company, including, among other things, the terms of this Agreement and any stock option agreement, restricted stock agreement, restricted stock unit agreement, performance share agreement and/or severance agreement Executive enters into with the Company from time to time (collectively, "Personal Compensation Information"), may be disclosed in filings with the SEC, the New York Stock Exchange ("NYSE") and/or other regulatory organizations upon the occurrence of certain triggering events. Such triggering events include, but are not limited to, the execution of this Agreement and any amendments thereto, changes in Executive's Base Salary, any annual incentive payment (whether in the form of cash or equity) awarded to Executive (in the past or after the date hereof), and the establishment of performance goals under the Company's incentive plans. Executive's execution of this Agreement will serve as Executive's acknowledgement that Executive's Personal Compensation Information may be publicly disclosed from time to time in filings with the SEC, NYSE or otherwise as required by applicable law.

2. Adjustments and Changes in Employment Status. Executive understands that the Company reserves the right to make personnel decisions regarding Executive's employment, including, but not limited to, decisions regarding any promotion, salary adjustment, transfer or disciplinary action, up to and including Termination (as defined below), consistent with the needs of the business of the Company.

For purposes of this Agreement, the capitalized terms "Termination" and "Terminate," shall mean Executive's Separation from Service (as defined below) from the Company. A "Separation from Service" shall have the meaning ascribed to such term in Treasury Regulations promulgated under Section 409A of the Internal Revenue Code of 1986, as amended (the "Code"), from time to time and other publications of the Internal Revenue Service published in the Internal Revenue Bulletin from time to time.

3. Protection of Proprietary and Confidential Information. Executive agrees that Executive's employment creates a relationship of confidence and trust with the Company with respect to Proprietary and Confidential Information (as defined below) of the Company learned by Executive during Executive's employment.

A. Executive agrees not to directly or indirectly use or disclose any of the Proprietary and Confidential Information of the Company or any of its affiliates at any time except in connection with the services Executive provides to such entities. "Proprietary and Confidential Information" shall mean trade secrets, confidential knowledge, data or any other proprietary or confidential information of the Company or any of its affiliates, or of any customers, members, employees or directors of any of such entities, but

shall not include any information that (i) was publicly known and made generally available in the public domain prior to the time of disclosure to Executive by the Company or (ii) becomes publicly known and made generally available after disclosure to Executive by the Company other than as a result of a disclosure by Executive in violation of this Agreement. By way of illustration but not limitation, "Proprietary and Confidential Information" includes: (i) trade secrets, documents, memoranda, reports, files, correspondence, lists and other written and graphic records affecting or relating to any such entity's business; (ii) confidential marketing information including without limitation marketing strategies, customer and client names and requirements, services, prices, margins and costs; (iii) confidential financial information; (iv) personnel information (including without limitation employee compensation); and (v) other confidential business information.

B. Executive further agrees that at all times during Executive's employment and thereafter, Executive will keep in confidence and trust all Proprietary and Confidential Information, and that Executive will not use or disclose any Proprietary and Confidential Information or anything related to such information without the written consent of the Company, except as may be necessary in the ordinary course of performing Executive's duties to the Company.

C. All Company property, including, but not limited to, Proprietary and Confidential Information, documents, data, records, apparatus, equipment and other physical property, whether or not pertaining to Proprietary and Confidential Information, provided to Executive by the Company or any of its affiliates or produced by Executive or others in connection with Executive's providing services to the Company or any of its affiliates shall be and remain the sole property of the Company or its affiliates (as the case may be) and shall be returned promptly to such appropriate entity as and when requested by such entity. Executive shall return and deliver all such property upon termination of Executive's employment, and Executive may not take any such property or any reproduction of such property upon such termination.

D. Executive recognizes that the Company and its affiliates have received and in the future will receive information from third parties which is private, proprietary or confidential information subject to a duty on such entity's part to maintain the confidentiality of such information and to use it only for certain limited purposes. Executive agrees that during Executive's employment, and thereafter, Executive owes such entities and such third parties a duty to hold all such private, proprietary or confidential information received from third parties in the strictest confidence and not to disclose it, except as necessary in carrying out Executive's work for such entities consistent with such entities' agreements with such third parties, and not to use it for the benefit of anyone other than for such entities or such third parties consistent with such entities' agreements with such third parties.

E. Executive's obligations under this Section 3 shall continue after the Termination of Executive's employment and any breach of this Section 3 shall be a material breach of this Agreement.

4. Physical Exam. Executive shall be required, on an annual basis, to undergo a physical examination and to send evidence that Executive has undergone such exam (but in no case the results of such exam) to the Senior Vice President of Organizational Effectiveness. The Company shall reimburse Executive for any out-of-pocket expenses relating to the physical examination that are not otherwise covered by Executive's health insurance plan.

5. Representations and Warranties of Executive.

A. No Violation; No Conflicts. Executive represents and warrants to the Company that the entering into of this Agreement and Executive's performance of Executive's duties hereunder, will not violate any agreements with, or trade secrets of, any other person or entity. Executive further represents and warrants that Executive does not have any relationship or commitment to any other person or entity that might be in conflict with Executive's obligations to the Company under this Agreement, including but not limited to outside employment, sales broker relationships, investments or business activities. Executive understands and agrees that while employed by the Company Executive is expected to refrain from engaging in any outside activities that might be in conflict with the business interests of the Company. In addition, Executive represents and warrants to the Company that Executive has not shared with or disclosed to, and will not share with or disclose to, the Company any proprietary or confidential information of Executive's previous employers or any other third party.

B. Legal Proceedings. Executive represents and warrants to the Company that Executive has not been arrested, indicted, convicted or otherwise involved in any criminal or civil action or legal matter that could affect Executive's ability to perform Executive's duties hereunder or that may have a negative impact on the Company, its reputation or its operations. Executive agrees, to the extent permitted by applicable law, to notify the Company's Senior Vice President of Organizational Effectiveness immediately in the event that Executive becomes party to any criminal or civil action or other legal matter in the future that could have an affect on the foregoing representation.

6. Executive Benefits.

A. Employee Benefit Programs. Executive shall be eligible to participate in the Company's various employee benefit programs and plans in place from time to time as long as Executive remains employed by the Company and Executive meets the applicable participation requirements. These benefit programs and plans include paid time off ("PTO"), holidays, group medical, dental, vision, term life, and short and long term disability insurance and participation in the Company's 401(k) plan, tuition reimbursement plan and deferred compensation plan. The Company or its subsidiaries or affiliates may modify, terminate or amend any benefit or plan in its discretion, retroactively or prospectively, subject only to applicable law.

B. Required Insurance. Executive will be covered by workers' compensation insurance and state disability insurance, as required by state law.

C. Financial Counseling Allowance. Executive will be entitled to be reimbursed up to the amount of \$5,000 per year for documented costs incurred for personal financial counseling services provided to Executive, including tax preparation, as long as Executive remains employed by the Company.

D. Incentive Bonus. Executive will be eligible to participate in the Health Net, Inc. Executive Incentive Plan ("EIP") in accordance with the terms of the EIP, which provides Executive with a target opportunity to earn each plan year up to 70% of

Executive's Base Salary as additional compensation according to the terms of the EIP. The bonus payment will range from 0% to 200% of target depending upon the actual results achieved, and specific, individually tailored measures will be established by the Company that must be achieved by Executive in order for Executive to be eligible to receive bonus payments for a given plan year. It is understood that the Committee and the Company will award bonus amounts, if any, as it deems appropriate consistent with the EIP.

E. Expenses. Subject to and in accordance with the Company's written policies for business and travel expenses, Executive will receive reimbursement for all business travel and other out-of-pocket expenses reasonably incurred by Executive in the performance of Executive's duties pursuant to this Agreement.

7. Equity Grants.

A. Initial Equity Grant. As of the Effective Date, Executive will be granted 10,000 performance shares (the "Performance Shares") which will vest and become non-forfeitable in accordance with the terms of the performance share agreement executed in connection with such grant. The Performance Shares granted to Executive will be granted under one of the Company's Long-Term Incentive Plans in accordance with and subject to the terms and conditions set forth in such plan and the agreement executed in connection with such grant.

B. Future Equity Grants. Any future equity grants made to Executive will be granted under one of the Company's Long-Term Incentive Plans, and will be subject to the terms of such plan and of the agreement executed in connection with such grant. Any future equity grants to Executive will be made at the discretion of the Committee.

C. Company Stock Ownership Requirement. In accordance with the Executive Officer Stock Ownership Policy adopted by the Board of Directors of the Company (the "Executive Stock Ownership Policy"), Executive is required to own shares of Common Stock of the Company having a value of one times (1x) Executive's Base Salary in effect from time to time pursuant to this Agreement (the "Stock Ownership Requirement"). The number of shares of Common Stock Executive is required to own will be calculated based on the average NYSE closing price per share of the Company's Common Stock (as adjusted for stock splits and similar changes to the Common Stock) for the most recently completed fiscal year of the Company.

Using Executive's current salary of \$397,254 and a stock price of \$52.69, which is the average closing price per share of the Company's Common Stock as of December 31, 2007, Executive's current stock ownership requirement is 7,539 ("Target Amount"). The Target Amount is subject to change from time to time based on (1) changes in the average closing sales price of the Company's Common Stock on an annual basis and (2) any changes in Executive's Base Salary made pursuant to and in accordance with Section 1B of this Agreement. Any shares of Company Common Stock that Executive owns, and any restricted stock units, shares of restricted stock or performance shares of the Company that Executive owns and have vested count toward the Target Amount. Stock options, unvested restricted stock units, unvested shares of restricted stock, unvested performance shares and shares of Common Stock gifted to others do not count toward the Target Amount. Under the Executive Stock Ownership Policy, Executive will have until four years from the Effective Date to comply with the Stock Ownership Requirement.

The Committee expects that Executive will make reasonable progress toward Executive's Stock Ownership Requirement. Executive will be notified on an annual basis of any changes in Executive's Target Amount.

8. Term of Employment. Executive's employment with the Company is at the mutual consent of Executive and the Company. Nothing in this Agreement is intended to guarantee Executive's continuing employment with the Company or employment for any specific length of time. Accordingly, either Executive or the Company may terminate the employment relationship at any time, with or without advance notice and with or without "Cause" (as defined below). Upon Termination of Executive's employment for any reason, in addition to any other payments that may be payable to Executive hereunder, Executive (or Executive's beneficiaries or estate) shall be paid (in each case to the extent not theretofore paid) within thirty (30) days following Executive's date of Termination (or such shorter period that may be required by applicable law): (a) Executive's annual Base Salary through such date, (b) accrued but unused PTO, (c) reimbursable expenses incurred by Executive prior to the Termination date and (d) amounts under any other compensatory plan, arrangement or program payment to which Executive may then be entitled. This Agreement constitutes a final and fully binding integrated agreement with respect to the at-will nature of the employment relationship.

9. Termination of Employment/Severance Pay.

A. Termination Without Cause Not Following Change in Control. If Executive's employment is Terminated by the Company without "Cause" (as defined in Section 10(D) below) at any time that is not within two (2) years after a "Change in Control" (as defined below) of Health Net, Inc., Executive will be entitled to receive, within thirty (30) days following the Termination of Executive's employment, provided that Executive signs, prior to the expiration of such (30) day period, a Separation Agreement, Waiver and Release of Claims substantially in the form attached hereto as Exhibit A, which is incorporated into this Agreement by reference, (i) a lump sum cash payment equal to twenty-four (24) months of Executive's Base Salary in effect immediately prior to the date of Executive's Termination, and (ii) the continuation of Executive's medical, dental and vision benefits (as maintained for Executive's benefit immediately prior to the date of Executive's Termination) (the "Benefits") for Executive and Executive's dependents for a period of six (6) months following the effective date of Executive's Termination, and (iii) the continuation, under COBRA, of Executive's Benefits for Executive and Executive's dependents for a period of eighteen (18) months, with premium payments paid by the Company on Executive's behalf, provided, that Executive properly elects to continue those benefits under COBRA.

For purposes of this Agreement, "Change in Control" is defined as any of the following which occurs subsequent to the effective date of Executive's employment:

(i) Any person (as such term is defined under Section 13(d)(3) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")), corporation or other entity (other than Health Net, Inc. or any of its subsidiaries, or any employee benefit plan sponsored by Health Net, Inc. or any of its subsidiaries) is or becomes the beneficial owner (as such term is defined in Rule

13d-3 under the Exchange Act) of securities of Health Net, Inc. representing twenty percent (20%) or more of the combined voting power of the outstanding securities of Health Net, Inc. which ordinarily (and apart from rights accruing under special circumstances) have the right to vote in the election of directors (calculated as provided in paragraph (d) of such Rule 13d-3 in the case of rights to acquire Health Net, Inc.'s securities) (the "Securities");

(ii) As a result of a tender offer, merger, sale of assets or other major transaction, the persons who are directors of Health Net, Inc. immediately prior to such transaction cease to constitute a majority of the Board of Directors of Health Net, Inc. (or any successor corporations) immediately after such transaction;

(iii) Health Net, Inc. is merged or consolidated with any other person, firm, corporation or other entity and, as a result, the shareholders of Health Net, Inc., as determined immediately before such transaction, own less than eighty percent (80%) of the outstanding Securities of the surviving or resulting entity immediately after such transaction:

(iv) A tender offer or exchange offer is made and consummated for the ownership of twenty percent (20%) or more of the outstanding Securities of Health Net, Inc.;

(v) Health Net, Inc. transfers substantially all of its assets to another person, firm, corporation or other entity that is not a wholly-owned subsidiary of Health Net, Inc.; or

(vi) Health Net, Inc. enters into a management agreement with another person, firm, corporation or other entity that is not a wholly-owned subsidiary of Health Net, Inc. and such management agreement extends hiring and firing authority over Executive to an individual or organization other than Health Net, Inc.

B. Termination Without Cause or For Good Reason Following Change in Control. If at any time within two (2) years after a Change in Control of Health Net, Inc. Executive's employment is Terminated by the Company without Cause or Executive Terminates Executive's employment for "Good Reason" (as defined below) (by giving the Company at least fourteen (14) days prior written notice of the effective date of Termination), then Executive will be entitled to receive, within thirty (30) days following the Termination of Executive's employment, provided that Executive signs, prior to the expiration of such thirty (30) day period, a Separation Agreement, Waiver and Release of Claims substantially in the form attached hereto as Exhibit A, which is incorporated into this Agreement by reference, (i) a lump sum payment equal to thirty-six (36) months of Executive's Base Salary in effect immediately prior to the date of Executive's Termination, and (ii) the continuation of Executive's Benefits for eighteen (18) months following Executive's date of Termination, and (iii) and after expiration of such eighteen (18) month Benefits continuation period, the continuation, under COBRA, of Benefits for Executive and Executive's dependents for a period of eighteen (18) months following the effective date of Executive's Termination with premium payments made by the Company on Executive's behalf, provided, that Executive properly elects to continue those benefits under COBRA, and provided, further, that in the event the Company requests, in writing, prior to such voluntary Termination by Executive for Good Reason that Executive continue in the employ of the Company

for a period of time up to 90 days following such Change in Control, then Executive shall forfeit such severance allowance if Executive voluntarily leaves the employ of the Company prior to the expiration of such period of time.

For purposes of this Agreement, the term “Good Reason” means any of the following which occurs, without Executive’s consent, subsequent to the effective date of a Change in Control as defined above:

(i) A demotion or a substantial reduction in the scope of Executive’s position, duties, responsibilities or status with the Company, or any removal of Executive from or any failure to reelect Executive to any of the positions (or functional equivalent of such positions) referred to in the introductory paragraphs hereof, except in connection with the Termination of Executive’s employment for Disability (as defined below), normal retirement or Cause or by Executive voluntarily other than for Good Reason;

(ii) A reduction by the Company in Executive’s Base Salary or a material reduction in the benefits or perquisites available to Executive as in effect immediately prior to any such reduction;

(iii) A relocation of Executive to a work location more than fifty (50) miles from Executive’s work location immediately prior to such proposed relocation; provided that such proposed relocation results in a materially greater commute for Executive based on Executive’s residence immediately prior to such relocation; or

(iv) The failure of the Company to obtain an assumption agreement from any successor contemplated under Section 13 of this Agreement.

C. Voluntary Termination. Notwithstanding anything to the contrary in this Agreement, whether express or implied, Executive may at any time Terminate Executive’s employment for any reason by giving the Company fourteen (14) days prior written notice of the effective date of Termination. In the event that Executive voluntarily Terminates employment with the Company (except for Good Reason within two (2) years after a Change in Control of Health Net, Inc.), then Executive shall not be eligible to receive any payments or continuation of Benefits set forth in this Section 10).

D. Termination by the Company for Cause. The Company may Terminate Executive’s employment for Cause at any time with or without advance notice. In the event of such Termination, Executive will not be eligible to receive any of the payments set forth in Section 10(A) or 10(B) above. For purposes of this Agreement, a Termination for “Cause” is defined as: (i) an act of dishonesty causing harm to the Company or any of its affiliates, (ii) the material breach of either the Company’s Code of Business Conduct and Ethics (the “Code of Conduct”) or any policy or procedure developed and published by the Company regarding compliance or ethics related to the Code of Conduct, (iii) habitual drunkenness or narcotic drug addiction, (iv) conviction of a felony or a misdemeanor involving moral turpitude, (v) willful refusal to perform or gross neglect of the duties assigned to Executive, (vi) the willful breach of any law that, directly or indirectly, affects the Company or any of its affiliates, (vii) a material breach by Executive following a Change in Control of those duties and responsibilities of Executive that do not differ in any material respect

from Executive's duties and responsibilities during the 90-day period immediately prior to such Change in Control (other than as a result of incapacity due to physical or mental illness) which is demonstrably willful and deliberate on Executive's part, which is committed in bad faith or without reasonable belief that such breach is in the best interests of the Company or any of its affiliates and which is not remedied in a reasonable period of time after receipt of written notice from the Company specifying such breach, or (viii) breach of Executive's obligations hereunder (or under any Company policy) to protect the proprietary and confidential information of the Company or any of its affiliates.

E. Termination Due to Death or Disability. In the event that Executive's employment is Terminated at any time due to Executive's death or "Disability" (as defined below), Executive (or Executive's beneficiaries or estate) shall be entitled to receive, provided Executive (or Executive's beneficiaries or estate, as applicable) signs a Separation Agreement, Waiver and Release of Claims substantially in the form attached hereto as Exhibit A, which is incorporated into this Agreement by reference, (i) continuation of Executive's Benefits for a period of twelve (12) months from the date of Termination and (ii) a lump sum payment equal to one times (1x) Executive's Base Salary in effect immediately prior to the date of Executive's Termination, to be paid within thirty (30) days following Executive's Termination of employment. For purposes of this Agreement, a Termination for "Disability" shall mean a Termination of Executive's employment due to Executive's absence from Executive's duties with the Company on a full-time basis for at least 180 consecutive days as a result of Executive's incapacity due to physical or mental illness.

10. Withholding. All payments required to be made by the Company hereunder to Executive or Executive's estate or beneficiaries shall be subject to the withholding of such amounts relating to taxes as the Company may reasonably determine should be withheld pursuant to any applicable law or regulation.

11. Restrictive Covenants.

A. Non-Competition. Executive hereby agrees that, during (i) the six (6)-month period following a Termination of Executive's employment with the Company that entitles Executive to receive severance benefits under this Agreement or a written agreement with or policy of the Company or (ii) the twelve (12)-month period following a Termination of Executive's employment with the Company that does not entitle Executive to receive such severance benefits (the period referred to in either clause (i) or (ii), the "Restricted Period"), Executive shall not undertake any employment or activity (including, but not limited to, consulting services) with a Competitor (as defined below) in any geographic area in which the Company or any of its affiliates operate (the "Market Area"), where the loyal and complete fulfillment of the duties of the competitive employment or activity would call upon Executive to reveal, to make judgments on or otherwise use or disclose any confidential business information or trade secrets of the business of the Company or any of its affiliates to which Executive had access during Executive's employment with the Company. For purposes of this Section, "Competitor" shall refer to any health maintenance organization or insurance company that provides managed health care or related services similar to those provided by the Company or any of its affiliates.

B. Non-Solicitation. In addition, Executive agrees that, during the applicable Restricted Period following Termination of Executive's employment with the Company, Executive shall not, directly or indirectly, (i) solicit, interfere with, hire, offer to hire or induce any person, who is or was an employee of the Company or any of its affiliates at the time of such solicitation, interference, hiring, offering to hire or inducement, to discontinue his/her relationship with the Company or any of its affiliates or to accept employment by, or enter into a business relationship with, Executive or any other entity or person or (ii) solicit, interfere with or otherwise contact any customer or client of the Company or any of its affiliates.

C. Modification of Restrictions. It is hereby further agreed that if any court of competent jurisdiction shall determine that the restrictions imposed in this Section 13 are unreasonable (including, but not limited to, the definition of Market Area or Competitor or the time period during which this provision is applicable), the parties hereto hereby agree to any restrictions that such court would find to be reasonable under the circumstances.

D. Injunction Rights. Executive also acknowledges that the services to be rendered by Executive to the Company are of a special and unique character, which gives this Agreement a peculiar value to the Company or any of its affiliates, the loss of which may not be reasonably or adequately compensated for by damages in an action at law, and that a material breach or threatened breach by Executive of any of the provisions contained in this Section 13 will cause the Company or any of its affiliates irreparable injury. Executive therefore agrees that the Company may be entitled, in addition to the remedies set forth above in this Section 13 and any other right or remedy, to a temporary, preliminary and permanent injunction, without the necessity of proving the inadequacy of monetary damages or the posting of any bond or security, enjoining or restraining Executive from any such violation or threatened violations.

12. Successors; Binding Agreement.

A. Survival Following Merger, Consolidation or Asset Transfer. This Agreement shall not be terminated by any merger or consolidation of the Company whereby the Company is or is not the surviving or resulting corporation or as a result of any transfer of all or substantially all of the assets of the Company. In the event of any such merger, consolidation or transfer of assets, the provisions of this Agreement shall be binding upon the surviving or resulting corporation or the person or entity to which such assets are transferred.

B. Survivor's Assumption of Agreement. The Company agrees that concurrently with any merger, consolidation or transfer of assets referred to in this Section 14, it will cause any successor or transferee to unconditionally assume, by written instrument delivered to Executive (or Executive's beneficiary or estate), all of the obligations of the Company hereunder. Failure of the Company to obtain such assumption prior to the effectiveness of any such merger, consolidation or transfer of assets shall entitle Executive to compensation and other benefits from the Company in the same amount and on the same terms as Executive would be entitled hereunder if Executive's employment were Terminated without Cause. For purposes of implementing the foregoing, the date on which any such merger, consolidation or transfer becomes effective shall be deemed the date of Termination.

C. Enforceability. This Agreement shall inure to the benefit of and be enforceable by Executive's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees. If Executive shall die while any amounts would be payable to Executive hereunder had Executive continued to live, all such amounts, unless otherwise provided herein, shall be paid in accordance with the terms of this Agreement to such person or persons appointed in writing by Executive to receive such amounts or, if no person is so appointed, to Executive's estate.

13. Section 409(A) of the Internal Revenue Code. It is the intention of the Company and Executive that this Agreement not result in unfavorable tax consequences to Executive under Section 409A of the Code, and the regulations and guidance promulgated thereunder ("Section 409A") and the Agreement shall be interpreted as to so comply. Notwithstanding anything to the contrary herein, the Company and Executive agree to the provisions set forth in this Section 15 in order to comply with the requirements of Section 409A.

A. If Executive is a "specified employee" (within the meaning of Section 409A) with respect to the Company, any non-qualified deferred compensation otherwise payable to or in respect of Executive in connection with Executive's Termination pursuant to this Agreement shall be delayed until the earliest date upon which such amounts may be paid without being subject to taxation under Section 409A. Any amount, the payment of benefit of which is delayed by application of the preceding sentence, shall be paid as soon as possible following the expiration of such period.

B. All incentive bonus payments described in Section 7(D) shall be paid to Executive, to the extent earned, in no event later than the last day of the "applicable 2-1/2 month period", as such term is defined in Treasury Regulation Section 1.409A-1(b)(4)(i)(A) with respect to such payment's treatment as a "short-term deferral" for purposes of Section 409A.

C. With respect to the Company's reimbursement and tax gross-up obligations under Sections 7(C) and 7(E) hereof, in no event shall any such reimbursements or gross-up payments be made later than the last day of Executive's taxable year following the taxable year in which the fee or expense was incurred or the tax payment was made, as applicable.

D. The provision of Benefits to Executive following Termination hereunder shall be subject to the provisions of Treasury Regulation 1.409A-3(i)1(iv)(A) and (B).

E. The Company and Executive agree to cooperate in good faith in an effort to comply with Section 409A. Under no circumstances shall the Company be responsible for any taxes, penalties, interest or other losses or expenses incurred by the Executive due to any failure to comply with Section 409A.

14. Company Policies. Executive's employment with the Company is subject to the terms and conditions contained in the Company's Associate Policy Manual (the "Policy Manual"), the content of which is incorporated by reference herein. Executive shall be required to read, understand and comply with the policies contained in the Policy Manual and, within 30 days of Executive's first date of employment, acknowledge receipt of the Policy Manual through HR Link, which can be accessed through the Company's intranet site.

15. Severability. If any term of this Agreement is held to be invalid, void or unenforceable, the remainder of this Agreement shall remain in full force and effect and shall in no way be affected and the parties shall use their best efforts to find an alternative way to achieve the same result.

16. Integrated Agreement. This Agreement supersedes any prior agreements, representations or promises of any kind, whether written, oral, express or implied between the parties hereto with respect to the subject matters herein. It constitutes the full, complete and exclusive agreement between Executive and the Company with respect to the subject matters herein. This Agreement cannot be changed unless in writing, signed by Executive and the Chief Executive Officer of the Company and approved by the Board of Directors of the Company (or the Committee, if permitted by the Committee's charter). The Company acknowledges and agrees that nothing contained herein shall be deemed to supercede, amend or otherwise modify the terms of the Indemnification Agreement dated as of the Effective Date between Executive and the Company.

17. Waiver. No waiver of any default hereunder shall operate as a waiver of any subsequent default. Failure by either party to enforce any of the terms or conditions of this Agreement, for any length of time or from time to time, shall not be deemed to waive or decrease the rights of such party to insist thereafter upon strict performance by the other party.

18. Notices. All notices and communications required or permitted hereunder shall be in writing and shall be deemed given (a) if delivered personally, (b) one (1) business day after being sent by Federal Express or a similar commercial overnight service, or (c) three (3) business days after being mailed by registered or certified mail, return receipt requested, prepaid and addressed to the following addresses, or at such other addresses as the parties may designate by written notice in the manner aforesaid:

If to the Company: Health Net, Inc.
21650 Oxnard Street, 22nd Floor
Woodland Hills, CA 91367
Attention: General Counsel

If to the Executive: Patricia T. Clarey
[ADDRESS]
[ADDRESS]

19. Governing Law. The interpretation, construction and performance of this Agreement shall be governed by and construed and enforced in accordance with the internal laws of the State of Delaware without regard to the principle of conflicts of laws. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provisions of this Agreement, which other provisions shall remain in full force and effect.

20. Survival and Enforcement. Sections 3, 8, 9, 11 and 12 of this Agreement and any rights and remedies arising out of this Agreement shall survive and continue in full force and effect in accordance with the respective terms thereof, notwithstanding any termination of this Agreement or a Termination of Executive's employment. The parties agree that the Company would be damaged irreparably in the event any provision of Sections 3, 11 and 12 of this Agreement were not performed in accordance with its terms or were otherwise breached and that money damages would be an inadequate remedy for any such nonperformance or breach. Therefore, the Company or its successors or assigns shall be entitled in addition to other rights and remedies existing in their favor, to an injunction or injunctions to prevent any breach or threatened breach of any of such provisions and to enforce such provisions specifically (without posting a bond or other security).

21. Acknowledgement. Executive acknowledges that Executive has had the opportunity to discuss the content of this Agreement with and obtain advice from Executive's attorney, have had sufficient time to and have carefully read and fully understood all of the provisions of this Agreement, and Executive is knowingly and voluntarily entering into this Agreement. Executive further acknowledges that Executive is obligated to become familiar with and comply at all times with all written policies of the Company.

[Signature Page to Follow]

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the Effective Date set forth above.

Executive

Health Net, Inc.

By: /s/ Patricia T. Clarey
Name: Patricia T. Clarey
Title: SVP, Chief Regulatory &
External Relations Officer

By: /s/ Jay M. Gellert
Name: Jay M. Gellert
Title: President and Chief Executive Officer

cc: Linda V. Tiano
Karin Mayhew
Debbie J. Colia/P. Clarey Personnel File

EXHIBIT A

[FORM OF SEPARATION AGREEMENT, WAIVER AND RELEASE OF CLAIMS]

This SEPARATION AGREEMENT, WAIVER AND RELEASE OF CLAIMS (this “**Separation Agreement and Release**”) is made and entered into as of the dates set forth on the signature pages hereto by and between Health Net, Inc. and its affiliates and subsidiaries (hereinafter referred to as the “**Company**”) and **[EXECUTIVE NAME]** (hereinafter referred to as the “**Executive**”).

WHEREAS, the Company and Executive are parties to an Employment Agreement dated as of **[DATE]** (the “Employment Agreement”) and are entering into this Separation Agreement and Release as a condition to Executive’s receipt of a severance payment thereunder (capitalized terms used but not defined herein shall have the meanings set forth in the Employment Agreement).

NOW, THEREFORE, the Company and Executive agree as follows:

1. Executive’s employment with the Company will terminate on **[TERM DATE]** (the “Termination Date”). Upon termination of employment, Executive will not represent to anyone that he is an employee of the Company and will not say or do anything purporting to bind the Company. Upon Executive’s termination of employment, Executive shall be deemed to have resigned from all other positions with the Company, if any, held by Executive.
2. Executive’s termination of employment with the Company shall be considered a **[DESCRIBE TYPE OF TERMINATION]** under the Employment Agreement, and Executive is therefore eligible to receive **[DESCRIBE PAYMENTS AND OTHER BENEFITS TO BE RECEIVED (SEVERANCE, BENEFIT CONTINUATION/COBRA, ETC.)]**.
3. Executive acknowledges that all unused accrued vacation and unused personal absence time will be paid in Executive’s final regular paycheck in keeping with the Company’s policy and practice or such shorter time as may be required by applicable law. Executive further acknowledges that no further vacation/paid-time-off or other benefits will accrue after the Termination Date.
4. Executive’s participation in all Company employee benefit plans as an active employee shall cease on the Termination Date, and Executive shall not be eligible to make contributions to or to receive Company matching contributions under the Health Net, Inc. 401(k) Associate Savings Plan, or to make any deferrals pursuant to any deferred compensation plan of the Company after the Termination Date (it being understood that Executive shall be entitled to all vested benefits accrued as of the date hereof under the Company’s 401(k) Savings Plan and any deferred compensation plan). If, immediately prior to the Termination Date, Executive participates in any Company employee welfare benefit plan, Executive’s participation in such plan shall continue on the same terms and conditions, including the same co-payment terms, until 11:59 p.m. (Pacific Time) on the last day of the month in which the Termination Date occurs.

5. In partial consideration of the Company providing Executive the payments and benefits set forth above and as a condition to receive such payments and benefits, which Executive acknowledges he is not otherwise entitled to receive, Executive freely and voluntarily enters into this Separation Agreement and Release and, by signing this Separation Agreement and Release, Executive, on his own behalf and on behalf of his heirs, beneficiaries, successors, representatives, trustees, administrators and assigns, hereby waives and releases the Company, and each of its past, present and future officers, directors, shareholders, employees, consultants, accountants, attorneys, agents, managers, insurers, sureties, parent and sister corporations, divisions, subsidiary corporations and entities, partners, joint venturers, affiliates, beneficiaries, successors, representatives and assigns, from any and all claims, demands, damages, debts, liabilities, controversies, obligations, actions or causes of action of any nature whatsoever, whether based on tort, statute, contract, indemnity, rescission or any other theory of recovery, including but not limited to claims arising under federal, state or local laws prohibiting discrimination in employment, including Title VII of the Civil Rights Act of 1964, as amended, the Civil Rights Act of 1870, as amended, claims of disability discrimination under the Americans with Disabilities Act, the Age Discrimination in Employment Act, as amended (“**ADEA**”), the Worker Adjustment and Retraining Notification Act (“**WARN**”), or claims growing out of any legal restrictions on the Company’s right to terminate its employees and whether for compensatory, punitive, equitable or other relief, whether known, unknown, suspected or unsuspected, against the Company, including without limitation claims which may have arisen or may in the future arise in connection with any event which occurred on or before the date of Executive’s execution of this Separation Agreement and Release. The provisions in this paragraph do not extend to any rights Executive may have to enforce the terms of this Agreement and are not intended to prohibit Executive from filing a claim for unemployment insurance.
6. Executive expressly waives any right or claim of right to assert hereafter that any claim, demand, obligation and/or cause of action has, through ignorance, oversight or error, been omitted from the terms of this Separation Agreement and Release. Executive makes this waiver with full knowledge of his rights and with specific intent to release both his known and unknown claims, and therefore specifically waives the provisions of Section 1542 of the Civil Code of California or other similar provisions of any other applicable law, which reads as follows:

“A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor.”

Executive understands and acknowledges the significance and consequence of this Separation Agreement and Release and of such specific waiver of Section 1542, and expressly agrees that this Agreement shall be given full force and effect according to each and all of its express terms and provisions, including those relating to unknown and unsuspected claims, demands, obligations and causes of action herein above specified.
7. Executive shall not initiate or cause to be initiated against the Company any compliance review, suit, action, investigation or proceeding of any kind, or voluntarily participate in same, individually or as a representative, witness or member of a class, under contract, law or regulation, federal, state or local, pertaining to any matter related to his employment with the Company,

unless Executive first cooperates in making his allegations known to the Company for the Company to take corrective action at a time and place designated by the Company. Executive represents and warrants that he has not, to date, initiated (or caused to be initiated) any such review, suit, action, investigation or proceeding; provided, however, that nothing in this Section 7 shall restrict Executive's ability to challenge the validity of any release herein of ADEA claims nor to any suit or action brought by Executive to assert such a challenge. In addition, Executive shall, without further compensation, cooperate with and assist the Company in the investigation of, preparation for or defense of any actual or threatened third party claim, investigation or proceeding involving the Company or its predecessors or affiliates and arising from or relating to, in whole or in part, Executive's employment with the Company or its predecessors or affiliates for which the Company requests Executive's assistance, which cooperation and assistance shall include, but not be limited to, providing testimony and assisting in information and document gathering efforts. In this connection, it is agreed that the Company will use its reasonable best efforts to assure that any request for such cooperation will not unduly interfere with Executive's other material business and personal obligations and commitments.

8. Executive agrees he will return to the Company immediately upon termination any building keys, security passes or other access or identification cards and any Company property that was in his possession, including but not limited to any documents, credit cards, computer equipment, mobile phones or data files. Executive agrees to clear all expense accounts and pay all amounts owed on any corporate credit cards which the Company previously issued to Executive, subject to the Company's obligation to reimburse Executive for any properly reimbursable business expenses in accordance with the Company's expense policies and procedures then in effect.
9. Executive shall not, without the Company's written consent by an authorized representative, at any time prior or subsequent to the execution of this Separation Agreement and Release, disclose, use, remove or copy any confidential, trade secret or proprietary information he acquired during the course of his employment by the Company, including without limitation, any technical, actuarial, economic, financial, procurement, provider, customer, underwriting, contractual, managerial, marketing or other information of any type that has economic value in the business in which the Company is engaged, but not including any previously published information or other information generally in the public domain.
10. In addition to any other part or term of this Separation Agreement and Release or the Employment Agreement, Executive agrees that he will not, (a) for a period of one (1) year from the date of this Agreement, irrespective of the reason for the termination, either directly or indirectly, on his own behalf or on behalf of any other person: (1) make known to any person, firm, corporation or other entity of any type, the names and addresses of any of the Company's customers, enrollees or providers or any other information pertaining to them; or (2) disrupt, solicit or influence or attempt to solicit, disrupt or influence any of the Company's customers, providers, vendors, agents or independent contractors with whom the Executive became acquainted during the course of employment or service for the purpose of terminating such a person's or entity's relationship with the Company or causing

such a person or entity to associate with a competitor of the Company, and (b) for **[a period of one (1) year] [the six (6) month period]** following the Termination Date undertake any employment or activity prohibited by the Employment Agreement. The prohibitions of this paragraph are not intended to deny employment opportunities within the Executive's field of employment but are limited only to those prohibitions necessary to protect the Company from unfair competition. In addition, Executive agrees that, for **[a period of one (1) year] [the six (6) month period]** following the Termination Date, he shall not, directly or indirectly solicit, interfere with, hire, offer to hire or induce any person, who is or was an employee of the Company or any of its affiliates at the time of such solicitation, interference, hiring, offering to hire or inducement, to discontinue his/her relationship with the Company or any of its affiliates or to accept employment by, or enter into a business relationship with, Executive or any other entity or person.

11. Executive further agrees that, in exchange for the consideration set forth in Section 2 hereof, Executive shall not make any disparaging comments and/or statements to anyone either orally or in writing about the Company and/or its employees.
12. Nothing contained herein shall be construed as an admission of any wrongful act, including but not limited to violation of any contract, express or implied, or any federal, state or local employment laws or regulations, and nothing contained herein shall be used for any purpose except in proceedings related to the enforcement of this Separation Agreement and Release.
13. If any part or term of this Separation Agreement and Release is held invalid or unenforceable by any court or arbitrator, such invalidity or unenforceability shall not affect in any way the validity or enforceability of any other part or term of this Separation Agreement and Release. In addition, if any court of competent jurisdiction construes the covenants contained in Section 10 hereof, or any part thereof, to be unenforceable in any respect, the court may reduce the duration or scope to the extent necessary so that the provision is enforceable, and the provision, as reduced, shall then be enforceable.
14. Executive agrees and acknowledges that this Separation Agreement and Release recites all payments and benefits Executive is entitled to receive hereunder and under the Employment Agreement, and that no other payments or benefits will be asserted or requested by Executive.
15. The Executive acknowledges that he has had an opportunity to consult and be represented by counsel of his own choosing in the review of this Separation Agreement and Release, and that he has been advised by the Company to do so, that the Executive is fully aware of this Separation Agreement and Release and of its legal effect, that the preceding paragraphs recite the sole consideration for this Separation Agreement and Release, and that Executive enters into this Separation Agreement and Release freely, without coercion, and based on the Executive's own judgment and not in reliance upon any representation or promise made by the other party, other than those contained herein. There may be no modification of the terms of this Separation Agreement and Release except in writing signed by the parties hereto including an appropriately authorized officer of the Company.

16. This Separation Agreement and Release constitutes the full, complete and exclusive agreement between Executive and the Company with respect to the subject matters herein and supersedes any prior agreements, representations or promises of any kind, whether written, oral, express or implied, with respect to the subject matters herein. This Separation Agreement and Release cannot be changed unless in writing, signed by Executive and an authorized officer of the Company.
17. If there is any dispute between the Company and Executive over the terms or obligations under this Separation Agreement and Release, that dispute shall be resolved by binding arbitration before a single neutral arbitrator who shall be a retired judge. The arbitration shall proceed in accordance with the then-current rules of the Commercial American Arbitration Association to the extent not inconsistent with this Separation Agreement and Release. The judgment of the arbitrator shall be final, binding and nonappealable, and may be entered in any state or federal court having jurisdiction thereafter. The arbitrator shall be bound to apply and follow the applicable state or federal laws in reaching a decision in this matter. Any disagreement regarding whether a dispute is required to be arbitrated pursuant to this Separation Agreement and Release shall be decided by the arbitrator. The Federal Arbitration Act, 9 U.S.C. Sections 1-16, shall govern the interpretation and enforcement of this Section 17. The prevailing party will be entitled to recover reasonable attorney's fees and costs incurred in any action to enforce or defend this Separation Agreement and Release.
18. This Separation Agreement and Release shall be construed and governed by the laws of the State of Delaware.

EXECUTIVE ACKNOWLEDGES BY SIGNING BELOW that (i) Executive has not relied upon any representations, written or oral, not set forth in this Separation Agreement and Release; (ii) at the time Executive was given this Separation Agreement and Release Executive was informed in writing by the Company that (a) Executive had at least 21 days in which to consider whether Executive would sign the Separation Agreement and Release and (b) Executive should consult with an attorney before signing the Separation Agreement and Release; and (iii) Executive had an opportunity to consult with an attorney and either had such consultations or has freely decided to sign this Separation Agreement and Release without consulting an attorney.

Executive further acknowledges that he may revoke acceptance of this Separation Agreement and Release by delivering a letter of revocation within seven (7) days after the later of the dates set forth below addressed to: Health Net, Inc., Organization Effectiveness Department, 21650 Oxnard Street, Woodland Hills, California 91367, Attention: Karin Mayhew.

Finally, Executive acknowledges that he understands that this Separation Agreement and Release will not become effective until the eighth (8th) day following his signing this Separation Agreement and Release and that if Executive does not revoke his acceptance of the terms of this Separation Agreement and Release within the seven (7) day period following the date on which Executive signs this Separation Agreement and Release as set forth above, this Separation Agreement and Release will be binding and enforceable.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties hereto have executed this Separation Agreement and Release as of the dates set forth below.

Executive

Health Net, Inc.

By: _____ **[EXHIBIT COPY]**

By: _____ **[EXHIBIT COPY]**

Name: _____

Name: _____

Title: _____

Title: _____

Dated: _____ **[TO BE INSERTED]**

Dated: _____ **[TO BE INSERTED]**

CERTIFICATIONS

I, Jay M. Gellert, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Health Net, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2008

/s/ JAY M. GELLERT

Jay M. Gellert
President and Chief Executive Officer

CERTIFICATIONS

I, Joseph C. Capezza, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Health Net, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2008

/s/ JOSEPH C. CAPEZZA

Joseph C. Capezza
Chief Financial Officer

**Certification of CEO and CFO Pursuant to
18 U.S.C. Section 1350,
as Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report on Form 10-Q of Health Net, Inc. (the "Company") for the quarterly period ended June 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Jay M. Gellert, as Chief Executive Officer of the Company, and Joseph C. Capezza, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ JAY M. GELLERT

Jay M. Gellert
Chief Executive Officer
August 8, 2008

/s/ JOSEPH C. CAPEZZA

Joseph C. Capezza
Chief Financial Officer
August 8, 2008