PRE PAID LEGAL SERVICES INC
Form 10-K
March 15, 2004

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

FORM 10-K

(Mark one)
(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

( )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: 1-9293

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

Oklahoma	73-1016728
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
One Pre-Paid Way Ada, Oklahoma	74820
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number including area code: (580) 436-1234

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 Par Value	New York Stock Exchange

Securities registered under Section 12 (g) of the Exchange Act: None

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 |X| No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K ( ).

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act) Yes |X| No [ ]

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked prices of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter. As of June 30, 2003 -$291,000,000

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: As of February 29, 2004 there were 16,791,225 shares of Common Stock, par value $.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE.

Portions of the Company's definitive proxy statement for its 2004 annual meeting of shareholders are incorporated into Part III of this Form 10-K by reference.

PRE-PAID LEGAL SERVICES, INC.
FORM 10-K

For the year ended December 31, 2003

TABLE OF CONTENTS

PART I.

ITEM 1. DESCRIPTION OF BUSINESS
- General
- Industry Overview
- Description of Memberships
- Specialty Legal Service Plans
- Provider Law Firms
- Identity Theft Shield Provider
- Marketing
- Operations
- Quality Control
- Competition
- Regulation
- Employees
- Foreign Operations
- Availability of Information

ITEM 2. DESCRIPTION OF PROPERTY

ITEM 3. LEGAL PROCEEDINGS

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

PART II.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES
- Market Price of and Dividends on the Common Stock
- Recent Sales of Unregistered Securities
- Equity Compensation Plans
- Issuer Purchases of Equity Securities

ITEM 6. SELECTED FINANCIAL DATA

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
- Overview of the Company's Financial Model
- Measures of Member retention
- Results of Operations:

Comparison of 2003 to 2002
Comparison of 2002 to 2001
Liquidity and Capital Resources
Forward-Looking Statements
Risk Factors

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

ITEM 9A. CONTROLS AND PROCEDURES

PART III. (Information required by Part III is incorporated by reference from the Company's definitive proxy statement for its 2004 annual meeting of shareholders.)

PART IV.

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

SIGNATURES

PRE-PAID LEGAL SERVICES, INC.
FORM 10-K

FOR THE YEAR ENDED DECEMBER 31, 2003

PART I.

ITEM 1. DESCRIPTION OF BUSINESS

General

Pre-Paid Legal Services, Inc. (the "Company") was one of the first companies in the United States organized solely to design, underwrite and market legal expense plans. The Company's predecessor commenced business in 1972 and began offering legal expense reimbursement services as a "motor service club" under Oklahoma law. In 1976, the Company was formed and acquired its predecessor in a stock exchange. The Company began offering Memberships independent of the motor service club product by adding a legal consultation and advice service, and in 1979 the Company implemented a legal expense benefit that provided for partial payment of legal fees in connection with the defense of certain civil and criminal actions. The Company's legal expense plans (referred to as "Memberships") currently provide for a variety of legal services in a manner similar to medical plans. In most states and provinces, standard plan benefits include preventive legal services, motor vehicle legal defense services, trial defense services, IRS audit services and a 25% discount off legal services not specifically covered by the Membership for an average monthly Membership fee of approximately $22. Additionally, in approximately 40 states, the Legal Shield rider can be added to the standard plan for only $1 per month and provides members with 24-hour access to a toll-free number for attorney assistance if the member is arrested or detained. Also, during the third quarter of 2003, the Company began offering its Identity Theft Shield ("IDT") to new and existing members at $9.95 per month if added to a legal service Membership or it may be purchased separately for $12.95 per month. The identity theft related benefits include a credit report and related instructional guide, a credit score and related instructional guide, credit report monitoring with daily online and monthly offline notification of any changes in credit information, up to $25,000 in credit restoration expense reimbursement and comprehensive identity theft restoration services.

Legal plan benefits are generally provided through a network of independent provider law firms, typically one firm per state or province and IDT plan benefits are provided by Kroll Background America, Inc., a subsidiary of Kroll Inc. ("Kroll"). Members have direct, toll-free access to Kroll or their provider law firm rather than having to call for a referral. At December 31, 2003, the Company had 1,418,997 Memberships in force with members in all 50 states, the District of Columbia and the Canadian provinces of Ontario, British Columbia, Alberta and Manitoba. Approximately 90% of such Memberships were in 29 states.

Industry Overview

Legal service plans, while used in Europe for more than one hundred years and representing more than a $4 billion European industry, were first developed in the United States in the late 1960s. Since that time, there has been substantial growth in the number of Americans entitled to receive various forms of legal services through legal service plans. According to the latest estimates developed by the National Resource Center for Consumers of Legal Services ("NRC") for 2002, there were 164 million Americans without any type of legal service plan. The NRC estimates that 122 million Americans were entitled to service through at least one legal service plan in 2002 although more than half are "free" plans that generally provide limited benefits on an automatic enrollment without any direct cost to the individual. The 122 million Americans compares to 4 million in 1981, 58 million in 1990 and 115 million in 2000. The legal service plan industry continues to evolve and market acceptance of legal service plans, as indicated by the continuing growth in the number of individuals covered by plans, is increasing.

Legal service plans are offered through various organizations and marketing methods and contain a wide variety of benefits. Free plans include those sponsored by labor unions, elder hotlines, the American Association of Retired Persons and the National Education Association according to NRC estimates, and accounted for approximately 56% of covered persons in 2002. The NRC estimates that an additional 27% are covered by employee assistance plans that are also automatic enrollment plans without direct cost to participants designed to provide limited telephonic access to attorneys for members of employee groups. Free plans and employee assistance plans therefore comprise approximately 83% of covered persons in 2002. Employer paid plans pursuant to which more comprehensive benefits are offered by the employer as a fringe benefit and the Armed Forces are each estimated by the NRC to account for approximately 5% of covered persons in 2002.

According to the NRC, the remaining covered persons in 2002 were covered by individual enrollment plans, other employment based plans, including voluntary payroll deduction plans, and miscellaneous plans. These plans were estimated by the NRC to account for approximately 8% of the market in 2002 and represent the market segment in which the Company primarily competes. According to the NRC, these plans typically have more comprehensive benefits, higher utilization, involve higher costs to participants, and are offered on an individual enrollment or voluntary basis.

Of the current work force covered by legal service plans, only 7% were estimated by the NRC to be covered by plans having full coverage. The Company believes these plans include benefits comparable to those provided by the

Company's Memberships. Accordingly, the Company believes that significant opportunities exist for successful marketing of the Company's Memberships to employee groups and other individual consumers.

According to the latest estimates of the census bureaus of the United States and Canada, currently the two geographic areas in which the Company operates, the number of households in the combined area exceeds 127 million. Since the Company has always disclosed its members in terms of Memberships and individuals covered by the Membership include the individual who purchases the Membership together with his or her spouse and never married children living at home up to age 21 or up to age 23 if the children are full time college students, the Company believes that its market share should be viewed as a percentage of households. Historically, the Company's primary market focus has been the "middle" eighty percent of such households rather than the upper and lower ten percent segments based on the Company's belief that the upper ten percent may already have a relationship with an attorney or law firm and the lower ten percent may not be able to afford the cost of a legal service plan. As a percentage of this defined "middle" market of approximately 100 million households, the Company currently has an approximate 1.4% share of the estimated market based on its existing 1.4 million active Memberships and, over the last 30 years, an additional 4% of households have previously purchased, but no longer own, Memberships. The Company routinely remarkets to previous members and reinstated approximately 66,000, 57,000 and 54,000 Memberships during 2003, 2002 and 2001, respectively.

Description of Memberships

The Memberships sold by the Company generally allow members to access legal services through a network of independent law firms ("provider law firms") under contract with the Company. Provider law firms are paid a monthly fixed fee on a capitated basis to render services to plan members residing within the state or province in which the provider law firm attorneys are licensed to practice. Because the fixed fee payments by the Company to provider law firms do not vary based on the type and amount of benefits utilized by the member, this capitated arrangement provides significant advantages to the Company in managing claims risk. At December 31, 2003, Memberships subject to the capitated provider law firm arrangement comprised approximately 99% of the Company's active Memberships. The remaining Memberships, approximately 1%, were primarily sold prior to 1987 and allow members to locate their own lawyer ("open panel") to provide legal services available under the Membership with the member's lawyer being reimbursed for services rendered based on usual, reasonable and customary fees, or are in states where there is no provider law firm in place and the Company's referral attorney network is utilized.

Family Legal Plan

The Family Legal Plan currently marketed in most jurisdictions by the Company consists of five basic benefit groups that provide coverage for a broad range of preventive and litigation-related legal expenses. The Family Legal Plan accounted for more than 93% of the Company's Membership fees in 2003 and approximately 95% of the outstanding Memberships at December 31, 2003. In addition to the Family Legal Plan, the Company markets other specialized legal services products specifically related to employment in certain professions described below.

In 12 states, certain of the Company's plans are available in the Spanish language. For the Spanish language plans, the provider law firms have both bilingual staff and lawyers and the Company has bilingual staff for both customer service and marketing service functions. The Company will continue to evaluate making its plans available in additional languages in markets where demand for such a product is expected to be sufficient to justify this additional cost.

In exchange for a fixed monthly, semi-annual or annual payment, members are entitled to specified legal services. Those individuals covered by the Membership include the individual who purchases the Membership along with his or her spouse and never married children living at home up to age 21 or up to age 23 if the children are full time college students. Also included are children up to age 18 for whom the member is legal guardian and any dependent child, regardless of age, who is mentally or physically disabled. Each Membership, other than the Business Owners' Legal Solutions Plan, is guaranteed renewable, except in the case of fraud or nonpayment of Membership fees. Historically, the Company has not raised rates to existing members. If new benefits become available, existing members may choose the newer, more comprehensive plan at a higher rate or keep their existing Memberships. Memberships are automatically renewed at the end of each Membership period unless the member cancels prior to the renewal date or fails to make payment on a timely basis.

The basic legal service plan Membership is sold as a package consisting of five separate benefit groups. Memberships range in cost from $14.95 to $26.00 per month depending in part on the schedule of benefits, which may vary from state or province in compliance with regulatory requirements. Benefits for domestic matters, bankruptcy and drug and alcohol related matters are limited in most Memberships.

Preventive Legal Services. These benefits generally offer unlimited toll-free access to a member's provider law firm for advice and consultation on any legal matter. These benefits also include letters and phone calls on the member's behalf, review of personal contracts and documents, each up to 10 pages in length, last will and testament preparation for the member and annual will reviews at no additional cost. Additional wills for spouse and other covered members may be prepared at a cost of $20.

Automobile Legal Protection. These benefits offer legal assistance for matters resulting from the operation of a licensed motor vehicle. Members have assistance available to them at no additional cost for: (a) defense in the court of original jurisdiction of moving traffic violations deemed meritorious, (b) defense in the court of original jurisdiction of any charge of manslaughter, involuntary manslaughter, vehicular homicide or negligent homicide as the result of a licensed motor vehicle accident, (c) up to 2.5 hours of assistance per incident for collection of minor property damages (up to $2,000) sustained by the member's licensed motor vehicle in an accident, (d) up to 2.5 hours of assistance per incident for collection of personal injury damages (up to $2,000) sustained by the member or covered family member while driving, riding or being struck as a pedestrian by a motor vehicle, and (e) up to 2.5 hours of assistance per incident in connection with an action, including an appeal, for the maintenance or reinstatement of a member's driver's license which has been canceled, suspended, or revoked. No coverage under this benefit of the basic legal service plan is offered to members for pre-existing conditions, drug or alcohol related matters, or for commercial vehicles over two axles or operation without a valid license.

Trial Defense. These benefits offer assistance to the member and the member's spouse through an increasing schedule of benefits based on Membership year. Up to 60 hours are available for the defense of civil or job-related criminal charges by the provider law firm in the first Membership year. The criminal action must be within the scope and responsibility of employment activities of the member or spouse. Up to 2.5 hours of assistance are available prior to trial, and the balance is available for actual trial services. The schedule of benefits under this benefit area increases by 60 hours each Membership year to: 120 hours in the second Membership year, 3 hours of which are available for pre-trial services; 180 hours in the third Membership year, 3.5 hours of which are available for pre-trial services; 240 hours in the fourth

Membership year, 4 hours of which are available for pre-trial services, to the maximum limit of 300 hours in the fifth Membership year, 4.5 hours of which are available for pre-trial services. This benefit excludes domestic matters, bankruptcy, deliberate criminal acts, alcohol or drug-related matters, business matters, and pre-existing conditions.

In addition to the pre-trial benefits of the basic legal plan described above, there are additional pre-trial hours available as an option, or add-on, to the basic plan. These optional benefits cost $9.00 per month and add 15 hours of pre-trial services during the first year of the Membership increasing 5 additional hours each Membership year to the maximum limit of 35 hours in the fifth Membership year and increases total pre-trial and trial defense hours available pursuant to the expanded Membership to 75 hours during the first Membership year to 335 hours in the fifth Membership year. These pre-trial hours are in addition to those hours already provided by the basic plan so that the member, in the first year of the Membership, has a combined total of 17.5 pre-trial hours available escalating to a combined total of 39.5 pre-trial hours in the fifth Membership year. There were approximately 598,000 subscribers of this benefit at December 31, 2003 compared to 614,000 at December 31, 2002.

IRS Audit Protection Services. This benefit offers up to 50 hours of legal assistance per year in the event the member, spouse or dependent children receive written notification of an Internal Revenue Service ("IRS") audit or are summoned in writing to appear before the IRS concerning a tax return. The 50 hours of assistance are available in the following circumstances: (a) up to 1 hour for initial consultation, (b) up to 2.5 hours for representation in connection with the audit if settlement with the IRS is not reached within 30 days, and (c) the remaining 46.5 hours of actual trial time if settlement is not achieved prior to litigation. Coverage is limited to audit notification received regarding the tax return for years during which the Membership is effective. Representation for charges of fraud or income tax evasion, business and corporate tax returns and certain other matters are excluded from this benefit.

With pre-trial benefits limited to 2.5 hours to 4.5 hours based on the Membership year for trial defense (without the pre-trial option described) and 3.5 hours for the IRS audit benefit, these benefits do not ensure complete pre-trial coverage. In order to receive additional pre-trial IRS audit or trial defense benefits, a matter must actually proceed to trial. The costs of pre-trial preparation that exceed the benefits under the Membership are the responsibility of the member. Provider law firms under the closed panel Membership have agreed to provide to members any additional pre-trial services beyond those stipulated in the Membership at a 25% discount from the provider law firm's customary and usual hourly rate. Retainer fees for these additional services may be required.

Preferred Member Discount. Provider law firms have agreed to provide to members any legal services beyond those stipulated in the Membership at a fee discounted 25% from the provider law firm's customary and usual hourly rate. This "customary and usual hourly rate" is a fixed single hourly rate for each provider firm that is generally an average of the firm's various hourly rates for its attorneys which typically vary based on experience and expertise.

Legal Shield Benefit

In approximately 40 states, the Legal Shield plan can be added to the standard or expanded Family Legal Plan for $1 per month and provides members with 24-hour access to a toll-free number for provider law firm assistance if the member is arrested or detained. The Legal Shield member, if detained, can present their Legal Shield card to the officer that has detained them to make it clear that they have access to legal representation and that they are requesting to contact a lawyer immediately. The benefits of the Legal Shield plan are subject to conditions imposed by the detaining authority, which may not allow for the provider law firm to communicate with the member on an immediate basis.

There were approximately 881,000 Legal Shield subscribers at December 31, 2003 compared to approximately 613,000 at December 31, 2002.

Identity Theft Shield Benefit

During the third quarter of 2003, the Company and Kroll Background America Inc., a subsidiary of Kroll Inc., announced a joint marketing agreement that allows the Company's independent sales associates to market Kroll's identity theft benefits. By adding the new Identity Theft Shield to their existing family Membership, members have toll free access to the identity theft specialists at Kroll. This benefit can be added to a legal service Membership for $9.95 per month or purchased separately for $12.95 per month. The identity theft related benefits include a credit report and related instructional guide, a credit score and related instructional guide, credit report monitoring with daily online and monthly offline notification of any changes in credit information, up to $25,000 in credit restoration expense reimbursement and comprehensive identity theft restoration services. There were approximately 91,000 subscribers at December 31, 2003 comprised of 87,000 subscribers at $9.95 per month and 4,000 subscribers at $12.95 per month.

Canadian Family Plan

The Family Legal Plan is currently marketed in the Canadian provinces of Ontario, British Columbia, Alberta and Manitoba. The Company began operations in Ontario and British Columbia during 1999, Alberta in February 2001 and Manitoba in August 2001. Benefits of the Canadian plan include expanded preventive benefits including assistance with Canadian Government agencies, warranty assistance and small claims court assistance as well as the preferred member discount. Canadian Membership fees collected during 2003 were approximately $4.2 million in U.S. dollars compared to $3.7 million collected in 2002 and $4.3 million collected in 2001. The Company plans to expand operations in other provinces and territories of Canada.

Specialty Legal Service Plans

In addition to the Family Legal Plan described above, the Company also offers other specialty or niche legal service plans. These specialty plans usually contain many of the Family Legal Plan benefits adjusted as necessary to meet specific industry or prospective member requirements. In addition to those specialty plans described below, the Company will continue to evaluate and develop other such plans as the need and market allow.

Business Owners' Legal Solutions Plan

The Business Owners' Legal Solutions plan was developed during 1995 and provides business oriented legal service benefits for small businesses with 99 or fewer employees. This plan was developed and test marketed in selected geographical areas and more widely marketed beginning in 1996 at a monthly rate of $69.00. This plan provides small businesses with legal consultation and correspondence benefits, contract and document reviews, debt collection assistance and reduced rates for any non-covered areas. During 1997, the coverage offered pursuant to this plan was expanded to include trial defense benefits and Membership in GoSmallBiz.com, an unrelated Internet based service provider. Through GoSmallBiz.com, members may receive unlimited business consultations from business consultants and have access to timely small business articles, educational software, Internet tools and more. This expanded plan is currently marketed at a monthly rate ranging from $69 to $150 ($175 in Canada) depending on the number of employees and provides business oriented legal service benefits for any for-profit business with 99 or fewer employees. This plan is available in 42 states and provinces and represented approximately 3.7%, 4.0% and 3.8% of the Company's Membership fees during 2003, 2002 and 2001, respectively.

Law Officers Legal Plan

The Law Officers Legal Plan, developed in 1991 and marketed to law enforcement officers, provides 24-hour job-related emergency toll-free access to a provider law firm and provides legal services associated with administrative hearings. This plan was designed to meet the legal needs of persons in the law enforcement profession and is currently marketed at the monthly rate of $16.00 or at a group rate of $14.95. The Company has members covered under the Law Officers Legal Plan in 27 states. The Law Officers Legal Plan offers the basic family legal plan benefits described above without the motor vehicle related benefits. These motor vehicle benefits are available in the Law Officers Legal Plan only for defense of criminal charges resulting from the operation of a licensed motor vehicle. Additionally, at no charge to the member, a 24-hour emergency hotline is available to access the services of the provider law firm in situations of job-related urgency. The Law Officers Legal Plan also offers representation at no additional charge for up to ten hours (five hours per occurrence) for two administrative hearings or inquiries per year and one pre-termination hearing per Membership year before a review board or arbitrator. Preparation and/or counsel for post-termination hearings are also available to members as a schedule of benefits, which increases with each Membership year. The schedule of benefits is similar to that offered under the Family Legal Plan Trial Defense, including the availability of the optional pre-trial hours described above for an additional $9.00 per month. During the years ended December 31, 2003, 2002 and 2001, the Law Officers Legal Plan accounted for approximately .9%, 1.4% and 1.5%, respectively, of the Company's Membership fees.

Commercial Driver Legal Plan

The Commercial Driver Legal Plan, developed in 1986, is designed specifically for the professional truck driver and offers a variety of driving-related benefits, including coverage for moving and non-moving violations. This plan provides coverage by a provider law firm for persons who drive a commercial vehicle. This legal service plan is currently offered in 45 states. In certain states, the Commercial Driver Legal Plan is underwritten by the Road America Motor Club, an unrelated motor service club. During the years ended December 31, 2003, 2002 and 2001, this plan accounted for approximately ..9%, 1.3% and .9%, respectively, of Membership fees. The Plan underwritten by the Road America Motor Club is available at the monthly rate of $35.95 or at a group rate of $32.95. Plans underwritten by the Company are available at the monthly rate of $32.95 or at a group rate of $29.95. Benefits include the motor vehicle related benefits described above, defense of Department of Transportation violations and the 25% discounted rate for services beyond plan scope, such as defense of non-moving violations. The Road America Motor Club underwritten plan includes bail and arrest bonds and services for family vehicles.

Home-Based Business Rider

The Home-Based Business plan was designed to provide small business owners access to commonly needed legal services. It can be added to the Expanded Family Legal Plan in approved states. To qualify, the business and residence address must be the same with three or fewer employees and be a for-profit business that is not publicly traded. Benefits under this plan include unlimited business telephone consultation, review of three business contracts per month, three business and debt collection letters per month and discounted trial defense rates. This plan also includes Membership in GoSmallBiz.com. This plan is available in 35 states and represented approximately 1.6%, 1.7% and 1.5% of the Company's Membership fees during 2003, 2002 and 2001, respectively.

Comprehensive Group Legal Services Plan

The Company introduced in late 1999 the Comprehensive Group plan, designed for the large group employee benefit market. This plan provides all the benefits of the Family Legal Plan as well as mortgage document preparation, assistance with uncontested legal situations such as adoptions, name changes, separations and divorces. Additional benefits include the preparation of health care power of attorney and living wills or directives to physicians. Although the Company has experienced increased sales of this plan during the last three years (8,795 Memberships, 7,051 Memberships and 3,462 Memberships during 2003, 2002 and 2001, respectively) and believes this plan improves its competitive position in the large group market, the Company continues to emphasize group marketing to employee groups of less than 50 rather than larger groups where there is more competition, price negotiation and typically a longer sales cycle.

Other than additional benefits such as the Legal Shield benefit described above, the basic structure and design of the Membership benefits has not significantly changed over the last several years. The consistency in plan design and delivery provides the Company consistent, accurate data about plan utilization which enables the Company to manage its benefit costs through the capitated payment structure to provider firms.

Provider Law Firms

The Company's Memberships generally allow members to access legal services through a network of independent provider law firms under contract with the Company generally referred to as "provider law firms." Provider law firms are paid a fixed fee on a per capita basis to render services to plan members residing within the state or province as provided by the contract. Because the fixed fee payments by the Company to provider law firms in connection with the Memberships do not vary based on the type and amount of benefits utilized by the member, this arrangement provides significant advantages to the Company in managing its cost of benefits. Pursuant to these provider law firm arrangements and due to the volume of revenue directed to these firms, the Company has the ability to more effectively monitor the customer service aspects of the legal services provided and the financial leverage to help ensure a customer friendly emphasis by the provider law firms. Generally, due to the volume of revenue that may be directed to particular provider law firms, the Company has access to larger, more diversified law firms. The Company, through its members, is typically the largest client base of its provider law firms.

Provider law firms are selected to serve members based on a number of factors, including recommendations from provider law firms and other lawyers in the area in which the candidate provider law firm is located and in neighboring states, investigation by the Company of bar association standing and client references, evaluation of the education, experience and areas of practice of lawyers within the firm, on-site evaluations by Company management, and interviews with lawyers in the firm who would be responsible for providing services. Most importantly, these candidate law firms are evaluated on the firm's customer service philosophy.

The majority of provider law firms are connected to the Company via high-speed digital links to the Company's management information systems, thereby providing real-time monitoring capability. This online connection offers the provider law firm access to specially designed software developed by the Company for administration of legal services by the firm. These systems provide statistical reports of each law firm's activity and performance and allow approximately 97% of members served by provider law firms to be monitored on a near real-time basis. The few provider law firms that are not online with the Company typically have a small Membership base and must provide various weekly reports to the Company to assist in monitoring the firm's service level. The combination of the online statistical reporting and weekly service reports for smaller provider law firms allows quality control monitoring of over 15 separate service delivery benchmarks. In addition, the Company regularly conducts extensive random surveys of members who have used the legal services of a provider law firm. The Company surveys members in each state every 60 days, compiles the results of such surveys and provides the provider law firms with copies of each survey and the overall summary of the results. If a member indicates on a survey the service did not meet their expectation, the member is contacted as soon as possible to resolve the issue.

Each month, provider law firms are presented with a comprehensive report of ratings related to the Company's online monitoring, member complaints, member survey evaluations, telephone reports and other information developed in connection with member service monitoring. If a problem is detected, immediate remedial actions are recommended by the Company to the provider law firms to eliminate service deficiencies. In the event the deficiencies of a provider law firm are not eliminated through discussions and additional training with the Company, such deficiencies may result in the termination of the provider law firm. The Company is in constant communication with its provider law firms and meets with them frequently for additional training, to encourage increased communications with the Company and to share suggestions relating to the timely and effective delivery of services to the Company's members.

Each attorney member of the provider law firm rendering services must have at least two years of experience as a lawyer, unless the Company waives this requirement due to special circumstances such as instances when the lawyer demonstrates significant legal experience acquired in an academic, judicial or similar capacity other than as a lawyer. The Company provides customer service training to the provider law firms and their support staff through on-site training that allows the Company to observe the individual lawyers of provider law firms as they directly assist the members.

Agreements with provider law firms: (a) generally permit termination of the agreement by either party upon 60 days prior written notice, (b) permit the Company to terminate the Agreement for cause immediately upon written notice, (c) require the firm to maintain a minimum amount of malpractice insurance on each of its attorneys, in an amount not less than $100,000, (d) preclude the Company from interference with the lawyer-client relationship, (e) provide for periodic review of services provided, (f) provide for protection of the Company's proprietary information and (g) require the firm to indemnify the Company against liabilities resulting from legal services rendered by the firm. The Company is precluded from contracting with other law firms to provide the same service in the same geographic area, except in situations where the designated law firm has a conflict of interest, the Company enrolls a group of 500 or more members, or when the agreement is terminated by either party. Provider law firms are precluded from contracting with other prepaid legal service companies without Company approval. Provider law firms receive a fixed monthly payment for each member who are residents in the service area and are responsible for providing the Membership benefits without additional remuneration. If a provider law firm delivers legal services to an open panel member, the law firm is reimbursed for services rendered according to the open panel Membership. As of December 31, 2003, provider law firms averaged approximately 59 employees each and on average are evenly split between support staff and lawyers.

The Company has had occasional disputes with provider law firms, some of which have resulted in litigation. The toll-free telephone lines utilized and paid for by the provider law firms are owned by the Company so that in the event of a termination, the members' calls can be rerouted very quickly. Nonetheless, the Company believes that its relations with provider law firms are generally very good. At the end of 2003, the Company had provider law firms representing 46 states and four provinces compared to 45 states and three provinces at the end of 2002 and 2001. During the last three calendar years, the Company's relationships with a total of four provider law firms were terminated by the Company or the provider law firm. As of December 31, 2003, 26 provider law firms have been under contract with the Company for more than eight years with the average tenure of all provider law firms being approximately 7 1/2 years.

The Company has an extensive database of referral lawyers who have provided services to its members for use by members when a designated provider law firm is not available. Lawyers with whom members have experienced verified service problems, or are otherwise inappropriate for the referral system, are removed from the Company's list of referral lawyers.

Identity Theft Shield Benefits Provider

Kroll is one of the world's leading independent risk consulting companies. Kroll provides a broad range of investigative, intelligence, financial, security, and technology services to help clients reduce risks, solve problems, and capitalize on opportunities. Headquartered in New York with more than 60 offices on six continents, Kroll has a multidisciplinary corps of more than 2,200 employees and serves a global clientele of law firms, financial institutions, corporations, nonprofit institutions, government agencies, and individuals. Over the last three years, Kroll has developed a unique solution for victims of identity theft. This new service is now available to Pre-Paid Legal members through the Identity Theft Shield benefit. Similar to the provider law firms, Kroll is paid a fixed fee on a monthly per capita basis to render services to IDT members

Marketing

Multi-Level Marketing

The Company markets Memberships through a multi-level marketing program that encourages individuals to sell Memberships and allows individuals to recruit and develop their own sales organizations. Commissions are paid only when a Membership is sold or an associate subscribes to the Company's eService package (described below). No commissions are paid based solely on recruitment. When a Membership is sold, commissions are paid to the associate making the sale, and to other associates (on average, 13 others at December 31, 2003 compared to 17 others at December 31, 2002) who are in the line of associates who directly or indirectly recruited the selling associate. The Company provides training materials, organizes area-training meetings and designates personnel at the home office specially trained to answer questions and inquiries from associates. The Company offers various communication avenues to its sales associates to keep such associates informed of any changes in the marketing of its Memberships. The primary communication vehicles utilized by the Company to keep its sales associates informed include extensive use of e-mail, an interactive voice-mail service, The Connection monthly magazine, the weekly Communication Show that may be heard via the Company's Internet webcasts, an interactive voice response system, a monthly DVD (digital video disc) program and the Company's website, prepaidlegal.com.

Multi-level marketing is primarily used for marketing based on personal sales since it encourages individual or group face-to-face meetings with prospective members and has the potential of attracting a large number of sales personnel within a short period of time. The Company's marketing efforts towards individuals typically target the middle income family or individual and seek to educate potential members concerning the benefits of having ready access to legal counsel for a variety of everyday legal problems. Memberships with individuals or families sold by the multi-level sales force constituted 75% of the Company's Memberships in force at December 31, 2003 compared to 73% at December 31, 2002 and 2001. Although other means of payment are available, approximately 73% of fees on Memberships purchased by individuals or families are paid on a monthly basis by means of automatic bank draft or credit card.

The Company's marketing efforts towards employee groups, principally on a payroll deduction payment basis, are designed to permit its sales associates to reach more potential members with each sales presentation and strive to capitalize on, among other things, what the Company perceives to be a growing interest among employers in the value of providing legal service plans to their employees. Memberships sold through employee groups constituted approximately 25% of total Memberships in force at December 31, 2003 compared to 27% at December 31, 2002 and 2001. Adverse publicity about the Company is responsible, to some extent, for the decline in group memberships on a percentage basis. The majority of employee group Memberships are sold to school systems, governmental entities and businesses. The Company emphasizes group marketing to employee groups of less than 50 rather than larger groups where there is more competition, price negotiation and typically a longer sales cycle. No group accounted for more than 1% of the Company's consolidated revenues from Memberships during 2003, 2002 or 2001. Substantially all group Memberships are paid on a monthly basis. The Company is active in legislative lobbying efforts to enhance the ability of the Company to market to public employee groups and to encourage Congress to reenact legislation to permit legal service plans to qualify for pre-tax payments under tax qualified employee cafeteria plans.

Sales associates are generally engaged as independent contractors and are provided with training materials and are given the opportunity to participate in Company training programs. Sales associates are required to complete a specified training program prior to marketing the Company's Memberships to employee groups. All advertising and solicitation materials used by sales associates must be approved by the Company prior to use. At December 31, 2003, the Company had 329,600 "vested" sales associates compared to 341,116 and 286,488 "vested" sales associates at December 31, 2002 and 2001, respectively. A sales associate is considered to be "vested" if he or she has personally sold at least three new Memberships per quarter or if he or she retains a personal Membership. A vested associate is entitled to continue to receive commissions on prior sales after all previous commission advances have been recovered. However, a substantial number of vested associates do not continue to market the Membership, as they are not required to do so in order to continue to be vested. During 2003, the Company had 84,207 sales associates who personally sold at least one Membership, of which 45,920 (55%) made first time sales. During 2002 and 2001 the Company had 103,112 and 81,613 sales associates producing at least one Membership sale, respectively, of which 65,383 (63%) and 46,687 (57%), respectively, made first time sales. During 2003, the Company had 10,685 sales associates who personally sold more than ten Memberships compared to 12,738 and 13,749 in 2002 and 2001, respectively. A substantial number of the Company's sales associates market the Company's Memberships on a part-time basis only. The decline in total vested sales associates, those making at least one membership sale in 2003, those making first time sales in 2003 and those that sold more than ten Memberships during 2003 are all attributable to the decline in new sales associates added during 2003. For the year 2003, new sales associates enrolled decreased 30% to 108,557 from the 155,663 enrolled in 2002.

The Company derives revenues from its multi-level marketing sales force, principally from a one-time enrollment fee of $65 from each new sales associate for which the Company provides initial marketing supplies and enrollment services to the associate. In January 1997, the Company implemented a new combination classroom and field training program, titled Fast Start to Success ("Fast Start"), aimed at increasing the level of new Membership sales per associate. During most of 2003, the Fast Start program provided a direct economic incentive to existing associates to help train new recruits in the form of a qualification, or training, bonus. Associates successfully completed the program by writing three new Memberships and recruiting a new sales associate or by personally selling five new Memberships within 60 days of the associate's start date. Associates in states that require the associate to become licensed had 60 days from the issue date on their license to complete the same requirements. Beginning January 1, 2004, new Fast Start associates must qualify within the first 45 days of their start date. The program typically requires a fee ranging from $34 to $184 per new associate, depending on special promotions the Company implements from time to time, that is earned by the Company upon completion of the training program. Amounts collected from sales associates are intended primarily to offset the Company's costs incurred in recruiting and training and providing materials to sales associates and are not intended to generate profits from such activities. Other revenues from sales associates represent the sale of marketing supplies and promotional materials and includes fees related to the Company's eService program for associates. The eService program provides subscribers Internet based back office support such as reports, on-line documents, tools, a personal e-mail account and multiple personalized web sites with "flash" movie presentations.

The Company's compensation plan for the multi-level marketing force is under continuous review by the Company to assure that the various financial incentives in the plan encourage the Company's desired goals. The Company offers various incentive programs from time to time and frequently adjusts the program to maintain appropriate incentives and to improve Membership production and retention.

The Company holds its International Convention once a year, typically in the spring, and a Leadership Summit, typically in the fall, and routinely hosts more than 10,000 of its sales associates at these events. These events are intended to provide additional training, corporate updates, new announcements, motivation and associate recognition. Additionally, the Company offers the Player's Club incentive program providing additional incentives to its associates as a reward for consistent, quality business. Associates can earn the right to attend an annual incentive trip by meeting monthly qualification requirements for the entire calendar year and maintaining certain personal retention rates for the Memberships sold during the calendar year. Associates can also earn the right to receive additional monthly bonuses by meeting the monthly qualification requirements for twelve consecutive months and maintaining certain personal retention rates for the Memberships sold during that twelve month period.

Regional Vice Presidents

The Company has a group of employees that serve as Regional Vice Presidents ("RVPs") responsible for associate activity in a given geographic region and with the ability to appoint independent contractors as Area Coordinators within the RVP's region. The RVPs have weekly reporting requirements as well as quarterly sales and recruiting goals. The RVP and Area Coordinator program provides a basis to effectively monitor current sales activity, further educate and motivate the sales force and otherwise enhance the relationships between the associates and the Company. New products and initiatives will continue to be channeled through the RVPs and Area Coordinators. At December 31, 2003, the Company had 80 RVPs in place.

Pre-Paid Legal Benefits Association

The PPL Benefits Association (PPLBA) was founded in 1999 with the intent of providing sales associates the opportunity to have access, at their own expense, to health insurance and life insurance benefits. Membership in the Association allows a sales associate to become eligible to enroll in numerous benefit programs, as well as take advantage of attractive affinity agreements. Membership in this association is open to sales associates that reach a certain level within the Company's marketing programs who also maintain an active personal legal services Membership. The PPLBA is a separate association not owned or controlled by the Company and is governed by a 9 member Board of Directors, including four officer positions. None of the officers or directors of the PPLBA serve in any such capacity with the Company. The PPLBA employs a Director of Associate Benefits paid by the Association. Affinity programs available to members of the PPLBA include credit cards, long-distance, wireless services, safety trip plan, mortgage and real estate assistance and a travel club. As determined by its Board of Directors, some of the revenue generated by the PPLBA through commissions from vendors of the benefits and affinity programs or contributed to the Association by the Company may be used to make open-market purchases of the Company's stock for use in stock bonus awards to Association members based on criteria established from time to time by the Board of Directors of the PPLBA. Since inception and through December 31, 2003, approximately 31,000 shares were purchased by the PPLBA for awards to its members. In 2002, the PPLBA offered cash in lieu of stock awards and approximately 21,000 shares purchased by the Association were sold to the Company on January 2, 2003 at the stock's closing price to fund the awards. For the 2003 stock bonus award program the PPLBA awarded approximately 10,000 shares of stock to Association members.

Cooperative Marketing

The Company has in the past, and may in the future, develop marketing strategies pursuant to which the Company seeks arrangements with insurance and service companies that have established sales forces. Under such arrangements, the agents or sales force of the cooperative marketing partner market the Company's Memberships along with the products already marketed by the partner's agents or sales force. Such arrangements allow the cooperative marketing partner to enhance its existing customer relationships and distribution channels by adding the Company's product to the marketing partner's existing range of products and services, while the Company is able to gain broader Membership distribution and access to established customer bases.

The Company has a cooperative marketing agreement with Atlanta-based Primerica Financial Services ("PFS"), a subsidiary of Citigroup, Inc. PFS is one of the largest financial services marketing organizations in North America with more than 100,000 personal financial analysts across the U.S. and Canada. The PFS cooperative marketing agreement resulted in approximately 15,000 Memberships during each of 2003 and 2002.

The Company has had limited success with cooperative marketing arrangements in the past and is unable to predict with certainty what success it will achieve, if any, under its existing or future cooperative marketing arrangements.

Operations

The Company's corporate operations involve Membership application processing, member-related customer service, various associate-related services including commission payments, receipt of Membership fees, related general ledger accounting, and managing and monitoring the provider law firm relationships.

The Company utilizes a management information system to control operations costs and monitor benefit utilization. Among other functions, the system evaluates benefit claims, monitors member use of benefits and monitors marketing/sales data and financial reporting records. Dominant company concerns in the architecture of private networks and web systems include security, scalability, capacity to accommodate peak traffic and business continuity in the event of a disaster. The Company believes its management information system has substantial capacity to accommodate increases in business data before substantial upgrades will be required. The Company believes this excess capacity will enable it to experience a significant increase in the number of members serviced with less than a commensurate increase of administrative costs.

The Company has built a strong Internet presence to strengthen the services provided to both members and associates. The Company's Internet site, at www.prepaidlegal.com, welcomes the multifaceted needs of our members, sales force, investors and prospects. It has also reduced costs associated with communicating critical information to the associate sales force.

The Company's operations also include departments specifically responsible for marketing support and regulatory and licensing compliance. The Company has an internal production staff that is responsible for the development of new audio and video sales materials.

Quality Control

In addition to the Company's quality control efforts for provider law firms described above, the Company also closely monitors the performance of its home office personnel, especially those who have telephone contact with members or sales associates. The Company records home office employee telephone calls with its members and sales associates to assure that Company policies are being followed and to gather data about recurring problems that may be avoided through modifications in policies. The Company also uses such recorded calls for training and recognition purposes.

Competition

The Company competes in a variety of market segments in the prepaid legal services industry, including, among others, individual enrollment plans, employee benefit plans and certain specialty segments. According to the latest (2002) estimates by NRC, an estimated 35% of the total estimated market in the segments in which the Company competes is served by a large number of small companies with regional areas of emphasis or union-based automatic enrollment plans. The remaining 65% of such market are served primarily by the Company and five other principal competitors: Hyatt Legal Plans (a MetLife company), ARAG Group (formerly Midwest Legal Services), LawPhone/ACS, National Legal Plan and Legal Services Plan of America (a GE Financial Assurance Partnership Marketing Group company, formerly the Signature Group). For employment-based plans other than employer paid, union-based automatic enrollment plans and employee assistance plans and for individual enrollment plans, the Company represents approximately 51% of the market share garnered by this group according to the NRC.

If a greater number of companies seek to enter the prepaid legal services market, the Company will experience increased competition in the marketing of its Memberships. However, the Company believes its competitive position is enhanced by its actuarial database, its existing network of provider attorney law firms and its ability to tailor products to suit various types of distribution channels or target markets. The Company believes that no other competitor has the ability to monitor the customer service aspect of the delivery of legal services to the same extent the Company does. Serious competition is most likely from companies with significant financial resources and advanced marketing techniques.

Regulation

The Company is regulated by or required to file with or obtain approval of State Insurance Departments, Secretaries of State, State Bar Associations and State Attorney General offices depending on individual state opinions of regulatory responsibility for legal expense plans. The Company is also required to file with similar government agencies in Canada. While some states or provinces regulate legal expense plans as insurance or specialized legal expense products, others regulate them as services.

As of December 31, 2003, the Company or one of its subsidiaries was marketing new Memberships in 38 states or provinces that require no special licensing. The Company's subsidiaries serve as operating companies in 16 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") and Pre-Paid Legal Services, Inc. of Florida

("PPLSIF"). Of the Company's total Memberships in force as of December 31, 2003, 38% were written in jurisdictions that subject the Company or one of its subsidiaries to insurance or specialized legal expense plan regulation.

The Company began selling Memberships in the Canadian provinces of Ontario and British Columbia during 1999, Alberta during February 2001 and Manitoba during August 2001. The Memberships currently marketed by the Company in such provinces do not constitute an insurance product and therefore are exempt from insurance regulation.

In states with no special licensing or regulatory requirements, the Company commences operations only when advised by the appropriate regulatory authority that proposed operations do not constitute conduct of the business of insurance. There is no assurance that Memberships will be exempt from insurance regulation even in states or provinces with no specific regulations. In these situations, the Company or one of its subsidiaries would be required to qualify as an insurance company in order to conduct business.

PPLCI serves as the operating company in most states where Memberships are determined to be an insurance product. PPLCI is organized as a casualty insurance company under Oklahoma law and as such is subject to regulation and oversight by various state insurance agencies where it conducts business. These agencies regulate the Company's forms, rates, trade practices, allowable investments and licensing of agents and sales associates. These agencies also prescribe various reports, require regular evaluations by regulatory authorities, and set forth-minimum capital and reserve requirements. The Company's insurance subsidiaries are routinely evaluated and examined by representatives from the various regulatory authorities in the normal course of business. Such examinations have not and are not expected to adversely impact the Company's operations or financial condition in any material way. The Company believes that all of its subsidiaries meet any required capital and reserve requirements. Dividends paid by PPLCI are restricted under Oklahoma law to available surplus funds derived from realized net profits.

The Company is required to register and file reports with the Oklahoma Insurance Commissioner as a member of a holding company system under the Oklahoma Insurance Holding Company System Regulatory Act. Transactions between PPLCI and the Company or any other subsidiary must be at arms-length with consideration for the adequacy of PPLCI's surplus, and must have prior approval of the Oklahoma Insurance Commissioner. Payment of any extraordinary dividend by PPLCI to the Company requires approval of the Oklahoma Insurance Commissioner. During 2001, PPLCI declared a $5 million dividend payable to the Company which was paid in 2002. During 2002, PPLCI declared a $6 million dividend which was paid in December of 2002. While PPLCI had approximately $3.5 million in surplus funds available for payment of an ordinary dividend in December 2002, no such dividend was declared or paid during 2003. At December 31, 2003 PPLCI had approximately $750,000 available for payment of an ordinary dividend. Any change in control of the Company, defined as acquisition by any method of more than 10% of the Company's outstanding voting stock, including rights to acquire such stock by conversion of preferred stock, exercise of warrants or otherwise, requires approval of the Oklahoma Insurance Commissioner. Holding company laws in some states in which PPLCI operates provide for comparable registration and regulation of the Company.

Certain states have enacted special licensing or regulatory requirements designed to apply only to companies offering legal service products. These states most often follow regulations similar to those regulating casualty insurance providers. Thus, the operating company may be expected to comply with specific minimum capitalization and unimpaired surplus requirements; seek approval of forms, Memberships and marketing materials; adhere to required levels of claims reserves, and seek approval of premium rates and agent licensing. These laws may also restrict the amount of dividends paid to the

Company by such subsidiaries. PPLSIF is subject to restrictions of this type under the laws of the State of Florida, including restrictions with respect to payment of dividends to the Company. At December 31, 2003, PPLSIF did not have funds available for payment of substantial dividends without the prior approval of the insurance commissioner.

As the legal plan industry matures, additional legislation may be enacted that would affect the Company and its subsidiaries. The Company cannot predict with any accuracy if such legislation would be adopted or its ultimate effect on operations, but expects to continue to work closely with regulatory authorities to minimize any undesirable impact.

The Company's operations are further impacted by the American Bar Association Model Rules of Professional Conduct ("Model Rules") and the American Bar Association Code of Professional Responsibility ("ABA Code") as adopted by various states. Arrangements for payments to a lawyer by an entity providing legal services to its members are permissible under both the Model Rules and the ABA Code, so long as the arrangement prohibits the entity from regulating or influencing the lawyer's professional judgment. The ABA Code prohibits lawyer participation in closed panel legal service programs in certain circumstances. The Company's agreements with provider law firms comply with both the Model Rules and the ABA Code. The Company relies on the lawyers serving as the designated provider law firms for the closed panel benefits to determine whether their participation would violate any ethical guidelines applicable to them. The Company and its subsidiaries comply with filing requirements of state bar associations or other applicable regulatory authorities.

The Company also is required to comply with state, provincial and federal laws governing the Company's multi-level marketing approach. These laws generally relate to unfair or deceptive trade practices, lotteries, business opportunities and securities. The Company has experienced no material problems with marketing compliance. In jurisdictions that require associates to be licensed, the Company receives all applications for licenses from the associates and forwards them to the appropriate regulatory authority. The Company maintains records of all associates licensed, including effective and expiration dates of licenses and all states in which an associate is licensed. The Company does not accept new Membership sale applications from any unlicensed associate in such jurisdictions.

Employees

At December 31, 2003, the Company and its subsidiaries employed 742 individuals on a full-time basis, exclusive of independent agents and sales associates who are not employees. None of the Company's employees are represented by a union. Management considers its employee relations to be good.

Foreign Operations

The Company began operations in the Canadian provinces of Ontario and British Columbia during 1999, Alberta in February 2001 and Manitoba in August 2001 and derived aggregate revenues, including Membership fees and revenues from associate services, from Canada of $4.5 million in U.S. dollars during 2003 compared to $4.0 million and $4.4 million in 2002 and 2001, respectively. Due to the relative stability of the United States and Canadian foreign relations and currency exchange rates, the Company believes that any risk of foreign operations or currency valuations is minimal and would not have a material effect on the Company's financial condition, liquidity or results of operations.

Availability of Information

The Company files periodic reports and proxy statements with the Securities and Exchange Commission. The public may read and copy any materials the Company files with the SEC at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. The public may obtain information about the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The Company files its reports with the SEC electronically. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of this site is http://www.sec.gov.

The Company's Internet address is www.prepaidlegal.com. The Company makes available on its website free of charge copies of its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) of the Exchange Act as soon as reasonably possible after the Company electronically files such material with, or furnishes it to, the SEC.

ITEM 2. DESCRIPTION OF PROPERTY

The executive and administrative offices of the Company and its subsidiaries are located at One Pre-Paid Way, Ada, Oklahoma. The newly completed office complex, containing approximately 170,000 square feet of office space, is owned by the Company and constructed on approximately 87 acres contributed to the Company by the City of Ada in 2001 as part of an economic development incentive package. Costs incurred through December 31, 2003 of approximately $30.7 million, including $706,000 in capitalized interest costs, have been paid from existing resources and proceeds from a $20 million line of credit for the new office construction. The Company has entered into construction contracts in the amount of $28.9 million with the general contractor pertaining to the new office complex. Total remaining costs of completion pursuant to these contracts from January 1, 2004 are estimated at approximately $3.1 million.

Continued growth over the past 11 years required the Company to lease and purchase several ancillary sites to accommodate its expanding workforce. In December over 600 employees departed their various worksites and moved to the newly constructed headquarters. The new headquarters contains two long bars of open office area designed to serve as podiums, which stretch east from the northern and southern edges of the tower. Two and three stories high respectively, the podiums house the call centers and Information Technology departments. Only 60 feet across, they are designed to ensure that employees are never more that thirty feet from a source of daylight. Shared corporate services -- including a 650-seat auditorium, dining hall, exercise facility, and a connecting corridor containing a company history gallery -- are located at the east end of the bars, creating a central courtyard. The courtyard features a reflecting pool and a 12-foot bronze sculpture of the Company's logo, the Lady of Justice, a universal symbol of justice. The building's main entrance welcomes its frequent visitors, celebrates the history of the Company, and is designed to convey the tradition of civic judicial buildings. The building is designed to expand over time without negatively impacting the site layout or the building concept and the Company emphasized the use of modular furnishings to provide enhanced flexibility. The Company placed importance on the goal of providing each employee with an excellent work environment.

Additionally, the Company fully utilizes another distribution facility located about two miles from its new offices and containing approximately 17,000 square feet of office and warehouse and shipping space. The Company's previous headquarters of approximately 40,000 square feet and two other buildings containing approximately 18,600 combined square feet located adjacent to the distribution facility are now used as disaster recovery, or business continuity, sites.

In addition to the property described above that is owned by the Company, the Company opened an additional Customer Care facility in Antlers, Oklahoma during March 2000, in building space provided by the City of Antlers at no cost to the Company. In conjunction with a rural economic development program coordinated by the City of Antlers, a new facility was built at no cost to the Company that can accommodate approximately 100 customer service representatives. The Company leased the facilities from the City of Antlers upon completion of the construction in November 2002.

ITEM 3. LEGAL PROCEEDINGS

The Company and various of its executive officers have been named as defendants in a putative securities class action originally filed in the United States District Court for the Western District of Oklahoma in early 2001 seeking unspecified damages on the basis of allegations that the Company issued false and misleading financial information, primarily related to the method the Company used to account for commission advance receivables from sales associates. On March 5, 2002, the Court granted the Company's motion to dismiss the complaint, with prejudice, and entered a judgment in favor of the defendants. Plaintiffs thereafter filed a motion requesting reconsideration of the dismissal which was denied. The plaintiffs have appealed the judgment and the order denying their motion to reconsider the judgment to the Tenth Circuit Court of Appeals. In August 2002 the lead institutional plaintiff withdrew from the case, leaving two individual plaintiffs as lead plaintiffs on behalf of the putative class. As of December 31, 2003, the briefing in the appeal had been completed. On January 14, 2004 oral argument was held in the appeal. The Company is unable to predict when a decision will be made on this appeal, and the ultimate outcome of the case is not determinable.

Beginning in the second quarter of 2001 multiple lawsuits were filed against the Company, certain officers, employees, sales associates and other defendants in various Alabama and Mississippi state courts by current or former members seeking actual and punitive damages for alleged breach of contract, fraud and various other claims in connection with the sale of Memberships. During 2003, there were at one time as many as 30 separate lawsuits involving approximately 285 plaintiffs in Alabama. As of December 31, 2003, as a result of dismissals or settlements for nominal amounts, the Company was aware of approximately 25 separate lawsuits involving approximately 98 plaintiffs that have been filed in multiple counties in Alabama. As of February 27, 2004, there were approximately 80 named plaintiffs in approximately 25 cases pending in Alabama. In February 2004, the claims of several additional plaintiffs in one of the cases were dismissed on summary judgment in the Company's favor. As of December 31, 2003, the Company was aware of 18 separate lawsuits involving approximately 432 plaintiffs in multiple counties in Mississippi. Certain of the Mississippi lawsuits also name the Company's provider attorney in Mississippi as a defendant. Proceedings in several of the eleven cases which name the Company's provider attorney as a defendant have been stayed pending the Mississippi Supreme Court's ruling on the Pre-Paid defendants' appeal of a trial court's granting of a partial summary judgment that the action is not required to be submitted to arbitration. At least three complaints have been filed by the law firm representing plaintiffs in eleven of the cases on behalf of certain of the Mississippi plaintiffs and others with the Attorney General of Mississippi in March 2002, December 2002 and August 2003. The Company has responded to the Attorney General's requests for information with respect to these complaints, and as of December 31, 2003, the Company was not aware of any further actions being taken by the Attorney General. In Mississippi, the Company has filed lawsuits in the United States District Court for the Southern and Northern Districts of Mississippi in which the Company seeks to compel arbitration of the various Mississippi claims under the Federal Arbitration Act and the terms of the Company's Membership agreements, and has appealed the state court rulings in favor of certain of the plaintiffs on the arbitration issue to the Mississippi Supreme Court. One of the federal courts has ordered arbitration of a case involving 8 plaintiffs. These cases are all in various stages of litigation, including trial settings beginning in Alabama in April 2004, and in Mississippi in May 2004, and seek varying amounts of actual and punitive damages. While the amount of Membership fees paid by the plaintiffs in the Mississippi cases is $500,000 or less, certain of the cases seek damages of $90 million. Additional suits of a similar nature have been threatened. The ultimate outcome of any particular case is not determinable.

On April 19, 2002, counsel in certain of the above-referenced Alabama suits also filed a similar suit against the Company and certain of its officers in the District Court of Creek County, Oklahoma on behalf of Jeff and Jana Weller individually and doing business as Hi-Tech Auto making similar allegations relating to the Company's Memberships and seeking unspecified damages on behalf of a "nationwide" class. The Pre-Paid defendants' preliminary motions in this case were denied, and on June 17, 2003, the Oklahoma Court of Civil Appeals reversed the trial court's denial of the Pre-Paid defendants' motion to compel arbitration, finding that the trial court erred when it denied Pre-Paid's motion to compel arbitration pursuant to the terms of the valid Membership contracts, and remanded the case to the trial court for further proceedings consistent with that opinion. There have been no material developments in this case since the June 17, 2003 Court of Appeals decision. The ultimate outcome of this case is not determinable.

On June 29, 2001, an action was filed against the Company in the District Court of Canadian County, Oklahoma. In 2002, the petition was amended to add five additional named plaintiffs and to add and drop certain claims. This action was originally a putative class action brought by Gina Kotwitz, later adding, George Kotwitz, Rick Coker, Richard Starke, Jeff Turnipseed and Aaron Bouren, on behalf of all sales associates of the Company. The amended petition seeks injunctive and declaratory relief, with such other damages as the court deems appropriate, for alleged violations of the Oklahoma Uniform Consumer Credit Code in connection with the Company's commission advances, and seeks injunctive and declaratory relief regarding the enforcement of certain contract provisions with sales associates, including a request stated in June 2003 for the imposition of a constructive trust as to earned commissions applied to the reduction of debit balances and disgorgement of all earned renewal commissions applied to the reduction of debit balances. On September 23, 2003 the court entered an order dismissing the class action allegations upon the motion of the plaintiffs. The order provides that the action will proceed only on an individual basis, and that the hearing on plaintiffs' motion for class certification previously set for February 2004 was cancelled. The Company has filed a motion for summary judgment, which was pending as of December 31, 2003. The ultimate outcome of this case is not determinable.

On March 1, 2002, an action was filed in the United States District Court for the Western District of Oklahoma by Caroline Sandler, Robert Schweikert, Sal Corrente, Richard Jarvis and Vincent Jefferson against the Company and certain executive officers. This action is a putative class action seeking unspecified damages filed on behalf of all sales associates of the Company and alleges that the marketing plan offered by the Company constitutes a security under the Securities Act of 1933 and seeks remedies for failure to register the marketing plan as a security and for violations of the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 in connection with representations alleged to have been made in connection with the marketing plan. The complaint also alleges violations of the Oklahoma Securities Act, the Oklahoma Business Opportunities Sales Act, breach of contract, breach of duty of good faith and fair dealing and unjust enrichment and violation of the Oklahoma Consumer Protection Act and negligent supervision. This case is subject to the Private Litigation Securities Reform Act. Pursuant to the Act, the Court has approved the named plaintiffs and counsel and an amended complaint was filed in August 2002. The Pre-Paid defendants filed motions to dismiss the complaint and to strike the class action allegations on September 19, 2002, and discovery in the action was stayed pending a ruling on the motion to dismiss. On July 24, 2003, the Court granted in part and denied in part the Pre-Paid defendants' motion to dismiss. The claims asserted under the Securities Exchange Act of 1934 and the Oklahoma Securities Act were dismissed without prejudice. The motion was denied as to the remaining claims. On July 23, 2003, the Court denied the motion to strike class action allegations at that time. The case is in the process of completion of class certification briefing currently scheduled to be concluded May 5, 2004, after which time the Court will make a determination as to whether the case may proceed as a class action. The ultimate outcome of this case is not determinable.

In December 2002, the West Virginia Supreme Court reversed a summary judgment which had been granted by the Circuit Court of Monangalia County, West Virginia in favor of the Company in connection with the claims of a former member, Georgia Poling and her daughters against the Company and a referral lawyer with respect to a 1995 referral. That action was originally filed in March 2000, and alleges breach of contract and fraud against the Company in connection with the referral. Plaintiffs seek actual and punitive damages in unspecified amounts. The case is set for trial in April 2004. The ultimate outcome of this case is not determinable.

On January 30, 2003, the Company announced that it had received a subpoena from the office of the United States Attorney for the Southern District of New York requesting information relating to trading activities in the Company's stock in advance of the January 2003 announcement of recruiting and Membership production results for the fourth quarter of 2002. The Company also received notice from the Securities and Exchange Commission that it is conducting an informal inquiry into the same subject and requesting that the Company voluntarily provide certain information. The Company has and will continue to respond to any such requests, the last of which occurred in July 2003. As of February 27, 2004, the Company was not aware of any further inquiries in either of these matters. The ultimate outcome of these matters is not determinable.

The Company is a defendant in various other legal proceedings that are routine and incidental to its business. The Company will vigorously defend its interests in all proceedings in which it is named as a defendant. The Company also receives periodic complaints or requests for information from various state and federal agencies relating to its business or the activities of its marketing force. The Company promptly responds to any such matters and provides any information requested.

While the ultimate outcome of these proceedings is not determinable, the Company does not currently anticipate that these contingencies will result in any material adverse effect to its 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 in the consolidated statements of income. The Company has established an accrued liability it believes will be sufficient to cover estimated damages in connection with various cases (exclusive of ongoing defense costs which are expensed as incurred), which at December 31, 2003 was $3.3 million. The Company believes it has 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 the Company's financial condition, operating results or cash flows in particular quarterly or annual periods.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Price of and Dividends on the Common Stock

At February 29, 2004, there were 5,772 holders of record (including brokerage firms and other nominees) of the Company's common stock, which is listed on the New York Stock Exchange under the symbol "PPD." The following table sets forth, for the periods indicated, the range of high and low sales prices for the common stock, as reported by the New York Stock Exchange.

	High	
2004:		
1st Quarter (through February 29)..	$ 26.33	$
2003:		
4th Quarter	$ 28.30	$
3rd Quarter..	25.21	
2nd Quarter..	27.40	
1st Quarter..	26.80	
2002:		
4th Quarter..	$ 30.49	$
3rd Quarter..	24.29	
2nd Quarter..	30.45	
1st Quarter..	31.75	

The Company has never declared a cash dividend on its common stock. However, due to recent changes in the Federal tax laws providing for certain preferential treatment of dividends in certain instances, the Company may reconsider its dividend policy.

It is anticipated that earnings generated from the operations of the Company will be used to finance the Company's growth, to continue to purchase shares of its stock, to retire existing debt and possibly to pay a cash dividend. The Company has lines of credit as described in "Management's Discussion and Analysis - Liquidity and Capital Resources," which prohibit payment of cash dividends in excess of $1.8 million per quarter on its common stock. Any decision by the Board of Directors of the Company to pay cash dividends in the future will depend upon, among other factors, the Company's earnings, financial condition, capital requirements and approval from its lender for any dividends in excess of $1.8 million per quarter. In addition, the Company's ability to pay dividends is dependent in part on its ability to derive dividends from its subsidiaries. The payment of dividends by PPLCI is restricted under the Oklahoma Insurance Code to available surplus funds derived from realized net profits and requires the approval of the Oklahoma Insurance Commissioner for any dividend representing more than 10% of such accumulated available surplus or an amount representing more than the previous years' net profits. During 2002 and 2001, PPLCI declared a $6 million and a $5 million dividend payable to the Company. Both the 2001 and 2002 dividends were paid during 2002. PPLSIF is similarly restricted pursuant to the insurance laws of Florida. At December 31, 2003, PPLSIF did not have funds available for payment of substantial dividends without the prior approval of the insurance commissioner. While PPLCI had approximately $3.5 million in surplus funds available for payment of an ordinary dividend in December 2002, no such dividend was declared or paid during 2003. At December 31, 2003 PPLCI had approximately $750,000 available for payment of an ordinary dividend. At December 31, 2003 the amount of restricted net assets of consolidated subsidiaries was $16.7 million.

Recent Sales of Unregistered Securities

None.

Equity Compensation Plans

The following table provides information with respect to the Company's equity compensation plans as of December 31, 2003, (other than its tax qualified Employee Stock Ownership Plan designed to provide retirement benefits).

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Numbe remain futur equi pla securi
Equity compensation plans approved by security holders (1).................	1,020,252	$24.75	
Equity compensation plans not approved by security holders (2)..............	255,247	21.31	
Total.................................	1,275,499	$24.06	

(1) These stock options have been issued pursuant to the Company's Stock Option Plan which has been approved by security holders.

(2) These stock options have been issued to the Company's Regional Vice Presidents ("RVPs") (described above) in order to encourage stock ownership by its RVPs and to increase the proprietary interest of such persons in its growth and financial success. These options have been granted periodically to RVPs since 1996. Options are granted at fair market value at the date of the grant and are generally immediately exercisable for a period of three years or within 90 days of termination, whichever occurs first. There were 106,002, 244,679 and 131,288 total options granted to RVPs in the years ended December 31, 2003, 2002 and 2001, respectively. The Company has decided to discontinue the RVP stock option grants immediately after the 2003 fourth quarter stock options are awarded in the first quarter of 2004.

Issuer Purchases of Equity Securities

The following table provides information about the Company's purchases of stock in the open market during the fourth quarter of 2003.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Total Number of Sh of Y U
October 2003..........	65,000	$ 27.44	65,000	
November 2003.........	95,400	26.85	95,400	
December 2003.........	378,000	25.97	378,000	
Total.................	538,400	$ 22.70	538,400	

1) The Company announced on April 6, 1999, a treasury stock purchase program authorizing management to acquire up to 500,000 shares of the Company's common stock. The Board of Directors has subsequently from time to time increased such authorization from 500,000 shares to 8,000,000 shares. The most recent authorization was for 1,000,000 additional shares May 23, 3003 and there has been no time limit set for completion of the repurchase program.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected financial and statistical data for the Company as of the dates and for the periods indicated. This information is not necessarily indicative of the Company's future performance. The following information should be read in conjunction with the Company's Consolidated Financial Statements and Notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operation included elsewhere herein.

	Year Ended December		
	2003	2002	2001
Income Statement Data:	(In thousands, except ratio, per shar		
Revenues:			
Membership fees....................................	$ 330,322	$ 308,401	$ 263,514
Associate services.................................	25,704	37,418	36,485
Product sales (2)..................................	-	-	60
Other..	5,287	4,804	3,602
Total revenues..................................	361,313	350,623	303,661
Costs and expenses:			
Membership benefits................................	111,165	103,761	87,429
Commissions..	115,386	119,371	111,060
Associate services and direct marketing............	28,929	32,566	29,879
General and administrative expenses................	36,711	33,256	28,243
Product costs (2)..................................	-	-	33
Other, net...	8,546	6,685	5,884
Total costs and expenses.........................	300,737	295,639	262,528

Income from continuing operations before income taxes and cumulative effect of change in accounting principle....	60,576	54,984	41,133
Provision for income taxes............................	20,669	18,970	13,519
Income from continuing operations before cumulative effect of change in accounting principle...................	39,907	36,014	27,614
Income (loss) from operations of discontinued UFL segment (net of applicable income tax benefit (expense) of $0, $387 and ($444) for years 2001, 2000 and 1999, respectectively).....................................	-	-	(504)
Income before cumulative effect of change in accounting principle...	39,907	36,014	27,110
Cumulative effect of adoption of SAB 101 (net of applicable income tax benefit of $546)..............	-	-	-
Net income..	39,907	36,014	27,110
Less dividends on preferred shares....................	-	-	-
Net income applicable to common stockholders............	$ 39,907	$ 36,014	$ 27,110
Basic earnings per common share from continuing operations before cumulative effect of accounting change	$ 2.28	$ 1.83	$ 1.28
Basic earnings per common share from discontinued operations...	-	-	(.02)
Basic earnings per common share before cumulative effect of change in accounting principle...................	2.28	1.83	1.26
Cumulative effect of adoption of SAB 101................	-	-	-
Basic earnings per common share.........................	$ 2.28	$ 1.83	$ 1.26

Selected Financial Data, continued

	Year Ended December		
	2003	2002	2001
	(In thousands, except ratio, per share		
Diluted earnings per common share from continuing operations before cumulative effect of accounting change	$ 2.27	$ 1.82	$ 1.28
Diluted earnings per common share from discontinued operations...	-	-	(.02)
Diluted earnings per common share before cumulative effect of accounting change.........................	2.27	1.82	1.26
Cumulative effect of adoption of SAB 101................	-	-	-
Diluted earnings per common share......................	$ 2.27	$ 1.82	$ 1.26
Pro forma amounts assuming adoption of SAB 101 is retroactively applied:			
Net income..			
Basic earnings per common share..			
Diluted earnings per common share..			
Weighted average number of common shares outstanding - basic................................	17,530	19,674	21,504

Weighted average number of common shares outstanding - diluted	17,599	19,764	21,544
Membership Benefits Cost and Statistical Data:			
Membership benefits ratio (1)	33.7%	33.6%	33.2%
Commissions ratio (1)	34.9%	38.7%	42.1%
General & administrative expense ratio (1)	11.1%	10.8%	10.7%
Product cost ratio (1) (2)	-	-	55.0%
Commission cost per new Membership sold	$ 172	$ 154	$ 152
New Memberships sold	671,857	773,767	728,295
Period end Memberships in force	1,418,997	1,382,306	1,242,908
Cash Flow Data:			
Net cash provided by operating activities	$ 51,693	$ 52,073	$ 37,801
Net cash (used in) provided by investing activities	(36,901)	(11,074)	(6,963)
Net cash (used in) financing activities	(14,191)	(34,431)	(27,414)
Balance Sheet Data:			
Total assets	$ 131,012	$ 96,836	$ 85,720
Total liabilities	101,438	61,864	43,496
Stockholders' equity	29,574	34,972	42,224

(1) The Membership benefits ratio, the commissions ratio and the general and administrative expense ratio represent those costs as a percentage of Membership fees. The product cost ratio represents product costs as a percentage of product sales for those years in which the Company sold products. These ratios do not measure total profitability because they do not take into account all revenues and expenses.

(2) During the fourth quarter of 1998, the Company completed the acquisition of TPN. Since its inception in late 1994, TPN had marketed personal and home care products, personal development products and services together with PRIMESTAR(R) satellite subscription television service to its members through a network marketing sales force. Product sales declined and were eventually eliminated following the TPN acquisition due to the concentration on Membership sales as opposed to the sale of goods and services.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview of the Company's Financial Model

The Company is in one line of business - the marketing of legal expense and other complimentary plans primarily through a multi-level marketing force to individuals. The Company's principal revenues are derived from membership fees, and to a much lesser extent, revenues from marketing associates. The Company's principal expenses are commissions, Membership benefits, associates services and direct marketing costs and general and administrative expense. The following table reflects the changes in these categories of revenues and expenses in the last 3 years (dollar amounts in 000's):

	% of	% Change from	% of	% Change from

	2003	Total Revenue	Prior Year	2002	Total Revenue	Prior Year	2001
Revenues:							
Membership fees........	$ 330,322	91.4	7.1	$ 308,401	88.0	17.0	$ 263,
Associate services.....	25,704	7.1	(31.3)	37,418	10.6	2.6	36,
Other..................	5,287	1.5	10.1	4,804	1.4	31.2	3,
	361,313	100.0	3.0	350,623	100.0	15.5	303,
Costs and expenses:							
Commissions............	115,386	31.9	(3.3)	119,371	34.0	7.5	111,
Membership benefits....	111,165	30.8	7.1	103,761	29.6	18.7	87,
Associate services and direct marketing.....	28,929	8.0	(11.2)	32,566	9.3	9.0	29,
General and administrative	36,711	10.2	10.4	33,256	9.5	17.7	28,
Other, net.............	8,546	2.4	27.8	6,685	1.9	13.0	5,
	300,737	83.2	1.7	295,639	84.3	12.6	262,
Provision for income taxes	20,669	5.7	9.0	18,970	5.4	40.3	13,
Loss from operations of discontinued UFL segment	-	-	-	-	-		(
Net income.................	$ 39,907	11.0	10.8	$ 36,014	10.3	32.8	$ 27,

The number of active Memberships in force and the average monthly fee will directly determine Membership fees and their impact on total revenues during any period. The two most important variables impacting the number of active Memberships during a period are the number of new Memberships written during the period combined with the retention characteristics of both new and existing Memberships. See "Measures of Member Retention" below for a discussion of the Company's Membership retention. Associate services revenues are a function of the number of new sales associates enrolled and the price of entry during the period, the number of associates subscribing to the Company's eService offering and the amount of sales tools purchased by the sales force.

Membership benefits expense is primarily determined by the number of active Memberships and the per capita contractual rate that exists between the Company and its benefits providers and during the last five years has been and is expected to continue to be a relatively fixed percentage of Membership revenues of approximately 33%-34%. Commissions paid to associates are primarily dependent on the number and price of new Memberships sold during a period and any special incentives that may be in place during the period. The Company expenses advance commissions ratably over the first month of the related Membership. The level of commission expense in relation to Membership revenues varies depending on the level of new Memberships written and is expected to be higher when the Company experiences increases in new Membership sales. During the last five years this percentage has ranged from approximately 35% to 48% of Membership revenues. Associate services and direct marketing expenses are directly impacted by the number of new associates enrolled during a period due to the cost of materials provided to such new associates, the number of associates subscribing to the Company's eService offering, the amount of sales tools purchased by the sales force as well as the number of those associates who successfully meet the Fast Start to Success training and incentive award program qualifications. Generally, these costs are more than offset by associate services revenue, although this did not occur in 2003 due to the lower entry fees charged during most of the year. General and administrative expenses are expected to trend up in terms of dollars, but remain relatively constant as a percent of revenues. During the past five years, general and administrative expenses have ranged from 8.7% to 10.2% of total revenues.

The primary benchmarks monitored by the Company throughout the various periods include the number of active Memberships and their related retention characteristics, the number of new Memberships written, the number of new associates enrolled and the percentage of new associates that successfully meet the Fast Start to Success qualification requirements.

The Company experienced decreases in both the number of new Memberships written and the number of new associates enrolled during 2003 compared to the prior year, the first year such a decrease has occurred in more than ten years. During the 2002 fourth quarter, the Company eliminated the commission advances to certain associates that had below average retention and due to below average retention rates of Internet submitted Memberships, the Company placed restrictions on those associates who are able to submit new memberships via the Internet. These actions naturally reduced the number of new memberships written and new associates enrolled during the 2002 fourth quarter and during 2003 but demonstrate the Company's commitment to improve Membership retention. The Company also attributes such decline, in part, to negative publicity (see Risk Factors). Such adverse publicity may affect the Company's ability to write new Memberships (especially in large employee groups), recruit new associates and may have a detrimental effect on the persistency of the Company's Memberships. However depending on the average monthly Membership fee and the entry price for new associates, the Company may experience declines in both areas in terms of numbers but may experience increases in both Membership fees and associate services revenue and vice versa

Although the Company has grown its active Membership base and related Membership fees in each of the past 11 years, the rate of growth has slowed to an unacceptable rate. The Company believes however, that its current product design, pricing parameters and business model are generally appropriate and it has no immediate plans to change these fundamental sectors. The Company's focus during 2004 will be on improved training of its associates, enhancing the quality and quantity of sales tools provided to new and existing associates, providing incentives for associates to write consistent, quality business and continued emphasis on improving the basic retention characteristics of its Memberships.

During the first part of 2004, the Company has updated its Fast Start to Success training program materials and hosted more than 600 Fast Start trainers at its new corporate headquarters in order to "train the trainers" on the updated training materials. Also, beginning in 2004, the Company has increased the amount of sales tools that are included in the new associate kit and provided a supplemental package of sale tools if the new associate qualifies pursuant to the Fast Start rules. The Company has also increased the number of "points" needed to qualify for its Player's Club incentive award program to encourage more productivity from both its new and existing associates.

Critical Accounting Policies

The Company's financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America. 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 the Company's financial condition or operating results. Many of these "critical accounting policies" are common in the insurance and financial services industries; others are specific to the Company's business and operations. The Company's 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.

Revenue recognition - Membership and Associate Fees

The Company's principal revenues are derived from Membership fees, most of which are collected on a monthly basis. Memberships are generally guaranteed renewable and non-cancelable except for fraud, non-payment of Membership fees or upon written request. Membership fees are recognized in income ratably over the related service period in accordance with Membership terms, which generally require the holder of the Membership to remit fees on an annual, semi-annual or monthly basis. Approximately 95% of members remit their Membership fees on a monthly basis, of which approximately 73% are paid in advance and, therefore, are deferred and recognized over the following month. At December 31, 2003 the deferred revenue associated with the Membership fees was $17.8 million which is classified as a current liability.

The Company also charges new members, who are not part of an employee group, a $10 enrollment fee. This enrollment fee and related incremental direct and origination costs are deferred and recognized in income over the estimated life of a Membership in accordance with SEC Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," ("SAB 101"). At December 31, 2003 the deferred revenue associated with the Membership enrollment fees was $7.9 million, of which $4.6 million was classified as a current liability. The Company computes the expected Membership life using over 20 years of actuarial data as explained in more detail in the Measures of Membership Retention section of MD&A. At December 31, 2003, management computed the expected Membership life to be approximately 3 years, which is unchanged from year end 2002. If the expected Membership life were to change significantly, which management does not expect in the short term, the deferred Membership enrollment fee and related costs would be recognized over a longer or shorter period.

The Company derives revenues from services provided to its marketing sales force from a one-time non-refundable enrollment fee of $65 from each new sales associate for which the Company provides initial sales and marketing supplies and enrollment services to the associate. Revenue from, and costs of, the initial sales and marketing supplies (approximately $11) are recognized when the materials are delivered to the associates. The remaining $54 of revenues and related incremental direct and origination costs are deferred and recognized over the estimated average active service period of associates which at December 31, 2003 is estimated to be approximately six months, unchanged from year end 2002. At December 31, 2003, the deferred revenue associated with sales associate enrollment fees was $1.4 million, which is classified as a current liability. Management estimates the active service period of an associate periodically based on the average number of months an associate produces new Memberships including those associates that fail to write any Memberships. If the active service period of associates changes significantly, which management does not expect in the short term, the deferred revenue and related costs would be recognized over the new estimated active service period.

Member and Associate Costs

Deferred costs represent the incremental direct and origination costs the Company incurs in enrolling new Members and new associates related to the deferred revenue discussed above, and that portion of payments made to provider law firms ($5.2 million deferred at December 31, 2003 which is classified as a current asset) and associates related to deferred Membership revenue. Deferred costs for enrolling new members include the cost of the Membership kit and salary and benefit costs for employees who process Membership enrollments, and were $5.6 million at December 31, 2003, of which $3.2 million is classified in current assets. Deferred costs for enrolling new associates include training and success bonuses paid to individuals involved in recruiting the associate and salary and benefit costs of employees who process associate enrollments, and were $1.2 million at December 31, 2003, and is classified as a current asset. Such costs are deferred to the extent of the lesser of actual costs incurred or the amount of the related fee charged for such services. Deferred costs are amortized to expense over the same period as the related deferred revenue as discussed above. Deferred costs that will be recognized within one year of the balance sheet date are classified as current and all remaining deferred costs are considered noncurrent. Associate related costs are reflected as associate services and direct marketing, and are expensed as incurred if not related to the deferred revenue discussed above. These costs include providing materials and services to associates, Fast Start bonuses, associate introduction kits, associate incentive programs, group marketing and marketing services departments (including costs of related travel, marketing events, leadership summits and international sales convention).

Commissions to Associates

Beginning with new Memberships written after March 1, 1995, the Company implemented a level commission schedule (approximately 27% per annum at December 31, 2001) with up to a three-year advance commission payment. Prior to March 1, 1995, the Company's commission program provided for advance commission payments to associates of approximately 70% of first year Membership premiums on new Membership sales and commissions were earned by the associate at a rate of approximately 16% in all subsequent years. Effective March 1, 2002, and in order to offer additional incentives for increased Membership retention rates, the Company returned to a differential commission structure with rates of approximately 80% of first year Membership premiums on new Memberships written and variable renewal commission rates ranging from five to 25% per annum based on the first 12 month Membership retention rate of the associate's personal sales and those of his organization. Beginning in August 2003, the Company allowed the associate to choose between the level commission structure and up to three year commission advance or the differential commission structure with a one year commission advance.

Prior to January 1997 the Company advanced commissions at the time of sale of all new Memberships. In January 1997, the Company implemented a policy whereby the associate receives only earned commissions on the first three sales unless the associate has successfully completed the Fast Start training program. For all sales beginning with the fourth Membership or all sales made by an associate successfully completing the Fast Start training program, the Company currently advances commission payments at the time of sale of a new Membership. The amount of cash potentially advanced upon the sale of a new Membership, prior to the recoupment of any charge-backs (described below), represents an amount equal to up to one-year commission earnings. Although the average number of marketing associates receiving an advance commission payment on a new Membership is 14, the overall initial advance may be paid to approximately 30 different individuals, each at a different level within the overall commission structure. The commission advance immediately increases an associate's unearned advance commission balance to the Company.

Although the Company, prior to March 1, 2002, advanced its sales associates up to three years commission when a Membership is sold and subsequent to March 1, 2002, up to one year commission, the average commission advance paid to its sales associates as a group is actually less than the maximum amount possible because some associates choose to receive less than a full advance and the Company pays less than a full advance on some of its specialty products. In addition, the Company may from time to time place associates on a less than full advance basis if there are problems with the quality of the business being submitted or other performance problems with an associate. Additionally, the Company does not advance commissions on certain categories of group business which have historically demonstrated below average retention characteristics. Also, any residual commissions due an associate (defined as commission on an individual Membership after the advance has been earned) are retained to reduce any remaining unearned commission advance balances prior to being paid to that sales associate. For those associates that have made at least 10 personal sales, opened at least one group and personally write 15% or more of their organizational business, 15% of their commissions are set aside in individual reserve balance accounts, further reducing the amount of advance commi