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PRE PAID LEGAL SERVICES INC

Form 10-Q

October 28, 2008

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
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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 September 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 \_\_\_\_\_

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Commission File Number: 001-09293

PRE-PAID LEGAL SERVICES, INC.  
(Exact name of registrant as specified in its charter)

Oklahoma  
(State or other jurisdiction of  
incorporation or organization)

73-1016728  
(I.R.S. Employer  
Identification No.)

One Pre-Paid Way, Ada, Oklahoma  
(Address of principal executive offices)

74820-5813  
(Zip Code)

(Registrants' telephone number, including area code): (580) 436-1234

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.

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(do not check if a smaller  
reporting company)

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

The number of shares outstanding of the registrant's common stock (excluding 4,852,179 shares held in treasury) as of October 22, 2008 was 11,616,604.

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PRE-PAID LEGAL SERVICES, INC.

FORM 10-Q

For the Quarter Ended September 30, 2008

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ITEM 1. FINANCIAL STATEMENTS

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PRE-PAID LEGAL SERVICES, INC.  
CONSOLIDATED BALANCE SHEETS  
(Amounts in 000's, except par values)

## ASSETS

Current assets:

Cash and cash equivalents.....	\$
Available-for-sale investments, at fair value.....	
Membership fees receivable.....	
Inventories.....	
Refundable income taxes.....	
Deferred member and associate service costs.....	
Deferred income taxes.....	
Other assets.....	

Total current assets.....	-----
Available-for-sale investments, at fair value.....	
Investments pledged.....	
Property and equipment, net.....	
Deferred member and associate service costs.....	
Other assets.....	

Total assets.....	----- \$ 1
-------------------	---------------

## LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:

Membership benefits.....	\$
Deferred revenue and fees.....	
Current portion of capital leases payable.....	
Current portion of notes payable.....	
Income taxes payable.....	
Accounts payable and accrued expenses.....	

Total current liabilities.....	-----
Capital leases payable.....	
Notes payable.....	
Deferred revenue and fees.....	
Deferred income taxes.....	
Other non-current liabilities.....	

Total liabilities.....	----- 1
------------------------	------------

Stockholders' equity:

Common stock, \$.01 par value; 100,000 shares authorized; 16,472 and 17,291 issued at September 30, 2008 and December 31, 2007, respectively.....	1
Retained earnings.....	
Accumulated other comprehensive income.....	
Treasury stock, at cost; 4,852 shares held at September 30, 2008 and December 31, 2007, respectively and 2004, respectively.....	(9)

Total stockholders' equity.....	-----
---------------------------------	-------

Total liabilities and stockholders' equity.....	----- \$ 1
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The accompanying notes are an integral part of these financial statements.

PRE-PAID LEGAL SERVICES, INC.  
CONSOLIDATED STATEMENTS OF INCOME  
(Amounts in 000's, except per share amounts)  
(Unaudited)

	Three Months Ended September 30,		Ni
	2008	2007	20
<b>Revenues:</b>			
Membership fees.....	\$ 109,268	\$ 107,713	\$ 327
Associate services.....	6,236	6,032	18
Other.....	1,019	1,132	3
	116,523	114,877	349
<b>Costs and expenses:</b>			
Membership benefits.....	37,587	37,475	112
Commissions.....	33,678	33,646	95
Associate services and direct marketing.....	5,358	8,902	17
General and administrative.....	12,531	13,717	38
Other, net.....	3,043	3,584	10
	92,197	97,324	275
Income before income taxes.....	24,326	17,553	74
Provision for income taxes.....	9,884	5,980	28
Net income.....	\$ 14,442	\$ 11,573	\$ 45
Basic earnings per common share.....	\$ 1.23	\$ .89	\$
Diluted earnings per common share.....	\$ 1.23	\$ .88	\$

The accompanying notes are an integral part of these financial statements.

PRE-PAID LEGAL SERVICES, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Amounts in 000's)  
(Unaudited)

	Three Months Ended September 30,		Ni
	2008	2007	20

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Net income.....	\$ 14,442	\$ 11,573	\$ 45
Other comprehensive (loss) income, net of tax:			
Foreign currency translation adjustment.....	(265)	529	
Unrealized (losses) gains on investments:			
Unrealized holding (losses) gains arising during period....	(357)	158	
Reclassification adjustment for realized losses included in net income.....	-	99	
	(357)	257	
Other comprehensive (loss) income, net of income taxes of \$(192) and \$164 for the three months and \$(361) and \$101 for the nine months ended September 30, 2008 and 2007, respectively.....			
	(622)	786	(1
Comprehensive income.....	\$ 13,820	\$ 12,359	\$ 44

The accompanying notes are an integral part of these financial statements.

PRE-PAID LEGAL SERVICES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Amounts in 000's)  
(Unaudited)

			Nin
			S
			-----
			2008
			-----
Cash flows from operating activities:			
Net income.....			\$ 45,
Adjustments to reconcile net income to net cash provided by operating activities:			
Benefit for deferred income taxes.....			(
Depreciation and amortization.....			6,
Increase in Membership fees receivable.....			(
Decrease in inventories.....			
Increase in refundable income taxes.....			(1,
Decrease (increase) in deferred member and associate service costs.....			
Increase in other assets.....			(
Increase in accrued Membership benefits.....			
Increase in deferred revenue and fees.....			
Increase in other non-current liabilities.....			1,
Decrease in income taxes payable.....			(5,
(Decrease) increase in accounts payable and accrued expenses.....			(
			-----
Net cash provided by operating activities.....			44,
Cash flows from investing activities:			
Additions to property and equipment.....			(4,
Purchases of investments - available for sale.....			(49,
Maturities and sales of investments - available for sale.....			49,

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Net cash (used in) provided by investing activities.....	(4,
<hr/>	
Cash flows from financing activities:	
Proceeds (use) from exercise of stock options.....	
Tax benefit on exercise of stock options.....	
Proceeds from issuance of debt.....	10,
Decrease in capital lease obligations.....	
Repayments of debt.....	(17,
Purchases and retirement of treasury stock.....	(36,
Net cash used in financing activities .....	(43,
<hr/>	
Net (decrease) increase in cash and cash equivalents.....	(3,
Cash and cash equivalents at beginning of period.....	24,
Cash and cash equivalents at end of period.....	\$ 21,
<hr/>	
Supplemental disclosure of cash flow information:	
Cash paid for interest.....	\$ 3,
<hr/>	
Cash paid for income taxes.....	\$ 36,
<hr/>	

The accompanying notes are an integral part of these financial statements.

PRE-PAID LEGAL SERVICES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Except for per share amounts, dollar amounts in tables are in thousands unless  
otherwise indicated)  
(Unaudited)

### Note 1 - Basis of Presentation

The accompanying consolidated financial statements and notes thereto have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been omitted. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in our 2007 Annual Report on Form 10-K. Terms such as "we", "our" and "us" are sometimes used as abbreviated references to Pre-Paid Legal Services, Inc.

In our opinion, the accompanying unaudited financial statements as of September 30, 2008, and for the three month and nine month periods ended September 30, 2008 and 2007, reflect adjustments (which were normal and recurring) which, in our opinion, are necessary for a fair statement of our financial position and results of operations of the interim periods presented. Results for the three month and nine month periods ended September 30, 2008 are not necessarily indicative of results expected for the full year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of

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the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Note 2 - Contingencies

On March 27, 2006 we received a complaint filed on March 24, 2006 by a former provider attorney law firm, Blackburn & McCune, PLLC, in Chancery Court of Davidson County, Tennessee seeking compensatory and punitive damages on the basis of allegations of breach of contract against the Company and our subsidiary Pre-Paid Legal Services, Inc. of Tennessee. On May 15, 2006 the trial court dismissed plaintiff's complaint in its entirety. Plaintiff filed a notice of appeal on June 13, 2006, and on August 24, 2007 the Court of Appeals reversed the ruling of the trial court and remanded the suit to the trial court for further proceedings. We filed a Petition for Rehearing which was denied on September 26, 2007. Discovery is ongoing. The ultimate outcome of this matter is not determinable.

On March 23, 2007 we received a Civil Investigative Demand from the Federal Trade Commission requesting information relating to our Identity Theft Shield and ADRS Program. We are working with the Federal Trade Commission to resolve the matter. The ultimate outcome of the matter is not determinable.

We are a defendant in various other legal proceedings that are routine and incidental to our business. We will vigorously defend our interests in all proceedings in which we are named as a defendant. We also receive periodic complaints or requests for information from various state and federal agencies relating to our business or the activities of our marketing force. We promptly respond to any such matters and provide any information requested.

While the ultimate outcome of these proceedings is not determinable, we do not currently anticipate that these contingencies will result in any material adverse effect to our financial condition or results of operation, unless an unexpected result occurs in one of the cases. The costs of the defense of these various matters are reflected as a part of general and administrative expense, or Membership benefits if fees relate to Membership issues, in the consolidated statements of income. We have established an accrued liability we believe will be sufficient to cover estimated damages in connection with various cases (exclusive of ongoing defense costs which are expensed as incurred), which at September 30, 2008 was \$500,000. We believe that we have meritorious defenses in all pending cases and will vigorously defend against the plaintiffs' claims. However, it is possible that an adverse outcome in certain cases or increased litigation costs could have an adverse effect upon our financial condition, operating results or cash flows in particular quarterly or annual periods.

Canadian taxing authorities are challenging portions of our commission and general and administrative deductions for tax years 1999 - 2002 and have tax assessments which aggregate \$5.7 million. The Canadian taxing authorities contend commission deductions should be matched with the membership revenue as received, we contend these commissions are deductible when paid. Under Canadian tax laws, our commission payments are treated as a prepaid expense. We base our deduction of commission on the fact that all the services (the sale of the membership) have been performed by the sales associate at the time of sale therefore this prepaid expense (the commission payments) is deductible when paid. Also, the commission payment is taxable to the sales associate when paid and each year we issue a T4 (Canadian 1099 equivalent) to sales associates for the total commission payments made during that year. In addition, Canadian taxing authorities have challenged our allocation of general and administrative expenses to Canadian operations. We contend the allocation of general and administrative expenses, based on the percentage of Canadian new memberships written and the Canadian percentage of memberships in force, is reasonable. During July 2007 we received a settlement offer from the Canadian taxing authorities regarding the general and administrative deductions which would

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allow us to claim a deduction on the Canadian tax return for over 70% of these items. This settlement offer would allow us to deduct the remaining 30% of these items on our US federal tax returns. We accepted this offer during the fourth quarter of 2007 and filed amended US federal tax returns. We met with the Canadian taxing authorities during March 2008 to explain our position relative to commissions and in July 2008 submitted a letter summarizing our position. During October 2008 the Canadian taxing authorities informed us they continue to believe our commission deductions should be matched with membership revenue as received. We are currently evaluating further appeals. The Canadian taxing authorities would not permit us to file the amended Canadian tax returns to reflect the changes in our general and administrative expense. We have established an accrued liability we believe will be sufficient to cover the estimated tax assessment in connection with these items, which at September 30, 2008 was \$477,000. As stated above, we believe that we have reasonable basis for our tax position relative to these items, however, it is possible that an adverse outcome could have an adverse effect upon our financial condition, operating results or cash flows in particular quarterly or annual periods.

### Note 3 - Treasury Stock Purchases

We announced on April 6, 1999, a treasury stock purchase program authorizing management to acquire up to 500,000 shares of our common stock. The Board of Directors has increased such authorization from 500,000 shares to 14 million shares during subsequent board meetings. At September 30, 2008 we had purchased 13.5 million treasury shares under these authorizations for a total consideration of \$399.4 million, an average price of \$29.53 per share. We purchased and formally retired 209,863 shares of our common stock during the 2008 third quarter for \$9.2 million, or an average price of \$43.75 per share, reducing our common stock by \$2,099 and our retained earnings by \$9.2 million. See Note 6 below. Given the current interest rate environment, the nature of other investments available and our expected cash flows, we believe that purchasing treasury shares enhances shareholder value and may seek alternative sources of financing to continue or accelerate the program. Any additional treasury stock purchases will be made at prices that we consider attractive and at such times that we believe will not unduly impact our liquidity.

### Note 4 - Earnings Per Share

Basic earnings per common share are computed by dividing net income by the weighted average number of shares of common stock outstanding during the respective period. Diluted earnings per common share are computed by dividing net income by the weighted average number of shares of common stock and dilutive potential common shares outstanding during the respective period. The weighted average number of common shares is increased by the number of dilutive potential common shares issuable on the exercise of options less the number of common shares assumed to have been purchased with the proceeds from the exercise of the options pursuant to the treasury stock method; those purchases are assumed to have been made at the average price of the common stock during the respective period.

	Three Months Ended September 30,		Ende
	2008	2007	20
Basic Earnings Per Share:			
Earnings:			
Net income.....	\$ 14,442	\$ 11,573	\$ 4
Shares:			



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Weighted average shares outstanding.....	11,746	13,068	1
<hr style="border-top: 1px dashed black;"/>			
Diluted Earnings Per Share:			
Earnings:			
Net income.....	\$ 14,442	\$ 11,573	\$ 4
<hr style="border-top: 1px dashed black;"/>			
Shares:			
<hr style="border-top: 1px dashed black;"/>			
Weighted average shares outstanding.....	11,746	13,068	1
Assumed exercise of options.....	17	26	
<hr style="border-top: 1px dashed black;"/>			
Weighted average number of shares, as adjusted.....	11,763	13,094	1
<hr style="border-top: 1px dashed black;"/>			
Shares issued pursuant to option exercises.....	8	-	
<hr style="border-top: 1px dashed black;"/>			

Options to purchase shares of common stock are excluded from the calculation of diluted earnings per share when their inclusion would have an anti-dilutive effect on the calculation. No options were excluded for the three month and nine month periods ended September 30, 2008 and 2007.

### Note 5 - Recently Issued Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. We adopted SFAS 157 on January 1, 2008, as required for our financial assets and financial liabilities. However, the FASB deferred the effective date of SFAS 157 for one year as it relates to fair value measurement requirements for nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value on a recurring basis. The adoption of SFAS 157 for our financial assets and financial liabilities did not have a material impact on our consolidated financial statements. We are evaluating the effect the implementation of SFAS 157 for our nonfinancial assets and nonfinancial liabilities will have on our consolidated financial statements. See Note 8 below.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. This statement is effective for us beginning January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements--an amendment of Accounting Research Bulletin No. 51 ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This statement is effective for us beginning January 1, 2009. We are currently evaluating the potential impact of the adoption of SFAS 160 on our consolidated financial position, results of operations or cash flows.

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In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" (SFAS 162). This statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in accordance with GAAP. With the issuance of this statement, the FASB concluded that the GAAP hierarchy should be directed toward the entity and not its auditor, and reside in the accounting literature established by the FASB as opposed to the American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards No. 69, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." This statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." We have evaluated the new statement and have determined that it will not have a significant impact on the determination or reporting of our financial results

In October 2008, the FASB issued FASB Staff Position FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" ("FSP 157-3"). FSP 157-3 clarified the application of FAS 157. FSP 157-3 demonstrated how the fair value of a financial asset is determined when the market for that financial asset is inactive. FSP 157-3 was effective upon issuance, including prior periods for which financial statements had not been issued. The implementation of this standard did not have an impact on our consolidated financial statements

### Note 6 - Notes Payable

During 2006, we received \$80 million of senior, secured financing (the "Senior Loan") from Wells Fargo Foothill, Inc. ("Wells Fargo") consisting of a \$75 million five year term loan facility (the "Term Facility") and a \$5 million five year revolving credit facility (the "Revolving Facility"). At September 30, 2008, we had the full Revolving Facility available to us. After payment of an origination fee of 1%, lender costs and retirement of \$15.3 million of existing bank indebtedness, the net proceeds of the Term Facility we received were \$58.8 million and used to purchase treasury stock.

The Term Facility provides for a five-year maturity and amortizes in monthly installments of \$1.25 million commencing August 1, 2006, with interest on the outstanding balances under the Term Facility and the Revolving Facility payable, at our option, at a rate equal to Wells Fargo base rate or at the 30 day LIBOR rate plus 150 basis points. The interest rate at September 30, 2008 was 3.99%, but increased to 5.22% effective October 1, 2008. We are also obligated to make additional quarterly payments equal to 50% of our "excess cash flow" (as defined in the Senior Loan agreement) if our Leverage Ratio is greater than or equal to 1 to 1 at the end of a quarter. Our Leverage Ratio was 0.60 to 1 at September 30, 2008. We expect to be able to repay the facilities with cash flow from operations. We have the right to prepay the Term Facility in whole or in part without penalty.

The Senior Loan is guaranteed by our non-regulated wholly owned subsidiaries and is secured by all of our tangible and intangible personal property (other than aircraft), including stock in all of our direct subsidiaries, and a mortgage on a building we recently acquired in Duncan, Oklahoma and remodeled to relocate and expand our existing customer service facility in Duncan.

In addition to customary covenants for loans of a similar type, the principal covenants for the Senior Loan are:

- \* a limitation on incurring any indebtedness in excess of the remaining existing bank indebtedness outstanding and \$2.3 million in permitted

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- capitalized leases or purchase money debt;
- \* a limitation on our ability to pay dividends or make stock purchases, other than with the net proceeds of the Term Loan, unless we meet certain cash flow tests;
- \* a prohibition on prepayment of other debt;
- \* a requirement to maintain consolidated EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization) for the twelve month period ending December 31, 2006 and each quarter thereafter of at least \$80 million (\$75 million for us and our top tier direct subsidiaries);
- \* a requirement to maintain a quarterly fixed charge coverage ratio (EBITDA (with certain adjustments) divided by the sum of interest expense, income taxes and scheduled principal payments) of at least 1.1 to 1;
- \* a requirement to maintain at least 1.3 million members;
- \* a requirement to maintain a Leverage Ratio (funded indebtedness as of the end of each quarter divided by EBITDA for the trailing twelve months) of no more than 1.5 to 1; and
- \* we must have availability (unused portion of the Revolving Facility) plus Qualified Cash (the amount of unrestricted cash and cash equivalents) greater than or equal to \$12,500,000.
- \* an event of default occurs if Harland Stonecipher ceases to be our Chairman and Chief Executive Officer for a period of 120 days unless replaced with a person approved by Wells Fargo.

We were in compliance with these covenants at September 30, 2008.

Our \$20 million real estate loan was fully funded in 2002 to finance our new headquarters building in Ada, Oklahoma and has a final maturity of August 2011. This loan, with interest at the 30 day LIBOR rate plus 150 basis points adjusted monthly, is secured by a mortgage on our headquarters. The interest rate at September 30, 2008 was 3.99%, but increased to 5.50% effective October 1, 2008, with monthly principal payments of \$191,000 plus interest with the balance of approximately \$2.3 million due at maturity. The real estate loan's financial covenants conform to those of the Senior Loan.

During 2007, we entered into a term loan agreement with Wells Fargo Equipment Finance, Inc. to refinance \$9.6 million indebtedness related to our aircraft. This loan, with interest at the 30 day LIBOR rate plus 89 basis points adjusted monthly, is secured by a mortgage on the aircraft and engines. The interest rate at September 30, 2008 was 3.38%, but increased to 4.89% effective October 1, 2008, with monthly principal payments of \$80,000 plus interest.

During June 2008 we received additional financing from Bank of Oklahoma for \$10 million on an unsecured basis repayable in 12 equal monthly payments beginning June 30, 2008, together with interest at LIBOR plus 162.5 basis points. The interest rate at September 30, 2008 was 4.11%, but increased to 5.63% effective October 1, 2008, with monthly principal payments of \$833,000 plus interest.

A schedule of outstanding balances as of September 30, 2008 is as follows:

Senior loan.....	\$ 42,500
Real estate loan.....	8,952
Aircraft loan.....	8,600
Unsecured stock repurchase loan.....	6,667
	-----
Total notes payable.....	66,719
Less: Current portion of notes payable.....	(24,908)
	-----
Long term portion.....	\$ 41,811
	-----

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A schedule of future maturities as of September 30, 2008 is as follows:

Repayment Schedule commencing October 2008:	
Year 1.....	\$ 24,908
Year 2.....	18,241
Year 3.....	17,836
Year 4.....	956
Year 5.....	956
Thereafter.....	3,822
Total notes payable.....	\$ 66,719

### Note 7 - Share-based Compensation

During the nine months ended September 30, 2008, the stock option activity under our stock option plans was as follows:

	Weighted Average Price	Number of Shares	Weighted Average Remaining Contractual Term (In Years)
	-----	-----	-----
Outstanding, January 1, 2008.....	\$ 20.08	58,500	
Granted.....	-	-	
Cancelled.....	-	-	
Exercised.....	20.57	(13,500)	
Outstanding, September 30, 2008.....	\$ 19.94	45,000	2.11
Options exercisable as of September 30, 2008....	\$ 19.94	45,000	2.11

Other information pertaining to option activity during the nine months ended September 30, 2008 and 2007 was as follows:

	September 30, 2008
	-----
Weighted average grant-date fair value of stock options granted.....	Not applicable
Total fair value of stock options vested.....	Not applicable
Total intrinsic value of stock options exercised.....	\$ 363

Under our stock option plan, 1,346,252 shares of our Common Stock are available for issuance. Options outstanding and exercisable were granted at a stock option price which was not less than the fair market value of our Common Stock on the date the option was granted and no option has a term in excess of ten years. Additionally, options vested and became exercisable either on the

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grant date or up to five years from the option grant date.

### Note 8 - Fair Value Measurement

On January 1, 2008, we adopted SFAS No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The Statement applies whenever other statements require or permit assets or liabilities to be measured at fair value. SFAS 157 is effective for fiscal years beginning after November 15, 2007, except for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis, for which application has been deferred for one year.

SFAS 157 established the following fair value hierarchy that prioritizes the inputs used to measure fair value:

Level 1: Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives, listed equities and U.S. government treasury securities.

Level 2: Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Instruments in this category include non-exchange-traded derivatives such as over the counter forwards, options and repurchase agreements.

Level 3: Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value. At each balance sheet date, we perform an analysis of all instruments subject to SFAS No. 157 and include in Level 3 all of those whose fair value is based on significant unobservable inputs.

The following table presents our financial assets and liabilities that were accounted for at fair value on a recurring basis as of September 30, 2008 by level within the fair value hierarchy (in thousands):

	Fair Value Measurements Using		
	Level 1	Level 2	Level 3
Available for sale investments.....	\$ -	\$ 37,408	\$ -

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Liabilities..... \$ - \$ - \$ -

For securities without a readily ascertainable market value (Level 2), we utilize pricing services and broker quotes. Such estimated fair values do not necessarily represent the values for which these securities could have been sold at the dates of the balance sheets.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND  
-----  
RESULTS OF OPERATIONS  
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The following discussion should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations in our Form 10-K for the year ended December 31, 2007, which describes, among other things, our basic business model, critical accounting policies, measures of Membership retention, and basic cash flow characteristics of our business. The following tables set forth changes in the principal categories of revenues and expenses and Membership and recruiting activity for the third quarter of 2008 compared to the third quarter of 2007 and the second quarter of 2008 (Table amounts in 000's). The sum of the percentages in the tables may not total due to rounding.

Three Months Ended September 30, 2008 compared to Three Months Ended September 30, 2007 and compared to Three Months Ended June 30, 2008	Three Months Ended Sept. 30, 2008	% of Total Revenue	% Change from Prior Year	% Change from Sequential Period	Three Months Ended Sept. 30, 2007	% of Total Revenue
<b>Revenues:</b>						
Membership fees.....	\$109,268	93.8	1.4	(0.2)	\$107,713	93.8
Associate services.....	6,236	5.3	3.4	(1.1)	6,032	5.3
Other.....	1,019	0.9	(10.0)	(7.0)	1,132	1.0
	116,523	100.0	1.4	(0.3)	114,877	100.0
<b>Costs and expenses:</b>						
Membership benefits.....	37,587	32.3	0.3	(0.7)	37,475	32.3
Commissions.....	33,678	28.9	0.1	8.0	33,646	29.0
Associate services and direct marketing.....	5,358	4.6	(39.8)	(23.8)	8,902	7.8
General and administrative.....	12,531	10.7	(8.6)	(8.9)	13,717	11.9
Other, net.....	3,043	2.6	(15.1)	4.0	3,584	3.1
	92,197	79.1	(5.3)	(0.6)	97,324	84.1
Income before income taxes.....	24,326	20.9	38.6	1.0	17,553	15.3
Provision for income taxes.....	9,884	8.5	65.3	9.4	5,980	5.2
Net income.....	\$14,442	12.4	24.8	(4.1)	\$11,573	10.1

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	9/30/2008	Three 6/
New Memberships: -----		
New legal service membership sales.....	137,227	
New "stand-alone" IDT membership sales.....	7,814	
	-----	
Total new membership sales.....	145,041	
	-----	
New "add-on" IDT membership sales.....	95,762	
Average Annual Membership fee.....	\$326.14	
Active Memberships:		
Active legal service memberships at end of period.....	1,488,259	1
Active "stand-alone" IDT memberships at end of period (see note below).....	87,634	
	-----	
Total active memberships at end of period.....	1,575,893	1
	-----	
Active "add-on" IDT memberships at end of period (see note below).....	681,118	
New Sales Associates:		
New sales associates recruited.....	37,820	
Average enrollment fee paid by new sales associates.....	\$56.17	
Average Membership fee in force:		
Average Annual Membership fee.....	\$301.40	

Identity Theft Shield ("IDT") memberships sold in conjunction with new legal plan memberships or "added-on" to existing legal plan memberships sell for \$9.95 per month and are not counted as "new" memberships but do increase the average premium and related direct expenses (membership benefits and commissions) of our membership base, while "stand alone" Identity Theft Shield memberships are not attached to a legal plan membership and sell for \$12.95 per month.

### Recently Issued Accounting Pronouncements

See Note 5 - Recently Issued Accounting Pronouncements in Item 1 above.

### Results of Operations - Third Quarter of 2008 compared to Third Quarter of 2007

Net income increased 25% for the third quarter of 2008 to \$14.4 million from \$11.6 million for the prior year's third quarter primarily due to an increase in membership fees of \$1.6 million, a decrease in general and administrative expenses of \$1.2 million and a decrease in associate services and direct marketing of \$3.5 million partially offset by an increase in Membership benefits of \$112,000 and an increase in provision for income taxes of \$3.9 million. Diluted earnings per share increased 40% to \$1.23 per share from 88 cents per share for the prior year's comparable quarter due to the 25% increase in net income and a 10% decrease in the weighted average number of diluted shares outstanding.

Membership fees totaled \$109.3 million during the 2008 third quarter compared to \$107.7 million for 2007, an increase of 1%. Membership fees and their impact on total revenues in any period are determined directly by the number of active Memberships in force during any such period and the monthly amount of such Memberships. The active Memberships in force are determined by both the number of new Memberships sold in any period together with the renewal rate of existing Memberships. New Membership sales decreased 6% during the three months ended September 30, 2008 to 145,041 from 154,301 during the comparable period of 2007. At September 30, 2008, there were 1,575,893 active Memberships

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in force compared to 1,574,556 at September 30, 2007, an increase of less than 1%. Additionally, the average annual fee per Membership has increased from \$298 for all Memberships in force at September 30, 2007 to \$301 for all Memberships in force at September 30, 2008, primarily as a result of a larger number of Identity Theft Shield memberships.

Associate services revenue increased by approximately \$204,000 to \$6.2 million during the third quarter of 2008 when compared to the 2007 quarter. New associates enrolled were 37,820 during the 2008 period compared to 43,555 for the same period of 2007. The average enrollment fees paid by new sales associates was \$56 and \$41 for the respective periods. The eService fees decreased to \$3.0 million for the third quarter of 2008 compared to \$3.2 million for the 2007 quarter. Future revenues from associate services will depend primarily on the number of new associates enrolled, the price charged for the Certified Field Trainer program and the number who choose to participate in our eService program, but we expect that such revenues will continue to be offset by the direct and indirect cost to us of training, providing associate services and other direct marketing expenses.

Other revenue declined 10% from \$1.1 million for the 2007 period to \$1.0 million for the 2008 period.

Total revenues increased 1% to \$116.5 million for the three months ended September 30, 2008 from \$114.9 million during the comparable period of 2007 due to a \$1.6 million increase in Membership fees and a \$204,000 increase in associate services revenue.

Membership benefits totaled \$37.6 million for the three months ended September 30, 2008 compared to \$37.5 million for the comparable period of 2007, and represented 34% and 35% of Membership fees for the 2008 and 2007 periods respectively. This Membership benefit ratio (Membership benefits as a percentage of Membership fees) should be reduced going forward as substantially all active Memberships provide for a capitated cost and we have reduced the capitated cost of the Identity Theft plan benefits effective April 1, 2007, with subsequent additional reductions on January 1, 2008, 2009 and 2010. During the three months ended September 30, 2008 we did incur additional cost associated with the installation of improved communications equipment to a portion of our provider firms.

Commissions to associates decreased less than 1% to \$33.7 million for the three months ended September 30, 2008 compared to \$33.6 million for the comparable period of 2007, and represented 31% of Membership fees for both periods. Commissions to associates are primarily dependent on the number of new Memberships sold during a period and the average fee of those Memberships. New Memberships sold during the third quarter of 2008 totaled 145,041, a 6% decrease from the 154,301 for 2007, and the "add-on" IDT Membership sales which are not included in these totals decreased 5% to 95,762 for the third quarter of 2008 from 100,888 for 2007. Our average Annual Membership fee written during the quarter of 2008 had a slight increase to \$326.14 from \$325.98 during the 2007 period. Our new Membership fees written during the third quarter of 2008 decreased 6% from 2007. Average commission per new Membership increased 6% to \$232 for the 2008 third quarter from \$218 for the 2007 period. The 6% decline in new Membership fees written would have resulted in an approximate 6% decline in commissions but we paid \$2.1 million in additional commissions due to a new bonus program that began in June 2008. Should we add additional commissions to our compensation plan or reduce the amount of chargebacks collected from our associates as we have from time to time, the commission cost per new Membership will increase accordingly.

Associate services and direct marketing expenses decreased to \$5.4 million for the three months ended September 30, 2008 from \$8.9 million for the comparable period of 2007. The decrease was primarily a result of decreased



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costs for incentive trips and bonuses, decreased costs of conventions and decreased costs for materials sent to new associates due to the reduction in the number of new associates enrolled during the quarter. We offer the Player's Club incentive program to provide additional incentives to our associates as a reward for consistent, quality business. Associates can earn the right to receive additional monthly bonuses by meeting monthly qualification requirements for a 12 month period and maintaining certain personal retention rates for the Memberships sold during the 12 month period. These expenses also include the costs of providing associate services and marketing expenses.

General and administrative expenses during the three months ended September 30, 2008 and 2007 were \$12.5 million and \$13.7 million, respectively, and represented 11% and 13%, respectively, of Membership fees for both periods. The \$1.2 million decrease in general and administrative expenses included decreases in advertising, bank services charges and telephone expense which were partially offset by increases in employee salaries and health care cost and consulting fees associated with Payment Card Industry compliance.

Other expenses, net, which include depreciation and amortization, litigation accruals, interest expense and premium taxes reduced by interest income, were \$3.0 million for the three months ended September 30, 2008 compared to \$3.6 million for the 2007 comparable period. Depreciation expense was \$2.2 million for the three months ended September 30, 2008 and \$2.1 million for the 2007 comparable period. Interest expense decreased to \$924,000 during the 2008 period from \$1.7 million during the comparable period of 2007 as a result of the reduction in debt and lower interest rates. Premium taxes decreased from \$494,000 for the three months ended September 30, 2007 to \$455,000 for the comparable period of 2008. Interest income decreased from \$674,000 for the three months ended September 30, 2007 to \$532,000 for the three months ended September 30, 2008, due to a decrease in cash and investment balances.

We have recorded a provision for income taxes of \$9.9 million (40.6% of pretax income) and \$6.0 million (34.1% of pretax income) for the three months ended September 30, 2008 and 2007, respectively. The increase in the tax rate for 2008 compared to 2007 is due to the inclusion of all income based taxes in the provision for income taxes and we expect the 2008 rate to be representative on a go forward basis.

Results of Operations - Third Quarter of 2008 compared to Second Quarter of 2008

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Third quarter 2008 membership fees decreased \$188,000 to \$109.3 million from \$109.5 million for the second quarter of 2008. Associate services revenues decreased during the 2008 third quarter by approximately \$67,000 to \$6.2 million from \$6.3 million for the 2008 second quarter and associate services and direct marketing expenses decreased by \$1.7 million during the same period. Membership benefits totaled \$37.6 million in the third quarter of 2008 compared to \$37.9 million for the 2008 second quarter and represented 34% of membership fees for the third quarter and 35% for the second quarter. Commissions to associates totaled \$33.7 million in the 2008 third quarter compared to \$31.2 million for the 2008 second quarter and represented 31% and 29%, respectively, of membership fees for the two periods. General and administrative expenses decreased during the 2008 third quarter to \$12.5 million compared to \$13.8 million for the 2008 second quarter and represented 11% and 13%, respectively, of membership fees for the two periods. The \$1.2 million decrease in general and administrative expenses included decreases in employee salaries and health care cost, postage and legal expenses which were partially offset by increases in computer maintenance fees, utilities and other taxes.

Results of Operations - First Nine Months of 2008 compared to First Nine Months

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of 2007

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Membership revenues increased 3% in the first nine months of 2008 to a record \$327.8 million compared to \$318.5 million for the first nine months of 2007. Net income increased 15% for the first nine months of 2008 to \$45.4 million from \$39.5 million for the prior year's comparable period primarily due to the increase of \$9.3 million in membership fees and a \$4.0 million decrease in associate services and direct marketing expenses, a \$2.7 million decrease in commissions, a \$981,000 decrease in general and administrative expenses, a \$485,000 decrease in other expenses, net partially offset by increases in Membership benefits expense of \$1.5 million and the provision for income taxes of \$9.2 million. Diluted earnings per share increased 27% to \$3.77 per share from \$2.96 per share for the prior year's comparable nine month period due to the 15% increase in net income and an approximate 10% decrease in the weighted average number of diluted shares outstanding.

Membership fees and their impact on total revenues in any period are determined directly by the number of active Memberships in force during any such period. The active Memberships in force are determined by both the number of new Memberships sold in any period together with the renewal rate of existing Memberships. New Membership sales decreased 9% during the nine months ended September 30, 2008 to 419,686 from 461,996 during the comparable period of 2007. At September 30, 2008, there were 1,575,893 active Memberships in force compared to 1,574,556 at September 30, 2007, an increase of less than 1%. Additionally, the average annual fee per Membership has increased from \$298 for all Memberships in force at September 30, 2007 to \$301 for all Memberships in force at September 30, 2008, primarily as a result of a larger number of Identity Theft Shield memberships.

Associate services revenue decreased 3% from \$19.1 million for the first nine months of 2007 to \$18.6 million during the comparable period of 2008 due to a decrease in new associates enrolled. Total new associates enrolled during the first nine months of 2008 were 89,722 compared to 112,773 for the same period of 2007. The eService fees remained relatively unchanged at \$9.2 million for both periods. Future revenues from associate services will depend primarily on the number of new associates enrolled, the price charged for the Certified Field Trainer program and the number who choose to participate in the Company's eService program, but the Company expects that such revenues will continue to be offset by the direct and indirect cost to the Company of training (including training bonuses paid), providing associate services and other direct marketing expenses.

Other revenue decreased \$212,000 from \$3.4 million for the nine month period ending September 2007 to \$3.2 million for the same period of 2008.

Primarily as a result of the increase in Membership fees, total revenues increased to \$349.6 million for the nine months ended September 30, 2008 from \$341.0 million during the comparable period of 2007 an increase of 3%.

Membership benefits totaled \$112.7 million for the nine months ended September 30, 2008 compared to \$111.2 million for the comparable period of 2007, and represented 34% of Membership fees for 2008 and 35% for the 2007 period. This Membership benefit ratio (Membership benefits as a percentage of Membership fees) should be reduced going forward as substantially all active Memberships provide for a capitated cost and we have reduced the capitated cost of the Identity Theft plan benefits effective April 1, 2007 with subsequent additional reductions on January 1, 2008, 2009 and 2010. During the nine months ended September 30, 2008 we did incur additional cost associated with the installation of improved communications equipment a portion of our provider firms.

Commissions to associates decreased 3% to \$95.7 million for the nine months ended September 30, 2008 compared to \$98.4 million for the comparable period of 2007, and represented 29% and 31% of Membership fees for such periods. Commissions to associates are primarily dependent on the number of new

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Memberships sold during a period and the average fee of those Memberships. New Memberships sold during the first nine months of 2008 totaled 419,686 a 9% decrease from the 461,996 for 2007, and the "add-on" IDT Membership sales which are not included in these totals decreased 9% to 259,648 for the third quarter of 2008 from 286,474 for 2007. Our average Annual Membership fee written during the first nine months of 2008 increased 2% to \$325.64 from \$320.36 for 2007. Our new Membership fees written during the first nine months of 2008 decreased 8% from 2007. The 8% decline in new Membership fees written would have resulted in an approximate 8% decline in commissions but we paid \$3.2 million in additional commissions due to a new bonus program that began in June 2008. Should we add additional commissions to our compensation plan or reduce the amount of chargebacks collected from its associates as it has from time to time, the commission cost per new Membership will increase accordingly.

Associate services and direct marketing expenses decreased to \$18.0 million for the nine months ended September 30, 2008 from \$22.0 million for the comparable period of 2007. The decrease was primarily a result of fewer new associates enrolled during the nine month period and decreased cost for incentive trips and bonuses. We offer the Player's Club incentive program to provide additional incentives to our associates as a reward for consistent, quality business. Associates can earn the right to receive additional monthly bonuses by meeting monthly qualification requirements for the entire calendar year and maintaining certain personal retention rates for the Memberships sold during the calendar year. These expenses also include the costs of providing associate services and marketing expenses.

General and administrative expenses during the nine months ended September 30, 2008 and 2007 decreased \$981,000 to \$38.9 million from \$39.8 million, and represented 12% and 13% of Membership fees for the two periods. The decrease in general and administrative expenses included decreases in state taxes, bank service charges and telephone expenses partially offset by an increase in accounting fees, advertising, employee salaries and health care cost, consulting fee associated with PCI compliance and legal fees.

Other expenses, net, which include depreciation and amortization, litigation accruals, interest expense and premium taxes reduced by interest income, was \$10.1 million for the nine months ended September 30, 2008 compared to \$10.6 million for the 2007 comparable period. Depreciation increased to \$6.6 million for the first nine months of 2008 from \$6.4 million for the comparable period of 2007. Litigation accruals increased by \$873,000 for the first nine months of 2008 to \$888,000 from 2007. Interest expense decreased to \$3.1 million during the 2008 period from \$5.3 million during the comparable period of 2007 as a result of lower indebtedness and lower interest rates. Premium taxes decreased from \$1.5 million for the nine months ended September 30, 2007 to \$1.4 million for the comparable period of 2008. Interest income decreased \$819,000 to \$1.8 million for the nine months ended September 30, 2008 from \$2.6 million for the comparable period of 2007, due to decreased cash and investment balances.

We have recorded a provision for income taxes of \$28.8 million (38.8% of pretax income) and \$19.5 million (33.1% of pretax income) for the first nine months ended September 30, 2008 and 2007, respectively. The increase in the tax rate for 2008 compared to 2007 is due to the inclusion of all income based taxes in the provision for income taxes and we expect the 2008 rate to be representative on a go forward basis.

### Liquidity and Capital Resources

#### General

Net cash flow provided by operating activities was \$44.3 million for the nine months ended September 30, 2008 compared to \$47.4 million for the same period in 2007. This \$3.1 million decrease was primarily the result of a \$7.5 million increase in cash receipts from our members, a \$1.9 million decrease in

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cash paid for interest and a \$4.0 million decrease in cash paid to our associates for commissions, offset by a \$1.4 million increase in cash paid to our providers for the delivery of benefits and a \$16.0 million increase in income tax payments.

Consolidated net cash used by investing activities was \$4.3 million for the first nine months of 2008 compared to net cash provided of \$26.5 million for the comparable period of 2007. This \$30.8 million change in investing activities resulted from a \$1 million decrease in additions to property and equipment and a \$168.9 million decrease in the maturities and sales of investments partially offset by a \$139.2 million decrease in investment purchases.

Net cash used in financing activities during the first nine months of 2008 was \$43.6 million compared to \$56.9 million for the comparable period of 2007. This \$13.3 million change was primarily comprised of a \$6.2 million decrease in debt repayments, \$6.6 million decreased treasury stock purchases, and the \$319,000 decrease in capital lease obligation payments.

We purchased and formally retired 832,848 shares of our common stock during the first nine months of 2008 for \$36.9 million, or an average price of \$44.36 per share, reducing our common stock by \$8,328 and our retained earnings by \$36.9 million. We had negative working capital of \$4.6 million at September 30, 2008, an increase of \$1.6 million compared to our negative working capital of \$3.0 million at December 31, 2007. The increase was primarily due to a \$5.6 million decrease in income taxes payable, a \$1.9 million increase in refundable income taxes and a \$1.0 million increase in the current portion of available-for-sale investments offset by a decrease of \$3.5 million in cash and cash equivalents and a \$6.7 million increase in the current portion of notes payable. The \$4.6 million negative working capital at September 30, 2008 would have been a \$6.9 million positive working capital excluding the current portion of deferred revenue and fees in excess of the current portion of deferred member and associate service costs. These amounts will be eliminated by the passage of time without the utilization of other current assets or us incurring other current liabilities. We do not expect any difficulty in meeting our financial obligations in the next 12 months.

At September 30, 2008 we reported \$54.9 million in cash and cash equivalents and unpledged investments compared to \$58.9 million at December 31, 2007. Our investments typically consist of certificates of deposit, investment grade (rated Baa or higher) bonds primarily issued by corporations and the United States Treasury, auction rate certificates and state and municipal tax-exempt bonds.

We generally advance significant commissions at the time a Membership is sold. During the nine months ended September 30, 2008, we advanced commissions, net of chargebacks, of \$91.2 million on new Membership sales compared to \$96.0 million for the same period of 2007. Since approximately 95% of Membership fees are collected on a monthly basis, a significant cash flow deficit is created on a per Membership basis at the time a Membership is sold. Since there are no further commissions paid on a Membership during the advance period, we typically derive significant positive cash flow from the Membership over its remaining life.

We expense advance commissions ratably over the first month of the related Membership. As a result of this accounting policy, our commission expenses are all recognized over the first month of a Membership and there is no commission expense recognized for the same Membership during the remainder of the advance period. We track our unearned advance commission balances outstanding in order to ensure the advance commissions are recovered before any renewal commissions are paid and for internal purposes of analyzing our commission advance program. While not recorded as an asset, unearned advance commission balances from associates as of September 30, 2008, and related activity for the nine month

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period then ended, were:

	(Amounts in 000)
Beginning unearned advance commission payments (1).....	\$ 184,531
Advance commission payments, net.....	91,189
Earned commissions applied.....	(96,644)
Advance commission payment write-offs.....	(2,624)
<hr/>	
Ending unearned advance commission payments before estimated unrecoverable payments (1).....	176,452
Estimated unrecoverable advance commission payments (1).....	(43,884)
<hr/>	
Ending unearned advance commission payments, net (1).....	\$ 132,568
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(1) These amounts do not represent fair value, as they do not take into consideration timing of estimated recoveries.

The ending unearned advance commission payments, net, above includes net unearned advance commission payments to non-vested associates of \$60.7 million. As such, at September 30, 2008 future commission payments and related expense should be reduced as unearned advance commission payments of \$72 million are recovered. Commissions are earned by the associate as Membership premiums are earned by us, usually on a monthly basis. For additional information concerning these commission advances, see our Annual report on Form 10-K under the heading Commissions to Associates in Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations.

We believe that we have significant ability to finance any future growth in Membership sales based on our recurring cash flow and existing amount of cash and cash equivalents and unpledged investments at September 30, 2008 of \$54.9 million. We expect to maintain cash and investment balances, including pledged investments, on an on-going basis of approximately \$20 to \$30 million in order to meet expected working capital needs and regulatory capital requirements. Cash balances in excess of this amount would be used for discretionary purposes such as additional treasury stock purchases subject to limitations in the Term Facility.

#### Notes Payable

See Note 6 - Notes Payable in Item 1 above.

#### Parent Company Funding and Dividends

Although we are the operating entity in many jurisdictions, our subsidiaries serve as operating companies in various states that regulate Memberships as insurance or specialized legal expense products. The most significant of these wholly owned subsidiaries are Pre-Paid Legal Casualty, Inc. ("PPLCI"), Pre-Paid Legal Services Inc. of Florida ("PPLSIF") and Legal Service Plans of Virginia, Inc. ("LSPV"). The ability of these entities to provide funds to us is subject to a number of restrictions under various insurance laws in the jurisdictions in which they conduct business, including limitations on the amount of dividends and management fees that may be paid and requirements to maintain specified levels of capital and reserves. In addition PPLCI will be required to maintain its stockholders' equity at levels sufficient to satisfy various state or provincial regulatory requirements, the most restrictive of which is currently \$3 million. Additional capital requirements of these

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entities, or any of our regulated subsidiaries, will be funded by us in the form of capital contributions or surplus debentures. We received a \$1.6 million dividend from LSPV during March 2008 and a \$2.5 million dividend in October 2008. Additionally, we received a \$7.4 million dividend from PPLCI during April 2008 and received regulatory approval for a \$7.5 million dividend from PPLCI that we expect to pay in October 2008.

### Contractual Obligations

There have been no material changes outside of the ordinary course of business in our contractual obligations from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2007, other than the incurrence of \$10 million in unsecured indebtedness in June 2008 to purchase additional shares of treasury stock which is repayable in equal monthly principal installments over the following 12 months with interest at LIBOR plus 162.5 basis points.

### Critical Accounting Policies

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Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are affected by management's application of accounting policies. If these estimates or assumptions are incorrect, there could be a material change in our financial condition or operating results. Many of these "critical accounting policies" are common in the insurance and financial services industries; others are specific to our business and operations. Our critical accounting policies include estimates relating to revenue recognition related to Membership and associate fees, deferral of Membership and associate related costs, expense recognition related to commissions to associates, accrual of incentive awards payable and accounting for legal contingencies. Each of these accounting policies and the application of critical accounting policies and estimates was discussed in our Annual Report on Form 10-K for the year ended December 31, 2007. There were no significant changes in the application of critical accounting policies or estimates during the first nine months of 2008. We are not aware of any reasonably likely events or circumstances which would result in different amounts being reported that would materially affect our financial condition or results of operations.

### Capital and Dividend Plans

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We continue to evaluate the desirability of additional share repurchases and additional cash dividends. We declared dividends of \$0.50 per share during 2004 and \$0.60 per share during 2005 and have previously announced that we will continue share repurchases, pay a dividend, or both, depending on our financial condition, available resources and market conditions, as well as compliance with our various loan covenants which limit our ability to repurchase shares or pay cash dividends. We expect to continue our open market repurchase program when we can acquire shares at prices we believe are attractive as we have existing authorization from the Board to purchase an additional 475,026 shares. We also continue to evaluate additional sources of financing that may enable us to accelerate the repurchase program at prices we believe are attractive.

### Forward-Looking Statements

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All statements in this report other than purely historical information, including but not limited to, statements relating to our future plans and objectives, expected operating results and the assumptions on which such forward-looking statements are based, constitute "Forward-Looking Statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and are based on our historical operating trends and financial condition as of September 30, 2008 and other information currently available to management. We caution that the Forward-Looking Statements are subject to all the risks and uncertainties incident to our

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business, including but not limited to risks described in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2007. Moreover, we may make acquisitions or dispositions of assets or businesses, enter into new marketing arrangements or enter into financing transactions. None of these can be predicted with certainty and, accordingly, are not taken into consideration in any of the Forward-Looking Statements made herein. For all of the foregoing reasons, actual results may vary materially from the Forward-Looking Statements. We assume no obligation to update the Forward-Looking Statements to reflect events or circumstances occurring after the date of the statement.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**  
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**Interest Rate Risk**

Our consolidated balance sheets include a certain amount of assets and liabilities whose fair values are subject to market risk. Due to our significant investment in fixed-maturity investments, interest rate risk represents the largest market risk factor affecting our consolidated financial position. Increases and decreases in prevailing interest rates generally translate into decreases and increases in fair values of those instruments. Additionally, fair values of interest rate sensitive instruments may be affected by the creditworthiness of the issuer, prepayment options, relative values of alternative investments, liquidity of the instrument and other general market conditions.

As of September 30, 2008, our investments consisted of the following:

Description	Fair Value
-----	-----
Obligations of state and political subdivisions.....	\$ 29,392
Certificates of deposit.....	6,189
Municipal Variable Rate Demand notes.....	1,000
Auction Rate Securities.....	375
U. S. Government obligations.....	221
Corporate obligations.....	231
	-----
Total investments.....	\$ 37,408
	-----

We do not hold any investments classified as trading account assets or derivative financial instruments.

The table below summarizes the estimated effects of hypothetical increases and decreases in interest rates on our fixed-maturity investment portfolio. It is assumed that the changes occur immediately and uniformly, with no effect given to any steps that we might take to counteract that change.

The hypothetical changes in market interest rates reflect what could be deemed best and worst case scenarios. The fair values shown in the following table are based on contractual maturities. Significant variations in market interest rates could produce changes in the timing of repayments due to prepayment options available. The fair value of such instruments could be affected and, therefore, actual results might differ from those reflected in the following table:

(In 000's)	Hypothetical change
Fair value	in interest rate
-----	(bp = basis points)
-----	-----

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Fixed-maturity investments at September 30, 2008 (1)...	\$ 29,844	100 bp increase 200 bp increase 50 bp decrease 100 bp decrease
Fixed-maturity investments at December 31, 2007 (1)....	\$ 33,692	100 bp increase 200 bp increase 50 bp decrease 100 bp decrease

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(1)

- (2) Excluding short-term investments with a fair value of \$7.6 million (\$6.2 million in certificates of deposit, \$1.0 million of variable rate demand notes and \$375,000 in auction rate securities) at September 30, 2008 and \$4.5 million at December 31, 2007.

The table above illustrates, for example, that an instantaneous 200 basis point increase in market interest rates at September 30, 2008 would reduce the estimated fair value of our fixed-maturity investments by approximately \$2.9 million at that date. At December 31, 2007, an instantaneous 200 basis point increase in market interest rates would have reduced the estimated fair value of our fixed-maturity investments by approximately \$2.7 million at that date. The definitive extent of the interest rate risk is not quantifiable or predictable due to the variability of future interest rates, but we do not believe such risk is material.

We primarily manage our exposure to investment interest rate risk by purchasing investments that can be readily liquidated should the interest rate environment begin to significantly change.

As of September 30, 2008, we had \$66.7 million in notes payable outstanding at interest rates indexed to the 30 day LIBOR rate that exposes us to the risk of increased interest costs if interest rates rise. The 30 day LIBOR rate increased by 144 basis points from 2.49% in September 2008 to 3.93% in October 2008 and was 3.53% at October 21, 2008. Assuming a 100 basis point increase in interest rates on the floating rate debt, annual interest expense would increase by approximately \$667,000. As of September 30, 2008, we had not entered into any interest rate swap agreements with respect to the term loans or our floating rate municipal bonds.

### Foreign Currency Exchange Rate Risk

Although we are exposed to foreign currency exchange rate risk inherent in revenues, net income and assets and liabilities denominated in Canadian dollars, the potential change in foreign currency exchange rates is not a substantial risk, as approximately 1% of our revenues are derived outside of the United States. As reflected in the attached Consolidated Statements of Comprehensive Income, we have recorded negative foreign currency translation adjustments of \$265,000 for the three months ended September 30, 2008 and have a cumulative positive foreign currency translation adjustment balance of \$1.1 million at September 30, 2008. These amounts are subject to change dynamically in conjunction with the relative values of the Canadian and U.S. dollars.

### ITEM 4. CONTROLS AND PROCEDURES

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Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure



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controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2008, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) during the quarter ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### PART II. OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS.

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See Note 2 of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this report for information with respect to legal proceedings.

#### ITEM 1A. RISK FACTORS

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There are a number of risk factors that could affect our financial condition or results of operations. See Note 2 in Part 1, Item 1 - Contingencies and Part II, Item 1 - Legal Proceedings. Please refer to page 14 and 15 of our 2007 Annual Report on Form 10-K for a description of other risk factors. There has not been any material changes in the risk factors disclosed in the Annual Report.

#### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

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##### Issuer Purchases of Equity Securities

The following table provides information about our purchases of stock in the open market during the third quarter of 2008.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number Shares that May Be Purchased Un- der the Plans or Programs (1)
July 2008.....	13,036	\$ 42.09	13,036	671,853
August 2008.....	107,350	44.14	107,350	564,503
September 2008.....	89,477	43.52	89,477	475,026
<b>Total.....</b>	<b>209,863</b>	<b>\$ 43.75</b>	<b>209,863</b>	

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(1) We announced on April 6, 1999, a treasury stock purchase program authorizing management to acquire up to 500,000 shares of our common stock in the open market. The Board of Directors has subsequently from time to time increased such authorization from 500,000 shares to 14 million shares. The most recent authorization was for 1 million additional shares on March 7, 2008 and there has been no time limit set for completion of the repurchase program.

See Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operation-Liquidity and Capital Resources" for a description of loan covenants that limit our ability to repurchase shares and pay dividends.

### ITEM 6. EXHIBITS.

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(a) Exhibits:

Exhibit No. -----	Description -----
3.1	Amended and Restated Certificate of Incorporation of the Company, as amended reference to Exhibit 3.1 of the Company's Report on Form 8-K dated June 27, 2005)
3.2	Amended and Restated Bylaws of the Company (Incorporated by reference to Company's Report on Form 10-Q for the period ended June 30, 2003)
*10.1	Employment Agreement effective January 1, 1993 between the Company and Harland C. Stonecipher (Incorporated by reference to Exhibit 10.1 of the Company's Annual Report on Form 10-K for the year ended December 31, 1992)
*10.2	Agreements between Shirley Stonecipher, New York Life Insurance Company and the Company regarding life insurance policy covering Harland C. Stonecipher (Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1985)
*10.3	Amendment dated January 1, 1993 to Split Dollar Agreement between Shirley Stonecipher and the Company regarding life insurance policy covering Harland C. Stonecipher (Incorporated by reference to Exhibit 10.3 of the Company's Annual Report on Form 10-KSB for the year ended December 31, 1992)
*10.4	Form of New Business Generation Agreement Between the Company and Harland C. Stonecipher (Incorporated by reference to Exhibit 10.22 of the Company's Annual Report on Form 10-K for the year ended December 31, 1986)
*10.5	Amendment to New Business Generation Agreement between the Company and Harland C. Stonecipher effective January, 1990 (Incorporated by reference to Exhibit 10.12 of the Company's Annual Report on Form 10-KSB for the year ended December 31, 1992)
*10.6	Amendment No. 2 to New Business Generation Agreement between the Company and Harland C. Stonecipher effective January, 1990 (Incorporated by reference to Exhibit 10.13 of the Company's Annual Report on Form 10-K for the year ended December 31, 2002)
*10.7	Stock Option Plan, as amended effective May 2003 (Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2004)
10.8	Loan agreement dated June 11, 2002 between Bank of Oklahoma, N.A. and the Company (Incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002)

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- 10.9 Form of Mortgage dated July 23, 2002 between Bank of Oklahoma, N.A. and the Company by reference to Exhibit 10.3 of the Company's Quarterly Report on Form 10-Q ended June 30, 2002)
- \*10.10 Deferred compensation plan effective November 6, 2002 (Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2002)
- \*10.11 Amended Deferred Compensation Plan effective January 1, 2005 (Incorporated by reference to Exhibit 10.16 of the Company's Report on Form 10-K for the year ended December 31, 2004)
- 10.12 Credit Agreement dated June 23, 2006 among Pre-Paid Legal Services, Inc, the Company, and Wells Fargo Foothill, Inc. as Arranger and Administrative Agent and Bank of Oklahoma, N.A. (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed June 27, 2006)
- 10.13 Security Agreement dated June 23, 2006 between Pre-Paid Legal Services, Inc, the Company, subsidiaries and Wells Fargo Foothill, Inc., as Agent (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed June 26, 2006)
- 10.14 Guaranty Agreement dated June 23, 2006 between certain subsidiaries of Pre-Paid Legal Services, Inc. and Wells Fargo Foothill, Inc., as Agent (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed June 27, 2006)
- 10.15 Mortgage, Assignment of Rents and Leases and Security Agreement by Pre-Paid Legal Services, Inc. in favor of Wells Fargo Foothill, Inc as Agent (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed June 26, 2006)
- 10.16 First Amendment to Loan Agreement dated June 23, 2006 between Pre-Paid Legal Services, Inc. and Bank of Oklahoma, N.A. (Incorporated by reference to Exhibit 10.5 of the Company's Current Report on Form 8-K filed June 26, 2006)
- 10.17 First Amendment to Credit Agreement dated September 10, 2007 between Pre-Paid Legal Services, Inc. and the lenders named therein and Wells Fargo Foothill, Inc. as administrative agent (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 10-Q for the period ended September 10, 2007)
- 10.18 Term Loan Agreement dated September 28, 2007 between Pre-Paid Legal Services, Inc. and Wells Fargo Equipment Finance, LLC (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed October 2, 2007)
- 10.19 Form of Aircraft Mortgage and Security Agreement between Pre-Paid Legal Services, Inc. and Wells Fargo Equipment Finance, LLC (Incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed October 2, 2007)
- 10.20 Second Amendment to Credit Agreement dated February 22, 2008 between Pre-Paid Legal Services, Inc. and the lenders named therein and Wells Fargo Foothill, Inc. as administrative agent (Incorporated by reference to Exhibit 10.20 of our Annual Report on Form 10-K for the year ended December 31, 2007)
- 10.21 Third Amendment to Credit Agreement dated June 5, 2008 between Pre-Paid Legal Services, Inc. and the lenders named therein and Wells Fargo Foothill, Inc. as administrative agent (Incorporated by reference to Exhibit 10.21 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2008)
- 10.22 Second Amendment to Loan Agreement dated June 6, 2008 between Pre-Paid Legal Services, Inc. and Bank of Oklahoma, N.A. (Incorporated by reference to Exhibit 10.22 of the Company's Current Report on Form 10-Q for the six-months ended June 30, 2008)
- 31.1 Certification of Harland C. Stonecipher, Chairman, Chief Executive Officer and President of the Company, Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934
- 31.2 Certification of Steve Williamson, Chief Financial Officer, Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934

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Securities Exchange Act of 1934

32.1 Certification of Harland C. Stonecipher, Chairman, Chief Executive Officer and President to 18 U.S.C. Section 1350

32.2 Certification of Steve Williamson, Chief Financial Officer, Pursuant to 18 U.S.C.  
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\* Constitutes a management contract or compensatory plan or arrangement required to be filed as an exhibit to this report.

SIGNATURES

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

PRE-PAID LEGAL SERVICES, INC.  
(Registrant)

Date: October 27, 2008 /s/ Harland C. Stonecipher  
-----  
Harland C. Stonecipher  
Chairman, Chief Executive  
Officer and President  
(Principal Executive Officer)

Date: October 27, 2008 /s/ Randy Harp  
-----  
Randy Harp  
Chief Operating Officer  
(Duly Authorized Officer)

Date: October 27, 2008 /s/ Steve Williamson  
-----  
Steve Williamson  
Chief Financial Officer  
(Principal Financial and  
Accounting Officer)

Exhibit 31.1

CERTIFICATION  
-----

I, Harland C. Stonecipher, certify that:

- (1) I have reviewed this quarterly report on Form 10-Q of Pre-Paid Legal Services, 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

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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 internal control over financial reporting (as defined in Exchange Act Rule 13 (a)-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 the 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: October 27, 2008

/s/ Harland C. Stonecipher

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Harland C. Stonecipher  
Chairman, Chief Executive  
Officer and President

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Exhibit 31.2

### CERTIFICATION

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I, Steve Williamson, certify that:

- (1) I have reviewed this quarterly report on Form 10-Q of Pre-Paid Legal Services, 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 internal control over financial reporting (as defined in Exchange Act Rule 13 (a)-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 the 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

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- (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: October 27, 2008                    /s/ Steve Williamson  
-----  
Steve Williamson  
Chief Financial Officer

Exhibit 32.1

Certification Pursuant to 18 U.S.C. Section 1350

Pursuant to 18 U.S.C. ss. 1350, the undersigned officer of Pre-Paid Legal Services, Inc. (the "Company"), hereby certifies that the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 (the "Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 27, 2008                    /s/ Harland C. Stonecipher  
-----  
Harland C. Stonecipher  
Chairman, Chief Executive  
Officer and President

Exhibit 32.2

Certification Pursuant to 18 U.S.C. Section 1350

Pursuant to 18 U.S.C. ss. 1350, the undersigned officer of Pre-Paid Legal Services, Inc. (the "Company"), hereby certifies that the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 (the "Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 27, 2008                    /s/ Steve Williamson  
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Steve Williamson  
Chief Financial Officer