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PRE PAID LEGAL SERVICES INC

Form 10-Q

October 27, 2009

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

FORM 10-Q

(Mark One)

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

For The Quarterly Period Ended September 30, 2009

or

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

For The Transition Period From \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-09293

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

Oklahoma 73-1016728
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

One Pre-Paid Way, Ada, Oklahoma 74820-5813
(Address of principal executive offices) (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No [ ]

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

Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ]
Smaller reporting Company [ ] (do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in

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Rule 12b-2 of the Exchange Act) Yes [ ] No [X]

The number of shares outstanding of the registrant's common stock (excluding 4,852,179 shares held in treasury) as of October 20, 2009 was 10,952,223.

PRE-PAID LEGAL SERVICES, INC.

FORM 10-Q

For the Quarter Ended September 30, 2009

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ITEM 1. FINANCIAL STATEMENTS

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

ASSETS

	Septem
	20
	-----
	(Unau
Current assets:	
Cash and cash equivalents.....	\$ 3
Available-for-sale investments, at fair value.....	
Membership fees receivable.....	
Inventories.....	
Refundable income taxes.....	
Deferred member and associate service costs.....	1
Deferred income taxes.....	
Other assets.....	
	-----
Total current assets.....	8
	-----
Available-for-sale investments, at fair value.....	2
Investments pledged.....	
Property and equipment, net.....	5
Deferred member and associate service costs.....	
Other assets.....	
	-----
Total assets.....	\$ 18
	-----

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:	
Membership benefits payable.....	\$ 1
Deferred revenue and fees.....	2
Current portion of capital leases payable.....	
Current portion of notes payable.....	1
Accounts payable and accrued expenses.....	1
	-----
Total current liabilities.....	7
	-----
Capital leases payable.....	
Notes payable.....	2
Deferred revenue and fees.....	
Deferred income taxes.....	
Other non-current liabilities.....	
	-----
Total liabilities.....	11
	-----
Stockholders' equity:	
Common stock, \$.01 par value; 100,000 shares authorized; 15,807 and 16,254 issued at September 30, 2009 and December 31, 2008, respectively.....	

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Retained earnings.....	15
Accumulated other comprehensive income (loss).....	
Treasury stock, at cost; 4,852 shares held at September 30, 2009 and December 31, 2008, respectively.....	(9)
Total stockholders' equity.....	6
Total liabilities and stockholders' equity.....	\$ 18

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

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

	Three Months Ended September 30,		Ni
	2009	2008	20
Revenues:			
Membership fees.....	\$ 105,435	\$ 109,268	\$ 317
Associate services.....	7,624	6,236	18
Other.....	888	1,019	2
	113,947	116,523	339
Costs and expenses:			
Membership benefits.....	35,991	37,587	108
Commissions.....	36,676	33,678	93
Associate services and direct marketing.....	7,827	5,358	21
General and administrative.....	12,613	12,531	38
Other, net.....	2,361	3,043	6
	95,468	92,197	267
Income before income taxes.....	18,479	24,326	71
Provision for income taxes.....	7,648	9,884	27
Net income.....	\$ 10,831	\$ 14,442	\$ 43
Basic earnings per common share.....	\$ .99	\$ 1.23	\$
Diluted earnings per common share.....	\$ .99	\$ 1.23	\$

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

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

	Three Months Ended September 30,		Ni 20
	2009	2008	
Net income.....	\$ 10,831	\$ 14,442	\$ 43
Other comprehensive income (loss), net of tax:			
Foreign currency translation adjustment.....	646	(265)	1
Unrealized gains (losses) on investments:			
Unrealized holding gains (losses) arising during period....	641	(357)	
Reclassification adjustment for realized (gains) losses included in net income.....	-	-	
	641	(357)	
Other comprehensive income (loss), net of income taxes of \$345 and \$(192) for the three months and \$416 and \$(361) for the nine months ended September 30, 2009 and 2008, respectively.....	1,287	(622)	1
Comprehensive income.....	\$ 12,118	\$ 13,820	\$ 45

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

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

Cash flows from operating activities:

	Nin S
Net income.....	\$ 43
Adjustments to reconcile net income to net cash provided by operating activities:	
Provision (benefit) for deferred income taxes.....	

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Depreciation and amortization.....	6	
Decrease (increase) in Membership fees receivable.....		
(Increase) decrease in inventories.....		
Increase in refundable income taxes.....	(3)	
(Increase) decrease in deferred member and associate service costs.....	(3)	
Increase in other assets.....	(2)	
(Decrease) increase in accrued Membership benefits.....		
Increase in deferred revenue and fees.....	2	
Increase in other non-current liabilities.....		
Decrease in income taxes payable.....		
Increase (decrease) increase in accounts payable and accrued expenses.....	3	
Net cash provided by operating activities.....	48	
Cash flows from investing activities:		
Additions to property and equipment.....	(2)	
Purchases of investments - available for sale.....	(12)	
Maturities and sales of investments - available for sale.....	11	
Net cash used in by investing activities.....	(3)	
Cash flows from financing activities:		
Proceeds from exercise of stock options.....		
Tax benefit on exercise of stock options.....		
Proceeds from issuance of debt.....		
Decrease in capital lease obligations.....		
Repayments of debt.....	(17)	
Purchases and retirement of treasury stock.....	(14)	
Net cash used in financing activities .....	(32)	
Net increase (decrease) in cash and cash equivalents.....	12	
Cash and cash equivalents at beginning of period.....	26	
Cash and cash equivalents at end of period.....	\$ 38	
Supplemental disclosure of cash flow information:		
Cash paid for interest.....		\$
Cash paid for income taxes.....		\$ 32
Non-cash activities - capital lease obligations incurred.....		\$

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

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

Note 1 - Basis of Presentation

The accompanying consolidated financial statements and notes thereto have

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been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been omitted. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in our 2008 Annual Report on Form 10-K. Terms such as "we", "our" and "us" are sometimes used as abbreviated references to Pre-Paid Legal Services, Inc.

In our opinion, the accompanying unaudited financial statements as of September 30, 2009, and for the three month and nine month periods ended September 30, 2009 and 2008, reflect adjustments (which were normal and recurring) which, in our opinion, are necessary for a fair statement of our financial position and results of operations of the interim periods presented. Results for the three month and nine month periods ended September 30, 2009 are not necessarily indicative of results expected for the full year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Note 2 - Contingencies

On March 27, 2006 we received a complaint filed by Blackburn & McCune PLLC, a former provider attorney law firm, in the Second Circuit Court of Davidson County, Tennessee seeking compensatory and punitive damages on the basis of allegations of breach of contract and fraud. On May 15, 2006 the trial court dismissed plaintiff's complaint in its entirety. Plaintiff amended the complaint to allege fraud and breach of fiduciary duty on June 12, 2006 and filed a notice of appeal on June 13, 2006. On August 24, 2007 the Court of Appeals reversed the ruling of the trial court and remanded the suit to the trial court for further proceedings. On June 24, 2009, the trial court granted our motion for summary judgment and dismissed plaintiff's action against us in its entirety. Plaintiff has appealed this order. The ultimate outcome of this matter is not determinable.

On March 23, 2007 we received a Civil Investigative Demand ("CID") from the Federal Trade Commission ("FTC") requesting information relating to our Identity Theft Shield and ADRS Program. On April 20, 2009 we received a letter from the FTC alleging misrepresentations in sales materials used in our Identity Theft Shield and ADRS program such that we made false and misleading claims about the effectiveness of ADRS for helping organizations comply with government data security requirements. Revisions to the marketing materials originally provided to the FTC have been made subsequent to the initial communication with the FTC. The FTC could decide to commence administrative or federal court proceedings for purposes of determining whether there has been a violation and might seek a variety of remedies, including injunctive relief. We are working with the FTC to reach a mutually acceptable resolution. The ultimate outcome of the matter is not determinable but we will vigorously defend our interests in this matter.

On October 5, 2009 we received a subpoena from the Division of Enforcement of the Securities and Exchange Commission ("SEC"). The subpoena requires us to produce a variety of documents pertaining to our treasury stock repurchase program; our ADRS program and other marketing practices; membership statistical information; segment reporting; the FTC contingency disclosure; and other operational practices. This investigation is a fact-finding inquiry and does not mean that the SEC has reached any conclusions. We are cooperating with the staff of the SEC and providing the requested information and expect to continue to do

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so. We are not able to predict what the outcome of these inquiries and comments may be or when they will be resolved.

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We are a defendant in various other legal proceedings that are routine and incidental to our business. We will vigorously defend our interests in all proceedings in which we are named as a defendant. We also receive periodic complaints or requests for information from various state and federal agencies relating to our business or the activities of our marketing force. We promptly respond to any such matters and provide any information requested. While the ultimate outcome of these proceedings is not determinable, we do not currently anticipate that these contingencies will result in any material adverse effect to our financial condition or results of operation, unless an unexpected result occurs in one of the cases. The costs of the defense of these various matters are reflected as a part of general and administrative expense, or Membership benefits if fees relate to Membership issues, in the consolidated statements of income. We believe that we have meritorious defenses in all pending cases and will vigorously defend against the claims and have not established an accrued liability for any estimated damages in connection with these various cases. However, it is possible that an adverse outcome in certain cases or increased litigation costs could have an adverse effect upon our financial condition, operating results or cash flows in particular quarterly or annual periods.

Canadian taxing authorities are challenging portions of our commission and general and administrative deductions for tax years 1999 - 2002 and have tax assessments which aggregate \$5.7 million. During 2007 we reached a settlement with Canadian taxing authorities regarding the general and administrative deductions which would allow us to claim a deduction on the Canadian tax return for over 70% of these items. This settlement offer allowed us to amend our U.S. federal tax returns and deduct the remaining 30% of these items. The Canadian and U.S. tax returns have been amended to reflect the changes in our general and administrative expense and credits/refunds for the associated taxes, penalty and interest. The Canadian taxing authorities contend commission deductions should be matched with the membership revenue as received, we contend these commissions are deductible when paid. Under Canadian tax laws, our commission payments are treated as a prepaid expense and we base our deduction of commission on the fact that all the services (the sale of the membership) have been performed by the sales associate at the time of sale, therefore this prepaid expense (the commission payments) is deductible when paid. Also, the commission payment is taxable to the sales associate when paid and each year we issue a T4 (Canadian 1099 equivalent) to sales associates for the total commission payments made during that year. We did not prevail on the commission issue on our appeal to the Canadian taxing authorities and on December 19, 2008 filed our Notice of Appeal with the Tax Court of Canada. During the 3rd quarter 2009 the Canadian taxing authorities indicated they are amenable to a settlement. We have paid all the assessed tax, penalty and interest relating to the commission issue and at September 30, 2009 have \$3 million recorded in Other Assets, Current which represents the amount of previously paid tax, penalty and interest for tax years 1999 through 2002 we expect to ultimately receive. It is possible that an adverse outcome could have an adverse effect upon our financial condition, operating results or cash flows in particular quarterly or annual periods.

### Note 3 - Treasury Stock Purchases

We announced on April 6, 1999, a treasury stock purchase program authorizing management to acquire up to 500,000 shares of our common stock. The Board of Directors has increased such authorization from 500,000 shares to 15 million shares through subsequent board actions. At September 30, 2009 we had purchased 14.2 million treasury shares under these authorizations for a total consideration of \$422.0 million, an average price of \$29.72 per share. We purchased and formally retired 15,666 shares of our common stock during the 2009



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third quarter for \$762,000, or an average price of \$48.62 per share, reducing our common stock by \$157 and our retained earnings by \$762,000. See Note 6 below. Given the current interest rate environment, the nature of other investments available and our expected cash flows, we believe that purchasing treasury shares enhances shareholder value and may seek alternative sources of financing to continue or accelerate the program. Any additional treasury stock purchases will be made at prices that we consider attractive and at such times that we believe will not unduly impact our liquidity.

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### Note 4 - Earnings Per Share

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

	Three Months Ended Sept. 30,		En
	2009	2008	20
Basic Earnings Per Share:			
Earnings:			
Net income.....	\$ 10,831	\$ 14,442	\$ 4
Shares:			
Weighted average shares outstanding.....	10,967	11,746	1
Diluted Earnings Per Share:			
Earnings:			
Net income.....	\$ 10,831	\$ 14,442	\$ 4
Shares:			
-----			
Weighted average shares outstanding.....	10,967	11,746	1
Assumed exercise of options.....	16	17	
Weighted average number of shares, as adjusted.....	10,983	11,763	1
Shares issued pursuant to option exercises.....	-	8	

Options to purchase shares of common stock are excluded from the calculation of diluted earnings per share when their inclusion would have an anti-dilutive effect on the calculation. No options were excluded for the three month and nine month periods ended September 30, 2009 and 2008.

### Note 5 - Recently Issued Accounting Pronouncements

In June 2009, the FASB issued guidance on the FASB Accounting Standards

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Codification(TM) ("Codification") and the Hierarchy of Generally Accepted Accounting Principles. This guidance establishes the Codification as the single official source of authoritative United States accounting and reporting standards for all non-governmental entities (other than guidance issued by the SEC). The Codification changes the referencing and organization on financial standards and is effective for interim and annual periods ending on or after September 15, 2009. We have applied the Codification to our disclosures beginning with our third quarter of fiscal 2009. As Codification is not intended to change the existing accounting guidance, its adoption did not have an impact on our financial statements.

In September 2006, the Financial Accounting Standards Board ("FASB") issued authoritative guidance which defined fair value, established a framework for measuring fair value, and expanded disclosures about fair value measurements. We adopted the guidance on January 1, 2008, as required for our financial assets and financial liabilities. However, the FASB deferred the effective date for one year as it relates to fair value measurement requirements for nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value on a recurring basis. The adoption of the guidance for our financial assets and financial liabilities did not have a material impact on our consolidated financial statements. The adoption of the guidance for our nonfinancial assets and nonfinancial liabilities had no impact on our consolidated financial statements.

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In February 2007, the FASB issued guidance on the fair value option for financial assets and financial liabilities. This guidance permits an entity to choose, at specified election dates, to measure eligible financial instruments and certain other items at fair value that are not currently required to be measured at fair value. An entity reports unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected are recognized in earnings as incurred and not deferred. The guidance also established presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This guidance was effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. At the effective date, an entity could elect the fair value option for eligible items that existed at that date. We did not elect the fair value option for eligible items that existed as of January 1, 2008. As such, the adoption of this guidance did not have any impact on our consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued guidance on business combinations which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. This guidance also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination and is effective for us beginning January 1, 2009.

In December 2007, the FASB issued guidance on noncontrolling interests in consolidated financial statements which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. The guidance also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This guidance is effective for us

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beginning January 1, 2009 and the adoption of this guidance had no impact on our consolidated financial position, results of operations or cash flows.

In May 2008, the FASB issued guidance on the hierarchy of Generally Accepted Accounting Principles that identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in accordance with GAAP. With the issuance of this guidance, the FASB concluded that the GAAP hierarchy should be directed toward the entity and not its auditor, and reside in the accounting literature established by the FASB as opposed to the American Institute of Certified Public Accountants (AICPA). This guidance is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board. The implementation of this guidance did not have a significant impact on the determination or reporting of our financial results.

In October 2008, the FASB issued guidance on determining the fair value of a financial asset when the market for that asset is not active which clarified how to determine the fair value of a financial asset when the market for that financial asset is inactive. This guidance was effective upon issuance, including prior periods for which financial statements had not been issued. The implementation of this guidance did not have an impact on our consolidated financial position, results of operations or cash flows.

In January 2009, the FASB provided additional guidance with respect to how entities determine whether an "other-than-temporary impairment" (OTTI) exists for certain beneficial interests in a securitized transaction, such as asset-backed securities and mortgage-backed securities, that (1) do not have a high quality rating or (2) can be contractually prepaid or otherwise settled such that the holder would not recover substantially all of its investment. This guidance was effective for us prospectively beginning October 1, 2008. We considered this additional guidance when classifying respective additional impairments as "temporary" or "other-than-temporary" beginning with the fourth quarter of 2008. This guidance had no impact on such classifications on our consolidated financial position, results of operations or cash flows.

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On April 9, 2009, the FASB and the Accounting Principles Board (APB) issued guidance on the interim disclosures about fair value of financial instruments to require disclosures about fair value of financial instruments in interim financial statements as well as in annual financial statements. The guidance required those disclosures in all interim financial statements. This guidance is effective for interim periods ending after June 15, 2009 and we adopted them in second quarter 2009. See Note 8.

In May 2009, the FASB issued guidance on subsequent events which modified the definition of what qualifies as a subsequent event--those events or transactions that occur following the balance sheet date, but before the financial statements are issued, or are available to be issued--and requires companies to disclose the date through which it has evaluated subsequent events and the basis for determining that date. We adopted this guidance beginning in the second quarter 2009, in accordance with the effective date. We have evaluated subsequent events through October 26, 2009.

In June 2009, the FASB issued a new accounting standard which provides amendments to previous guidance on the consolidation of variable interest entities. This standard clarifies the characteristics that identify a variable interest entity (VIE) and changes how a reporting entity identifies a primary beneficiary that would consolidate the VIE from a quantitative risk and rewards calculation to a qualitative approach based on which variable interest holder has controlling financial interest and the ability to direct the most significant activities that impact the VIE's economic performance. This

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statement requires the primary beneficiary assessment to be performed on a continuous basis. It also requires additional disclosures about an entity's involvement with a VIE, restrictions on the VIE's assets and liabilities that are included in the reporting entity's consolidated balance sheet, significant risk exposures due to the entity's involvement with the VIE, and how its involvement with a VIE impacts the reporting entity's consolidated financial statements. The standard is effective for fiscal years beginning after November 15, 2009. We will adopt the standard on January 1, 2010 and have not yet determined the impact on our consolidated financial statements.

In August 2009, the FASB further updated the fair value measurement guidance to clarify how an entity should measure liabilities at fair value. The update reaffirms fair value is based on an orderly transaction between market participants, even though liabilities are infrequently transferred due to contractual or other legal restrictions. However, identical liabilities traded in the active market should be used when available. When quoted prices are not available, the quoted price of the identical liability traded as an asset, quoted prices for similar liabilities or similar liabilities traded as an asset, or another valuation approach should be used. This update also clarifies that restrictions preventing the transfer of a liability should not be considered as a separate input or adjustment in the measurement of fair value. We will adopt the provisions of this update for fair value measurements of liabilities effective October 1, 2009, which we do not expect to have a material impact on our consolidated financial statements.

In October 2009, the FASB issued an update to existing guidance on revenue recognition for arrangements with multiple deliverables. This update will allow companies to allocate consideration received for qualified separate deliverables using estimated selling price for both delivered and undelivered items when vendor-specific objective evidence or third-party evidence is unavailable. Additional disclosures discussing the nature of multiple element arrangements, the types of deliverables under the arrangements, the general timing of their delivery, and significant factors and estimates used to determine estimated selling prices are required. We will adopt this update for new revenue arrangements entered into or materially modified beginning January 1, 2011. We have not yet determined the impact on our consolidated financial statements.

### Note 6 - Notes Payable

During 2006, we received \$80 million of senior, secured financing (the "Senior Loan") from Wells Fargo Foothill, Inc. ("Wells Fargo") consisting of a \$75 million five year term loan facility (the "Term Facility") and a \$5 million five year revolving credit facility (the "Revolving Facility"). At September 30, 2009, we had the full Revolving Facility available to us. After payment of an origination fee of 1%, lender costs and retirement of \$15.3 million of existing bank indebtedness, the net proceeds of the Term Facility we received were \$58.8 million and used to purchase treasury stock.

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The Term Facility provides for a five-year maturity and amortizes in monthly installments of \$1.25 million commencing August 1, 2006, with interest on the outstanding balances under the Term Facility and the Revolving Facility payable, at our option, at a rate equal to Wells Fargo base rate or at the 30 day LIBOR rate plus 150 basis points. The interest rate at September 30, 2009 was 1.75%. We are also obligated to make additional quarterly payments equal to 50% of our "excess cash flow" (as defined in the Senior Loan agreement) if our Leverage Ratio is greater than or equal to 1 to 1 at the end of a quarter. Our Leverage Ratio was 0.41 to 1 at September 30, 2009. We expect to be able to repay the facilities with cash flow from operations. We have the right to prepay the Term Facility in whole or in part without penalty.

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

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

- \* a limitation on incurring any indebtedness in excess of the remaining existing bank indebtedness outstanding and \$2.3 million in permitted capitalized leases or purchase money debt;
- \* a limitation on our ability to pay dividends or make stock purchases, other than with the net proceeds of the Term Loan, unless we meet certain cash flow tests;
- \* a prohibition on prepayment of other debt;
- \* a requirement to maintain consolidated EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization) for the twelve month period ending December 31, 2006 and each quarter thereafter of at least \$80 million (\$75 million for us and our top tier direct subsidiaries);
- \* a requirement to maintain a quarterly fixed charge coverage ratio (EBITDA (with certain adjustments) divided by the sum of interest expense, income taxes and scheduled principal payments) of at least 1.1 to 1;
- \* a requirement to maintain at least 1.3 million members;
- \* a requirement to maintain a Leverage Ratio (funded indebtedness as of the end of each quarter divided by EBITDA for the trailing twelve months) of no more than 1.5 to 1;
- \* we must have availability (unused portion of the Revolving Facility) plus Qualified Cash (the amount of unrestricted cash and cash equivalents) greater than or equal to \$12,500,000; and,
- \* an event of default occurs if Harland Stonecipher ceases to be our Chairman and Chief Executive Officer for a period of 120 days unless replaced with a person approved by Wells Fargo.

We were in compliance with these covenants at September 30, 2009.

Our \$20 million real estate loan was fully funded in 2002 to finance our new headquarters building in Ada, Oklahoma and has a final maturity of August 2011. This loan, with interest at the 30 day LIBOR rate plus 150 basis points adjusted monthly, is secured by a mortgage on our headquarters. The interest rate at September 30, 2009 was 1.75%, with monthly principal payments of \$191,000 plus interest with the balance of approximately \$2.3 million due at maturity. The real estate loan's financial covenants conform to those of the Senior Loan.

During 2007, we entered into a term loan agreement with Wells Fargo Equipment Finance, Inc. to refinance \$9.6 million indebtedness related to our aircraft. This loan, with interest at the 30 day LIBOR rate plus 89 basis points adjusted monthly, is secured by a mortgage on the aircraft and engines. The interest rate at September 30, 2009 was 1.14%, with monthly principal payments

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of \$80,000 plus interest.

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During June 2008 we received additional financing from Bank of Oklahoma in the form of an unsecured stock repurchase loan for \$10 million on an unsecured basis repayable in 12 equal monthly payments beginning June 30, 2008, together with interest at LIBOR plus 162.5 basis points. This loan was completely repaid pursuant to its terms.

A schedule of outstanding balances as of September 30, 2009 is as follows:

Senior loan.....	\$ 27,500
Real estate loan.....	6,667
Aircraft loan.....	7,644
	-----
Total notes payable.....	41,811
Less: Current portion of notes payable.....	(18,241)
	-----
Long term portion.....	\$ 23,570
	-----

A schedule of future maturities as of September 30, 2009 is as follows:

Repayment Schedule commencing October 2009:	
-----	
Year 1.....	\$ 18,241
Year 2.....	15,741
Year 3.....	3,051
Year 4.....	956
Year 5.....	956
Thereafter.....	2,866
	-----
Total notes payable.....	\$ 41,811
	-----

### Note 7 - Share-based Compensation

During the nine months ended September 30, 2009, the stock option activity under our stock option plans was as follows:

	Weighted Average Price	Number of Shares	Weighted Average Remaining Contractual Term (In Years)
	-----	-----	-----
Outstanding, January 1, 2009.....	\$ 19.70	42,500	
Granted.....	-	-	
Cancelled.....	-	-	
Exercised.....	23.93	(4,500)	
Outstanding, September 30, 2009.....	\$ 19.20	38,000	1.42
	-----	-----	-----
Options exercisable as of September 30, 2009....	\$ 19.20	38,000	1.42

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Other information pertaining to option activity during the nine months ended September 30, 2009 and 2008 was as follows:

	September 30, 2009
Weighted average grant-date fair value of stock options granted.....	Not applicable
Total fair value of stock options vested.....	Not applicable
Total intrinsic value of stock options exercised.....	\$ 40

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

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Note 8 - Fair Value Measurement

On January 1, 2008, we adopted SFAS No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The Statement applies whenever other statements require or permit assets or liabilities to be measured at fair value. SFAS 157 established the following fair value hierarchy that prioritizes the inputs used to measure fair value:

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

Level 2: Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Instruments in this category include obligations of state and political subdivisions, government guaranteed bank debt, auction rate certificates and corporate obligations.

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

The following table presents our financial assets and liabilities that were accounted for at fair value on a recurring basis as of September 30, 2009 by level within the fair value hierarchy (in thousands):

September 30, 2009	Fair Value Measurements Using		
	Level 1	Level 2	Level 3
Available for sale investments.....	\$ -	\$ 39,008	\$ -
September 30, 2008			
Available for sale investments.....	\$ -	\$ 37,408	\$ -

For securities without a readily ascertainable market value (Level 2), we utilize pricing services and broker quotes. Our pricing service's evaluations are based on market data. Our pricing service utilizes evaluated pricing models that vary by asset class and incorporate available trade, bid and other market information. Because many fixed income securities do not trade on a daily basis, our pricing service's evaluated pricing applications apply available information as applicable through processes such as benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing, to prepare evaluations. Such estimated fair values do not necessarily represent the values for which these securities could have been sold at the dates of the balance sheets.

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Our financial instruments consist primarily of cash, certificates of deposit, short-term investments, debt and equity securities, Membership fees receivable, Membership benefits payable, notes payable and accounts payable and accrued expenses. Fair value estimates have been determined by us, using available market information and appropriate valuation methodologies. Fair values of inactively traded debt securities are based on quoted market prices of identical or similar securities or based on observable inputs like interest rates. The carrying value of cash, certificates of deposit, Membership fees receivable, Membership benefits payable and accounts payable and accrued expenses are considered to be representative of their respective fair value, due to the short term nature of these instruments. The carrying value of notes payable is considered to be representative of their respective fair values, due to the variable interest rate feature of such notes. The fair value disclosures relating to debt and equity securities are presented above.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the



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Management's Discussion and Analysis of Financial Condition and Results of Operations in our Form 10-K for the year ended December 31, 2008, which describes, among other things, our basic business model, critical accounting policies, measures of Membership retention, and basic cash flow characteristics of our business. The following tables set forth changes in the principal categories of revenues and expenses and Membership and recruiting activity for the third quarter of 2009 compared to the third quarter of 2008 and the second quarter of 2009 (Table amounts in 000's). The sum of the percentages in the tables may not total due to rounding.

Three Months Ended September 30, 2009 compared to Three Months Ended September 30, 2008 and compared to Three Months Ended June 30, 2009	Three Months Ended Sept. 30, 2009	% of Total Revenue	% Change from Prior Year	% Change from Sequential Period	Three Months Ended Sept. 30, 2008	% of Total Revenue
<b>Revenues:</b>						
Membership fees.....	\$105,435	92.5	(3.5)	(0.1)	\$109,268	93.0
Associate services.....	7,624	6.7	22.3	29.0	6,236	5.0
Other.....	888	0.8	(12.9)	(8.4)	1,019	0.0
	113,947	100.0	(2.2)	(1.4)	116,523	100.0
<b>Costs and expenses:</b>						
Membership benefits.....	35,991	31.5	(4.2)	(0.1)	37,587	32.0
Commissions.....	36,676	32.2	8.9	25.0	33,678	28.0
Associate services and direct marketing.....	7,827	6.9	46.1	20.4	5,358	4.0
General and administrative.....	12,613	11.1	0.7	(2.4)	12,531	10.0
Other, net.....	2,361	2.1	(22.4)	28.0	3,043	2.0
	95,468	83.8	3.5	10.2	92,197	79.0
Income before income taxes.....	18,479	16.2	(24.0)	(28.3)	24,326	20.0
Provision for income taxes.....	7,648	6.7	(22.6)	(23.4)	9,884	8.0
Net income.....	\$10,831	9.5	(25.0)	(31.4)	\$14,442	12.0

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New Memberships:	Three 9/30/2009
-----	-----
New legal service membership sales.....	166,377
New "stand-alone" IDT membership sales.....	8,645
	-----
Total new membership sales.....	175,022
	-----
New "add-on" IDT membership sales.....	112,653
Average Annual Membership fee.....	\$325.60
Active Memberships:	

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Active legal service memberships at end of period.....	1,455,492
Active "stand-alone" IDT memberships at end of period (see note below).....	90,063
	-----
Total active memberships at end of period.....	1,545,555
	-----
Active "add-on" IDT memberships at end of period (see note below).....	710,795
New Sales Associates:	
-----	
New sales associates recruited.....	75,398
Average enrollment fee paid by new sales associates.....	\$79.31
Average Membership fee in force:	
-----	
Average Annual Membership fee.....	\$302.86
Note - reflects 4,137 net transfers from "add-on" status to "stand-alone" status during the quarter	

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

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

Results of Operations - Third Quarter of 2009 compared to Third Quarter of 2008

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Net income decreased 25% for the third quarter of 2009 to \$10.8 million from \$14.4 million for the prior year's third quarter primarily due to a decrease in Membership fees of \$3.8 million, an increase in commission expenses of \$3.0 million, an increase in associate services and direct marketing expenses of \$2.5 million, a decrease in other revenues of \$131,000 and an increase in general and administrative expenses of \$82,000 partially offset by a decrease in the provision for income taxes of \$2.2 million, an increase in associate services revenue of \$1.4 million, a decrease in Membership benefits of \$1.6 million, and a decrease in other, net expenses of \$682,000. Diluted earnings per share decreased 20% to \$0.99 per share from \$1.23 per share for the prior year's comparable quarter due to the 25% decrease in net income and an 8% decrease in the weighted average number of diluted shares outstanding.

Membership fees totaled \$105.4 million during the 2009 third quarter compared to \$109.3 million for 2008, a decrease of 4%. Membership fees and their impact on total revenues in any period are determined directly by the number of active Memberships in force during any such period and the monthly amount of such Memberships. The active Memberships in force are determined by both the number of new Memberships sold in any period together with the renewal rate of existing Memberships. New Membership sales increased 21% during the three months ended September 30, 2009 to 175,022 from 145,041 during the comparable period of 2008. At September 30, 2009, there were 1,545,555 active Memberships in force compared to 1,575,893 at September 30, 2008, a decrease of 2%. The average annual fee per Membership has increased from \$301 for all Memberships in force at September 30, 2008 to \$303 for all Memberships in force at September 30, 2009, primarily as a result of a larger number of Identity Theft Shield memberships.

Associate services revenue increased by approximately \$1.4 million to \$7.6

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million during the third quarter of 2009 when compared to the 2008 quarter. New associates enrolled increased 99% to 75,398 during the 2009 period compared to 37,820 for the same period of 2008. The average enrollment fees paid by new sales associates were \$79 and \$56 for the respective periods. The eService fees decreased to \$2.4 million for the third quarter of 2009 compared to \$3.0 million for the 2008 quarter. Future revenues from associate services will depend primarily on the number of new associates enrolled, the price charged for new associates and the number who choose to participate in our eService program, but we expect that such revenues will continue to be offset by the direct and indirect cost to us of training, providing associate services and other direct marketing expenses.

Other revenue declined 13% from \$1.0 million for the 2008 period to \$888,000 for the 2009 period.

Total revenues decreased 2% to \$113.9 million for the three months ended September 30, 2009 from \$116.5 million during the comparable period of 2008 due to a \$3.8 million decrease in Membership fees and a \$131,000 decrease in other revenues offset by a \$1.4 million increase in associate services revenue.

Membership benefits, which primarily represent payments to provider law firms and Kroll Background America, Inc., a subsidiary of Kroll Inc. ("Kroll"), totaled \$36.0 million for the three months ended September 30, 2009 compared to \$37.6 million for the comparable period of 2008, and represented 34% of Membership fees for both periods. This Membership benefit ratio (Membership benefits as a percentage of Membership fees) should be reduced going forward as substantially all active Memberships provide for a capitated cost and we have reduced the capitated cost of the Identity Theft plan benefits effective April 1, 2007, with an additional reduction on January 1, 2010.

Commissions to associates increased 9% to \$36.7 million for the three months ended September 30, 2009 compared to \$33.7 million for the comparable period of 2008, and represented 35% and 31% of Membership fees for the respective periods. Commissions to associates are primarily dependent on the number of new Memberships sold during a period and the average fee of those Memberships. New Memberships sold during the third quarter of 2009 totaled 175,022, a 21% increase from the 145,041 for 2008, and the "add-on" IDT Membership sales which are not included in these totals increased 18% to 112,653 for the third quarter of 2009 from 95,762 for 2008. Our average Annual Membership fee written during the quarter of 2009 had a slight decrease to \$325.60 from \$326.14 during the 2008 period. Our new Membership fees written during the third quarter of 2009 decreased 4% from 2008. Average commission per new Membership decreased from \$232 to \$210 for the 2009 third quarter. The 21% increase in new Memberships sold resulted in an approximate 9% increase in commissions. Should we add additional commissions to our compensation plan or reduce the amount of chargebacks collected from our associates as we have from time to time, the commission cost per new Membership will increase accordingly.

Associate services and direct marketing expenses increased to \$7.8 million for the three months ended September 30, 2009 from \$5.4 million for the comparable period of 2008. The increase was primarily a result of increased costs for bonuses and increased costs for materials and related freight sent to new associates due to the increase in the number of new associates enrolled during the quarter. We offer the Player's Club incentive program to provide additional incentives to our associates as a reward for consistent, quality business. Associates can earn the right to receive additional monthly bonuses by meeting monthly qualification requirements for a 12 month period and maintaining certain personal retention rates for the Memberships sold during the 12 month period. These expenses also include the costs of providing associate services and marketing expenses.

General and administrative expenses during the three months ended September

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30, 2009 increased to \$12.6 from \$12.5 for the comparable period of 2008 and represented 12% and 11%, respectively, of Membership fees for the two periods. The increase in general and administrative expenses included bank service charges, other taxes and consulting fees associated with Payment Card Industry compliance which were partially offset by decreases in depreciation, employee expenses and legal fees.

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Other expenses, net, which include depreciation and amortization, litigation accruals, interest expense and premium taxes reduced by interest income, were \$2.4 million for the three months ended September 30, 2009 compared to \$3.0 million for the 2008 comparable period. Depreciation expense was \$2.0 million for the three months ended September 30, 2009 and \$2.2 million for the 2008 comparable period. Interest expense decreased to \$261,000 during the 2009 period from \$924,000 during the comparable period of 2008 as a result of the reduction in debt and lower interest rates. Premium taxes decreased from \$455,000 for the three months ended September 30, 2008 to \$444,000 for the comparable period of 2009. Interest income decreased from \$532,000 for the three months ended September 30, 2008 to \$389,000 for the three months ended September 30, 2009, due to a decrease in interest rates.

We have recorded a provision for income taxes of \$7.6 million (41.4% of pretax income) and \$9.9 million (40.6% of pretax income) for the three months ended September 30, 2009 and 2008, respectively.

Results of Operations - Third Quarter of 2009 compared to Second Quarter of 2009

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Third quarter 2009 membership fees decreased approximately \$81,000 to \$105.4 million from \$105.5 million for the second quarter of 2009. Associate services revenues increased during the 2009 third quarter by approximately \$1.7 million to \$7.6 million from \$5.9 million for the 2009 second quarter and associate services and direct marketing expenses increased by \$1.3 million during the same period. Membership benefits totaled \$36.0 million for both periods and represented 34% of membership fees for the two periods. Commissions to associates totaled \$36.7 million in the 2009 third quarter compared to \$29.3 million for the 2009 second quarter and represented 35% and 28%, respectively, of membership fees for the two periods. General and administrative expenses decreased \$309,000 during the 2009 third quarter to \$12.6 million compared to \$12.9 million for the 2009 second quarter and represented 12% of membership fees for the two periods. The decrease in general and administrative expenses included decreases in legal fees, employee costs and consulting fees which were partially offset by increases in postage and bank service charges.

Results of Operations - First Nine Months of 2009 compared to First Nine Months  
of 2008

-----  
Membership revenues decreased 3% in the first nine months of 2009 to \$317.9 million compared to \$327.8 million for the first nine months of 2008. Net income decreased 4% for the first nine months of 2009 to \$43.7 million from \$45.4 million for the prior year's comparable period primarily due to the decrease of \$9.9 million in Membership revenues, a \$3.1 million increase in associate services and direct marketing expenses, a decrease in other revenues of \$425,000 and an increase in general and administrative expenses of \$52,000 partially offset by a decrease in Membership benefits of \$4.5 million, a \$2.7 million decrease in commissions, a decrease in other, net expenses of \$3.6 million, a decrease in the provision for income taxes of \$791,000 and an increase in Associate services revenues of \$232,000. Diluted earnings per share increased 5% to \$3.95 per share from \$3.77 per share for the prior year's comparable nine month period. The 5% increase in diluted earnings per share is due to a 4% decrease in net income and an approximate 7% decrease in the weighted average

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number of diluted shares outstanding.

Membership fees and their impact on total revenues in any period are determined directly by the number of active Memberships in force during any such period. The active Memberships in force are determined by both the number of new Memberships sold in any period together with the renewal rate of existing Memberships. New Membership sales increased less than one percent during the nine months ended September 30, 2009 to 419,847 from 419,686 during the comparable period of 2008. At September 30, 2009, there were 1,545,555 active Memberships in force compared to 1,575,893 at September 30, 2008, a decrease of 2%. The average annual fee per Membership has increased from \$301 for all Memberships in force at September 30, 2008 to \$303 for all Memberships in force at September 30, 2009.

Associate services revenue increased 1% from \$18.6 million for the first nine months of 2008 to \$18.8 million during the comparable period of 2009 due to a increase in associate enrollment fees offset partially by a decrease in eService fees. Total new associates enrolled increased 39% during the first nine months of 2009 to 124,441 compared to 89,722 for the same period of 2008 and average enrollment fees paid by new sales associates increased from \$83 during the 2008 period to \$106 during the 2009 nine months due to a higher average enrollment fee available during the 2009 period. The eService fees decreased to \$7.5 million during the first nine months of 2009 compared to \$9.2 million for the comparable period of 2008. Future revenues from associate services will depend primarily on the number of new associates enrolled, the price charged and the number who choose to participate in the Company's eService program, but the Company expects that such revenues will continue to be offset by the direct and indirect cost to the Company of training (including training bonuses paid), providing associate services and other direct marketing expenses.

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Other revenue decreased \$425,000 from \$3.2 million for the nine month period ending September 30, 2008 to \$2.8 million for the same period of 2009.

Primarily as a result of the decrease in Membership fees, total revenues decreased to \$339.5 million for the nine months ended September 30, 2009 from \$349.6 million during the comparable period of 2008, a decrease of 3%.

Membership benefits totaled \$108.2 million for the nine months ended September 30, 2009 compared to \$112.7 million for the comparable period of 2008, and represented 34% of Membership fees for both periods. This Membership benefit ratio (Membership benefits as a percentage of Membership fees) should be reduced going forward as substantially all active Memberships provide for a capitated cost and we have reduced the capitated cost of the Identity Theft plan benefits effective April 1, 2007 with subsequent additional reductions on January 1, 2010.

Commissions to associates decreased 3% to \$93.0 million for the nine months ended September 30, 2009 compared to \$95.7 million for the comparable period of 2008, and represented 29% of Membership fees for both periods. Commissions to associates are primarily dependent on the number of new Memberships sold during a period and the average fee of those Memberships. New Memberships sold during the first nine months of 2009 increased slightly to 419,847 for the nine months ended September 30, 2009 from 419,686 for the comparable period of 2008, and the "add-on" IDT Membership sales which are not included in these totals increased 1% to 263,512 for the third quarter of 2009 from 259,648 for 2008. Our average Annual Membership fee written during the first nine months of 2009 decreased less than one percent to \$324.96 from \$325.80 for 2008. Our new Membership fees written during the first nine months of 2009 decreased 3% from 2008. Should we add additional commissions to our compensation plan or reduce the amount of chargebacks collected from its associates as it has from time to time, the

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commission cost per new Membership will increase accordingly.

Associate services and direct marketing expenses increased to \$21.1 million for the nine months ended September 30, 2009 from \$18.0 million for the comparable period of 2008. The increase was primarily a result of increased cost for Fast Start bonuses, incentive trip expenses and increased costs for materials and related freight sent to new associates due to the increase in the number of new associates enrolled during the period partially offset by a decline in direct marketing expenses. We offer the Player's Club incentive program to provide additional incentives to our associates as a reward for consistent, quality business. Associates can earn the right to receive additional monthly bonuses by meeting monthly qualification requirements for the entire calendar year and maintaining certain personal retention rates for the Memberships sold during the calendar year. These expenses also include the costs of providing associate services and marketing expenses.

General and administrative expenses during the nine months ended September 30, 2009 and 2008 were unchanged at \$38.9 million for both periods and represented 12% of Membership fees for the two periods.

Other expenses, net, which include depreciation and amortization, litigation accruals, interest expense and premium taxes reduced by interest income, was \$6.5 million for the nine months ended September 30, 2009 compared to \$10.1 million for the 2008 comparable period. Depreciation decreased to \$6.1 million for the first nine months of 2009 from \$6.6 million for the comparable period of 2008. Litigation accruals decreased by \$450,000 for the first nine months of 2009 from an increase of \$888,000 in the 2008 period including a \$450,000 reduction in previously accrued amounts for the nine months ended September 30, 2009. Interest expense decreased to \$925,000 during the 2009 period from \$3.1 million during the comparable period of 2008 as a result of lower indebtedness and lower interest rates. Premium taxes were \$1.3 million for the nine months ended September 30, 2009 and \$1.4 million for the comparable period of 2008. Interest income decreased \$248,000 to \$1.5 million for the nine months ended September 30, 2009 from \$1.8 million for the comparable period of 2008, due to lower interest rates.

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We have recorded a provision for income taxes of \$28.0 million (39.0% of pretax income) and \$28.8 million (38.8% of pretax income) for the first nine months ended September 30, 2009 and 2008, respectively.

### Liquidity and Capital Resources

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#### General

Net cash flow provided by operating activities was \$48.4 million for the nine months ended September 30, 2009 compared to \$44.3 million for the same period in 2008. This \$4.1 million increase was primarily the result of a \$3.4 million decrease in income tax payments, a \$4.5 million decrease in cash paid to our providers for the delivery of benefits associates, and a \$2.2 million decrease in cash paid for interest reduced by a \$10.1 million decrease in cash receipts from our members.

Consolidated net cash used by investing activities was \$3.3 million for the first nine months of 2009 compared to net cash used of \$4.3 million for the comparable period of 2008. This \$1.0 million change in investing activities resulted from a \$1.9 million decrease in additions to property and equipment and a \$36.7 million decrease in the investment purchases partially offset by \$37.6 million in maturities and sales of investments.

Net cash used in financing activities during the first nine months of 2009 was \$32.8 million compared to \$43.6 million for the comparable period of 2008.

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This \$10.8 million change was primarily comprised of a \$10.0 million decrease in proceeds from issuance of debt and an \$834,000 increase in debt repayments offset by a \$22.1 million decreased treasury stock purchases.

We purchased and formally retired 451,486 shares of our common stock during the first nine months of 2009 for \$14.8 million, or an average price of \$32.84 per share, reducing our common stock by \$4,515 and our retained earnings by \$14.8 million. We had working capital of \$8.8 million at September 30, 2009, an increase of \$11.1 million compared to our negative working capital of \$2.3 million at December 31, 2008. The increase was primarily due to a \$12.4 million increase in cash and cash equivalents, a \$3.5 million increase in refundable income taxes, a \$3.5 million increase in deferred member and associate service costs, a \$4.2 million decrease in the current portion of notes payable partially offset by a \$7.2 million decrease in the current portion of available-for-sale investments, an increase of \$3.0 million in deferred revenues and fees and a \$1.9 million increase in accounts payable and accrued expenses. The \$8.8 million working capital at September 30, 2009 would have been a \$19.0 million in working capital excluding the current portion of deferred revenue and fees in excess of the current portion of deferred member and associate service costs. These amounts will be eliminated by the passage of time without the utilization of other current assets or us incurring other current liabilities. We do not expect any difficulty in meeting our financial obligations in the next 12 months.

At September 30, 2009 we reported \$73.5 million in cash and cash equivalents and unpledged investments compared to \$60.0 million at December 31, 2008. Our investments typically consist of obligations of state and political subdivisions, certificates of deposit and government guaranteed bank debt.

We generally advance significant commissions at the time a Membership is sold. During the nine months ended September 30, 2009, we advanced commissions, net of chargebacks, of \$94.0 million on new Membership sales compared to \$94.7 million for the same period of 2008. Since approximately 95% of Membership fees are collected on a monthly basis, a significant cash flow deficit is created on a per Membership basis at the time a Membership is sold. Since there are no further commissions paid on a Membership during the advance period, we typically derive significant positive cash flow from the Membership over its remaining life.

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We expense advance commissions ratably over the first month of the related Membership. As a result of this accounting policy, our commission expenses are all recognized over the first month of a Membership and there is no commission expense recognized for the same Membership during the remainder of the advance period. We track our unearned advance commission balances outstanding in order to ensure the advance commissions are recovered before any renewal commissions are paid and for internal purposes of analyzing our commission advance program. While not recorded as an asset, unearned advance commission balances from associates as of September 30, 2009, and related activity for the nine month period then ended, were:

	(Amounts in 000's)
Beginning unearned advance commission payments (1).....	\$ 174,371
Advance commission payments, net.....	88,855
Earned commissions applied.....	(84,109)
Advance commission payment write-offs.....	(2,995)
Ending unearned advance commission payments before estimated unrecoverable payments (1).....	176,122
Estimated unrecoverable advance commission payments (1).....	(46,130)
Ending unearned advance commission payments, net (1).....	\$ 129,992

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(1) These amounts do not represent fair value, as they do not take into consideration timing of estimated recoveries.

The ending unearned advance commission payments, net, above includes net unearned advance commission payments to non-vested associates of \$66.5 million. As such, at September 30, 2009 future commission payments and related expense should be reduced as unearned advance commission payments of \$64 million are recovered. Commissions are earned by the associate as Membership premiums are earned by us, usually on a monthly basis. For additional information concerning these commission advances, see our Annual report on Form 10-K under the heading Commissions to Associates in Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations.

We believe that we have the ability to finance the next twelve months of operations, anticipated capital expenditures and required debt repayment obligations based on our existing amount of cash and cash equivalents and unpledged investments at September 30, 2009 of \$73.5 million. We believe our long-term liquidity needs will be met by our ability to generate cash flow from operations and our existing cash and cash equivalent balances. We expect to maintain cash and investment balances, including pledged investments, on an on-going basis of approximately \$20 to \$30 million in order to meet expected working capital needs and regulatory capital requirements. Cash balances in excess of this amount would be used for discretionary purposes such as additional treasury stock purchases subject to limitations in the Term Facility.

#### Notes Payable

See Note 6 - Notes Payable in Item 1 above.

#### Parent Company Funding and Dividends

Although we are the operating entity in many jurisdictions, our subsidiaries serve as operating companies in various states that regulate Memberships as insurance or specialized legal expense products. The most significant of these wholly owned subsidiaries are Pre-Paid Legal Casualty, Inc. ("PPLCI"), Pre-Paid Legal Services Inc. of Florida ("PPLSIF") and Legal Service Plans of Virginia, Inc. ("LSPV"). The ability of these entities to provide funds to us is subject to a number of restrictions under various insurance laws in the jurisdictions in which they conduct business, including limitations on the amount of dividends and management fees that may be paid and requirements to maintain specified levels of capital and reserves. In addition PPLCI will be required to maintain its stockholders' equity at levels sufficient to satisfy various state or provincial regulatory requirements, the most restrictive of which is currently \$3 million. Additional capital requirements of these entities, or any of our regulated subsidiaries, will be funded by us in the form of capital contributions or surplus debentures. During 2008, we received \$4.1 million in dividends from LSPV and \$14.9 million in dividends from PPLCI.

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#### Contractual Obligations

There have been no material changes outside of the ordinary course of business in our contractual obligations from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008.

#### Critical Accounting Policies

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Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are affected by management's application of accounting policies. If these estimates or assumptions are



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incorrect, there could be a material change in our financial condition or operating results. Many of these "critical accounting policies" are common in the insurance and financial services industries; others are specific to our business and operations. Our critical accounting policies include estimates relating to revenue recognition related to Membership and associate fees, deferral of Membership and associate related costs, expense recognition related to commissions to associates, accrual of incentive awards payable and accounting for legal contingencies. Each of these accounting policies and the application of critical accounting policies and estimates was discussed in our Annual Report on Form 10-K for the year ended December 31, 2008. There were no significant changes in the application of critical accounting policies or estimates during the first nine months of 2009. We are not aware of any reasonably likely events or circumstances which would result in different amounts being reported that would materially affect our financial condition or results of operations.

### Capital and Dividend Plans

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We continue to evaluate the desirability of additional share repurchases and additional cash dividends. We declared dividends of \$0.50 per share during 2004 and \$0.60 per share during 2005 and have previously announced that we will continue share repurchases, pay a dividend, or both, depending on our financial condition, available resources and market conditions, as well as compliance with our various loan covenants which limit our ability to repurchase shares or pay cash dividends. We expect to continue our repurchase program when we can acquire shares at prices we believe are attractive as we have existing authorization from the Board to purchase an additional 802,774 shares. We also continue to evaluate additional sources of financing that may enable us to accelerate the repurchase program at prices we believe are attractive.

### Forward-Looking Statements

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All statements in this report other than purely historical information, including but not limited to, statements relating to our future plans and objectives, expected operating results and the assumptions on which such forward-looking statements are based, constitute "Forward-Looking Statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and are based on our historical operating trends and financial condition as of September 30, 2009 and other information currently available to management. We caution that the Forward-Looking Statements are subject to all the risks and uncertainties incident to our business, including but not limited to risks described in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2008. Moreover, we may make acquisitions or dispositions of assets or businesses, enter into new marketing arrangements or enter into financing transactions. None of these can be predicted with certainty and, accordingly, are not taken into consideration in any of the Forward-Looking Statements made herein. For all of the foregoing reasons, actual results may vary materially from the Forward-Looking Statements. We assume no obligation to update the Forward-Looking Statements to reflect events or circumstances occurring after the date of the statement.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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#### Disclosures About Market Risk

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

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alternative investments, liquidity of the instrument and other general market conditions. As of September 30, 2009, our investments consisted of the following:

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Description	Fair Value
Obligations of state and political subdivisions.....	\$ 32,327
Certificates of deposit.....	4,070
Government guaranteed bank debt.....	1,602
Corporate obligations.....	407
Auction Rate Securities.....	375
U. S. Government obligations.....	227
Total investments.....	\$ 39,008

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

The table below summarizes the estimated effects of hypothetical increases and decreases in interest rates on our fixed-maturity investment portfolio. It is assumed that the changes occur immediately and uniformly, with no effect given to any steps that we might take to counteract that change. The hypothetical changes in market interest rates reflect what could be deemed best and worst case scenarios. The fair values shown in the following table are based on contractual maturities. Significant variations in market interest rates could produce changes in the timing of repayments due to prepayment options available. The fair value of such instruments could be affected and, therefore, actual results might differ from those reflected in the following table:

	(in 000's) Fair value	Hypothetical change in interest rate (bp = basis points)
Fixed-maturity investments at September 30, 2009 (1)...	\$ 34,563	100 bp increase 200 bp increase 50 bp decrease 100 bp decrease
Fixed-maturity investments at December 31, 2008 (1)....	\$ 31,360	100 bp increase 200 bp increase 50 bp decrease 100 bp decrease

(1) Excluding short-term investments (certificates of deposits and auction rate certificates) with a fair value of \$4.4 million at September 30, 2009 and \$6.1 million at December 31, 2008.

The table above illustrates, for example, that an instantaneous 200 basis point increase in market interest rates at September 30, 2009 would reduce

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the estimated fair value of our fixed-maturity investments by approximately \$3.2 million at that date. At December 31, 2008, an instantaneous 200 basis point increase in market interest rates would have reduced the estimated fair value of our fixed-maturity investments by approximately \$2.9 million at that date. The definitive extent of the interest rate risk is not quantifiable or predictable due to the variability of future interest rates, but we do not believe such risk is material.

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

### Interest Rate Risk

As of September 30, 2009, we had \$41.8 million in notes payable outstanding at interest rates indexed to the 30 day LIBOR rate that exposes us to the risk of increased interest costs if interest rates rise. Assuming a 100 basis point increase in interest rates on the floating rate debt, annual interest expense would increase by approximately \$418,000. As of September 30, 2009, we had not entered into any interest rate swap agreements with respect to the term loans or our floating rate municipal bonds.

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### Foreign Currency Exchange Rate Risk

Although we are exposed to foreign currency exchange rate risk inherent in revenues, net income and assets and liabilities denominated in Canadian dollars, the potential change in foreign currency exchange rates is not a substantial risk, as approximately 1% of our revenues are derived outside of the United States. As reflected in the attached Consolidated Statements of Comprehensive Income, we have recorded positive foreign currency translation adjustments of \$1.1 million for the nine months ended September 30, 2009 and have a cumulative positive foreign currency translation adjustment balance of \$724,000 at September 30, 2009. These amounts are subject to change dynamically in conjunction with the relative values of the Canadian and U.S. dollars.

## ITEM 4. CONTROLS AND PROCEDURES

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Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2009, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) during the quarter ended September 30, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS.

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

### ITEM 1A. RISK FACTORS

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There are a number of risk factors that could affect our financial condition or results of operations. See Note 2 of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this report for information with respect to legal proceedings, any of which could have a material adverse effect on our financial condition and results of operations. Please refer to pages 15 - 17 of our 2008 Annual Report on Form 10-K for a description of other risk factors. There has not been any material changes in the risk factors disclosed in the Annual Report.

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

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#### Issuer Purchases of Equity Securities

The following table provides information about our purchases of stock during the third quarter of 2009.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number Shares that May Be Purchased Under the Plans or Programs (1)
July 2009.....	8,274	\$ 48.82	8,274	810,166
August 2009.....	3,756	47.57	3,756	806,410
September 2009.....	3,636	49.28	3,636	802,774
Total.....	15,666	\$ 48.62	15,666	

(1) We announced on April 6, 1999, a treasury stock purchase program authorizing management to acquire up to 500,000 shares of our common stock. The Board of Directors has subsequently from time to time increased such authorization from 500,000 shares to 15 million shares. The most recent authorization was for 1 million additional shares on February 18, 2009 and there has been no time limit set for completion of the repurchase program.

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

### ITEM 6. EXHIBITS.

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(a) Exhibits:

Exhibit No. -----	Description -----
3.1	Amended and Restated Certificate of Incorporation of the Company, as amended (Incorporated in the Company's Report on Form 8-K dated June 27, 2005)
3.2	Amended and Restated Bylaws of the Company (Incorporated by reference to Exhibit 3.1 of the Company's Report on Form 10-Q for the period ended June 30, 2003)
*10.1	Employment Agreement effective January 1, 1993 between the Company and Harland C. Stonecipher (Incorporated by reference to Exhibit 10.1 of the Company's Annual Report on Form 10-KSB for the year ended December 31, 1992)
*10.2	Agreements between Shirley Stonecipher, New York Life Insurance Company and the Company covering Harland C. Stonecipher (Incorporated by reference to Exhibit 10.21 of the Company's Annual Report on Form 10-KSB for the year ended December 31, 1985)
*10.3	Amendment dated January 1, 1993 to Split Dollar Agreement between Shirley Stonecipher and New York Life Insurance policy covering Harland C. Stonecipher (Incorporated by reference to Exhibit 10.23 of the Company's Annual Report on Form 10-KSB for the year ended December 31, 1992)
*10.4	Form of New Business Generation Agreement Between the Company and Harland C. Stonecipher (Incorporated by reference to Exhibit 10.22 of the Company's Annual Report on Form 10-K for the year ended December 31, 1992)
*10.5	Amendment to New Business Generation Agreement between the Company and Harland C. Stonecipher (Incorporated by reference to Exhibit 10.12 of the Company's Annual Report on Form 10-K for the year ended December 31, 1992)
*10.6	Amendment No. 2 to New Business Generation Agreement between the Company and Harland C. Stonecipher (Incorporated by reference to Exhibit 10.13 of the Company's Annual Report on Form 10-K for the year ended December 31, 2002)
*10.7	Stock Option Plan, as amended effective May 2003 (Incorporated by reference to Exhibit 10.14 of the Company's Annual Report on Form 10-K for the year ended December 31, 2004)
10.8	Loan agreement dated June 11, 2002 between Bank of Oklahoma, N.A. and the Company (Incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the six-months ended June 30, 2002)
10.9	Form of Mortgage dated July 23, 2002 between Bank of Oklahoma, N.A. and the Company (Incorporated by reference to Exhibit 10.3 of the Company's Quarterly Report on Form 10-Q for the six months ended June 30, 2002)
*10.10	Deferred compensation plan effective November 6, 2002 (Incorporated by reference to Exhibit 10.15 of the Company's Annual Report on Form 10-K for the year ended December 31, 2002)
*10.11	Amended Deferred Compensation Plan effective January 1, 2005 (Incorporated by reference to Exhibit 10.16 of the Company's Report on Form 10-K for the year ended December 31, 2004)
10.12	Credit Agreement dated June 23, 2006 among Pre-Paid Legal Services, Inc, the lenders of Foothill, Inc. as Arranger and Administrative Agent and Bank of Oklahoma, N.A. (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed June 27, 2006)
10.13	Security Agreement dated June 23, 2006 between Pre-Paid Legal Services, Inc and certain subsidiaries of Foothill, Inc., as Agent (Incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed June 26, 2006)
10.14	Guaranty Agreement dated June 23, 2006 between certain subsidiaries of Pre-Paid Legal Services, Inc and certain subsidiaries of Foothill, Inc., as Agent (Incorporated by reference to Exhibit 10.3 of the Company's Current Report on Form 8-K filed June 27, 2006)

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- 10.15 Mortgage, Assignment of Rents and Leases and Security Agreement by Pre-Paid Legal Services, Inc. as Agent (Incorporated by reference to Exhibit 10.4 of the Company's Current Report on Form 10-Q for the quarter ended June 30, 2006)
- 10.16 First Amendment to Loan Agreement dated June 23, 2006 between Pre-Paid Legal Services, Inc. and Wells Fargo Foothill, Inc. as administrative agent (Incorporated by reference to Exhibit 10.5 of the Company's Current Report on Form 10-Q for the quarter ended June 30, 2006)
- 10.17 First Amendment to Credit Agreement dated September 10, 2007 between Pre-Paid Legal Services, Inc. and Wells Fargo Foothill, Inc. as administrative agent (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed September 10, 2007)
- 10.18 Term Loan Agreement dated September 28, 2007 between Pre-Paid Legal Services, Inc. and Wells Fargo Foothill, Inc. as administrative agent (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 10-K for the year ended December 31, 2007)

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- 10.19 Form of Aircraft Mortgage and Security Agreement between Pre-Paid Legal Services, Inc. and Wells Fargo Foothill, Inc. as administrative agent (Incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 10-Q for the quarter ended June 30, 2007)
- 10.20 Second Amendment to Credit Agreement dated February 22, 2008 between Pre-Paid Legal Services, Inc. and Wells Fargo Foothill, Inc. as administrative agent (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 10-K for the year ended December 31, 2007)
- 10.21 Third Amendment to Credit Agreement dated June 5, 2008 between Pre-Paid Legal Services, Inc. and Wells Fargo Foothill, Inc. as administrative agent (Incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q for the six-months ended June 30, 2008)
- 10.22 Second Amendment to Loan Agreement dated June 6, 2008 between Pre-Paid Legal Services, Inc. and Wells Fargo Foothill, Inc. as administrative agent (Incorporated by reference to Exhibit 10.22 of the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008)
- 31.1 Certification of Harland C. Stonecipher, Chairman, Chief Executive Officer and President of the Company, Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934
- 31.2 Certification of Steve Williamson, Chief Financial Officer, Pursuant to Rule 13a-14(a) of 1934
- 32.1 Certification of Harland C. Stonecipher, Chairman, Chief Executive Officer and President of the Company, Pursuant to 18 U.S.C. Section 1350
- 32.2 Certification of Steve Williamson, Chief Financial Officer, Pursuant to 18 U.S.C. Section 1350

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\* Constitutes a management contract or compensatory plan or arrangement required to be filed as an exhibit to this report.

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### SIGNATURES

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

PRE-PAID LEGAL SERVICES, INC.  
(Registrant)

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Date: October 26, 2009

/s/ Harland C. Stonecipher

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Harland C. Stonecipher  
Chairman, Chief Executive  
Officer and President  
(Principal Executive Officer)

Date: October 26, 2009

/s/ Randy Harp

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Randy Harp  
Chief Operating Officer  
(Duly Authorized Officer)

Date: October 26, 2009

/s/ Steve Williamson

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Steve Williamson  
Chief Financial Officer  
(Principal Financial and  
Accounting Officer)