Annual Report 2005

Pre-Paid Legal Services®, Inc.

Life Events Legal Plan

Harland C. Stonecipher

Chairman, Chief Executive Officer, and President of the Company

Dear Shareholders,

To give you some appreciation for the professional competence and dedication of the Pre-Paid Legal Services provider attorney network, the remainder of this Annual Report will introduce you to the attorneys and law firms that make up that network. We have over 1,000 attorneys in law firms serving in 48 states and four Canadian provinces to deliver the professional services our Life Events Legal Plan provides. Last year our members called our attorneys for professional assistance 2.8 million times.

We and our provider law firms have an ongoing common goal. We want Pre-Paid Legal members to feel they have an attorney as a lifetime partner not only to help them with unexpected legal problems but to help them deal with everyday life events that should, but commonly do not, receive legal oversight.

To help you understand the value of a Pre-Paid Legal membership, visit our website, www.prepaidlegal.com. Read a selection of 800 letters from our members thanking us for helping them solve their various life problems. We receive hundreds of letters each month. That these members took the time to write says a lot. Also note the wide variety of situations our members turn to our Provider Lawyers for needed professional assistance. These letters are a clear testimony to the value of the Pre-Paid Legal membership.

Our ability to deliver sound legal assistance to our Pre-Paid Legal members in a prompt, user-friendly fashion is what Pre-Paid Legal is all about. We want our members to feel the comfort of having an attorney/partner a phone call away. We want our members to enjoy the same satisfaction, the same comfort that the Pre-Paid Legal members who wrote those 800 letters so clearly have.

We in Ada and our provider law firms want to make the Pre-Paid Legal membership ever more user-friendly, ever more valuable. This requires an ongoing effort. Last year we sent over 300,000 surveys to members who used their Life Events Legal Plan. We monitor the time it takes to answer each and every phone call. We have monthly conference calls with all of our provider law firms. We and our provider law firms meet several times a year to share best practices. All of this to help the Pre-Paid Legal provider law firms become ever more efficient in the delivery of needed legal assistance. We doubt other law firms do anything even remotely similar.

Now couple this with our method of compensation.

A law practice is no different from a medical practice or any other professional practice. Like it or not, economics remain a reality. Someone has to pay the bills. To continue to practice, the rent, the staff, utilities, insurance, etc. have to be paid. Our attorneys receive a percentage of the monthly membership fees paid by members in their state or assigned district. Last year we paid our provider law firms $111,500,000. Pre-Paid Legal is either each provider law firm's largest client or one of their largest clients. Each Pre-Paid Legal member thus becomes an important client of the Pre-Paid Legal provider law firm. The delivery of prompt and professional service is thus the goal of each Pre-Paid Legal attorney.

Also important, also unique, our compensation method gives Pre-Paid Legal attorneys the satisfaction of helping solve problems for members/clients regardless of the economics of that particular problem. Again, the impact of this is clearly displayed in the letters on our website.

If you are not a Pre-Paid Legal member, I urge you to become one. Again, visit our website, www.prepaidlegal.com. Read those 800 letters. You, too, can have an attorney/partner a phone call away.

Included in this annual report are profiles of several Pre-Paid provider law firms and individual attorneys. We feel fortunate to have these quality law firms in our legal network. They are dedicated to giving Pre-Paid members the highest quality professional attention.

Harland C. Stonecipher

Life Events Legal Plan

For $26 a month or less, we give our members access to affordable, professional legal counsel not only for traditional legal problems but for everyday events such as buying a house or a car, creating a will, handling a problem with an insurance company, dealing with identity theft, and much more where legal review should be routine but rarely is. These events can be among the most important events in a person's life, yet there is a tendency for them to take place without proper legal review. For Pre-Paid Legal members, access to legal counsel is only a toll-free phone call away.

Our product is unique. Our product has great value. We have been providing a Life Events Legal Plan for over three decades. Today over 1.5 million families benefit from the Pre-Paid Legal Life Events Legal Plan. This, we think, is only the beginning.

Our Provider Law Firms

The core of our business.

We understand the legal system can be intimidating. But it doesn't have to be. We have over 1,000 attorneys in law firms serving 48 states and 4 Canadian provinces to deliver the professional services our Life Events Legal Plan provides. Some 95 of our attorneys have held leadership roles in their states' bar associations. Some 79 have been elected officials. Sixty-five have held judicial positions. On average, our attorneys have been in the profession over 15 years. Some of our firms have been serving their communities for decades. Our Toronto law firm was founded in 1884!

We believe our network of provider law firms is a unique and valuable asset. We would like to introduce you to a few of our provider attorneys and law firms.

Pre-Paid Legal Services®, Inc.

Presents

Gallery Of Attorneys

Portraits Of Our Attorneys And
The Services We Provide.

Catherine Brame

One of the first calls Catherine Brame handled as a Pre-Paid Legal provider attorney changed her professional career.

On an extremely hot and humid summer day in Louisiana, a distraught mother living near New Orleans called for help with a delinquent utility bill. Her young son was dependent on oxygen due to a serious asthma problem. The mother was understandably worried that her electricity would be turned off. She turned to her Pre-Paid Legal attorney.

Catherine quickly called the utility company and negotiated a payment plan with no interruption of service.

This may sound like a small problem, but it was not to the mother.

"I will never forget her reaction and how grateful she was. She was sold on Pre-Paid Legal and so was I. From then on my professional focus was on my firm's Pre-Paid Legal members' needs."

Catherine has been immersed in the legal world since 1982, first as a paralegal where she realized she had a fascination and a fondness for the profession. Provosty, Sadler, deLaunay, Fiorenza & Sobel became a Pre-Paid Legal Provider Law Firm for Louisiana in August 1994.

Her favorite quote? *"If we are to keep democracy, there must be a commandment. Thou shalt not ration justice."*

– Judge Learned Hand

Provosty, Sadler, deLaunay, Fiorenza & Sobel, A Professional Corporation

Pre-Paid Legal Provider Since 1994

Member Testimonials

I too am pleased with Pre-Paid Legal. I have used its services three times now with happy results. Thanks Pre-Paid for letters that got positive and satisfying results. Thanks also for great work on my Will. For the Will, I was remarkably given the name of a local attorney who eventually assisted me in getting the Will notarized—and she did this at no cost to me.

Pre-Paid Legal's services, for me, have not only equaled, but have also gone far above the minimal cost of my membership.

Thanks Pre-Paid (the wonderful professionals who make up this wonderful organization) for such great service not indicative at all of the age in which we live.

PPL Member, Louisiana

I called the law firm that was assigned to me with a question about how to evict someone that was not paying rent and how to do it legally. They gave me step by step details and I was very glad I called. I probably saved myself plenty time and money because the way I was supposed to do the eviction and the way I would have done it, were not the same.

I am very thankful the law firm was there to answer my questions.

This service is very much appreciated.
PPL Member, Louisiana

Lisle Law Firm, PA (Arkansas)

Firm Established: 1988
Pre-Paid Legal Provider Since 1988

One firm attorney was a state senator, served as a Springdale city attorney and as a school board member. Another was the Springdale deputy city attorney and currently serves as the Elm Springs prosecuting attorney. Another has been recognized for being one of the Arkansas Volunteer Lawyers for the Elderly for over nine years.

Kivel & Howard LLP (Oregon)

Firm Established: 2006
Became Pre-Paid Legal Provider: 2006

Kivel & Howard lawyers serve on various boards including Mt. Hood Habitat for Humanity, Jewish Family and Children Service Organization, Gallery Players Community Theater, and the Salvation Army. One lawyer is a founding trustee of The Park Academy as well as a trustee for the Oregon Ballet. Members of the firm also volunteer with Legal Aid Services of Oregon and St. Matthews Legal Clinic, and one attorney trains dogs for Guide Dogs for the Blind.

Evans, Loewenstein, Shimanovsky & Moscardini, LTD (Illinois)

Firm Established: 1978
Became Pre-Paid Legal Provider: 1992

Some of the organizations supported by lawyers in the firm include: Habitat for Humanity, PAWS (Pets are Worth Saving – Chicago), Wheaton Park District Baseball, Will Grundy Center for Independent Living, one lawyer serves as a director for Our Lady of Angels (Retirement Home), and one lawyer is a founding member of the Northwestern University Latino Steering Committee.

Jim Merritt

Jim Merritt is the managing partner for the Pre-Paid Legal business for Berry Quackenbush and Stuart in South Carolina and Tennessee. Jim grew up in a poor neighborhood in North Charleston, South Carolina. "As I grew up I saw there were bullies in the real world just like those I found in my neighborhood. I thought it would be great to turn the tables on the bullies. The law seemed to offer the perfect tool for that."

In late March 1999 Jim handled his first Pre-Paid Legal case. It involved a large HMO that denied payment for vital medical treatments for an 18-month-old child. Because of Jim's intervention, the HMO reversed its position. The phone call Jim received from the boy's mother thanking him reminded Jim of why he had become an attorney.

"It occurred to me that Pre-Paid was all about balancing the scales of justice. Two months later I took over the management of my firm's Pre-Paid business. I have never looked back," he said.

"Being a trial attorney can 'thin out' your soul. Since I have been with Pre-Paid, on every level – from professional to personal, from faith in my profession to faith in my God - I could not be happier."

Jim's favorite quote is, "Care more than others think wise; Risk more than others think safe; Dream more than others think practical; Expect more than others think possible."

- Unknown

Berry Quackenbush & Stuart, PA

Pre-Paid Legal Provider Since 1996

Member Testimonials

Since becoming a Pre-Paid Legal member, I have neglected until now to recognize the work of my provider attorney of the provider firm in South Carolina.

On the numerous occasions I have used my membership she has carefully and patiently advised me on every issue of tax and accounting; providing in each instance not only her capability as counsel, but also her particular attention to customer service.

Her assistance in the last year alone has saved me several thousands of dollars in unnecessary taxes, as well as added legal fees, more than covering the cost of my membership over a lifetime. In doing so, she has convinced me of the value of my membership and earned my loyalty to your company and her firm.

My provider attorney consistently demonstrates a degree of professionalism and concern for her clients that deserves my thanks and your recognition. I trust that you will accept my regards and convey to the partners of her firm my appreciation of my provider attorney for performing with such diligence a job that all should do so well.

I remain very truly yours
PPL Member, South Carolina

I'm writing this letter to commend my provider lawyer for his outstanding representation for me concerning a traffic violation.

He is a compassionate, professionally competent, punctual and has a sense of humor. I am truly grateful that a man of his caliber is available to the members of PPL.

Sincerely yours,
PPL Member, South Carolina

Robinson, Kriger & McCallum (Maine)

Firm Established: 1978
Pre-Paid Legal Provider Since 2003

One firm attorney has served as chair of the state Bar Association's Workers Compensation Section. Another has served as chair of the Bar Association's Insurance Law Section. Ten attorneys are authors and speakers. Three have been members of municipal planning or zoning appeals boards. One has been listed several times in The Best Lawyers in America.

For over 20 years the firm has written, edited, and published COMP: *The Maine Workers' Compensation Journal*.

Parker Stanbury, LLP (California)

Firm Established: 1927
Pre-Paid Legal Provider Since 1994

The firm has some 137 staff members, including 67 attorneys, serving Pre-Paid Legal members in California. They received over 335,000 requests for service in 2005 from Pre-Paid Legal members.

The firm supports the YMCA and Literacy Outreach Program. Attorneys have served as a member and officer of a Youth Sports Coalition and as a Chairperson of a City Volunteer Recognition Program, and others volunteer for Legal Aid of Los Angeles County, the Parole Organization, and the Guardian Ad Litem Program through the local Bar Association.

Powers, Chapman, DeAgostino, Meyers & Milia, PC (Michigan)

Firm Established: 1928
Pre-Paid Legal Provider Since 1994

The firm has 33 attorneys. Several have held office on Michigan Bar Association committees as well as county and municipal bar associations. Two have been published in legal journals. Several have been or are currently elected officials, have held seats on boards of directors, and have provided legal service for non-profit charitable organizations.

Lawrence H. Framme III

Larry became a lawyer because he thought it was the most interesting thing he could do with a degree in Government and Economics.

"I thought it would be challenging to help people. I went to school in the 1960s when I thought I could change the world, and to be an attorney was a good way to do that. I was at least partly right."

Larry has always been active in community affairs. He was twice the chairman of a major political party in his state and helped to elect the governor of the state of Virginia. He then served in the governor's cabinet and on the boards of two of the state's largest public higher education systems. For many years he was on the boards of the local and regional YMCAs and other non-profit organizations. He served on his church parish council and coached grade school basketball and baseball teams.

Larry's firm, Framme Law Firm, PC, now serves as the Pre-Paid Legal Provider Law Firm in Virginia, Mississippi, Rhode Island, Vermont, New Hampshire, and Massachusetts.

There are many memorable events that have come from Larry's work as a Pre-Paid Legal Provider Attorney, but one stands out. It was handing a check for more than $1 million to a member whose husband was killed by a negligent driver.

His favorite quote is, "I have sworn upon the altar of God, eternal hostility against every form of tyranny over the mind of man."

- Thomas Jefferson.

Framme Law Firm, PC

Pre-Paid Legal Provider Since 1996

Member Testimonials

It is with great pleasure that I inform you that because of your efforts as an attorney I have received sufficient reimbursement for the replacement tires on my (SUV). It has been approximately nine months since my tire literally separated at the seams and I incurred close to $500 in unanticipated expenses to replace them. After contacting (the car maker) and being told they were not the responsible party, I contacted (the tire manufacturer). I was told on multiple occasions that my specific tires were not included in "the big recall."

It was then that I felt my efforts were useless even as an educated woman; there was no power in my individual voice. I decided to give my Pre-Paid Legal membership a try and actually put it to the test.

Well, today I received that check in the mail totaling $483.96. I can't thank you enough for your dedication and professionalism. From start to finish, I felt like I was high priority client. Even taking the time to return my calls on the weekend. This may seem like a minimal amount of money, but if it had not been for my Pre-Paid Legal membership it would have been chalked off as a loss, and as mother of three, I can't afford to just throw away that kind of money. I am so glad that my family has "the power" of an attorney.

PPL Member, Virginia

There's not enough time or days to explain my gratitude. I guess the best thing that I would be able to do right now is to say "Thank you (to my provider attorney and firm), and Pre-Paid Legal for providing me the knowledge and legal power to make a well informed decision. My family and I thank you." If anyone ever needs to have me speak to the value this service amounts to, I would have no problem standing in front of a stadium full of people and letting them know how much this service would help their family, relatives and friends.

Thank you again. This is definitely one satisfied customer.

PPL Member, Virginia

Ross & Matthews, P.C. (Texas)

Firm Established: 1990
Pre-Paid Legal Provider Since 1990

The firm has 106 attorneys. Five of the firm's attorneys have served in various capacities in leadership roles with various Bar Associations, eight are current or past elected officials, and four have been in judicial positions.

Wagner, Falconer & Judd, LTD (Minnesota, Wisconsin)

Firm Established: 1932
Pre-Paid Legal Provider Since 1997

Wagner, Falconer & Judd is a Midwest based law firm with offices in Minneapolis, MN and Milwaukee and LaCrosse, WI. Ten attorneys in the firm have authored work and serve as speakers at various events. One attorney was named to the Board of Directors for the Racine, Wisconsin Cerebral Palsy Association. Another is a former Chairman of the Commercial Law League Midwest District.

The firm's lawyers and staff are active in the community, serving in various roles from coaching youth athletics to serving on the boards of non profit corporations.

Weinstock, Friedman & Friedman, PA (Maryland)

Firm Established: 1921
Pre-Paid Legal Provider Since 1986

The Weinstock firm is one of the largest law firms in Maryland. Many of the firm's attorneys participate in local and state Bar Association commissions and panels on a regular basis. One serves as president-elect of the Commercial Law League of America, a bar association focused on creditors' rights and bankruptcy. Two are adjunct professors at a law school. One has held a judicial position. Many are either authors or speakers.

Ron Glantz

Ron has practiced law for over 25 years. He is a former chairman of the Florida Bar Pre-Paid Legal Services Committee and a former president of the American Pre Paid Legal Services Institute (API). "I have always been a proponent of the concept of prepaid and group legal services." Ron has always been concerned with making legal representation more affordable.

After undergoing Pre-Paid Legal's rigorous selection process Ron personally met with Harland Stonecipher in Ada, Oklahoma.

"After the interview it became clear to me that Pre-Paid Legal would allow me to fulfill my dream to combine the socially worthwhile endeavor of making excellent legal representation more affordable and my desire to be an entrepreneur. We just celebrated our 10-year anniversary as the Pre-Paid Legal provider firm in South Florida." Ron devotes significant time to a children's charity, Spirituality for Kids (SFK).

His favorite quote is, *"Those who danced were thought to be quite insane by those who could not hear the music."*

– Angela Monet.

Glantz & Glantz, PA

Pre-Paid Legal Provider Since 1996

Member Testimonials

Last year at this time, I was almost in fear of losing in excess of $17,000 on an Internet company that misrepresented itself to me and through hard sell and my desire to believe their tale of riches, I invested - within weeks I was in over my head.

I contacted Pre-Paid Legal and my case was assigned to an ANGEL. She was on my side, from day one. She had the knowledge I needed to respond to this fraud, the compassion to recognize my plight and calm my fears, and the tenacity of a pit bull who never backed up an inch - she attacked from day one and in the end I received everything I had hoped to and all but a few monthly payments were returned to me.

I tell everyone who even mentions their legal problem to me of Pre-Paid Legal and my provider attorney. They are one and the same!

An extremely satisfied customer,
PPL Member, Florida

Recently, I had the misfortune of being sued. It was frightening to me, not knowing exactly what the outcome would be. I am sure that most people feel the same way. I called the 800 number for Pre-Paid Legal Services, and they referred me to your firm. An attorney responded to my call and calmed my fears immediately. He answered my questions and put me at ease. He also returned all of my phone calls very quickly.

The big day came, and we met at the courthouse. He did an outstanding job, to say the least. He knew exactly what he was doing and brought about a very favorable verdict in my behalf. He was so nice and I will never forget his kindness. He is a real asset to your firm, and I would not hesitate to call on him again.

Sincerely,
PPL Member, Florida

Welch, Gold & Siegel , P.C.
(Pennsylvania)

Firm Established: 1980
Pre-Paid Legal Provider Since 1996

The firm estimates 91% of the calls requiring legal attention have to do with everyday life events. In essence, the firm's primary activity is to help Pre-Paid Legal members prevent legal problems from occurring.

All of the firm's attorneys are active in various legal organizations. One served as an elected official. Another held a judicial position. One was recently named a "Pennsylvania Super Lawyer" in the area of personal injury law. Another was named a "Rising Star" in the area of business and corporate law by Philadelphia Magazine.

Dempsey, Roberts & Smith, LTD
(Nevada)

Firm Established: 1992
Pre-Paid Legal Provider Since 1995

One of the firm's attorneys has held a judicial position. Two have been recognized on a regular basis for their participation in the Clark County Pro Bono Project. The firm has also been recognized several times for its work with the Pro Bono Project.

Willinger, Willinger & Bucci, PC
(Connecticut)

Firm Established: 1990
Pre-Paid Legal Provider Since

Two of the firm's attorneys have been state Bar Association leaders. Two are authors. Five have been appointed to act as special masters or attorney trial referees in the state or federal court.

One is the former mayor of Bridgeport, the largest city in Connecticut. Five are former members of various boards. Three have received community recognition. The firm as a whole has been honored for its involvement in many charity events.

Melvin C. Hall

Melvin C. Hall has practiced law for 25 years. Now serving members in Oklahoma and Colorado, his firm was one of the first chosen by Pre-Paid Legal when the Provider Law Firm system was implemented in 1986.

"The joy and satisfaction of making a difference in the lives of the members of Pre-Paid Legal Services is unsurpassed," he said. "The availability of Pre-Paid Legal has improved the justice system tremendously." One of the most memorable moments of Hall's career serving as a Provider Attorney was handing a multi-million dollar check to a member. "I will never forget it," Hall said.

In addition to maintaining a full-time law practice, he is an adjunct professor at the University of Oklahoma teaching a class on Employment Law and the Civil Rights Movements.

When he's not in the office helping Pre-Paid Legal members, Hall enjoys playing tennis and golf.

He was recently appointed to the Board of Directors of World Neighbors, Inc. He was as an Assistant District Attorney from 1981-1983. He was executive director of the Oklahoma Human Rights Commission from 1983-1987, and a board member and legal counsel to the Oklahoma State Chamber of Commerce and Industry from 1989-1993. From 1992-1999, he was a University of Oklahoma regent.

Hall's favorite quote is from Nelson Mandela, "There are few misfortunes that cannot turn into personal triumph if you have the iron will and the necessary skill."

Riggs, Abney, Neal, Turpen, Orbison & Lewis, Inc.

Pre-Paid Legal Provider Since 1987

Member Testimonials

I want to thank you for multiple reasons.

First, for being the type of person that I would want my attorney to be. When I placed the call, I was feeling very incomplete for many reasons. I am a single mom and have been since 1988 so I want to believe that I can do anything a mom or dad can do. This was the first vehicle that my son had purchased in which he was actually going to incur debt or monthly payments. I couldn't believe that I had allowed the car salesman to take advantage of the two of us in such a blatant manner.

I immediately felt better after my first conversation with you not because I thought that I would receive any funds from this situation but the support that you gave me. You immediately let me know this was important and you would research my rights immediately. Thanks for your wonderful caring personality.

Then during our second conversation, you let me know that I really didn't have a legal foot to stand on but wanted to go ahead and write a letter on my behalf. You didn't give me the impression that I was going to win anything but I received a lot of gratification just having the letter sent on my behalf. I thank you for this, too!

Then I received my copy of the letter and I was thrilled. Such a strong letter that basically let them know that yes, they did take advantage of my son and me but we weren't going to just smile and walk away!

The call yesterday was just icing on the cake. The fact that your excellent letter recovered all the funds that they had cheated us out of makes you my star!

You are an excellent representative of what a Pre-Paid Legal Attorney should be and the actions that they should take for our membership base!

I have used my membership multiple times in the past but this was the best!

Thanks for everything.
PPL Member, Oklahoma

Feldman, Kramer & Monaco (New York)

Firm Established: 1979
Pre-Paid Legal Provider Since 1997

The firm has 57 attorneys. Five have been or are state Bar Association leaders. Ten are authors and speakers. Seven are current or past elected officials. Five have held judicial positions. Several have received community recognition for outstanding Pro Bono work.

Mattleman, Weinroth & Miller, P.C. (New Jersey, Delaware)

Firm Established: 1930s
Pre-Paid Legal Provider Since 1997

Two firm attorneys are former municipal court judges. One is a former president of the City of Philadelphia School Board. Another is a former Township Council Member. The firm is very active in community affairs with special involvement in the South Jersey Regional Children's Hospital and various national organizations including the Front Row Foundation.

Mills and Mills LLP (Ontario, Canada)

Firm Established: 1884
Pre-Paid Legal Provider Since 1999

Mills and Mills LLP is the oldest law firm in Ontario, perhaps in Canada, that has had at least one member of the founding family involved with the firm from the beginning. One firms lawyer is an Ontario Bar Association leader. Six are authors and speakers. Four firm lawyers were elected officials. Three held judicial positions, and many have received various achievement awards and recognition from charities and other groups.

Pre-Paid Legal Services®, Inc.

FORM 10K

Life Events Legal Plan

Thirteen Years of Continued Growth: The Numbers

(In Millions)

Membership Fees:
We have grown our membership base and revenues for 13 consecutive years. During 2005 membership fees increased 10% due to the 6% growth of the active membership base combined with the 5% increased in the average annual fee per member. The 5% increase in the average annual fee per member was primarily a result of the increase in our IDT membership base.

(In Thousands)

Cash Flow:
Our business model allows for growth of top-line membership fees while generating significant cash flow. As shown in the accompanying chart, cash flow from operations before changes in assets and liabilities has grown significantly since year 2000. The decline from 2004 to 2005 was due to the 19% increase in new membership fees written which resulted in a 19% increase in commissions.

(In Thousands)

Outstanding Shares:
Our free cash flow continues to be utilized to reduce the number of shares outstanding. Due to the share repurchase program which began in April of 1999, the number of shares outstanding has been reduced by more than 36% to 15.1 million as of March 17, 2005.

Diluted Earnings Per Share:
The growth in diluted earnings per share for each of the previous five years was achieved with increasing top-line membership revenue while reducing the number of shares outstanding. The reduction shown for 2005 was a result of the increase in commissions due to the 19% increase in new membership fees written.

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

FORM 10-K

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

For the fiscal year ended December 31, 2005

☐ 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 (State or other jurisdiction of incorporation or organization)	73-1016728 (I.R.S. Employer Identification No.)
One Pre-Paid Way Ada, Oklahoma (Address of principal executive offices)	74820 (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 if registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

Indicate by check mark 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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Check one:

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated file ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes ☐ 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, 2005 -$456,454,000

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 17, 2006 there were 15,480,767 shares of Common Stock, par value $.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE.
Portions of our definitive proxy statement for its 2006 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, 2005

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

FOR THE YEAR ENDED DECEMBER 31, 2005

PART I

ITEM 1. BUSINESS.

General

We were one of the first companies in the United States organized solely to design, underwrite and market legal expense plans. Our predecessor commenced business in 1972 and began offering legal expense reimbursement services as a "motor service club" under Oklahoma law. In 1976, we were formed and acquired our predecessor in a stock exchange. We began offering Memberships independent of the motor service club product by adding a legal consultation and advice service, and in 1979 we implemented a legal expense benefit that provided for partial payment of legal fees in connection with the defense of certain civil and criminal actions. Our 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 $20. 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, we began offering our Identity Theft Shield ("IDT") to new and existing members at $9.95 per month if added to a legal service Membership ("add-on IDT") or it may be purchased separately for $12.95 per month ("stand-alone IDT"). 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 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, 2005, we had 1,542,789 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 and provinces.

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. The National Resource Center for Consumers of Legal Services ("NRC") previously provided market information for different types of legal service plans and estimates of number of users. However, the NRC is no longer in existence and we are unaware of any current comparable information sources. In the last NRC report in 2002, the NRC estimated there were 164 million Americans without any type of legal service plan. The NRC estimated 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. We believe 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.

"Public Perceptions of Lawyers: Consumer Research Findings, April 2002" prepared on behalf of the American Bar Association concluded that nearly seven in ten households had some occasion during the past year

that might have led them to hire a lawyer. This report further suggested that "*for the consumer, legal services are among the most difficult services to buy. The prospect of doing so is rife with uncertainty and potential risk.*" And further concluded that "*the challenge (and opportunity) for the legal profession is to make lawyers more accessible and less threatening to consumers who might need them.*"

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 and 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. There are also employer paid plans pursuant to which more comprehensive benefits are offered by the employer as a fringe benefit. Finally, there are individual enrollment plans, other employment based plans, including voluntary payroll deduction plans, and miscellaneous plans. These plans typically have more comprehensive benefits, higher utilization, involve higher costs to participants, and are offered on an individual enrollment or voluntary basis. This is the market segment in which we compete.

According to the latest estimates of the census bureaus of the United States and Canada, the two geographic areas in which we operate, the number of households in the combined area exceeds 127 million. Since we have always disclosed our 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, we believe that our market share should be viewed as a percentage of households. Historically, our primary market focus has been the "middle" eighty percent of such households rather than the upper and lower ten percent segments based on our 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, we currently have an approximate 1.5% share of the estimated market based on our existing 1.5 million active Memberships and, over the last 30 years, an additional 5% of households have previously purchased, but no longer own, Memberships. We routinely remarket to previous members and reinstated approximately 79,000, 72,000 and 66,000 Memberships during 2005, 2004 and 2003, respectively.

Description of Memberships

The Memberships we sell generally allow members to access legal services through a network of independent law firms ("provider law firms") under contract with us. 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 us 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 us in managing claims risk. At December 31, 2005, Memberships subject to the capitated provider law firm arrangement comprised approximately 99% of our 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 our referral attorney network described below is utilized.

Family Legal Plan

The Family Legal Plan we currently market in most jurisdictions 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 92% of our Membership fees in 2005 and 2004. In addition to the Family Legal Plan, we market other specialized legal services products specifically related to employment in certain professions described below.

In 12 states, certain of our plans are available in the Spanish language. For the Spanish language plans, the provider law firms have both bilingual staff and lawyers and we have bilingual staff for customer service, attorney resources and marketing service functions. We will continue to evaluate making our 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, we have 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 $25.00 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.

Motor Vehicle 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 571,000 subscribers of this benefit at December 31, 2005 compared to 545,000 at December 31, 2004.

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 for All Other Services. 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 41 states and four Canadian provinces, 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. The Legal Shield benefit was introduced in 1999. There were approximately 1,015,000 Legal Shield subscribers at December 31, 2005 compared to approximately 932,000 at December 31, 2004.

Identity Theft Shield Benefit

During the third quarter of 2003, we announced a joint marketing agreement with Kroll Background America Inc., a subsidiary of Kroll Inc., that allows our independent sales associates to market Kroll's identity theft benefits in 49 states and four Canadian provinces. 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 and comprehensive identity theft restoration services. There were approximately 513,000 and 311,000 subscribers at December 31, 2005 and 2004, respectively, comprised of 461,000 and 284,000 subscribers at $9.95 per month and 52,000 and 27,000 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. We 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 2005 were approximately $5.6 million in U.S. dollars compared to $4.4 million collected in 2004 and $4.2 million collected in 2003.

Specialty Legal Service Plans

In addition to the Family Legal Plan described above, we also offer 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, we 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 three Canadian provinces and represented approximately 3.4%, 4.3% and 3.7% of our Membership fees during 2005, 2004 and 2003, 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. We have 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, 2005, 2004 and 2003, the Law Officers Legal Plan accounted for approximately 1.6%, 1.4% and .9%, respectively, of our 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, 2005, 2004 and 2003, this plan accounted for approximately .9%, 1.2% 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 us 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 37 states and one Canadian province and represented approximately 1.8%, 1.4% and 1.6% of our Membership fees during 2005, 2004 and 2003, respectively.

Comprehensive Group Legal Services Plan

In late 1999 we introduced the Comprehensive Group plan, designed for the large group employee benefit market. This plan, available in 35 states, 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 we have experienced decreased sales of this plan during the last year (4,444 Memberships, 4,482 Memberships and 8,795 Memberships during 2005, 2004 and 2003, respectively), we still believe this plan improves our competitive position in the large group market. We continue 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 and Identity Theft Shield benefits 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 us consistent, accurate data about plan utilization which enables us to manage our benefit costs through the capitated payment structure to provider firms. We frequently evaluate and consider other plan benefits that may include other services complimentary to the basic legal service plan.

Provider Law Firms

Our Memberships generally allow members to access legal services through a network of independent provider law firms under contract with us 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 us 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 us in managing our cost of benefits. Pursuant to these provider law firm arrangements and due to the volume of revenue directed to these firms, we have the ability to more effectively monitor the customer service aspects of the legal services provided, the financial leverage to help ensure a customer friendly emphasis by the provider law firms and we have has access to larger, more diversified law firms. Through our members, we are typically the largest client base of our 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, our investigation 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 our 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.

Approximately 87% of provider law firms, representing 98% of our legal service members, are connected to us via high-speed digital links to our management information systems, thereby providing real-time monitoring capability. This online connection offers the provider law firm access to specially designed software developed by us for administration of legal services by the firm. These systems provide statistical reports of each law firm's activity and performance and allow virtually all of the 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 us typically have a small Membership base and must provide various weekly reports to us 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, we regularly conduct extensive random surveys of members who have used the legal services of a provider law firm. We survey members in each state every 60 days, compile the results of such surveys and provide 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 our online monitoring, member complaints, member survey evaluations, telephone reports and other information developed in connection with member service monitoring. If a problem is detected, we recommend immediate remedial actions 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 us, such deficiencies may result in the termination of the provider law firm. We are in constant communication with our provider law firms and meet with them frequently for additional training, to encourage increased communications with us and to share suggestions relating to the timely and effective delivery of services to our members. We have recently empanelled a provider committee consisting of four specific provider law firm members to meet with us on a quarterly basis in order to improve the flow of communications between our provider law firms and our management.

Each attorney member of the provider law firm rendering services must have at least two years of experience as a lawyer, unless we waive 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. We provide customer service training to the provider law firms and their support staff through on-site training that allows us 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 us 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 us from interference with the lawyer-client relationship, (e) provide for periodic review of services provided, (f) provide for protection of our proprietary information and (g) require the firm to indemnify us against liabilities resulting from legal services rendered by the firm. We are 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, we enroll 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 our 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, 2005, provider law firms averaged approximately 54 employees each and on average are evenly split between support staff and lawyers.

We have 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 us so that in the event of a termination, the members' calls can be rerouted very quickly. Nonetheless, we believe that our relations with provider law firms are generally very good. At the end of 2005, we had provider law firms representing 48 states and four provinces compared to 46 states and four provinces at the end of 2004 and 2003. During the last three calendar years, our relationships with a total of eight provider law firms were terminated by us or the provider law firm. As of December 31, 2005, 28 provider law firms have been under contract with us for more than eight years with the average tenure of all provider law firms being approximately 7.7 years.

We have an extensive database of referral lawyers who have provided services to our 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 our list of referral lawyers.

Identity Theft Shield Benefits Provider

Kroll is one of the world's leading risk consulting companies. For more than 30 years, Kroll has helped companies, government agencies and individuals reduce their exposure to risk and capitalize on business opportunities. Kroll is an operating unit of Marsh & McLennan Companies, Inc., the global professional services firm. With offices in more than 60 cities in the U.S. and abroad, Kroll can operate and restructure businesses; scrutinize accounting practices and financial documents; gather and filter electronic evidence for attorneys; recover lost or damaged data from computers and servers; conduct in-depth investigations; screen domestic and foreign-born job candidates; protect individuals, and enhance security systems and procedures. Kroll's clients include many of the world's largest and most prestigious corporations, law firms, academic institutions, non-profit organizations, sovereign governments and high net-worth individuals, entertainers and celebrities. Kroll's seasoned professionals were handpicked and recruited from leading management consulting companies, top law firms, international auditing companies, multinational corporations, special operations forces, law enforcement and intelligence agencies. Kroll also maintains a network of highly trained specialists in cities throughout the world who can respond to global needs 24 hours a day, seven days a week. Over the last three years, Kroll has developed a unique solution for victims of identity theft and this service is now available to our 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

We market 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. 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, 9 others at December 31, 2005 compared to 13 others at December 31, 2004 and 2003) who are in the line of associates who directly or indirectly recruited the selling associate. We provide training materials, organize area-training meetings and designate personnel at the home office specially trained to answer questions and inquiries from associates. We offer various communication avenues to our sales associates to keep such associates informed of any changes in the marketing of our Memberships. The primary communication vehicles we utilize to keep our sales associates informed include extensive use of conference calls and e-mail, an interactive voice-mail service, *The Connection* monthly magazine, an interactive voice response system, a monthly DVD (digital video disc) program and our 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. Our 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 80% of our Memberships in force at December 31, 2005, compared to 75% at December 31, 2004 and 2003. Although other means of payment are available, approximately 74% of fees on Memberships purchased by individuals or families are paid on a monthly basis by means of automatic bank draft or credit card.

Group marketing

Our marketing efforts towards employee groups, principally on a payroll deduction payment basis, are designed to permit our sales associates to reach more potential members with each sales presentation and strive to capitalize on, among other things, what we perceive to be a growing interest among employers in the value of providing legal and identity theft service plans to their employees. Memberships sold through employee groups constituted approximately 20% of total Memberships in force at December 31, 2005, compared to 25% at December 31, 2004 and 2003. Adverse publicity from certain new publications about us is responsible, to some extent, for the decline in group Memberships on a percentage basis. We believe such adverse publicity makes opening new employee groups more difficult and negatively impacts the retention rates of existing employee group Memberships. The majority of employee group Memberships are sold to school systems, governmental entities and businesses.

We 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. No group accounted for more than 1% of our consolidated revenues from Memberships during 2005, 2004 or 2003. Substantially all group Memberships are paid on a monthly basis. We are active in legislative lobbying efforts to enhance our ability 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.

General

Sales associates are generally engaged as independent contractors and are provided with training materials and are given the opportunity to participate in our training programs. Sales associates are required to complete a specified training program prior to marketing our Memberships to employee groups. All advertising and solicitation materials used by sales associates must be approved by us prior to use. At December 31, 2005, we had 468,365 "vested" sales associates compared to 343,696 and 329,600 "vested" sales associates at December 31, 2004 and 2003, 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 2005, we had 103,248 sales associates who personally sold at least one Membership, of which 61,238 (59%) made first time sales. During 2004 and 2003 we had 79,716 and 84,207 sales associates producing at least one Membership sale, respectively, of which 41,699 (52%) and 45,920 (55%), respectively, made first time sales. During 2005, we had 11,221 sales associates who personally sold more than ten Memberships compared to 9,895 and 10,685 in 2004 and 2003, respectively. A substantial number of our sales associates market our Memberships on a part-time basis only. For the year 2005, new sales associates enrolled increased 125% to 242,223 with an average enrollment fee of $57 from the 107,552 enrolled in 2004 with an average enrollment fee of $142.

We derive revenues from our multi-level marketing sales force, principally from a one-time enrollment fee from each new sales associate for which we provide initial marketing supplies and enrollment services to the associate. Average enrollment fees paid by new sales associates were $57, $142 and $136 for 2005, 2004 and 2003, respectively. We have a combination classroom and field training program, titled Fast Start to Success ("Fast Start"), aimed at increasing the level of new Membership sales per associate. Associates successfully complete the program by writing three new Memberships and recruiting a new sales associate or by personally selling five new Memberships within 45 days of the associate's start date. Associates in states that require the associate to become licensed have 45 days from the issue date on their license to complete the same requirements. Amounts collected from sales associates are intended primarily to offset our 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 include fees related to our *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.

We continually review our compensation plan for the multi-level marketing force to assure that the various financial incentives in the plan encourage our desired goals. We offer various incentive programs from time to time and frequently adjust the program to maintain appropriate incentives and to improve Membership production and retention.

We hold our International Convention once a year, typically in the spring, and a Leadership Summit, typically in the fall, and routinely host more than 10,000 of our sales associates at these events. These events are intended to provide additional training, corporate updates, new announcements, motivation and associate recognition. Additionally, we offer the *Player's Club* incentive program providing additional incentives to our 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

We have 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 us. New products and initiatives will continue to be channeled through the RVPs and Area Coordinators. At December 31, 2005, we had 106 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 our marketing programs who also maintain an active personal legal services Membership. The PPLBA is a separate association not owned or controlled by us and is governed by an 8 member Board of Directors, including four officer positions. None of the officers or directors of the PPLBA serve in any such capacity with us. 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 us may be used to make open-market purchases of our 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, 2005, approximately 39,000 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 us on January 2, 2003 at the stock's closing price to fund the awards. The PPLBA awarded approximately 3,300, 5,000 and 10,000 shares of stock to Association members representing the 2005, 2004 and 2003 stock bonus awards, respectively.

Cooperative Marketing

We have in the past, and may in the future, develop marketing strategies pursuant to which we seek 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 our 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 our product to the marketing partner's existing range of products and services, while we are able to gain broader Membership distribution and access to established customer bases.

We have 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 23,000 new Membership sales during 2005 compared to 19,000 and 15,000, respectively for 2004 and 2003.

We have had limited success with cooperative marketing arrangements in the past and are unable to predict with certainty what success we will achieve, if any, under our existing or future cooperative marketing arrangements.

Operations

Our 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, human resources, internal audit and managing and monitoring the provider law firm relationships.

We utilize 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. Our dominant 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. We believe our management information system has substantial capacity to accommodate increases in business data before substantial upgrades will be required. We believe this excess capacity will enable us to experience a significant increase in the number of members serviced with less than a commensurate increase of administrative costs.

We have built a strong Internet presence to strengthen the services provided to both members and associates. Our 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.

Our operations also include departments specifically responsible for marketing support and regulatory and licensing compliance. We have an internal production staff that is responsible for the development of new audio and video sales materials.

Quality Control

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

Competition

We compete in a variety of market segments in the legal service plan industry, including, among others, individual enrollment plans, employee benefit plans and certain specialty segments. Our principal competitors are Hyatt Legal Plans (a MetLife company), ARAG® North America, National Legal Plan and Legal Services Plan of America (a GE Financial company, formerly the Signature Group). Most of these concentrate their marketing to larger employer groups and offer open panel plans.

If a greater number of companies seek to enter the legal service plan market, we will experience increased competition in the marketing of our Memberships. However, we believe our competitive position is enhanced by our actuarial database, our existing network of provider attorney law firms and our ability to tailor products to suit various types of distribution channels or target markets. We believe that no other competitor has the ability to monitor the customer service aspect of the delivery of legal services to the same extent we do. Finally, we have intentionally concentrated our group marketing to small employer groups. Serious competition is most likely from companies with significant financial resources and advanced marketing techniques.

Regulation

We are 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. We are 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, 2005, we or one of our subsidiaries were marketing new Memberships in 37 states or provinces that require no special licensing. Our 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”), Pre-Paid Legal Services, Inc. of Florida (“PPLSIF”) and Legal Service Plans of Virginia, Inc. (“LSPV”). Of our total Memberships in force as of December 31, 2005, 26%

were written in jurisdictions that subject us or one of our subsidiaries to insurance or specialized legal expense plan regulation. We are actively working with regulators in the various states in which our subsidiaries are regulated as insurance to explore other regulatory alternatives to eliminate some of the agent licensing or financial and marketing regulation that is prevalent in the insurance industry.

We 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 we currently market 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, we commence 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, we or one of our 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 PPLCI'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. Our 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 our operations or financial condition in any material way. We believe that all of our 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.

We are 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 us or any other subsidiary must be at arms-length with consideration for the adequacy of PPLCI's surplus, and may require prior approval of the Oklahoma Insurance Commissioner. Payment of any extraordinary dividend by PPLCI to us requires approval of the Oklahoma Insurance Commissioner. 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 the greater of 10% of such accumulated available surplus or the previous years' net profits. During 2005, PPLCI declared and paid a $4.1 million dividend to us. No dividends were declared or paid by PPLCI during 2004 or 2003. At January 1, 2006 PPLCI had approximately $6.1 million available for payment of an ordinary dividend. Any change in our control, defined as acquisition by any method of more than 10% of our 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 us.

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 us 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 us. At January 1, 2006, neither PPLSIF nor LSPV had funds available for payment of substantial dividends without the prior approval of the insurance commissioner. LSPV declared and paid us a $3.7 million dividend during 2005.

As the legal plan industry continues to mature, additional legislation may be enacted that would affect us and our subsidiaries. We cannot predict with any accuracy if such legislation would be adopted or its ultimate effect on operations, but expect to continue to work closely with regulatory authorities to minimize any undesirable impact and, as noted above, to reduce regulatory cost and burden where possible.

Our 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. Our agreements with provider law firms comply with both the Model Rules and the ABA Code. We rely 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. We and our subsidiaries comply with filing requirements of state bar associations or other applicable regulatory authorities.

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

Employees

At December 31, 2005, we employed 815 individuals on a full-time basis, exclusive of independent agents and sales associates who are not employees, and excluding RVPs described above. None of our employees are represented by a union. We consider our employee relations to be good.

Foreign Operations

We 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 $6.0 million in U.S. dollars during 2005 compared to $4.7 million and $4.5 million in 2004 and 2003, respectively. In addition, we incur expenses in Canada in relation to these revenues. Due to the relative stability of the United States and Canadian foreign relations and currency exchange rates, we believe that any risk of foreign operations or currency valuations is minimal and would not have a material effect on our financial condition, liquidity or results of operations.

Availability of Information

We file periodic reports and proxy statements with the Securities and Exchange Commission ("SEC"). The public may read and copy any materials we file 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. We file our 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.

Our Internet address is www.prepaidlegal.com. We make available on our website free of charge copies of our 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 we electronically file such material with, or furnish it to, the SEC.

ITEM 1A. RISK FACTORS

Our financial position, results of operations and cash flows are subject to various risks, many of which are not exclusively within our control that may cause actual performance to differ materially from historical or projected future performance. Information contained within this Form 10-K should be carefully considered by investors in light of the risk factors described below. In addition to factors discussed elsewhere in this report, the following are some of the important factors that could affect our financial condition or results of operations:

Our future results may be adversely affected if Membership persistency or renewal rates are lower than our historical experience.

We have over 20 years of actual historical experience to measure the expected retention of new members. These retention rates could be adversely affected by the quality of services delivered by provider law firms, the existence of competitive products or services, our ability to provide administrative services to members or other factors. If our Membership persistency or renewal rates are less than we have historically experienced, our cash flow, earnings and growth rates could be adversely affected.

We may not be able to grow Memberships and revenues at the same rate as we have historically experienced and have recently experienced declines in new Membership sales and associate recruitment.

Our year end active Memberships have increased 6%, 2% and 3% in the years ended December 31, 2005, 2004 and 2003, respectively. Changes in net income for the same three years were (12%), 2% and 11%, respectively. Our ability to grow Memberships and revenues is substantially dependent upon our ability to expand or enhance the productivity of our sales force, develop additional legal expense products, develop alternative marketing methods or expand geographically. There is no assurance that we will be able to achieve increases in Membership and revenue growth comparable to our historical growth rates.

We are dependent upon the continued active participation of our principal executive officer.

Our success depends substantially on the continued active participation of our principal executive officer, Harland C. Stonecipher. Although our management includes other individuals with significant experience in our business, the loss of the services of Mr. Stonecipher could have a material adverse effect on our financial condition and results of operations.

There is litigation pending that may have a material adverse effect on us if adversely determined.

See “Item 3. Legal Proceedings.”

We are in a regulated industry and regulations could have an adverse effect on our ability to conduct our business.

We are regulated by or required to file with or obtain approval of State Insurance Departments, State Bar Associations and State Attorney General's Offices, depending on individual state positions regarding regulatory responsibility for legal service plans. Regulation of our activities is inconsistent among the various states in which we do business with some states regulating legal service plans as insurance or specialized legal service products and others regulating such plans as services. Such disparate regulation requires us to structure our Memberships and operations differently in certain states in accordance with the applicable laws and regulations. Our multi-level marketing strategy is also subject to U.S. federal, Canadian provincial and U.S. state regulation under laws relating to consumer protection, pyramid sales, business opportunity, lotteries and multi-level marketing. Changes in the regulatory environment for our business could increase the compliance costs we incur in order to conduct our business or limit the jurisdictions in which we are able to conduct business.

The business in which we operate is competitive.

There are a number of existing and potential competitors that have the ability to offer competing products that could adversely affect our ability to grow. In addition, we may face competition from a growing number of Internet based legal sites with the potential to offer legal and related services at competitive prices. Increased competition could have a material adverse effect on our financial condition and results of operations. See “Description of Business – Competition.”

We are dependent upon the success of our marketing force.

Our principal method of product distribution is through multi-level marketing. The success of a multi-level marketing force is highly dependent upon our ability to offer a commission and organizational structure and sales training and incentive program that enable sales associates to recruit and develop other sales associates to create an organization. There are a number of other products and services that use multi-level marketing as a distribution method and we must compete with these organizations to recruit, maintain and grow our multi-level marketing force. In order to do so, we may be required to increase our marketing costs through increases in commissions, sales incentives or other features, all of which could adversely affect our future earnings. In addition, the level of confidence of the sales associates in our ability to perform is an important factor in maintaining and growing a multi-level marketing force. Adverse financial developments concerning us, including negative publicity or common stock price declines, could adversely affect our ability to maintain the confidence of our sales force.

Our stock price may be affected by the significant level of short sellers of our stock.

As of January 13, 2006, the New York Stock Exchange reported that approximately 4.7 million shares of our stock were sold short, which constitutes approximately 30% of our outstanding shares and 45% of our public float, representing one of the largest short interest percentages of any New York Stock Exchange listed company. Short sellers expect to make a profit if our shares decline in value. We have been the subject of a negative publicity campaign from several known sources of information who support short sellers. The existence of this short interest position may contribute to volatility in our stock price and may adversely affect the ability of our stock price to rise if market conditions or our performance would otherwise justify a price increase.

We have not been able to increase our employee group Membership sales.

Our success in growing Membership sales is dependent in part on our ability to market to employee groups. At December 31, 2005, group memberships represented 20% of total Memberships compared to 25% at December 31, 2004 and 2003. Adverse publicity about us may affect our ability to market successfully to employee groups, particularly larger groups. There is no assurance that we will be able to increase our group business.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

Our executive and administrative offices and our subsidiaries are located at One Pre-Paid Way, Ada, Oklahoma. The office complex, owned by us, contains approximately 170,000 square feet of office space and was constructed on approximately 87 acres contributed to us by the City of Ada in 2001 as part of an economic development incentive package. Construction was completed in 2004 at a cost of approximately $34.1 million, including $706,000 in capitalized interest costs, and was funded from existing resources and proceeds from a $20 million line of credit.

Continued growth over the past 12 years required us to lease and purchase several ancillary sites to accommodate our expanding workforce before constructing our new 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 our logo, the Lady of Justice, a universal symbol of justice. The building's main entrance welcomes its frequent visitors, celebrates our history, 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 we emphasized the use of modular furnishings to provide enhanced flexibility. We placed importance on the goal of providing each employee with an excellent work environment.

Additionally, we fully utilize another distribution facility located about two miles from our new offices and containing approximately 17,000 square feet of office and warehouse and shipping space. Our 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 we own, we 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 us. In conjunction with a rural economic development program coordinated by the City of Antlers, a new facility was built at no cost to us that can accommodate approximately 100 customer service representatives. We leased the facilities from the City of Antlers upon completion of the construction in November 2002. During 2005, in conjunction with economic development incentives, we leased additional office space in Duncan, Oklahoma which currently is occupied by approximately 90 of our customer service representatives and during January 2006, we acquired an additional 40,000 square foot building in Duncan that can hold 350 customer service representatives when remodeling is completed later in 2006. We are considering similar arrangements with other cities within Oklahoma to help diversify our access to competent labor pools.

ITEM 3. LEGAL PROCEEDINGS.

We and various 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 we issued false and misleading financial information, primarily related to the method we used to account for commission advance receivables from sales associates. On March 5, 2002, the Court granted our 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 and as of February 17, 2006, a decision was pending. We are 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 us, 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 2004, there were at one time as many as 30 separate lawsuits involving approximately 285 plaintiffs in Alabama. As of February 17, 2006, as a result of dismissals, summary judgments, or settlements for nominal amounts, there were no lawsuits remaining in Alabama. As of February 17, 2006, we were aware of 7 separate lawsuits involving approximately 406 plaintiffs in multiple counties in Mississippi. Certain of the Mississippi lawsuits also name our former provider attorney in Mississippi as a defendant. In Mississippi, we filed lawsuits in the United States District Court for the Southern and Northern Districts of Mississippi in which we seek to compel arbitration of the various Mississippi claims under the Federal Arbitration Act and the terms of our Membership agreements. 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 in Mississippi in May, 2006, and seek varying amounts of actual and punitive damages. We have tried three separate lawsuits in Mississippi. The first trial in Mississippi on these cases resulted in a unanimous jury verdict in our favor, including other named defendants, on all claims on October 19, 2004, while the second and third trials in Mississippi resulted in insubstantial plaintiffs' verdicts on February 15, 2005 and May 9, 2005, respectively. On August 16, 2005 the Circuit Judge in the February 15, 2005 trial overturned the jury's finding of fraud and fraudulent misrepresentation on the grounds that the evidence was insufficient to support those claims and reduced the damages awarded by the jury to a total of $525 for four plaintiffs. On July 18, 2005 the Circuit Judge in the May 9, 2005 trial entered an order granting plaintiff's motion to reconsider the submission of the issue of punitive damages to the jury, and trial on that issue was held in November 2005. The trial on that issue resulted in punitive damage verdicts against us and against our chief executive officer in the collective total amount of $9.9 million. Pre-Paid will seek post judgment

and appellate relief in that case. Although 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. 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 us and certain 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 our 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. On December 3, 2004, the District Court ordered the plaintiffs to proceed with the arbitration. On October 16, 2005 plaintiff Jana Weller died, and on December 20, 2005 we filed a Suggestion of Death Upon the Record with respect thereto. The ultimate outcome of this case is not determinable.

On October 3, 2005 we received a Civil Investigative Demand from the Commissioner of Consumer Protection of the State of Connecticut requesting information relating to our memberships and commissions to associates in Connecticut. As of February 17, 2006, we were in the process of responding to the request. The ultimate outcome of this matter is not determinable.

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

While the ultimate outcome of these proceedings is not determinable, we do not currently anticipate that these contingencies will result in any material adverse effect to our financial condition or results of operation, unless an unexpected result occurs in one of the cases. The costs of the defense of these various matters are reflected as a part of general and administrative expense, or Membership benefits if fees relate to Membership issues, in the consolidated statements of income. We have established an accrued liability we believe will be sufficient to cover estimated damages in connection with various cases (exclusive of ongoing defense costs which are expensed as incurred), which at December 31, 2005 was $2.5 million. We believe that we have meritorious defenses in all pending cases and will vigorously defend against the plaintiffs' claims. However, it is possible that an adverse outcome in certain cases or increased litigation costs could have an adverse effect upon our financial condition, operating results or cash flows in particular quarterly or annual periods.

Canadian taxing authorities are challenging portions of our commission and general and administrative deductions for tax years 1999 - 2002 and have tax assessments which aggregate $5.7 million. The Canadian taxing authorities contend commission deductions should be matched with the membership revenue as received, we contend these commissions are deductible when paid. Under Canadian tax laws, our commission payments are treated as a prepaid expense. We base our deduction of commission on the fact that all the services (the sale of the membership) have been performed by the sales associate at the time of sale therefore this prepaid expense (the commission payments) is deductible when paid. Also, the commission payment is taxable to the sales associate when paid and each year we issue a T4 (Canadian 1099 equivalent) to sales associates for the total commission payments made during that year. In addition, Canadian taxing authorities have challenged our allocation of general and administrative expenses to Canadian operations. We contend the allocation of general and administrative expenses, based on the percentage of Canadian new memberships written and the Canadian percentage memberships in force, is reasonable. At December 31, 2005 we have accrued $472,000 for this assessment.

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

None.

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

At February 17, 2006, there were 5,486 holders of record (including brokerage firms and other nominees) of our 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	Low
2006:		
1st Quarter (through February 17)	$39.90	$35.35
2005:		
4th Quarter	$48.40	$37.20
3rd Quarter	52.77	36.35
2nd Quarter	47.00	33.51
1st Quarter	38.37	30.69
2004:		
4th Quarter	$40.39	$25.45
3rd Quarter	26.10	22.25
2nd Quarter	25.50	22.27
1st Quarter	26.33	21.57

On December 6, 2004, we declared our first cash dividend of $0.50 per share on our outstanding shares of common stock. The following table sets forth, for 2005 and 2004, the declaration date, the per share dividend amount, the aggregate dividend amount, the record date and the payable date of cash dividends that we have declared on our outstanding shares of common stock:

Declared	Per Share	Aggregate Amount	Record Date	Payment Date
December 6, 2004	$ 0.50	$ 7.8 million	December 20, 2004	January 14, 2005
April 4, 2005	0.30	4.6 million	April 25, 2005	May 16, 2005
December 19, 2005	0.30	4.6 million	December 30, 2005	January 13, 2006

It is anticipated that earnings generated from our operations will be used to finance our growth, to continue to purchase shares of our stock, to retire existing debt and possibly pay cash dividends. We have loans as described in "Management's Discussion and Analysis – Liquidity and Capital Resources," which currently prohibit payment of cash dividends in excess of 65% of net income. Any decision by our Board of Directors to pay additional cash dividends in the future will depend upon, among other factors, our earnings, financial condition, capital requirements and approval from our lender for any dividends in excess of 65% of net income. In addition, our ability to pay dividends is dependent in part on our ability to derive dividends from our 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 the greater of 10% of such accumulated available surplus or the previous years' net profits. PPLSIF and LSPV are similarly restricted pursuant to their respective insurance laws. The following table reflects subsidiary dividends during the last three years:

	Dividends Paid			Dividends Available
Regulated Subsidiary	**2005**	**2004**	**2003**	**1/1/2006**
Pre-Paid Legal Casualty, Inc.	$ 4.1 million	–	–	$ 6.1 million
Legal Service Plans of Virginia	3.7 million	–	–	–

At December 31, 2005 the amount of restricted net assets of consolidated subsidiaries was $25.3 million, representing amounts that may not be paid to us as dividends either under the applicable regulations or without regulatory approval. At January 1, 2006 PPLCI had approximately $6.1 million available for payment to us of an ordinary dividend.

Recent Sales of Unregistered Securities

None.

Equity Compensation Plans

The following table provides information with respect to our equity compensation plans as of December 31, 2005, (other than our 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)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders (1)	474,500	$ 20.82	1,346,252
Equity compensation plans not approved by security holders (2)	32,667	22.70	–
Total	507,167	$ 20.94	1,346,252

(1) These stock options have been issued pursuant to our Stock Option Plan which has been approved by security holders. We do not expect to grant any additional options under this plan.

(2) These stock options have been issued to our Regional Vice Presidents ("RVPs") (described above) in order to encourage stock ownership by our RVPs and to increase the proprietary interest of such persons in our 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 36,751 and 106,002 total options granted to RVPs in the years ended December 31, 2004 and 2003, respectively. We discontinued the RVP stock option grants immediately after the 2003 fourth quarter stock options were awarded in the first quarter of 2004.

Issuer Purchases of Equity Securities

The following table provides information about our purchases of stock in the open market during the fourth quarter of 2005.

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 of Shares that May Yet Be Purchased Under the Plans or Programs (1)
October 2005	–	–	–	586,082
November 2005	–	–	–	586,082
December 2005	–	–	–	586,082
Total	–	–	–	

(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 10,000,000 shares. The most recent authorization was for 1,000,000 additional shares August 9, 2004 and there has been no time limit set for completion of the repurchase program. In addition, we purchased 980,518 shares for $26.00 per share in a tender offer completed on September 28, 2004.

ITEM 6. SELECTED FINANCIAL DATA.

The following table sets forth selected financial and statistical data for us as of the dates and for the periods indicated. This information is not necessarily indicative of our future performance. The following information should be read in conjunction with our 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 31,				
	2005	**2004**	**2003**	**2002**	**2001**
Income Statement Data:	(In thousands, except ratio, per share and Membership amounts)				
Revenues:					
Membership fees	$ 389,255	$ 355,461	$ 330,322	$ 308,401	$ 263,514
Associate services	28,963	24,901	25,704	37,418	36,485
Other	5,162	5,575	5,287	4,804	3,662
Total revenues	423,380	385,937	361,313	350,623	303,661
Costs and expenses:					
Membership benefits	137,150	122,280	111,165	103,761	87,429
Commissions	141,631	118,757	115,386	119,371	111,060
Associate services and direct marketing	30,453	29,325	28,929	32,566	29,879
General and administrative expenses	49,015	43,742	36,711	33,256	28,243
Other, net	10,456	9,578	8,546	6,685	5,917
Total costs and expenses	368,705	323,682	300,737	295,639	262,528
Income from continuing operations before income taxes and cumulative effect of change in accounting principle	54,675	62,255	60,576	54,984	41,133
Provision for income taxes	18,863	21,478	20,669	18,970	13,519
Income from continuing operations	35,812	40,777	39,907	36,014	27,614
Income (loss) from operations of discontinued UFL segment (net of applicable income tax benefit of $0 for 2001)	–	–	–	–	(504)
Net income applicable to common stockholders	$ 35,812	$ 40,777	$ 39,907	$ 36,014	$ 27,110
Basic earnings per common share from continuing operations	$ 2.31	$ 2.50	$ 2.28	$ 1.83	$ 1.28
Basic earnings per common share from discontinued operations	–	–	–	–	(.02)
Basic earnings per common share	$ 2.31	$ 2.50	$ 2.28	$ 1.83	$ 1.26
Diluted earnings per common share from continuing operations	$ 2.29	$ 2.48	$ 2.27	$ 1.82	$ 1.28
Diluted earnings per common share from discontinued operations	–	–	–	–	(.02)
Diluted earnings per common share	$ 2.29	$ 2.48	$ 2.27	$ 1.82	$ 1.26
Dividends declared per common share	$ .60	$ .50	$ –	$ –	$ –
Weighted average number of common shares outstanding – basic	15,470	16,313	17,530	19,674	21,504
Weighted average number of common shares outstanding – diluted	15,652	16,458	17,599	19,764	21,544

Selected Financial Data, continued

	Year Ended December 31,				
	2005	2004	2003	2002	2001
Membership Benefits Cost and Statistical Data:	(In thousands, except ratio, per share and Membership amounts)				
Membership benefits ratio (1)	35.2%	34.4%	33.7%	33.6%	33.2%
Commissions ratio (1)	36.4%	33.4%	34.9%	38.7%	42.1%
General and administrative expense ratio (1)	12.6%	12.3%	11.1%	10.8%	10.7%
Commission cost per new Membership sold	$ 202	$ 190	$ 172	$ 154	$ 152
New Memberships and stand-alone IDT plans sold	700,727	624,525	671,857	773,767	728,295
Period end Memberships and stand-alone IDT plans in force	1,542,789	1,451,700	1,418,997	1,382,306	1,242,908
New add-on IDT memberships sold	441,108	335,792	89,928	–	–
Period end add-on IDT memberships in force	461,094	283,889	86,602	–	–
Average annual Membership fee	$ 287	$ 274	$ 262	$ 256	$ 251
Cash Flow Data:					
Net cash provided before changes in assets and liabilities	$ 45,443	$ 51,689	$ 47,731	$ 42,699	$ 30,679
Net cash provided by operating activities	50,131	47,263	51,693	52,073	37,801
Net cash used in investing activities	(15,545)	(11,322)	(36,901)	(11,074)	(6,963)
Net cash used in financing activities	(26,601)	(31,428)	(14,191)	(34,431)	(27,414)
Balance Sheet Data:					
Total assets	$ 164,865	$ 146,064	$ 131,012	$ 96,836	$ 85,720
Total liabilities	113,471	114,617	101,438	61,864	43,496
Stockholders' equity	51,394	31,447	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. These ratios do not measure total profitability because they do not take into account all revenues and expenses.

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

Overview of the Our Financial Model

We are in one line of business - the marketing of legal expense and other complimentary plans primarily through a multi-level marketing force to individuals. Our principal revenues are derived from Membership fees, and to a much lesser extent, revenues from marketing associates. Our 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):

Revenues:	2005	% of Total Revenue	% Change from Prior Year	2004	% of Total Revenue	% Change from Prior Year	2003	% of Total Revenue	% Change from Prior Year
Membership fees	$ 389,255	91.9	9.5	$ 355,461	92.1	7.6	$ 330,322	91.4	7.1
Associate services	28,963	6.8	16.3	24,901	6.5	(3.1)	25,704	7.1	(31.3)
Other	5,162	1.2	(7.4)	5,575	1.4	5.4	5,287	1.5	10.1
	423,380	100.0	9.7	385,937	100.0	6.8	361,313	100.0	3.0
Costs and expenses:									
Commissions	141,631	33.5	19.3	118,757	30.8	2.9	115,386	31.9	(3.3)
Membership benefits	137,150	32.4	12.2	122,280	31.7	10.0	111,165	30.8	7.1
Associate services and direct marketing	30,453	7.2	3.9	29,325	7.6	1.4	28,929	8.0	(11.2)
General and administrative	49,015	11.6	12.1	43,742	11.3	19.2	36,711	10.2	10.4
Other, net	10,456	2.5	9.2	9,578	2.5	12.1	8,546	2.4	27.8
	368,705	87.1	13.9	323,682	83.9	7.6	300,737	83.2	1.7
Provision for income taxes	18,863	4.5	(12.2)	21,478	5.6	3.9	20,669	5.7	9.0
Net income	$ 35,812	8.5	(12.2)	$ 40,777	10.6	2.2	$ 39,907	11.0	10.8

The following table reflects certain data concerning our Membership sales and associate recruiting:

New Memberships:	12/31/2005	% Change from Prior Year	12/31/2004	% Change from Prior Year	12/31/2003
New legal service Membership sales	666,595	11.1	599,929	(10.1)	667,480
New "stand-alone" IDT Membership sales	34,132	38.7	24,596	461.9	4,377
Total new Membership sales	700,727	12.2	624,525	(7.0)	671,857
New "add-on" IDT Membership sales	441,108	31.4	335,792	273.4	89,928
Average Annual Membership fee	$322.04	6.2	$303.36	10.2	$275.22
Active Memberships:					
Active legal service memberships at end of period	1,490,847	4.6	1,424,707	.7	1,414,746
Active "stand-alone" IDT memberships at end of period	51,942	92.4	26,993	535.0	4,251
Total active memberships at end of period	1,542,789	6.3	1,451,700	2.3	1,418,997
Active "add-on" IDT memberships at end of period	461,094	62.4	283,889	227.8	86,602
New Sales Associates:					
New sales associates recruited	242,223	125.2	107,552	(.9)	108,557
Average enrollment fee paid by new sales associates	$56.61	(60.3)	$142.49	(4.4)	$136.45
Average Membership fee in force:					
Average Annual Membership fee	$286.60	4.6	$274.02	4.4	$262.36

During the third quarter of 2003, we began offering our Identity Theft Shield ("IDT") to new and existing members at $9.95 per month if added to a legal service Membership or $12.95 per month if purchased separately.

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 our 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 our *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 us and our 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%-35% but could increase should the number of IDT memberships increase at a faster pace than the legal Memberships.. 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. We expense 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 we experience increases in new Membership sales. During the last five years this percentage has ranged from approximately 33% to 42% 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 our *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. Prior to 2003 these costs were more than offset by associate services revenue, however this did not occur in 2005, 2004 or 2003 primarily due to the lower entry fees charged during most of the periods. General and administrative expenses are expected to trend up in terms of dollars, but remain relatively constant as a percent of Membership fees. During the past five years, general and administrative expenses have ranged from 11% to 13% of Membership fees.

The primary benchmarks monitored by us 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.

Although we have grown our active Membership base and related Membership fees in each of the past 13 years, the rate of growth has not been one we find acceptable. We believe however, that our current product design, pricing parameters and business model are generally appropriate and we have no immediate plans to change these fundamental sectors. Our focus during 2006 will continue to be on improved training of our associates, enhancing the quality 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 our Memberships.

Critical Accounting Policies

Our 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 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.

Revenue recognition - Membership and Associate Fees

Our 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, 2005 the deferred revenue associated with the Membership fees was $20.8 million which is classified as a current liability.

We also charge 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") as revised by SEC Staff Accounting Bulletin No. 104. At December 31, 2005 the deferred revenue associated with the Membership enrollment fees was $6.9 million, of which $3.9 million was classified as a current liability. We compute the expected Membership life using more than 20 years of actuarial data as explained in more detail in "Measures of Membership Retention" below. At December 31, 2005, management computed the expected Membership life to be approximately 3 years, which is unchanged from year end 2004. 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.

We derive revenues from services provided to our marketing sales force primarily from a one-time non-refundable enrollment fee from each new sales associate for which we provide initial sales and marketing supplies and enrollment services to the associate. Average enrollment fees paid by new sales associates were $57, $142 and $136 for 2005, 2004 and 2003, respectively. Revenue from, and costs of, the initial sales and marketing supplies (approximately $14) are recognized when the materials are delivered to the associates. The remaining 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, 2005 is estimated to be approximately six months, unchanged from year end 2004. At December 31, 2005, the deferred revenue associated with sales associate enrollment fees was $1.6 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 we incur in enrolling new Members and new associates related to the deferred revenue discussed above, and that portion of payments made to provider law firms ($6.5 million deferred at December 31, 2005 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 $6.6 million at December 31, 2005, of which $3.6 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 $800,000 at December 31, 2005, and are 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, we 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, our commission program provided for advance commission payments to associates of approximately 70% of first year Membership fees 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, we returned to a differential commission structure with rates of approximately 80% of first year Membership fees 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, we 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 we advanced commissions at the time of sale of all new Memberships. In January 1997, we 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, we currently advance 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 10, 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 us.

Although prior to March 1, 2002, we advanced our sales associates up to three years commission when a Membership was sold and subsequent to March 1, 2002, up to one year commission, the average commission advance paid to our 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 we pay less than a full advance on some of our specialty products. In addition, we 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, we do 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 commissions. The average commission advance paid as a percentage of the maximum advance possible pursuant to our commission structures was approximately 75%, 78% and 80% during 2005, 2004 and 2003, respectively. The commission cost per new Membership sold has increased over the prior year by 6%, 10% and 12% for 2005, 2004 and 2003, respectively, and varies depending on the compensation structure that is in place at the time a new Membership is sold, the monthly Membership fee of the Membership sold and the amount of any charge-backs (recoupment of previous commission advances) that are deducted from amounts that would otherwise be paid to the various sales associates that are compensated for the Membership sale. Should we add additional products, such as the Identity Theft Shield described above or add additional commissions to our compensation plan or reduce the amount of chargebacks collected from our associates, the commission cost per new Membership will increase accordingly.

We expense advance commissions ratably over the first month of the related Membership. At December 31, 2005, advance commissions deferred were $5.3 million and included as a current asset. 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 for the following years ended December 31 were:

	2005	**2004**	**2003**
	(Amounts in 000's)		
Beginning unearned advance commission balances (1)	$ 183,060	$ 191,894	$ 227,084
Advance commissions, net of chargebacks and other	142,535	115,942	113,030
Earned commissions applied	(127,084)	(122,393)	(145,371)
Advance commission write-offs	(2,719)	(2,383)	(2,849)
Ending unearned advance commission balances before estimated unrecoverable balances (1)	195,792	183,060	191,894
Estimated unrecoverable advance commission balances (1)(2)	(33,879)	(28,554)	(24,862)
Ending unearned advance commission balances, net (1)	$ 161,913	$ 154,506	$ 167,032

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

(2) Estimated unrecoverable advances increased as a percentage of ending advances from 13% at December 31, 2003 to 17% at December 31, 2005 primarily due to the change in the compensation structure described above from a 36-month possible advance to a 12-month possible advance and fewer new Memberships written during 2003 and 2004. The commission structure change allows the advances to be earned more quickly by the associate and the reduction in new Memberships written creates fewer new advances.

The ending unearned advance commission balances, net, above includes net unearned advance commission balances of non-vested associates of $40 million, $27 million and $30 million at December 31, 2005, 2004 and 2003, respectively. As such, at December 31, 2005 future commissions and related expense will be reduced as unearned advance commission balances of $122 million are recovered. Commissions are earned by the associate as Membership fees are earned by us, usually on a monthly basis. We reduce unearned advance commission balances or remit payments to associates, as appropriate, when commissions are earned. Should a Membership lapse before the advances have been recovered for each commission level, we, except as described below, generate an immediate "charge-back" to the applicable sales associate to recapture up to 50% of any unearned advance on Memberships written prior to March 1, 2002, and 100% on any Memberships written thereafter. Beginning in August 2003, we allowed the associate to choose between the level commission structure and up to three year commission advance and up to 50% chargebacks or the differential commission structure with a one year commission advance and up to 100% chargebacks. This charge-back is deducted from any future advances that would otherwise be payable to the associate for additional new Memberships. In order to encourage additional Membership sales, we waived chargebacks for associates that met certain criteria in December 2002 and March 2003, which effectively increases our commission expense. Any remaining unearned advance commission balance may be recovered by withholding

future residual earned commissions due to an active associate on active Memberships. Additionally, even though a commission advance may have been fully recovered on a particular Membership, no additional commission earnings from any Membership are paid to an associate until all previous advances on all Memberships, both active and lapsed, have been recovered. We also have reduced chargebacks from 100% to 50% for certain senior marketing associates who have demonstrated the ability to maintain certain levels of sales over specified periods and maintain certain Membership retention levels. We may adjust chargebacks from time to time in the future in order to encourage certain production incentives.

We have the contractual right to require associates to repay unearned advance commission balances from sources other than earned commissions including cash (a) from all associates either (i) upon termination of the associate relationship, which includes but is not limited to when an associate becomes non-vested or (ii) when it is ascertained that earned commissions are insufficient to repay the unearned advance commission payments and (b) upon demand, from agencies or associates who are parties to the associate agreements signed between October 1989 and July 1992 or July 1992 to August 1998, respectively. The sources, other than earned commissions, that may be available to recover associate unearned advance commission balances are potentially subject to limitation based on applicable state laws relating to creditors' rights generally. Historically, we have not demanded repayments of the unearned advance commission balances from associates, including terminated associates, because collection efforts would likely increase costs and have the potential to disrupt our relationships with our sales associates. This business decision by us has a significant effect on our cash flow by electing to defer collection of advance payments of which approximately $33.9 million were not expected to be collected from future commissions at December 31, 2005. However, we regularly review the unearned advance commission balance status of associates and will exercise our right to require associates to repay advances when management believes that such action is appropriate.

Non-vested associates are those that are no longer "vested" because they fail to meet our established vesting requirements by selling at least three new Memberships per quarter or retaining a personal Membership. Non-vested associates lose their right to any further commissions earned on Memberships previously sold at the time they become non-vested. As a result we have no continuing obligation to individually account to these associates as we do to active associates and are entitled to retain all commission earnings that would be otherwise payable to these terminated associates. We do continue to reduce the unearned advance commission balances for commissions earned on active Memberships previously sold by those associates. Substantially all individual non-vested associate unearned advance commission balances were less than $1,000 and the average balance was $407 at December 31, 2005.

Although the advance commissions are expensed ratably over the first month of the related Membership, we assess, at the end of each quarter, on an associate-by-associate basis, the recoverability of each associate's unearned advanced commission balance by estimating the associate's future commissions to be earned on active Memberships. Each active Membership is assumed to lapse in accordance with our estimated future lapse rate, which is based on our actual historical Membership retention experience as applied to each active Membership's year of origin. The lapse rate is based on our more than 20-year history of Membership retention rates, which is updated quarterly to reflect actual experience. We also closely review current data for any trends that would affect the historical lapse rate. The sum of all expected future commissions to be earned for each associate is then compared to that associate's unearned advance commission balance. We estimate unrecoverable advance commission balances when expected future commissions to be earned on active Memberships (aggregated on an associate-by-associate basis) are less than the unearned advance commission balance. If an associate with an outstanding unearned advance commission balance has no active Memberships, the unearned advance commission balance is written off but has no financial statement impact as advance commissions are expensed ratably over the first month of the related Memberships. Refer to "Measures of Member Retention – *Expected Membership Life, Expected Remaining Membership Life*" for a description of the method used by us to estimate future commission earnings.

Further, our analysis of the recoverability of unearned advance commission balances is also based on the assumption that the associate does not write any new Memberships. We believe that this assessment methodology is highly conservative since our actual experience is that many associates do continue to sell new Memberships and we, through our chargeback rights, gain an additional source to recover unearned advance commission balances.

Changes in our estimates with respect to recoverability of unearned commissions could occur if the underlying Membership persistency changes from historical levels. Should Membership persistency decrease, the unearned commissions would be recovered over a longer period and the amount not recovered would most likely increase, although any increase in uncollectible unearned commissions would not have any immediate expense impact since the commission advances are expensed in the month they incurred. Holding all other factors constant, the decline in persistency would also lead to lower Membership fees, less net income and less cash flow from operations. Conversely, should persistency increase, the unearned commissions would be recovered more quickly, the amount unrecovered would decrease and, holding all other factors constant, we would enjoy higher Membership fees, more net income and more cash flow from operations.

Incentive awards payable

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. The incentive awards payable at any date is estimated based on an evaluation of the existing associates that have met the monthly qualifications, any changes to the monthly qualification requirements, the estimated cost for each incentive earned and the number of associates that have historically met the personal retention rates. At December 31, 2005, the accrued amount payable was $3.1 million. Changes to any of these assumptions would directly affect the amount accrued but we do not expect any of the significant trends impacting this account to change significantly in the near term.

Legal Contingencies

We are subject to various legal proceedings and claims, the outcomes of which are subject to significant uncertainty. Given the inherent unpredictability of litigation, it is difficult to estimate the impact of litigation on our financial condition or results of operation. SFAS 5, *Accounting for Contingencies*, requires that an estimated loss from a loss contingency should be accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. We evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. We have established an accrued liability we believe will be sufficient to cover estimated damages in connection with various cases, which at December 31, 2005 was $2.5 million. This process requires subjective judgment about the likely outcomes of litigation. Liabilities related to most of our lawsuits are especially difficult to estimate due to the nature of the claims, limitation of available data and uncertainty concerning the numerous variables used to determine likely outcomes or the amounts recorded. Litigation expenses are recorded as incurred and we do not accrue for future legal fees. 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. See “Legal Proceedings.”

Other General Matters

Operating Ratios

Three principal operating measures monitored by us in addition to measures of Membership retention are the Membership benefits ratio, commission ratio and the general and administrative expense ratio. The Membership benefits ratio, the commissions ratio and the general and administrative expense ratio represent those costs as a percentage of Membership fees. We strive to maintain these ratios as low as possible while at the same time providing adequate incentive compensation to our sales associates and provider law firms. These ratios do not measure total profitability because they do not take into account all revenues and expenses.

Cash Flow Considerations Relating to Sales of Memberships

We generally advance significant commissions at the time a Membership is sold. Since approximately 95% of Membership fees are collected on a monthly basis, a significant cash flow deficit is created at the time a Membership is sold. This deficit is reduced as monthly Membership fees are remitted and no additional commissions are paid on the Membership until all previous unearned advance commission balances have been fully recovered. Since the cash advanced at the time of sale of a new Membership may be recovered over a multi-year

period, cash flow from operations may be adversely affected depending on the number of new Memberships written in relation to the existing active base of Memberships and the composition of new or existing sales associates producing such Memberships.

Investment Policy

Our investment policy is to some degree controlled by certain insurance regulations, which, coupled with management's own investment philosophy, results in a conservative investment portfolio that is not risk oriented. Our investments consist of common stocks, investment grade (rated Baa or higher) preferred stocks and investment grade bonds primarily issued by corporations, the United States Treasury, federal agencies, federally sponsored agencies and enterprises, as well as mortgage-backed securities and state and municipal tax-exempt bonds. We are required to pledge investments to various state insurance departments as a condition to obtaining authority to do business in certain states.

New Accounting Standards Issued

In November 2005, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") FAS 115-1 and FAS 124-1 "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." This FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in this FSP is applicable to reporting periods beginning after December 15, 2005. Management does not expect the adoption of this FSP to have a material effect on our consolidated financial position and results of operations.

In December 2004, the FASB issued SFAS No. 123(R) "Share-Based Payment," which replaces SFAS No. 123 "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25 "Accounting for Stock Issued to Employees." In March 2005, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 107 "Share-Based Payment," which provides interpretive guidance related to SFAS No. 123(R). SFAS No. 123(R) requires compensation costs related to share-based payment transactions to be recognized in the financial statements. With limited exceptions, the amount of compensation cost is measured based on the grant-date fair value of the equity or liability instruments issued. SFAS No. 123(R) requires liability awards to be remeasured each reporting period and compensation costs to be recognized over the period that an employee provides service in exchange for the award. Management plans to adopt this statement on the modified prospective basis beginning January 1, 2006, and does not expect adoption of this statement to have a material effect on our consolidated financial position and results of operations. Subsequent to adoption of this statement, share-based benefits will be valued at fair value using the Black-Scholes option pricing model for option grants and the grant date fair market value for stock awards. Compensation amounts so determined will be expensed over the applicable vesting period.

In May 2005, the FASB issued SFAS No. 154 "Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20, and FASB Statement No. 3" ("SFAS 154"). SFAS 154 replaces APB Opinion No. 20, "Accounting Changes," and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirements for the accounting for and reporting of a change in accounting principle. This statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 31, 2005.

Measures of Member Retention

One of the major factors affecting our profitability and cash flow is our ability to retain a Membership, and therefore continue to receive fees, once it has been sold. We monitor our overall *Membership persistency rate*, as well as the *retention rates* with respect to Memberships sold by individual associates and agents and retention rates with respect to Memberships by year of issue, geographic region, utilization characteristics and payment method, and other sub groupings.

Terminology

The following terms are used in describing the various measures of retention:

- *Membership life* is a period that commences on the day of initial enrollment of a member and continues until the individual's Membership eventually terminates or lapses (the terms *terminate* or *lapse* may be used interchangeably here).

- *Membership age* means the time since the Membership has been in effect.

- *Lapse rate* means the percentage of Memberships of a specified group of Memberships that *lapse* in a specified time period.

- *Retention rate* is the complement of a *lapse rate*, and means the percentage of Memberships of a specified group that remain in force at the end of a specified time period.

- *Persistency* and *retention* are used in a general context to mean the tendency for Memberships to continue to remain in force, while the term *persistency rate* is a specific measure that is defined below.

- *Lapse rates, retention rates, persistency rates,* and *expected Membership life* may be referred to as measures of *Membership retention*.

- *Expected Membership life* means the average number of years a new Membership is expected to remain in force.

- *Blended rate* when used in reference to any measure of member retention means a rate computed across a mix of Memberships of various *Membership ages*.

- *Expected remaining Membership life* means the number of additional years that an existing member is expected to continue to renew from a specific point in time based on the *Membership life*.

Variations in Membership Retention by Sub-Groups, Impact on Aggregate Numbers

Company wide measures of Membership retention include data relating to members who can potentially be further sorted by identifiable sub-groupings. For example, Memberships may be subdivided into those owned by members who are or are not sales associates, to those who are or are not members of group plans, etc.

Measures of Membership retention of different sub-groups may vary. For example, our experience indicates that first year retention rate of Memberships owned by members who also are sales associates is approximately 8% better than retention of Memberships owned by non-associate members. While this correlation can be identified, the cause and effect relationship here cannot be isolated. These sales associate members have a financial incentive to retain the Membership in order to continue to receive commissions. They also likely have a better understanding and appreciation of the benefits of the Membership, which may have contributed in fact to their decision to also become a sales associate. Additionally, members who have accessed the services of the provider law firms historically have higher retention rates than those who have not.

All aggregate measures of Membership retention or expected life may be impacted by shifts in the underlying enrollment mix of sub-groups that have different retention rates. For example, Memberships owned by new members who also are sales associates increased during 2005 for the first time in the past five years, primarily due to the 125% increase in new sales associates enrolled during 2005 compared to 2004. Since associate members have a known higher first year retention rate, a shift in mix alone could, over time, cause an increase in reported aggregate retention measures and expected member life, even if the retention rates within each sub-group do not change. Despite this increase in associate owned Memberships, our blended first year retention rate and lapse rate remain unchanged from the previous year. It is important to note that all blended rates discussed here may reflect the impact of such shifts in enrollment mixes. At December 31, 2005, 410,493 of the active 1,542,789

Memberships were also vested associates which represent 27% of the total active Memberships compared to 21% at December 31, 2004 and 2003. The following table shows total new Memberships sold during each year and the number and percentage of Memberships sold to persons who are associates.

Year	Total New Memberships	Associate Memberships	Ratio
2001	728,295	103,515	14.2%
2002	773,767	119,326	15.4%
2003	671,857	86,406	12.9%
2004	624,525	89,230	14.3%
2005	700,727	220,290	31.4%

Variations in Retention over Life of a Membership, Impact on Aggregate Measures

Measures of member retention also vary significantly by the Membership age. Historically, we have observed that Memberships in their first year have a significantly higher lapse rate than Memberships in their second year, and so on. The following chart shows the historical observed lapse rates and corresponding yearly retention rates as a function of Membership age. For example, 49.1% of all new Memberships lapse during the first year, leaving 50.9% still in force at the end of the first year. More tenured Memberships have significantly lower lapse rates. For example, by year seven lapse rates are under 10% and annual retention exceeds 90%. The following table shows as of December 31, 2005 and 2004 our blended retention rate and lapse rates based on our historical experience for the last 25 years.

Membership Retention versus Membership Age

As of December 31, 2004				As of December 31, 2005		
Yearly Lapse Rate	Yearly Retention	End of Year Memberships	Membership Year	Yearly Lapse Rate	Yearly Retention	End of Year Memberships
		100.0	0			100.0
49.1%	50.9%	50.9	1	49.1%	50.9%	50.9
28.2%	71.8%	36.5	2	31.8%	68.2%	34.7
21.1%	78.9%	28.8	3	23.3%	76.7%	26.6
17.1%	82.9%	23.9	4	16.5%	83.5%	22.2
15.3%	84.7%	20.2	5	12.2%	87.8%	19.5
11.9%	88.1%	17.8	6	10.3%	89.7%	17.5
9.5%	90.5%	16.1	7	9.1%	90.9%	15.9

Membership Persistency

Our *Membership persistency rate* is a specific computation that measures the number of Memberships in force at the end of a year as a percentage of the total of (i) Memberships in force at the beginning of such year, plus (ii) new Memberships sold during such year. From 1981 through the year ended December 31, 2005, our annual *Membership persistency rates*, using the foregoing method, have averaged approximately 71.8%.

Year	Beginning Memberships	New Memberships	Total	Ending Memberships	Persistency
2001	1,064,805	728,295	1,793,100	1,242,908	69.3%
2002	1,242,908	773,767	2,016,675	1,382,306	68.5%
2003	1,382,306	671,857	2,054,163	1,418,997	69.1%
2004	1,418,997	624,525	2,043,522	1,451,700	71.0%
2005	1,451,700	700,727	2,152,427	1,542,789	71.7%

Our overall *Membership persistency rate* varies based on, among other factors, the relative age of total Memberships in force, and shifts in the mix of members enrolled. Our overall *Membership persistency rate* could become lower when the Memberships in force include a higher proportion of newer Memberships, as will happen

following periods of rapid growth. Our overall *Membership persistency rate* could also become lower when the new enrollments include a higher proportion of non-associate members.

Unless offset by other factors, these factors could result in a decline in our overall *Membership persistency rate* as determined by the formula described above, but does not necessarily indicate that the new Memberships written are less persistent.

Expected Membership Life

Using historical data through 2005 for all past Members enrolled, the *expected Membership life* can be computed to be approximately three years. This number represents the average number of years a new Membership can be expected to remain in force. Although about half of all new Memberships may lapse in the first year, the expected Membership life is much longer due to the contribution of higher annual retention rates in subsequent years.

Since our experience is that the retention rate of a given generation of new Memberships improves with Membership age, the *expected remaining Membership life* of a Membership also increases with Membership age. For example, while a new Membership may have an *expected Membership life* of three years, the *expected remaining Membership life* of a Membership that reaches its first year anniversary is approximately 4.7 years.

Since the actual population of Memberships in force at any time is a distribution of ages from zero to more than 20 years, the *expected remaining Membership life* of the entire population at large greatly exceeds three years per Membership. As of December 31, 2005, based on the historical data described above, the current *expected remaining Membership life* of the actual population is over six years per Membership. This measure is used by us to estimate the future revenues expected from Memberships currently in place.

Expected Membership life measures are based on more than 20 years of historical Membership retention data, unlike the *Membership persistency rate* described above which is computed from, and determined by, the most recent one-year period only. Both or these measures however include data from Memberships of all Membership ages and hence are referred to as "blended" measures.

Actions that May Impact Retention in the Future

The potential impact on our future profitability and cash flow due to future changes in Membership retention can be significant. While blended retention rates have not changed dramatically over the past five years, we have implemented several initiatives beginning in 2002 aimed at improving the retention rate of both new and existing Memberships. Such initiatives include an optional revised compensation structure featuring variable renewal commission rates ranging from five to 25% per annum based on the 12 month Membership retention rate of the associate's personal sales and those of his organization and implementation of a "non-taken" administrative fee to sales associates of $35 for any Membership application that is processed but for which a payment is never received. We have designed and implemented an enhanced member "life cycle" communication process aimed at both increasing the overall amount of communication from us to the members as well as more specific target messaging to members based on the length of their Membership as well as utilization characteristics. We believe that such efforts may ultimately increase the utilization by members and therefore lead to higher retention rates. However, the effects of these efforts through 2005 on improving retention have not been meaningful. We intend to continue to develop programs and initiatives designed to improve retention.

Results of Operations

Comparison of 2005 to 2004

Net income for 2005 decreased 12% to $35.8 million from $40.8 million for 2004. Diluted earnings per share for 2005 decreased 8% to $2.29 per share from $2.48 per share for the prior year due to decreased net income of 12% and an approximate 5% decrease in the weighted average number of outstanding shares. Membership revenues for 2005 were up 10% to $389.3 million from $355.5 million for the prior year marking the thirteenth consecutive year of increased Membership revenue.

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 12% during 2005 to 700,727 from 624,525 during 2004. At December 31, 2005, there were 1,542,789 active Memberships in force compared to 1,451,700 at December 31, 2004, an increase of 6%. Additionally, the average annual fee per Membership has increased from $274 for all Memberships in force at December 31, 2004 to $287 for all Memberships in force at December 31, 2005, a 5% increase, primarily as a result of increased sales of our Identity Theft Shield Membership during year 2005.

Associate services revenue increased 16% from $24.9 million for 2004 to $29.0 million during 2005 primarily as a result of more associates enrolling in the *eService* program. The *eService* fees totaled $10.8 million during 2005 compared to $7.6 million for 2004, an increase of 42%. We recognized revenue from associate fees of approximately $13.9 million during 2005 compared to $14.6 million during 2004, a decrease of 5%. New associates typically pay a fee ranging from $49 to $249, depending on special promotions we implement from time to time. Although the new enrollments of sales associates increased 125% during 2005 to 242,223 from 107,552 for 2004, the average associate fee paid during 2005 was $56.61 compared to $142.49 for 2004, a decrease of 60%. 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 largely offset by the direct and indirect cost to us of training, providing associate services and other direct marketing expenses.

Other revenue decreased 7%, from $5.6 million to $5.2 million primarily due to the decrease in revenue recognized from Membership enrollment fees.

Primarily as a result of the increase in Membership fees, total revenues increased to $423.4 million for 2005 from $385.9 million during 2004, an increase of 10%.

Membership benefits, which primarily represent payments to provider law firms and Kroll, totaled $137.2 million for 2005 compared to $122.3 million for 2004, and represented 35% of Membership fees for 2005 and 34% for 2004. This Membership benefits ratio (Membership benefits as a percentage of Membership fees) should remain near current levels as substantially all active Memberships provide for a capitated benefit in the absence of any changes in the capitated benefit level, which has not changed significantly since 1993. However, since the benefit ratio of the IDT Memberships is higher than the legal Memberships, we expect the benefits ratio to increase above 35% if we continue to increase the IDT Membership base and revenues.

Commissions to associates increased 19% from $118.8 million for 2004 to $141.6 million for 2005, and represented 33% and 36% of Membership fees for such years. 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 2005 totaled 700,727, a 12% increase from the 624,525 sold during 2003, but the "add-on" IDT Membership sales are not included in these totals and have increased 31% to 441,108 for 2005 from 335,792 for 2004 which increased our average Annual Membership fee 6% to $322.04 for 2005 from $303.36 for 2004. The increase in the number of new Memberships sold with an increase in the average Annual Membership fee resulted in a 19% increase in the Membership Fees written.

Associate services and direct marketing expenses increased to $30.5 million for 2005 from $29.3 million for 2004. Fast Start training fees and bonuses incurred were approximately $4.8 million during 2005 compared to $3.7 million in 2004. This $1.1 million increase in Fast Start training fees and bonuses, a $1.5 million increase in the cost of new Associate kits, a $1.4 million increase in direct marketing and marketing services costs, and a $150,000 increase in Players Club and supply costs was partially offset by a $1.0 million decrease in promotional bonuses and management team overrides and a $2.0 million decrease in amortization of deferred associate cost and other costs. The Fast Start training fees and bonuses are affected by the number of new sales associates that attend Fast Start class and successfully meet the qualification criteria established by us, i.e. more training bonuses will be paid when a higher number of new sales associates meet such criteria. These expenses include the costs of providing associate services and marketing expenses as discussed under *Member and Associate Costs*.

General and administrative expenses during 2005 and 2004 were $49.0 million and $43.7 million, respectively, and represented 12.6% and 12.3%, respectively, of Membership fees for such years. Increases in the 2005 period were attributable primarily to increases in printing and fulfillment costs associated with our new Membership kit, higher employee costs, bank services charges and Sarbanes Oxley compliance costs.

Other expenses, net, which includes depreciation and amortization, litigation accruals, premium taxes and interest expense reduced by interest income, increased 9% to $10.5 million for 2005 from $9.6 million for 2004. Depreciation and amortization decreased to $7.5 million for 2005 from $7.7 million for 2004. Litigation accruals have been reduced $303,000 and $121,000 during 2005 and 2004, respectively. Premium taxes increased from $1.7 million for 2004 to $2.1 million for 2005 due to increased revenues in the states in which we pay premium taxes. Interest expense increased to $2.7 million for 2005 compared to $2.0 million for the prior year. Interest income decreased to $1.5 million for 2005 from $1.7 million for 2004.

The provision for income taxes decreased during 2005 to $18.9 million compared to $21.5 million for 2004, representing 34.5% of income before income taxes for both years.

Comparison of 2004 to 2003

Net income for 2004 increased 2% to $40.8 million from $39.9 million for 2003. Diluted earnings per share for 2004 increased 9% to $2.48 per share from $2.27 per share for the prior year due to increased net income of 2% and an approximate 9% decrease in the weighted average number of outstanding shares. Membership revenues for 2004 were up 8% to $355.5 million from $330.3 million for the prior year marking the twelfth consecutive year of increased Membership revenue.

Membership fees and their impact on total revenues in any period are determined directly by the number of active Memberships in force during any such period. The active Memberships in force are determined by both the number of new Memberships sold in any period together with the renewal rate of existing Memberships. New Membership sales decreased 7% during 2004 to 624,525 from 671,857 during 2003. At December 31, 2004, there were 1,451,700 active Memberships in force compared to 1,418,997 at December 31, 2003, an increase of 2%. Additionally, the average annual fee per Membership has increased from $262 for all Memberships in force at December 31, 2003 to $274 for all Memberships in force at December 31, 2004, a 5% increase, as a result of a larger number of Legal Shield subscribers, increased sales of our business oriented Memberships, and the introduction of the Identity Theft Shield Membership during the last quarter of 2003.

Associate services revenue decreased 3% from $25.7 million for 2003 to $24.9 million during 2004 primarily as a result of a decline in new enrollments of sales associates and fewer associates enrolling in the *eService* program. The *eService* fees totaled $7.6 million during 2004 compared to $8.4 million for 2003, a decrease of 9%. We had a slight increase in fees for the *Fast Start* program for 2004. We received training fees of approximately $8.9 million during 2004 compared to $7.7 million during 2003. The $8.9 million and $7.7 million for 2004 and 2003, respectively, in training fees was collected from approximately 105,247 new sales associates who elected to participate in *Fast Start* in 2004 compared to 107,490 during 2003. New associates electing to participate in *Fast Start* decreased to 98% of new associates during 2004 from 99% for 2003. Total new associates enrolled during 2004 were 107,552 compared to 108,557 for 2003, a decrease of 1%.

Other revenue increased 6%, from $5.3 million to $5.6 million primarily due to the increase in revenue recognized from Membership enrollment fees.

Primarily as a result of the increase in Membership fees, total revenues increased to $385.9 million for 2004 from $361.3 million during 2003, an increase of 7%.

Membership benefits, which represent payments to provider law firms and Kroll, totaled $122.3 million for 2004 compared to $111.2 million for 2003, and represented 34% of Membership fees for both years.

Commissions to associates increased 3% from $115.4 million for 2003 to $118.8 million for 2004, and represented 35% and 33% of Membership fees for such years. These amounts were reduced by $196,000 and $165,000, respectively, representing Membership lapse fees. New Memberships sold during 2004 totaled 624,525,

a 7% decrease from the 671,857 sold during 2003, but the "add-on" IDT Memberships are not included in these totals and have increased from 86,602 at December 31, 2003 to 283,889 at December 31, 2004 which caused our total commissions to increase during 2004.

Associate services and direct marketing expenses increased to $29.3 million for 2004 from $28.9 million for 2003. Fast Start training bonuses incurred were approximately $3.1 million during 2004 compared to $2.9 million in 2003. This $200,000 increase in bonuses, a $233,000 increase in the amortization of deferred associate costs and a $1.0 million increase in the cost of marketing supplies were primarily offset by a $1.1 million decrease in direct marketing costs and marketing team overrides. The Fast Start training bonuses are affected by the number of new sales associates that successfully meet the qualification criteria established by us, i.e. more training bonuses will be paid when a higher number of new sales associates meet such criteria. These expenses also include the costs of providing associate services and marketing expenses as discussed under *Member and Associate Costs*.

General and administrative expenses during 2004 and 2003 were $43.7 million and $36.7 million, respectively, and represented 12% and 11%, respectively, of Membership fees for such years. Increases in the 2004 period were attributable primarily to increases in printing and fulfillment costs associated with our new Membership kit which we fully introduced in 2004, increases in other taxes (other than Federal income tax), higher employee costs, legal fees and Sarbanes Oxley compliance costs.

Other expenses, net, which includes depreciation and amortization, litigation accruals and premium taxes reduced by interest income, increased 12% to $9.6 million for 2004 from $8.5 million for 2003. Depreciation and amortization increased to $7.7 million for 2004 from $7.1 million for 2003. Premium taxes decreased from $2.7 million for 2003 to $1.7 million for 2004 due to decreased revenues in the states in which we pay premium taxes. Interest income increased to $1.7 million for 2004 from $1.4 million for 2003. Interest expense increased to $2.0 million for 2004 compared to $123,000 for the prior year. At December 31, 2004 we reported $56.6 million in cash and investments (after utilizing $37.4 million to purchase approximately 1.5 million treasury shares of our common stock during 2004) compared to $51.6 million at December 31, 2003.

The provision for income taxes increased during 2004 to $21.5 million compared to $20.7 million for 2003, representing 34.5% and 34.1% of income before income taxes for 2004 and 2003, respectively.

Liquidity and Capital Resources

The number of active Memberships in force and the average monthly fee will directly determine Membership fees collected and their contribution to cash flow from operations during any period. Cash receipts from associate services are directly impacted by the number of new sales associates enrolled and the price of entry during the period, the number of associates subscribing to our *eService* offering and the amount of sales tools purchased by the sales force.

The cash outlay related to Membership benefits is directly impacted by the number of active Memberships and the contractual rate that exists between us and our benefits providers. 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. Cash requirements related to associate services and direct marketing activities 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 our *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.

Membership revenues are more than sufficient to fund the cash requirements for membership benefits (at approximately 34%-35% of Membership revenues), commissions (ranging from 33% to 36% of Membership revenues) and general and administrative expense (at approximately 12.5% of Membership revenues). We have generated significant cash flow from operations before changes in assets and liabilities of approximately $45 million, $52 million and $48 million in 2005, 2004 and 2003, respectively. As discussed below, we have used a significant portion of our cash flow to repurchase shares of our stock in the open market. Cash flow from

operations could be reduced if we experienced significant growth in new members because of the negative cash flow characteristics of our commission advance policies discussed above.

As a result of our ability to generate cash flow from operations, including in periods of Membership growth, we have not historically been dependent on, and do not expect to need in the future, external sources of financing from the sale of securities or from bank borrowings to fund our basic business operations. However, as described below, during the last three years, we incurred debt for limited and specific purposes to permit us to construct a new corporate headquarters, purchase equipment and to accelerate our treasury stock purchase program.

General

Consolidated net cash provided by operating activities before changes in assets and liabilities was $45.4 million, $51.7 million and $47.7 million for 2005, 2004 and 2003, respectively. Consolidated net cash provided by operating activities was $50.1 million, $47.3 million and $51.7 million for 2005, 2004 and 2003, respectively. Cash provided by operating activities decreased $2.9 million during 2005 compared to 2004 primarily due to a $4.1 million increase in the change in accounts payable and accrued expenses and other net, the $2.5 million increase in the change in deferred member and associate service costs and the $2.1 million increase in the change in refundable income taxes partially offset by the $5.0 million decrease in net income a $1.3 million decrease in the provision for deferred income taxes and a $220,000 decrease in depreciation and amortization

Net cash used in investing activities was $15.5 million, $11.3 million and $36.9 million for 2005, 2004 and 2003, respectively. In addition to capital expenditures of $14.8 million, $10.9 million and $27.0 million during 2005, 2004 and 2003, respectively, our purchases of available-for-sale investments exceeded the maturities and sales of such investments by $767,000, $443,000 and $9.9 million in 2005, 2004 and 2003, respectively.

Net cash used in financing activities was $26.6 million, $31.4 million and $14.2 million for 2005, 2004 and 2003, respectively. This $4.8 million change during 2005 was primarily comprised of a $25.8 million decrease in purchases of treasury stock partially offset by a $5.2 million decrease in proceeds from issuance of debt, a $3.1 million increase in repayment of debt, a $700,000 decrease in proceeds from sale of common stock on exercise of options and a $12.4 million increase in dividends paid.

We had a consolidated working capital deficit of $3.1 million at December 31, 2005, a decrease of $18.6 million compared to a consolidated working capital deficit of $21.7 million at December 31, 2004. The decrease was primarily due to the $8.0 million increase in cash and a $5.9 million increase in current available-for-sale investments. The $3.1 million working capital deficit at December 31, 2005 would have been $7.0 million in excess working capital excluding the $10.1 million of 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. Additionally, at the current rate of cash flow provided by continuing operations ($50.1 million during 2005) and our contractual commitment that limits the amount of any future dividends, we do not expect any difficulty in meeting our financial obligations in the short term or the long term.

We generally advance significant commissions to associates at the time a Membership is sold. We expense these advances ratably over the first month of the related Membership. During 2005, we paid advance commissions to associates of $138.8 million on new Membership sales compared to $115.9 million for 2004. 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. See *Commissions to Associates* above for additional information on advance commissions.

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 10,000,000 shares during subsequent board meetings. At December 31, 2005, we had purchased 9.4 million treasury shares under these authorizations for $222.5 million, an average price of $23.64 per share, including $11.7 million of purchases in 2005. Treasury stock purchases will be made at prices that are considered attractive by management and at such times that management believes will not unduly impact our liquidity,

however, due to restrictions contained in our debt agreements with lenders, we are limited in our treasury stock purchases. At December 31, 2005, we had more than $19.8 million availability under existing bank covenant restrictions to purchase additional treasury shares. No time limit has been set for completion of the treasury stock purchase program. Given the current interest rate environment, the nature of other investments available and our expected cash flows, management believes that purchasing treasury shares enhances shareholder value. We expect to continue our treasury stock program. From time to time, we evaluate alternative sources of financing to continue or accelerate this program.

We believe that we have significant ability to finance expected future growth in Membership sales based on our existing amount of cash and cash equivalents and unpledged investments at December 31, 2005 of $59.9 million. We expect to maintain cash and cash equivalents and investment balances on an on-going basis of approximately $20 million to $30 million in order to meet expected working capital needs and regulatory capital requirements. Balances in excess of this amount would be used for discretionary purposes such as treasury stock purchases, dividends, and advance repayment of debt subject to the restrictions contained in our debt agreements.

As more fully discussed in Item 2 - Description of Property, we completed a new office complex during 2004 containing approximately 170,000 square feet of office space constructed on approximately 87 acres contributed to us by the City of Ada in 2001 as part of an economic development incentive package. Costs incurred of approximately $34.1 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.

Our real estate loan of $20 million was fully funded in December 2003 with interest at the 30 day LIBOR rate plus 2.25%, adjusted monthly, and repayments began in December 2003 with monthly principal payments of $190,000 plus interest with a balloon payment on September 30, 2008. The interest rate at December 31, 2005 was 6.56%. The loan is primarily collateralized by a first mortgage on the 87 acre home office complex, the 170,000 square foot home office complex, our rights to receive Membership fees on a portion of our Memberships and by a security interest covering all equipment. The real estate loan agreement provides for financial covenants substantially the same as those described below for the stock purchase loan.

Our $31.5 million stock purchase loan was fully funded in September 2004 with interest at the 30 day LIBOR rate plus 3%, adjusted monthly, and repayments began in October 2004 with 24 monthly principal payments of $1.3 million ending September 30, 2006. The interest rate at December 31, 2005 was 7.31%. The loan is primarily collateralized by our rights to receive Membership fees on a portion of our Memberships and a pledge of the stock of our subsidiaries. The definitive agreement contains covenants prohibiting us from pledging assets, incurring additional indebtedness and selling assets. In addition to customary events of default, an additional event of default occurs if Harland C. Stonecipher ceases to be our chairman and Chief Executive Officer for 90 days. Pre-payment of the loan is permitted. The loan agreements contain the following financial covenants: (a) our quarterly Debt Coverage Ratio (as defined in the loan agreements) shall not be less than 110%; (b) our cancellation rate on contracts less than or equal to twelve months old shall not exceed 45% on a trailing 12 month basis, calculated on a quarterly basis; (c) we shall maintain a rolling twelve month average retention rate of Membership contracts in place for greater than eighteen months of not less than 70%, calculated on a monthly basis; (d) we shall not pay dividends or purchase treasury shares, which during any fiscal quarter, on a combined basis, would exceed sixty five percent (65%) of our cumulative net income for all previous fiscal quarters beginning July 1, 2004 less any dividends or stock purchases in such previous fiscal quarters, with provisions for carry forwards of unused availability; and, (e) our tangible net worth shall not fall below $10 million for the period of time dating from September 30, 2004, $15 million beginning March 31, 2005 and $25 million beginning December 31, 2005. At December 31, 2005, we were restricted from paying dividends or purchasing treasury shares in excess of $19.8 million pursuant to these covenants. We were in compliance with the above covenants at December 31, 2005.

Our $11.5 million aircraft loan was fully funded in November 2005 with interest payable monthly at the 30 day LIBOR rate plus 1.75%, adjusted monthly, and requires monthly principal installments of $96,000 beginning December 31, 2005 with the remaining balance payable in a final installment due November 30, 2012. The interest rate at December 31, 2005 was 6.06%. The loan is primarily collateralized by the aircraft purchased. In addition to customary events of default, if Harland C. Stonecipher ceases to be our Chief Executive Officer for a period of 90 consecutive days an event of default will occur.

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 PPLCI, PPLSIF and LSPV. The ability of these subsidiaries 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 PPLCI, PPLSIF or LSPV, or any of our regulated subsidiaries, will be funded by us in the form of capital contributions or surplus debentures. During February 2004, we made a capital contribution to a wholly-owned subsidiary of PPLCI, Pre-Paid Legal Services of Tennessee, Inc. in the amount of $600,000. At January 1, 2006, neither PPLSIF nor LSPV had funds available for payment of substantial dividends without the prior approval of the insurance commissioner. While PPLCI had surplus funds available for payment of an ordinary dividend, no such dividend was declared or paid during 2004 or 2003. At January 1, 2006 PPLCI had approximately $6.1 million available for payment of an ordinary dividend. At December 31, 2005 the amount of restricted net assets of consolidated subsidiaries was $25.3 million, representing amounts that may not be paid to us as dividends either under the applicable regulations or without regulatory approval.

Contractual Obligations

The following table reflects our contractual obligations as of December 31, 2005.

	Payments Due by Period (In Thousands)				
Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt	$ 38,470	$ 15,250	$ 15,255	$ 2,304	$ 5,661
Purchase obligations (1)	13,778	9,561	4,116	101	–
Capital leases	2,647	420	501	162	1,564
Deferred compensation plan	3,932	–	–	–	3,932
Operating leases	300	127	169	4	–
Total (2)	$ 59,127	$ 25,358	$ 20,041	$ 2,571	$ 11,157

(1) Includes contractual commitments pursuant to executory contracts for products and services such as voice and data services and contractual obligations related to future Company events such as hotel room blocks, meeting space and food and beverage guarantees. We expect to receive proceeds from such future events and reimbursement from provider law firms for certain voice and data services that will partially offset these obligations.

(2) Does not include commitments for attorney provider payments, commissions, etc. which are expected to remain in existence for several years but as to which our obligations vary directly either based on Membership revenues or new Memberships sold and are not readily estimable.

Forward-Looking Statements

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 December 31, 2005 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 below. 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 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

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 alternative investments, liquidity of the instrument and other general market conditions.

As of December 31, 2005, substantially all of our investments were in investment grade (rated Baa or higher) fixed-maturity investments and interest-bearing money market accounts including certificates of deposit. 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 management 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:

	Fair value	Hypothetical change in interest rate (bp = basis points)	Estimated fair value after hypothetical change in interest rate
		(Dollars in thousands)	
Fixed-maturity investments at December 31, 2005 (1)	$ 27,541	100 bp increase	$ 26,129
		200 bp increase	24,809
		50 bp decrease	27,723
		100 bp decrease	28,613
Fixed-maturity investments at December 31, 2004 (1)	$ 27,023	100 bp increase	$ 25,454
		200 bp increase	24,024
		50 bp decrease	27,605
		100 bp decrease	28,288

(1) Excluding short-term investments with a fair value of $2.6 million and $2.5 million at December 31, 2005 and 2004, respectively.

The table above illustrates, for example, that an instantaneous 200 basis point increase in market interest rates at December 31, 2005 would reduce the estimated fair value of our fixed-maturity investments by approximately $2.7 million at that date. At December 31, 2004, and based on the fair value of fixed-maturity investments of $27.0 million, an instantaneous 200 basis point increase in market interest rates would have reduced the estimated fair value of our fixed-maturity investments by approximately $3.0 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 interest rate risk by purchasing investments that can be readily liquidated should the interest rate environment begin to significantly change.

Interest Rate Risk

We are exposed to market risk related to changes in interest rates. As of December 31, 2005, we had $38.5 million in notes payable outstanding at interest rates indexed to the 30 day LIBOR rate that exposes it 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, interest expense would increase by approximately $385,000. As of December 31, 2005, we had not entered into any interest rate swap agreements with respect to the term loans.

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.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

PRE-PAID LEGAL SERVICES, INC. AND SUBSIDIARIES
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(All other schedules have been omitted since the required information is not applicable or because the information is included in the consolidated financial statements or the notes thereon.)

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Pre-Paid Legal Services, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Pre-Paid Legal Services, Inc. and subsidiaries (the "Company") maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Management of the Company is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by COSO. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2005 and 2004, and the related statements of income, cash flows and changes in stockholders' equity for each of the three years in the period ended December 31, 2005 and our report dated February 23, 2006 expressed an unqualified opinion on those financial statements.

/s/ GRANT THORNTON LLP

Oklahoma City, Oklahoma
February 23, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Pre-Paid Legal Services, Inc.

We have audited the accompanying consolidated balance sheets of Pre-Paid Legal Services, Inc. and subsidiaries (the "Company") as of December 31, 2005 and 2004, and the related consolidated statements of income, cash flows and changes in stockholders' equity for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pre-Paid Legal Services, Inc. and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

We have also audited Schedule I as of December 31, 2005 and 2004 and for each of the three years in the period ended December 31, 2005. In our opinion, this schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 23, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ GRANT THORNTON LLP

Oklahoma City, Oklahoma
February 23, 2006

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. In order to evaluate the effectiveness of internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act, our management has conducted an assessment, including testing, using the criteria in *Internal Control–Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Our system of internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on the assessment, our management has concluded that we maintained effective internal control over financial reporting as of December 31, 2005, based on criteria in *Internal Control–Integrated Framework* issued by COSO. Management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2005, has been audited by Grant Thornton LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

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

ASSETS

	December 31, 2005	December 31, 2004
Current assets:		
Cash and cash equivalents	$ 33,957	$ 25,972
Available-for-sale investments, at fair value	6,742	804
Membership fees receivable	5,395	4,961
Inventories	1,717	1,623
Refundable income taxes	–	1,241
Deferred member and associate service costs	16,210	15,420
Deferred income taxes	4,894	4,829
Other assets	5,236	3,518
Total current assets	74,151	58,368
Available-for-sale investments, at fair value	19,213	25,455
Investments pledged	4,307	4,381
Property and equipment, net	58,947	51,232
Deferred member and associate service costs	3,003	2,580
Other assets	5,244	4,048
Total assets	$ 164,865	$ 146,064

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Membership benefits	$ 11,638	$ 10,340
Deferred revenue and fees	26,287	24,585
Current portion of capital leases payable	321	338
Current portion of notes payable	15,250	18,036
Common stock dividends payable	4,643	7,796
Accounts payable and accrued expenses	19,095	15,451
Total current liabilities	77,234	76,546
Capital leases payable	1,296	1,618
Notes payable	23,220	27,050
Deferred revenue and fees	3,007	2,361
Deferred income taxes	4,782	4,248
Other non-current liabilities	3,932	2,794
Total liabilities	113,471	114,617
Stockholders' equity:		
Common stock, $.01 par value; 100,000 shares authorized; 20,326 and 20,465 issued at December 31, 2005 and 2004, respectively	203	205
Retained earnings	149,832	129,290
Accumulated other comprehensive income	387	980
Treasury stock, at cost; 4,852 shares held at December 31, 2005 and 2004, respectively	(99,028)	(99,028)
Total stockholders' equity	51,394	31,447
Total liabilities and stockholders' equity	$ 164,865	$ 146,064

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

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

	Year Ended December 31,		
	2005	**2004**	**2003**
Revenues:			
Membership fees	$ 389,255	$ 355,461	$ 330,322
Associate services	28,963	24,901	25,704
Other	5,162	5,575	5,287
	423,380	385,937	361,313
Costs and expenses:			
Membership benefits	137,150	122,280	111,165
Commissions	141,631	118,757	115,386
Associate services and direct marketing	30,453	29,325	28,929
General and administrative	49,015	43,742	36,711
Other, net	10,456	9,578	8,546
	368,705	323,682	300,737
Income before income taxes	54,675	62,255	60,576
Provision for income taxes	18,863	21,478	20,669
Net income	$ 35,812	$ 40,777	$ 39,907
Basic earnings per common share	$ 2.31	$ 2.50	$ 2.28
Diluted earnings per common share	$ 2.29	$ 2.48	$ 2.27
Dividends declared per common share	$ .60	$ .50	$ –

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

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

	Year Ended December 31,		
	2005	**2004**	**2003**
Cash flows from operating activities:			
Net income	$ 35,812	$ 40,777	$ 39,907
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for deferred income taxes	912	2,197	288
Depreciation and amortization	7,489	7,709	7,082
Tax benefit on exercise of stock options	1,221	775	234
Compensation expense relating to contribution of stock to ESOP	–	231	220
Cash provided by operating activities before changes in assets and liabilities	45,434	51,689	47,731
(Increase) decrease in accrued Membership income	(434)	(386)	672
(Increase) decrease in inventories	(94)	(766)	355
Decrease (increase) in refundable income taxes	1,241	(910)	(56)
(Increase) decrease in deferred member and associate service costs	(1,213)	(1,410)	40
Increase in other assets	(2,914)	(2,431)	(2,407)
Increase in accrued Membership benefits	1,298	1,051	679
Increase (decrease) in deferred revenue and fees	2,348	(147)	215
Increase in other non-current liabilities	1,138	1,349	1,445
Increase (decrease) in accounts payable and accrued expenses and other, net	3,327	(776)	3,019
Net cash provided by operating activities	50,131	47,263	51,693
Cash flows from investing activities:			
Additions to property and equipment	(14,778)	(10,879)	(27,012)
Purchases of investments – available-for-sale	(18,312)	(24,135)	(15,695)
Maturities and sales of investments – available-for-sale	17,545	23,692	5,806
Net cash used in investing activities	(15,545)	(11,322)	(36,901)
Cash flows from financing activities:			
Proceeds from issuance of debt	13,829	19,000	42,700
Repayments of debt	(20,445)	(17,335)	(9,912)
Proceeds from exercise of stock options	4,439	5,176	2,014
Purchases of treasury stock	(11,673)	(37,461)	(48,292)
Proceeds from other financing	–	–	1,000
Decrease in capital lease obligations	(339)	(808)	(1,701)
Dividends paid	(12,412)	–	–
Net cash used in financing activities	(26,601)	(31,428)	(14,191)
Net increase in cash and cash equivalents	7,985	4,513	601
Cash and cash equivalents at beginning of year	25,972	21,459	20,858
Cash and cash equivalents at end of year	$ 33,957	$ 25,972	$ 21,459
Supplemental disclosure of cash flow information:			
Cash paid for interest, net of amount capitalized	$ 2,432	$ 1,752	$ 78
Cash paid for income taxes	$ 13,350	$ 19,429	$ 20,200
Non-cash activities – cash dividends declared but not paid	$ 4,643	$ 7,796	$ –
Non-cash activities – capital lease obligations incurred	$ –	$ 1,058	$ 2,481
Non-cash activities – asset additions due to trade-in allowance	$ 426	$ –	$ –

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

PRE-PAID LEGAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Amounts and shares in 000's, except dividend rates and par values)

	Common Stock		Capital in Excess of	Retained	Accum.	Treasury Stock		
	Shares	Amount	Par Value	Earnings	OCI[1]	Shares	Amount	Total
January 1, 2003	23,688	$ 237	$ 43,219	$ 90,254	$ 290	4,852	$ (99,028)	$ 34,972
Contributed to Company's ESOP plan	8	–	220	–	–	–	–	220
Exercise of stock options and other	105	–	2,014	–	–	–	–	2,014
Income tax benefit related to exercise of stock options	–	–	234	–	–	–	–	234
Net income	–	–	–	39,907	–	–	–	39,907
Other comprehensive income	–	–	–	–	519	–	–	519
Treasury shares purchased	–	–	–	–	–	2,127	(48,292)	(48,292)
Treasury shares retired	(2,127)	(20)	(45,687)	(2,585)	–	(2,127)	48,292	–
December 31, 2003	21,674	217	–	127,576	809	4,852	(99,028)	29,574
Contributed to Company's ESOP plan	10	–	–	231	–	–	–	231
Exercise of stock options and other	234	2	–	5,174	–	–	–	5,176
Income tax benefit related to exercise of stock options	–	–	–	775	–	–	–	775
Net income	–	–	–	40,777	–	–	–	40,777
Other comprehensive income	–	–	–	–	171	–	–	171
Treasury shares purchased	–	–	–	–	–	1,453	(37,461)	(37,461)
Treasury shares retired	(1,453)	(14)	–	(37,447)	–	(1,453)	37,461	–
Common stock dividends incurred	–	–	–	(7,796)	–	–	–	(7,796)
December 31, 2004	20,465	205	–	129,290	980	4,852	(99,028)	31,447
Exercise of stock options and other	197	1	–	4,438	–	–	–	4,439
Income tax benefit related to exercise of stock options	–	–	–	1,221	–	–	–	1,221
Net income	–	–	–	35,812	–	–	–	35,812
Other comprehensive income	–	–	–	–	(593)	–	–	(593)
Treasury shares purchased	–	–	–	–	–	336	(11,673)	(11,673)
Treasury shares retired	(336)	(3)	–	(11,670)	–	(336)	11,673	–
Common stock dividends incurred	–	–	–	(9,259)	–	–	–	(9,259)
December 31, 2005	20,326	$ 203	$ –	$ 149,832	$ 387	4,852	$ (99,028)	$ 51,394

(1) Other Comprehensive Income	**Year Ended December 31,**		
	2005	**2004**	**2003**
Net income	$ 35,812	$ 40,777	$ 39,907
Other comprehensive income, net of tax:			
Foreign currency translation adjustment	100	153	137
Unrealized gains on investments:			
Unrealized holding (losses) gains arising during period,	(871)	116	469
Less: reclassification adjustment for losses (gains) included in net income	178	(98)	(87)
	(693)	18	382
Other comprehensive income, net of income taxes of $(443), $12 and $206 in 2005, 2004 and 2003, respectively	(593)	171	519
Comprehensive income	$ 35,219	$ 40,948	$ 40,426

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

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

Note 1 - Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Pre-Paid Legal Services, Inc. (the "Parent") and subsidiaries (collectively, the "Company") develops and markets legal service plans (referred to as "Memberships"). The Memberships sold by us allow members to access legal services through a network of independent law firms ("provider law firms") under contract with us. During the third quarter of 2003, we began offering our Identity Theft Shield 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 nationwide provider of the Identity Theft Shield benefits and the Provider law firms are paid a fixed fee on a capitated basis to render services to plan members residing within the state or province in which the provider law firm is licensed to practice. Because the fixed fee payments by us to benefit providers do not vary based on the type and amount of benefits utilized by the member, this capitated arrangement provides significant advantages to us in managing claims risk. At December 31, 2005, Memberships subject to the capitated benefit provider arrangement comprised approximately 99% of our active Memberships. The remaining Memberships, approximately 1%, were primarily sold prior to 1987 and allow members to locate their own lawyer 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. Memberships are generally guaranteed renewable and Membership fees are principally collected on a monthly basis, although approximately 5% of Members have elected to pay their fees in advance on an annual or semi-annual basis. At December 31, 2005, we had 1,542,789 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 the Memberships were in 29 states and provinces. The Memberships are marketed by an independent sales force referred to as "associates."

Basis of Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") which vary in some respects from statutory accounting principles used when reporting to state insurance regulatory authorities.

Principles of Consolidation

The consolidated financial statements include our accounts and our wholly owned subsidiaries, as well as those of PPL Agency, Inc. (See Note 10 for additional information regarding PPL Agency, Inc.). Our primary subsidiaries include Pre-Paid Legal Casualty, Inc. ("PPLCI") and Pre-Paid Legal Services, Inc. of Florida ("PPLSIF"). All significant intercompany accounts and transactions have been eliminated.

Reclassifications

Certain amounts in the prior periods presented have been reclassified to conform to the current period financial statement presentation. These reclassifications have no effect on previously reported net income.

Foreign Currency Translation

The financial results of our Canadian operations are measured in local currency and then translated into U.S. dollars. All balance sheet accounts have been translated using the current rate of exchange at the balance sheet date. Results of operations have been translated using the average rates prevailing throughout the year.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management 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.

Fair Value of Financial Instruments

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. 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 value, due to the variable interest rate feature of such notes. The fair value disclosures relating to debt and equity securities are presented in Note 2.

Cash and Cash Equivalents

We consider all highly liquid unpledged investments with maturities of three months or less at time of acquisition to be cash equivalents. We place our temporary cash investments with high credit quality financial institutions. At times such investments may be in excess of the Federal Deposit Insurance Corporation (FDIC) insurance limit. We have not experienced any losses in such accounts and believe we are not exposed to any significant credit risk on cash and cash equivalents.

Investments

We classify our investments held as available-for-sale and account for them at fair value with unrealized gains and losses, net of taxes, excluded from earnings and reported as other comprehensive income. We classify available-for-sale securities as current if we expect to sell the securities within one year, or if we intend to utilize the securities for current operations. All other available-for-sale securities are classified as non-current.

All investment securities are adjusted for amortization of premiums and accretion of discounts. Amortization of premiums and accretion of discounts are recorded to income over the contractual maturity or estimated life of the individual investment on the level yield method. Gain or loss on sale of investments is based upon the specific identification method. Income earned on our investments in certain state and political subdivision debt instruments is not generally taxable for federal income tax purposes.

Membership fees receivable

Our Membership fees receivable consists of amounts due from members for services provided pursuant to their Membership contract. Membership fees are principally collected on a monthly basis. Membership fees receivable is a result of a portion of members, mostly group members, who pay their Membership fees in arrears and are recorded at amounts due under the terms of the Membership agreement. An allowance for doubtful accounts is not necessary as the recorded amount is adjusted to net realizable value at period-end based on our historical experience and the short period of time after period-end in which the accounts will be collected.

Inventories

Inventories include the cost of materials and packaging and are stated at the lower of cost or market.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation of property and equipment is computed using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the estimated useful lives of the related assets or the period of the lease, whichever is shorter. Maintenance and repairs are expensed as incurred and renewals and betterments are capitalized. Interest cost incurred during the construction period of major facilities is capitalized. The capitalized interest is recognized as part of the asset to which it relates and is amortized over the asset's estimated useful life.

Revenue recognition - Membership and Associate Fees

Our 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.

We also charge new members, who are not part of an employee group, a $10 enrollment fee. This enrollment fee and related incremental direct and origination costs of $10 for 2005 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"). We compute the expected Membership life using more than 20 years of actuarial data. At December 31, 2005, we computed the expected Membership life to be approximately 3 years. 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.

We derive revenues from services provided to our marketing sales force primarily from a one-time non-refundable enrollment fee from each new sales associate for which we provide initial sales and marketing supplies and enrollment services to the associate. Average enrollment fees paid by new sales associates were $57, $142 and $136 for 2005, 2004 and 2003, respectively. Revenue from, and costs of, the initial sales and marketing supplies (approximately $14) are recognized when the materials are delivered to the associates. The remaining 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, 2005 is estimated to be approximately six months, unchanged from year end 2004. At both December 31, 2005 and 2004, the deferred revenue associated with sales associate enrollment fees was $1.6 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.

We also encourage participation in a training program ("Fast Start") that allows an associate who successfully completes the program to advance through the various commission levels at a faster rate. Associate services revenue also includes revenue recognized on the sale of marketing supplies and promotional material to associates and includes fees related to our *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.

Member and Associate Costs

Deferred costs represent the incremental direct and origination costs we incur in enrolling new Members and new associates related to the deferred revenue discussed above, and that portion of payments made to provider law firms 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. 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. 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. 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, the associate incentive program, group marketing and marketing services departments (including costs of related travel, marketing events, leadership summits and international sales convention). Shipping and handling costs of $2.8 million in 2005 and $2.4 million in 2004 are primarily included in Associate services and direct marketing costs.

Membership Benefits Liability

The Membership benefits liability represents per capita amounts due the provider of Identity Theft Shield benefits and provider law firms on approximately 99% of the Memberships and claims reported but not paid and actuarially estimated claims incurred but not reported on the remaining non-provider Memberships which represent approximately 1%. We calculate the benefit liability on the non-provider Memberships based on completion factors

that consider historical claims experience based on the dates that claims are incurred, reported to us and subsequently paid. Processing costs related to these claims are accrued based on an estimate of expenses to process such claims.

Income Taxes

We account for income taxes using the asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that are recognized in different periods in our financial statements and tax returns. In estimating future tax consequences, we generally consider all future events other than future changes in the tax law or rates that have not been enacted.

Deferred income taxes are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. We record deferred tax assets related to the recognition of future tax benefits of temporary differences and net operating loss and tax credit carryforwards. To the extent that realization of such benefits is not considered more likely than not, we establish a valuation allowance to reduce such assets to the estimated realizable amount.

Commissions to Associates

Prior to March 1, 2002, we had a level Membership commission schedule of approximately 27% of Membership fees and advanced the equivalent of up to three years of commissions on new Membership sales. Effective March 1, 2002, and in order to offer additional incentives for increased Membership retention rates, we returned to a differential commission structure with rates of approximately 80% of first year Membership fees on new Memberships written and variable renewal commission rates ranging from five to 25% per annum based on the 12 month Membership retention rate of the associate's sales organization. Beginning in August 2003, we 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.

We expense advance commissions ratably over the first month of the related Membership. As a result of this accounting policy, our advance commission expenses are recorded in the first month of a Membership and there is no commission expense recognized for the same Membership during the remainder of the advance period. Associates must qualify for advance commissions by writing at least three Memberships.

Long-Lived Assets

We review long-lived assets to be held and used in operations when events or changes in circumstances indicate that the assets might be impaired. The carrying value of long-lived assets is considered impaired when the identifiable undiscounted cash flows estimated to be generated by those assets are less than their carrying amounts. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair value of the long-lived asset. Fair value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved. Losses on long-lived assets to be disposed of are determined in a similar manner, except that fair values are reduced by disposal costs.

Stock-Based Compensation

We have a stock-based employee compensation plan, which is described more fully in Note 13. We account for this plan under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

	Year Ended December 31,		
	2005	2004	2003
Net income, as reported	$ 35,812	$ 40,777	$ 39,907
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	–	(441)	(860)
Pro forma net income	$ 35,812	$ 40,336	$ 39,047

Earnings per share:			
Basic - as reported	$ 2.31	$ 2.50	$ 2.28
Basic - pro forma	$ 2.31	$ 2.47	$ 2.23
Diluted - as reported	$ 2.29	$ 2.48	$ 2.27
Diluted - pro forma	$ 2.29	$ 2.45	$ 2.22

The estimated fair value of options granted to employees during 2004 and 2003 (no options were granted during 2005) was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used: no dividend yield; risk-free interest rate of 2.16% for 2004 and 2.38% for 2003; expected life of 3-5 years; and expected volatility for the years ending December 31, 2004 and 2003 were 52.8% and 55.9%, respectively. Using these assumptions, the weighted average fair values at date of grant for options granted during 2004 and 2003 were $8.74 and $8.63, respectively.

The exercise of certain stock options which have been granted gives rise to compensation which is includable in the taxable income of the option grantee and deductible by us for federal and state income tax purposes. Such compensation results from increases in the fair market value of our common stock subsequent to the date of grant of the applicable exercised stock options, and in accordance with Accounting Principles Board Opinion No. 25, such compensation is not recognized as an expense for financial accounting purposes and the related tax benefits are recorded in capital in excess of par value.

Incentive awards payable

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. The incentive awards payable at any date is estimated based on an evaluation of the existing associates that have met the monthly qualifications, any changes to the monthly qualification requirements, the estimated cost for each incentive earned and the number of associates that have historically met the personal retention rates. Changes to any of these assumptions would directly affect the amount accrued but we do not expect any of the significant trends impacting this account to change significantly in the near term.

Legal Contingencies

We account for legal contingencies in accordance with SFAS 5, *Accounting for Contingencies*, which requires that a loss contingency should be accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. We evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. This process requires subjective judgment about the likely outcomes of litigation. Liabilities related to most of our lawsuits are especially difficult to estimate due to the nature of the claims, limitation of available data and uncertainty concerning the numerous variables used to determine likely outcomes or the amounts recorded. Litigation expenses are recorded as incurred and we do not accrue for future legal fees. 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.

Segment Information

Operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker(s) in deciding how to allocate resources and in assessing performance. Disclosures about products and services and geographic areas are presented in Note 16.

New Accounting Standards Issued

In November 2005, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") FAS 115-1 and FAS 124-1 "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." This FSP addresses the determination as to when an investment is considered impaired,

whether that impairment is other than temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in this FSP is applicable to reporting periods beginning after December 15, 2005. Management does not expect the adoption of this FSP to have a material effect on our consolidated financial position and results of operations.

In December 2004, the FASB issued SFAS No. 123(R) "Share-Based Payment," which replaces SFAS No. 123 "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25 "Accounting for Stock Issued to Employees." In March 2005, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 107 "Share-Based Payment," which provides interpretive guidance related to SFAS No. 123(R). SFAS No. 123(R) requires compensation costs related to share-based payment transactions to be recognized in the financial statements. With limited exceptions, the amount of compensation cost is measured based on the grant-date fair value of the equity or liability instruments issued. SFAS No. 123(R) requires liability awards to be remeasured each reporting period and compensation costs to be recognized over the period that an employee provides service in exchange for the award. Management plans to adopt this statement on the modified prospective basis beginning January 1, 2006, and does not expect adoption of this statement to have a material effect on our consolidated financial position and results of operations. Subsequent to adoption of this statement, share-based benefits will be valued at fair value using the Black-Scholes option pricing model for option grants and the grant date fair market value for stock awards. Compensation amounts so determined will be expensed over the applicable vesting period.

In May 2005, the FASB issued SFAS No. 154 "Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20, and FASB Statement No. 3" ("SFAS 154"). SFAS 154 replaces APB Opinion No. 20, "Accounting Changes," and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirements for the accounting for and reporting of a change in accounting principle. This statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 31, 2005.

Note 2 - Investments

A summary of the amortized cost, unrealized gains and losses and fair values of our investments at December 31, 2005 and 2004 follows:

	December 31, 2005			
	Amortized	Gross Unrealized		Fair
Available-for-Sale	Cost	Gains	Losses	Value
U.S. Government obligations	$ 9,482	$ 65	$ (120)	$ 9,427
Corporate obligations	2,453	8	(80)	2,381
Equity securities	136	23	–	159
Obligations of state and political subdivisions	15,743	133	(142)	15,734
Certificates of deposit	2,561	–	–	2,561
Total	$ 30,375	$ 229	$ (342)	$ 30,262

	December 31, 2004			
	Amortized	Gross Unrealized		Fair
Available-for-Sale	Cost	Gains	Losses	Value
U.S. Government obligations	$ 9,784	$ 146	$ (39)	$ 9,891
Corporate obligations	2,982	28	(9)	3,001
Equity securities	417	663	–	1,080
Obligations of state and political subdivisions	13,898	271	(38)	14,131
Certificates of deposit	2,537	–	–	2,537
Total	$ 29,618	$1,108	$ (86)	$ 30,640

In determining whether declines in the fair value of available-for-sale securities below their cost are other than temporary, management considers the financial condition of the issuer, causes for the decline in fair value (i.e., interest rate fluctuations or declines in creditworthiness) and severity and duration of the decline, among other things. At December 31, 2005 we had 60 securities (primarily municipal securities) with unrealized losses in four consecutive quarters with combined market losses of $94,000. These losses were determined to be temporary since substantially all of these securities were AAA rated and we intend to hold to maturity Additionally, we recognized a loss for an other than temporary decline of $282,000 related to our equity securities.

The contractual maturities of our available-for-sale investments in debt securities and certificates of deposit at December 31, 2005 by maturity date follows:

	Amortized Cost	Fair Value
One year or less	$ 3,187	$ 3,195
Two years through five years	5,928	5,882
Six years through ten years	14,503	14,369
More than ten years	6,621	6,657
Total	$ 30,239	$ 30,103

Our investment securities are included in the accompanying consolidated balance sheets at December 31, 2005 and 2004 as follows:

	December 31,	
	2005	2004
Available-for-sale investments (current)	$ 6,742	$ 804
Available-for-sale investments (non-current)	19,213	25,455
Investments pledged	4,307	4,381
Total	$ 30,262	$ 30,640

We are required to pledge investments to various state insurance departments as a condition to obtaining authority to do business in certain states. The fair value of investments pledged to state regulatory agencies is as follows:

	December 31,	
	2005	2004
Certificates of deposit	$ 2,361	$ 2,537
Obligation of state and political subdivisions	–	131
U. S. Government obligations	1,946	1,713
Total	$ 4,307	$ 4,381

Proceeds from sales of investments during 2005, 2004 and 2003 were $13.2 million, $4.6 million and $4.7 million, respectively, and resulted in gross realized gains of $98,000, $224,000 and $154,000 and gross realized losses of $108,000, $63,000 and $19,000, respectively.

Note 3 - Property and Equipment

Property and equipment is comprised of the following:

	Estimated Useful Life	December 31, 2005	December 31, 2004
Equipment, furniture and fixtures	3-10 years	$ 34,204	$ 31,727
Computer software	3 years	11,461	9,342
Building and improvements	20-40 years	36,542	36,540
Automotive and aviation equipment	3-10 years	13,489	3,104
Land	N/A	170	170
		95,866	80,883
Accumulated depreciation		(36,919)	(29,651)
Property and equipment, net		$ 58,947	$ 51,232

As of December 31, 2005 and 2004, capitalized interest of $706,000 was included in the cost of the building.

Note 4 – Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses are comprised of the following:

	December 31, 2005	December 31, 2004
Accounts payable	$ 6,303	$ 4,873
Marketing bonuses payable	2,099	1,792
Incentive awards payable	3,082	2,616
Litigation accrual	2,472	3,013
Other	5,139	3,157
Total	$ 19,095	$ 15,451

Note 5 – Notes Payable

Our real estate loan of $20 million was fully funded in December 2003 with interest at the 30 day LIBOR rate plus 2.25%, adjusted monthly, and repayments began in December 2003 with monthly principal payments of $190,000 plus interest with a balloon payment on September 30, 2008. The interest rate at December 31, 2005 was 6.56%. The loan is primarily collateralized by a first mortgage on the 87 acre home office complex, the 170,000 square foot home office complex, our rights to receive Membership fees on a portion of our Memberships and by a security interest covering all equipment. The real estate loan agreement provides for financial covenants substantially the same as those described below for the stock purchase loan.

Our $31.5 million stock purchase loan was fully funded in September 2004 with interest at the 30 day LIBOR rate plus 3%, adjusted monthly, and repayments began in October 2004 with 24 monthly principal payments of $1.3 million ending September 30, 2006. The interest rate at December 31, 2005 was 7.31%. The loan is primarily collateralized by our rights to receive Membership fees on a portion of our Memberships and a pledge of the stock of our subsidiaries. The definitive agreement contains covenants prohibiting us from pledging assets, incurring additional indebtedness and selling assets. In addition to customary events of default, an additional event of default occurs if Harland C. Stonecipher ceases to be our chairman and Chief Executive Officer for 90 days. Pre-payment of the loan is permitted. The loan agreements contain the following financial covenants: (a) our quarterly Debt Coverage Ratio (as defined in the loan agreements) shall not be less than 110%; (b) our cancellation rate on contracts less than or equal to twelve months old shall not exceed 45% on a trailing 12 month basis, calculated on a quarterly basis; (c) we shall maintain a rolling twelve month average retention rate of Membership contracts in place for greater than eighteen months of not less than 70%, calculated on a monthly basis; (d) we shall not pay dividends

or purchase treasury shares, which during any fiscal quarter, on a combined basis, would exceed sixty five percent (65%) of our cumulative net income for all previous fiscal quarters beginning July 1, 2004 less any dividends or stock purchases in such previous fiscal quarters, with provisions for carry forwards of unused availability; and, (e) our tangible net worth shall not fall below $10 million for the period of time dating from September 30, 2004, $15 million beginning March 31, 2005 and $25 million beginning December 31, 2005. At December 31, 2005, we were restricted from paying dividends or purchasing treasury shares in excess of $19.8 million pursuant to these covenants. We were in compliance with the above covenants at December 31, 2005.

Our $11.5 million aircraft loan was fully funded in November 2005 with interest payable monthly at the 30 day LIBOR rate plus 1.75%, adjusted monthly, and requires monthly principal installments of $96,000 beginning December 31, 2005 with the remaining balance payable in a final installment due November 30, 2012. The interest rate at December 31, 2005 was 6.06%. The loan is primarily collateralized by the aircraft purchased. In addition to customary events of default, if Harland C. Stonecipher ceases to be our Chief Executive Officer for a period of 90 consecutive days an event of default will occur.

A schedule of outstanding balances as of December 31, 2005 and 2004 is as follows:

	December 31,	
	2005	2004
Real estate loan	$ 15,238	$ 17,524
Stock purchase loan	11,813	27,562
Aircraft	11,419	–
Total notes payable	38,470	45,086
Less: Current portion of notes payable	(15,250)	(18,036)
Long term portion	$ 23,220	$ 27,050

A schedule of future maturities as of December 31, 2005 is as follows:

Repayment Schedule commencing January 2006:	
Year 1	$ 15,250
Year 2	3,437
Year 3	11,818
Year 4	1,152
Year 5	1,152
Thereafter	5,661
Total notes payable	$ 38,470

Note 6 - Income Taxes

The provision for income taxes consists of the following:

	Year Ended December 31,		
	2005	2004	2003
Current	$ 17,951	$ 19,281	$ 20,381
Deferred	912	2,197	288
Total provision for income taxes	$ 18,863	$ 21,478	$ 20,669

A reconciliation of the statutory Federal income tax rate to the effective income tax rate is as follows:

	Year Ended December 31,		
	2005	2004	2003
Statutory Federal income tax rate	35.0%	35.0%	35.0%
Tax exempt interest	(.4)	(.2)	(.1)
Wage tax credits	(.5)	(.5)	(.5)
Other	.4	.2	(.3)
Effective income tax rate	34.5%	34.5%	34.1%

Deferred tax liabilities and assets at December 31, 2005 and 2004 are comprised of the following:

	December 31,	
	2005	2004
Deferred tax liabilities relating to:		
Unrealized investment gains, net	$ –	$ 399
Deferred member and associate service costs	7,493	7,020
Property and equipment	7,008	4,854
Total deferred tax liabilities	14,501	12,273
Deferred tax assets relating to:		
Expenses not yet deducted for tax purposes	2,497	2,265
Deferred revenue and fees	11,425	10,509
Unrealized investment losses, net	44	–
Other	647	80
Total deferred tax assets	14,613	12,854
Net deferred tax asset	$ 112	$ 581

Our deferred tax assets and liabilities are included in the accompanying consolidated balance sheets at December 31, 2005 and 2004 as follows.

	December 31,	
	2005	2004
Deferred income taxes (current asset)	$ 4,894	$ 4,829
Deferred income taxes (non-current liability)	(4,782)	(4,248)
Net deferred tax asset	$ 112	$ 581

A significant portion of the deferred tax assets recognized relate to deferred revenue and fees. A valuation allowance was not recorded since we believe that there was sufficient positive evidence to support our conclusion not to record a valuation allowance. Management believes that we will realize the tax benefit of these deferred tax assets in the future because of our history of pre-tax income. However, there can be no assurance that we will generate taxable income or that all of our deferred tax assets will be utilized.

Note 7 - Stockholders' Equity

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 10 million shares during subsequent board meetings. At December 31, 2005, we had purchased 9.4 million treasury shares under these authorizations for a total consideration of $222.5 million, an average price of $23.64 per share. We purchased and formally retired 336,100 shares of our common stock during 2005 for $11.7 million, or an average price of $34.73 per share, reducing our common stock by $3,361 and our retained earnings by $11.7 million. At December 31, 2005 and 2004, we had 15.5 million and 15.6 million common shares outstanding, respectively, net of treasury shares. 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.

We have lines of credit (see Note 5) that prohibit payment of cash dividends on our common stock in excess of 65% of net income. Any decision by our Board of Directors to pay cash dividends in the future will depend upon, among other factors, our earnings, financial condition, capital requirements and approval from our lender for any dividends in excess of 65% of net income. In addition, our ability to pay dividends is dependent in part on our ability to derive dividends from our 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 the greater of 10% of such accumulated available surplus or the previous years' net profits. PPLSIF is similarly restricted pursuant to the insurance laws of Florida. At January 1, 2006, PPLSIF did not have funds available for payment of substantial dividends without the prior approval of the insurance commissioner. During 2005, PPLCI declared and paid a $4.1 million dividend to us. No dividends were declared or paid during 2004 or 2003. At January 1, 2006 PPLCI had approximately $6.1 million available for payment of an ordinary dividend. At December 31, 2005 the amount of restricted net assets of consolidated subsidiaries was $25.3 million, representing amounts that may not be paid to us as dividends either under the applicable regulations or without regulatory approval.

Note 8 – Other Expenses, net

The components of Other expenses, net are as follows:

	Year Ended December 31,		
	2005	2004	2003
Depreciation	$ 7,489	$ 7,709	$ 7,082
Premium taxes	2,059	1,698	2,703
Interest expense	2,682	1,990	123
Litigation accrual expense	(303)	(121)	-
Interest income	(1,471)	(1,698)	(1,362)
Total Other expenses, net	$10,456	$ 9,578	$ 8,546

Interest expense is net of capitalized interest of $0, $0 and $586,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

Note 9 - Comprehensive Income

Comprehensive income is comprised of two subsets - net income and other comprehensive income. Included in other comprehensive income for us are foreign currency translation adjustments and unrealized gains on investments. These items are accumulated within the Statements of Changes in Stockholders' Equity under the caption "Accumulated Other Comprehensive Income." As of December 31, accumulated other comprehensive income, as reflected in the Consolidated Statements of Changes in Stockholders' Equity, was comprised of the following:

	2005	2004
Foreign currency translation adjustments	$ 456	$ 356
Unrealized gains (losses) on investments, net of income taxes of $(44) and $399	(69)	624
Accumulated other comprehensive income	$ 387	$ 980

Note 10 - Related Party Transactions

Through December 31, 2005, our Chairman, Harland C. Stonecipher, was the owner of PPL Agency, Inc. ("Agency"). Effective January 1, 2006 we acquired Agency from Mr. Stonecipher but prior to the acquisition we had agreed to indemnify and hold him harmless for any personal losses incurred as a result of his ownership of this corporation and any income earned by Agency accrued to us. We provide management and administrative services

for Agency, for which we received specified management fees and expense reimbursements. No consideration was paid to Mr. Stonecipher.

Agency's financial position and results of operations are included in our financial statements on a combined basis after elimination of intercompany transactions. Agency earned commissions, net of amounts paid directly to its agents by the underwriter, during 2005, 2004 and 2003 of $114,000, $220,000 and $119,000, respectively, through its sales of insurance products of an unaffiliated company. Agency had net income of $16,000, $127,000 and $20,000 for the years ended December 31, 2005, 2004 and 2003, respectively, after incurring commissions earned by Mr. Stonecipher of $57,000, $55,000 and $57,000, respectively, and annual management fees paid to us of $36,000 for 2005, 2004 and 2003.

Mr. Stonecipher and his wife, Shirley A. Stonecipher, own Stonecipher Aviation LLC ("SA") and Mr. and Mrs. Stonecipher together with Wilburn L. Smith, our National Marketing Director and formerly our President and one of our directors , own S & S Aviation LLC ("S&SA"). We had agreed to reimburse SA and S&SA for certain expenses pertaining to trips made by Company personnel for Company business purposes using aircraft owned by SA and S&SA. Such reimbursement represents the pro rata portion of direct operating expenses, such as fuel, maintenance, pilot fees and landing fees, incurred in connection with such aircraft based on the relative number of flights taken for Company business purposes versus the number of other flights during the applicable period. No reimbursement is made for depreciation, capital expenditures or improvements relating to such aircraft. During 2004 and 2003 we paid $329,000 and $307,000, respectively, to SA and paid $561,000 and $592,000 to S&SA during 2004 and 2003, respectively, as reimbursement for such transportation expenses.

On December 9, 2004, we entered into and consummated an agreement with SA to purchase a 1980 Beech King Air 200 airplane for a purchase price of $1,083,355. On the same date, we entered into and consummated an agreement to purchase a 1983 Mitsubishi MU-300 jet airplane owned by S&SA for a purchase price of $1,230,200. In connection with the purchase of this plane, we also agreed to pay the expenses associated with a pending avionics upgrade, inspection and maintenance of approximately $450,000. On the same date, we also purchased the leasehold interest in a hangar building located at the Ada Municipal airport which is used as the hangar facility for the two purchased planes for a purchase price of $465,000 and also purchased certain equipment and furniture used at the facility for a purchase price of $9,272. The hangar and related equipment was purchased from SA, which constructed the hangar and acquired the equipment at its expense. Under the terms of the lease, which we assumed, which expires in 2027, we are obligated to pay annual rental of $10 per year. The purchase prices were paid in cash from our existing cash resources. The Audit Committee of the Board of Directors and the full Board, with Mr. Stonecipher abstaining, approved all of the transactions. The prices for each of the planes and hangar were determined by independent appraisals and the related equipment and furniture was purchased for book value, which approximates fair market value. The Board determined that it was appropriate for us to acquire ownership of the airplanes and hangar in light of the fact that the planes are used almost exclusively in furtherance of our business. On November 30, 2005, we purchased a LearJet 60 and traded in our existing Mitsubishi MU-300 jet airplane. We will be reimbursed for personal use of our aircraft, if any.

John W. Hail, one of our directors, served as our Executive Vice President, Director and Agency Director from July 1986 through May 1988 and also served as Chairman of the Board of Directors of TVC Marketing, Inc., which was our exclusive marketing agent from April 1984 through September 1985. Pursuant to agreements between Mr. Hail and us entered into during the period in which Mr. Hail was one of our executive officers, Mr. Hail receives override commissions from renewals of certain Memberships initially sold by us during such period. During 2005, 2004 and 2003, such override commissions on renewals totaled $75,000, $79,000 and $81,000, respectively. Mr. Hail also owns interests ranging from 12% to 100% in corporations not currently affiliated with us, including TVC Marketing, Inc., but which were engaged in the marketing of our legal service Memberships and which earn renewal commissions from Memberships previously sold. These entities earned renewal commissions of $551,000, $557,000 and $552,000 during 2005, 2004 and 2003, respectively, of which $314,000, $322,000 and $300,000, respectively, was passed through as commissions to their sales agents.

During 2003, we terminated a marketing services agreement with a senior marketing associate, and commenced an action in the District Court of Pontotoc County, Oklahoma alleging breach of contract and seeking to collect $1.4 million in outstanding notes receivable arising from loans made by us at various times between 1998

and 2001. Due to uncertainties about the full recoverability of these notes, we recorded a reserve and bad debt expense of $515,000 in 2003 to write down the notes to our estimate of their recoverable value. Each quarter, we evaluate the recoverability of these notes receivable and adjust the reserve accordingly. During 2005 we increased the reserve by $21,000 to $555,000 at December 31, 2005.

Note 11 – Leases

At December 31, 2005, we were committed under noncancelable operating and capital leases, principally for buildings and equipment. Aggregate rental expense under all operating leases was $108,000, $79,000 and $93,000 in 2005, 2004 and 2003, respectively.

Future commitments commencing January 2006 related to noncancelable operating leases are as follows:

Year Ended December 31,	
2006	$ 127
2007	106
2008	63
2009	4
Total operating lease commitments	$ 300

Future minimum lease payments commencing in January 2006 related to capital leases are as follows:

Year Ended December 31,	
2006	$ 420
2007	420
2008	81
2009	81
2010	81
Thereafter	1,564
Total minimum lease payments	2,647
Less: Imputed interest	(1,030)
Present value of net minimum lease payments	1,617
Less: Current portion	(321)
Non current portion of capital leases payable	$ 1,296

We entered into two capital leases near the end of 2002 and one early in 2003 to acquire equipment and buildings. These capital leases expire at various dates through 2032. The capital lease assets are included in property and equipment as follows at December 31, 2005 and December 31, 2004.

	December 31,	
	2005	2004
Equipment, furniture and fixtures	$ 1,670	$ 1,670
Buildings and improvements	314	314
	1,984	1,984
Less: accumulated amortization	(445)	(91)
Net capital lease assets	$ 1,539	$ 1,893

Note 12 - Commitments and Contingencies

We and various 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 we issued false and misleading financial information, primarily related to the method we used to account for commission advance receivables from sales associates. On March 5, 2002, the Court granted our 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 and as of February 17, 2006, a decision was pending. We are 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 us, 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 2004, there were at one time as many as 30 separate lawsuits involving approximately 285 plaintiffs in Alabama. As of February 17, 2006, as a result of dismissals, summary judgments, or settlements for nominal amounts, there were no lawsuits remaining in Alabama. As of February 17, 2006, we were aware of 7 separate lawsuits involving approximately 406 plaintiffs in multiple counties in Mississippi. Certain of the Mississippi lawsuits also name our former provider attorney in Mississippi as a defendant. In Mississippi, we filed lawsuits in the United States District Court for the Southern and Northern Districts of Mississippi in which we seek to compel arbitration of the various Mississippi claims under the Federal Arbitration Act and the terms of our Membership agreements. 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 in Mississippi in May, 2006, and seek varying amounts of actual and punitive damages. We have tried three separate lawsuits in Mississippi. The first trial in Mississippi on these cases resulted in a unanimous jury verdict in our favor, including other named defendants, on all claims on October 19, 2004, while the second and third trials in Mississippi resulted in insubstantial plaintiffs' verdicts on February 15, 2005 and May 9, 2005, respectively. On August 16, 2005 the Circuit Judge in the February 15, 2005 trial overturned the jury's finding of fraud and fraudulent misrepresentation on the grounds that the evidence was insufficient to support those claims and reduced the damages awarded by the jury to a total of $525 for four plaintiffs. On July 18, 2005 the Circuit Judge in the May 9, 2005 trial entered an order granting plaintiff's motion to reconsider the submission of the issue of punitive damages to the jury, and trial on that issue was held in November 2005. The trial on that issue resulted in punitive damage verdicts against us and against our chief executive officer in the collective total amount of $9.9 million. Pre-Paid will seek post judgment and appellate relief in that case. Although 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. 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 us and certain 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 our 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. On December 3, 2004, the District Court ordered the plaintiffs to proceed with the arbitration. On October 16, 2005 plaintiff Jana Weller died, and on December 20, 2005 we filed a Suggestion of Death Upon the Record with respect thereto. The ultimate outcome of this case is not determinable.

On October 3, 2005 we received a Civil Investigative Demand from the Commissioner of Consumer Protection of the State of Connecticut requesting information relating to our memberships and commissions to associates in Connecticut. As of February 17, 2006, we were in the process of responding to the request. The ultimate outcome of this matter is not determinable.

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

While the ultimate outcome of these proceedings is not determinable, we do not currently anticipate that these contingencies will result in any material adverse effect to our financial condition or results of operation, unless an unexpected result occurs in one of the cases. The costs of the defense of these various matters are reflected as a part of general and administrative expense, or Membership benefits if fees relate to Membership issues, in the consolidated statements of income. We have established an accrued liability we believe will be sufficient to cover estimated damages in connection with various cases (exclusive of ongoing defense costs which are expensed as incurred), which at December 31, 2005 was $2.5 million. We believe that we have meritorious defenses in all pending cases and will vigorously defend against the plaintiffs' claims. However, it is possible that an adverse outcome in certain cases or increased litigation costs could have an adverse effect upon our financial condition, operating results or cash flows in particular quarterly or annual periods.

During January 2006, we acquired an additional 40,000 square foot building in Duncan for $1 million that can hold 350 customer service representatives when remodeling is completed later in 2006.

Canadian taxing authorities are challenging portions of our commission and general and administrative deductions for tax years 1999 - 2002 and have tax assessments which aggregate $5.7 million. The Canadian taxing authorities contend commission deductions should be matched with the membership revenue as received, we contend these commissions are deductible when paid. Under Canadian tax laws, our commission payments are treated as a prepaid expense. We base our deduction of commission on the fact that all the services (the sale of the membership) have been performed by the sales associate at the time of sale therefore this prepaid expense (the commission payments) is deductible when paid. Also, the commission payment is taxable to the sales associate when paid and each year we issue a T4 (Canadian 1099 equivalent) to sales associates for the total commission payments made during that year. In addition, Canadian taxing authorities have challenged our allocation of general and administrative expenses to Canadian operations. We contend the allocation of general and administrative expenses, based on the percentage of Canadian new memberships written and the Canadian percentage memberships in force, is reasonable. At December 31, 2005 we have accrued $472,000 for this assessment.

Note 13 - Stock Options, Stock Ownership Plan and Benefit Plan

We have a stock option plan (the "Plan") under which the Board of Directors (the "Board") or our Stock Option Committee (the "Committee") may grant options to purchase shares of our common stock. The Plan permits the granting of options to our directors, officers and employees to purchase our common stock at not less than the fair value at the time the options are granted. The Plan provides for option grants to acquire up to 3,000,000 shares and permits the granting of incentive stock options as defined under Section 422 of the Internal Revenue Code at an exercise price for each option equal to the market price of our common stock on the date of the grant and a maximum term of 10 years. Options not qualifying as incentive stock options under the Plan have a maximum term of 15 years. The Board or Committee determines vesting of options granted under the Plan. No options may be granted under the Plan after December 12, 2012. We have not granted options under the Plan since March 2004.

The Plan previously provided for automatic grants of options to our non-employee directors. Under the Plan, each incumbent non-employee director and any new non-employee director received options to purchase 10,000 shares of common stock on March 1 of each year. The options granted each year were immediately exercisable as to 2,500 shares and vested in additional increments of 2,500 shares on the following June 1st, September 1st, and December 1st in the year of grant, subject to continued service by the non-employee director during such periods. Options granted to non-employee directors under the Plan have an exercise price equal to the closing price of the common stock on the date of grant. These automatic grants of options to non-employee directors were eliminated effective January 1, 2005, and therefore no further grants to non-employee directors will be made.

Also included below are stock options that were issued to our Regional Vice Presidents ("RVPs") in order to encourage stock ownership by our RVPs and to increase the proprietary interest of such persons in our growth and financial success. These options have been granted periodically to RVPs since 1996. Options were granted at fair market value at the date of the grant and were generally immediately exercisable for a period of three years or within 90 days of termination, whichever occurs first. Although there we no options granted to RVPs during 2005, there were 36,751 and 106,002 total options granted to RVPs in the years ended December 31, 2004 and 2003,

respectively. We discontinued the RVP stock option grants immediately after the 2003 fourth quarter stock options were awarded in the first quarter of 2004.

A summary of the status of our total stock option activity as of December 31, 2005, 2004 and 2003, and for the years ended on those dates is presented below:

	2005		2004		2003	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	862,490	$ 23.88	1,275,499	$ 24.06	1,498,392	$ 26.09
Granted	–	–	76,751	23.42	153,502	20.99
Exercised	(345,642)	28.24	(234,170)	22.10	(105,514)	25.42
Terminated	(9,681)	22.33	(255,590)	26.27	(270,881)	35.45
Outstanding at end of year	507,167	$ 20.94	862,490	$ 23.88	1,275,499	$ 24.06
Options exercisable at year end	507,167	$ 20.94	837,490	$ 23.99	1,206,124	$ 24.18

The following table summarizes information about stock options outstanding and exercisable at December 31, 2005:

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
$16.46 – $17.03	176,000	.6	$ 16.51
$19.20 – $23.93	117,219	3.4	21.37
$24.20 – $26.11	213,948	1.4	24.35
	507,167	1.5	$ 20.94

During 1988, we adopted an employee stock ownership plan. Under the plan, employees may elect to defer a portion of their compensation by making contributions to the plan. Up to seventy-five percent of the contributions made by employees may be used to purchase Company common stock. At our option, we may make matching contributions to the plan, and recorded expense during 2005, 2004 and 2003 of $342,000, $232,000 and $220,000, based on contributions of cash during 2005 and contributions of Company stock of 10,100 shares and 8,220 shares during 2004 and 2003, respectively.

In November 2002, we adopted a deferred compensation plan, which permits executive officers and key employees to defer receipt of a portion of their compensation. Deferred amounts accrue hypothetical returns based upon investment options selected by the participant. We have amended the deferred compensation plan, effective January 1, 2005, to comply with new provisions of Section 409A of the Internal Revenue Code. Deferred amounts are paid in cash based on the value of the investment option and are generally payable following termination of employment in a lump sum or in installments as elected by the participant, but the plan provides for financial hardship distributions, distributions in the event of total disability or death and distributions upon a change in control. The plan also provides for a death benefit of $500,000 for each participant. Although the plan is unfunded and represents an unsecured liability of ours to the participants, we have purchased variable life insurance policies owned by us to insure the lives of the group of participants and to finance our obligations under the plan. As of December 31, 2005 and 2004, we had an aggregate deferred compensation liability of $3.9 million and $2.8 million, respectively, which is included in other non-current liabilities. At December 31, 2005, the cash value of the underlying insurance policies owned by us was $3.7 million and included in other assets.

Note 14 - 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 year.

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 year. The weighted average number of common shares is also 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.

	Year Ended December 31,		
Basic Earnings Per Share:	2005	2004	2003
Earnings:			
Income from continuing operations	$ 35,812	$ 40,777	$ 39,907
Shares:			
Weighted average shares outstanding	15,470	16,313	17,530
Diluted Earnings Per Share:			
Earnings:			
Income from continuing operations after assumed conversions	$ 35,812	$ 40,777	$ 39,907
Shares:			
Weighted average shares outstanding	15,470	16,313	17,530
Assumed exercise of options	182	145	69
Weighted average number of shares, as adjusted	15,652	16,458	17,599

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. Options to purchase 218,000 shares and 799,000 shares with an average exercise price of $32.05 and $27.48 were excluded from the calculation of diluted earnings per share for the years ended December 31, 2004 and 2003, respectively. No options were excluded from the diluted earnings per share calculation for the year ended December 31, 2005.

Note 15 - Selected Quarterly Financial Data (Unaudited)

Following is a summary of the unaudited interim results of operations for the years ended December 31, 2005 and 2004.

Selected Quarterly Financial Data
(In thousands, except per share amounts)

2005	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenues	$100,895	$105,619	$107,582	$109,284
Net income	8,948	6,853	8,644	11,367
Basic income per common share (1):				
Net Income	$ .57	$ .45	$ .56	$ .73
Diluted income per common share (1):				
Net Income	$ .57	$ .44	$ .55	$ .73

2004				
Revenues	$ 94,609	$ 95,429	$ 96,853	$ 99,046
Net income	10,622	10,006	9,657	10,492
Basic income per common share (1):				
Net Income	$ .63	$ .61	$ .59	$ .68
Diluted income per common share (1):				
Net Income	$ .63	$ .60	$ .58	$ .66

(1) The sum of EPS for the four quarters may differ from the annual EPS due to rounding and the required method of computing weighted average number of shares in the respective periods.

Note 16 - Segment Information

Substantially all of our business is currently conducted in the United States. Revenues from our Canadian operations for 2005, 2004 and 2003 were $6.0 million, $4.7 million and $4.5 million, respectively. We have no significant long-lived assets located in Canada.

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

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES.

Controls and Procedures

Our principal executive officer (Chairman, Chief Executive Officer and President) and principal financial officer (Chief Financial Officer) have evaluated our disclosure controls and procedures as of December 31, 2005, and have concluded that these controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 (15 U.S.C. § 78a et seq) is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit is accumulated and communicated to management, including the principal executive officer and the principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

During the fourth quarter of 2005, no change occurred in our internal control over financial reporting that materially affected, or is likely to materially affect, our internal control over financial reporting.

Management's Annual Report on Internal Control over Financial Reporting

At year end 2004 as disclosed in our Form 10-K, we were unable to complete the required assessment of our internal control over financial reporting for the reasons stated in the 2004 Form 10-K. During 2005, we have remedied the various material deficiencies that existed at year end 2004 and as of December 31, 2005 are able to complete our assessment and report which is located in Item 8 of this report.

Certifications

Our Chief Executive and Chief Financial Officers have completed the certifications required to be filed as an Exhibit to this Report (See Exhibits 31.1 and 31.2) relating to the design of our disclosure controls and procedures and the design of our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION.

None.

PART III

In accordance with the provisions of General Instruction G (3), information required by Items 10 through 14 of Form 10-K are incorporated herein by reference to our Proxy Statement for the Annual Meeting of Shareholders to be filed prior to April 30, 2006.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

(a) The following documents are filed as part of this report:

(1) Financial Statements: See Index to Consolidated Financial Statements and Consolidated Financial Statement Schedule set forth on page 39 of this report.

(2) Exhibits: For a list of the documents filed as exhibits to this report, see the Exhibit Index following the signatures to this report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PRE-PAID LEGAL SERVICES, INC.

Date: February 27, 2006

By: /s/ Randy Harp
Randy Harp
Chief Operating Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name	Position	Date
/s/ Harland C. Stonecipher Harland C. Stonecipher	Chairman of the Board of Directors (Principal Executive Officer)	February 27, 2006
/s/ Randy Harp Randy Harp	Chief Operating Officer	February 27, 2006
/s/ Steve Williamson Steve Williamson	Chief Financial Officer (Principal Financial and Accounting Officer)	February 27, 2006
/s/ Orland G. Aldridge Orland G. Aldridge	Director	February 27, 2006
/s/ Martin H. Belsky Martin H. Belsky	Director	February 27, 2006
/s/ Peter K. Grunebaum Peter K. Grunebaum	Director	February 27, 2006
/s/ John W. Hail John W. Hail	Director	February 27, 2006
/s/ Thomas W. Smith Thomas W. Smith	Director	February 27, 2006

PRE-PAID LEGAL SERVICES, INC AND SUBSIDIARIES
Schedule I – Condensed Financial Information of the Registrant

PRE-PAID LEGAL SERVICES, INC. (Parent Company)
CONDENSED FINANCIAL INFORMATION OF THE REGISTRANT
BALANCE SHEETS
(Amounts in 000's)

ASSETS

	December 31,	
	2005	**2004**
Current assets:		
Cash and cash equivalents	$ 28,505	$ 22,991
Available-for-sale investments, at fair value	–	510
Membership income receivable	3,971	3,225
Inventories	1,717	1,623
Refundable income taxes	–	1,241
Deferred member and associate service costs	14,854	13,893
Other assets	2,874	2,933
Total current assets	51,921	46,416
Available-for-sale investments, at fair value	239	1,181
Investments pledged	374	374
Property and equipment, net	58,702	50,916
Investments in and amounts due to/from subsidiaries, net	39,626	31,331
Deferred member and associate service costs	2,752	2,325
Other assets	5,755	4,538
Total assets	$159,369	$137,081

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Membership benefits	$ 11,241	$ 9,903
Deferred revenue and fees	21,767	19,544
Current portion of capital leases payable	321	338
Current portion of notes payable	15,250	18,036
Common stock dividends payable	4,643	7,796
Accounts payable and accrued expenses	18,335	11,963
Total current liabilities	71,557	67,580
Capital leases payable	1,296	1,618
Notes payable	23,220	27,050
Deferred revenue and fees	2,490	1,877
Deferred income taxes	5,480	4,715
Other non-current liabilities	3,932	2,794
Total liabilities	107,975	105,634
Stockholders' equity:		
Common stock	203	205
Retained earnings	149,832	129,290
Accumulated other comprehensive income	387	980
Treasury stock, at cost	(99,028)	(99,028)
Total stockholders' equity	51,394	31,447
Total liabilities and stockholders' equity	$159,369	$137,081

See accompanying notes to condensed financial statements.

PRE-PAID LEGAL SERVICES, INC. (Parent Company)
CONDENSED FINANCIAL INFORMATION OF THE REGISTRANT
STATEMENTS OF INCOME
(Amounts in 000's)

	Year Ended December 31,		
	2005	**2004**	**2003**
Revenues:			
Membership fees	$ 289,553	$ 260,959	$ 211,824
Associate services	28,683	24,618	25,499
Other	4,714	5,247	3,796
	322,950	290,824	241,119
Costs and expenses:			
Membership benefits	102,354	89,016	66,524
Commissions	111,129	88,963	68,353
Associate services and direct marketing	30,311	24,618	28,823
General and administrative	30,127	32,037	14,711
Other, net	9,385	9,157	6,792
	283,306	243,791	185,203
Income before income taxes and equity in net income of subsidiaries	39,644	47,033	55,916
Provision for income taxes	13,677	16,226	19,080
Income before equity in net income of subsidiaries	25,967	30,807	36,836
Equity in net income of subsidiaries	9,845	9,970	3,071
Net income	$ 35,812	$ 40,777	$ 39,907

See accompanying notes to condensed financial statements.

PRE-PAID LEGAL SERVICES, INC. (Parent Company)
CONDENSED FINANCIAL INFORMATION OF THE REGISTRANT
STATEMENTS OF CASH FLOWS
(Amounts in 000's)

	Year Ended December 31,		
	2005	**2004**	**2003**
Net cash provided by operating activities	$ 46,586	$ 38,393	$ 50,271
Cash flows from investing activities:			
Additions to property and equipment	(14,778)	(10,879)	(27,012)
Purchases of investments – available-for-sale	–	(2,858)	(9,915)
Maturities and sales of investments – available-for-sale	307	11,783	–
Net cash used in investing activities	(14,471)	(1,954)	(36,927)
Cash flows from financing activities:			
Proceeds from exercise of stock options	4,439	5,176	2,014
Decrease in capital lease obligations	(339)	(808)	(1,701)
Purchases of treasury stock	(11,673)	(37,462)	(48,292)
Proceeds from issuance of debt	13,829	19,000	42,700
Repayments of debt	(20,445)	(17,335)	(9,912)
Dividends paid	(12,412)	–	–
Proceeds from other financing	–	–	1,000
Net cash used in financing activities	(26,601)	(31,429)	(14,191)
Net increase in cash and cash equivalents	5,514	5,010	(847)
Cash and cash equivalents at beginning of year	22,991	17,981	18,828
Cash and cash equivalents at end of year	$ 28,505	$ 22,991	$ 17,981
Supplemental disclosure of cash flow information:			
Cash paid for interest, net of amount capitalized	$ 2,432	$ 1,752	$ 78
Cash paid for income taxes	$ 13,350	$ 19,429	$ 20,200
Non-cash activities – cash dividends declared but not paid	$ 4,643	$ 7,796	$ –
Non-cash activities – capital lease obligations incurred	$ –	$ 1,058	$ 2,481
Non-cash activities – asset additions due to trade-in allowance	$ 426	$ –	$ –

See accompanying notes to condensed financial statements.

PRE-PAID LEGAL SERVICES, INC. (Parent Company)
CONDENSED FINANCIAL INFORMATION OF THE REGISTRANT
Notes to Condensed Financial Statements

Basis of Presentation
In the parent-company-only financial statements, Pre-Paid Legal Services, Inc.'s ("Parent Company") investment in subsidiaries is stated at cost plus equity in undistributed earnings of subsidiaries since the date of acquisition. The parent-company-only financial statements should be read in conjunction with the Parent Company's consolidated financial statements.

Notes 5 and 12 and the first two paragraphs of Note 10 to the consolidated financial statements of Pre-Paid Legal Services, Inc. relate to the Parent Company and therefore have not been repeated in these notes to condensed financial statements.

Expense Advances and Reimbursements
Pursuant to management agreements with certain subsidiaries, which have been approved by insurance regulators, commission advances are paid and expensed by the Parent Company and the Parent Company is compensated for a portion of its general and administrative expenses determined in accordance with the agreements.

Dividends from Subsidiaries
Dividends paid to the Parent Company from its subsidiaries are accounted for by the equity method. During 2005, PPLCI declared and paid a $4.1 million dividend to us. No dividends were declared or paid during 2004 or 2003.

INDEX TO EXHIBITS

Exhibit No.	Description
3.1	Restated Certificate of Incorporation of the Company (Incorporated by reference to Exhibit 3.1 of our Annual Report on Form 10-K for the year ended December 31, 2004)
3.2	Amended and Restated Bylaws of the Company (Incorporated by reference to Exhibit 3.1 of our 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 our 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 regarding life insurance policy covering Harland C. Stonecipher (Incorporated by reference to Exhibit 10.21 of our Annual Report on Form 10-K for the year ended December 31, 1985)
*10.3	Amendment dated January 1, 1993 to Split Dollar Agreement between Shirley Stonecipher and the Company regarding life insurance policy covering Harland C. Stonecipher (Incorporated by reference to Exhibit 10.3 of our 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 our Annual Report on Form 10-K for the year ended December 31, 1986)
*10.5	Amendment to New Business Generation Agreement between the Company and Harland C. Stonecipher effective January, 1990 (Incorporated by reference to Exhibit 10.12 of our Annual Report on Form 10-KSB for the year ended December 31, 1992)
*10.6	Amendment No. 2 to New Business Generation Agreement between the Company and Harland C. Stonecipher effective January, 1990 (Incorporated by reference to Exhibit 10.13 of our 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 10.7 of our 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 our Quarterly Report on Form 10-Q for the six-months ended June 30, 2002)
10.9	Security agreement dated June 11, 2002 between Bank of Oklahoma, N.A. and the Company (Incorporated by reference to Exhibit 10.2 of our Quarterly Report on Form 10-Q for the six months ended June 30, 2002)
10.10	Form of Mortgage dated July 23, 2002 between Bank of Oklahoma, N.A. and the Company (Incorporated by reference to Exhibit 10.3 of our Quarterly Report on Form 10-Q for the six months ended June 30, 2002)
*10.11	Deferred compensation plan effective November 6, 2002 (Incorporated by reference to Exhibit 10.14 of our Annual Report on Form 10-K for the year ended December 31, 2002)
10.12	Loan agreement dated September 19, 2003 between Registrant and Bank of Oklahoma, N.A., Comerica Bank and First United Bank & Trust (Incorporated by reference to Exhibit 10.1 of our Report on Form 10-Q for the period ended September 30, 2003)
10.13	Aircraft purchase agreement dated December 9, 2004 by and between S&S Aviation, LLC and the Company (Incorporated by reference to Exhibit 10.13 of our Annual Report on Form 10-K for the year ended December 31, 2004)

10.14	Aircraft purchase agreement dated December 9, 2004 by and between Harland C. Stonecipher and/or Shirley A. Stonecipher and Stonecipher Aviation, LLC and the Company (Incorporated by reference to Exhibit 10.14 of our Annual Report on Form 10-K for the year ended December 31, 2004)
10.15	Assignment and Assumption of Lease dated December 20, 2004 between Harland C. and Shirley Stonecipher and the Company (Incorporated by reference to Exhibit 10.15 of our Annual Report on Form 10-K for the year ended December 31, 2004)
*10.16	Amended Deferred Compensation Plan effective January 1, 2005 (Incorporated by reference to Exhibit 10.16 of our Annual Report on Form 10-K for the year ended December 31, 2004)
21.1	List of Subsidiaries of the Company
23.1	Consent of Grant Thornton LLP
31.1	Certification of Harland C. Stonecipher, Chairman and Chief Executive Officer, pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934
31.2	Certification of Steve Williamson, Chief Financial Officer, pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934
32.1	Certification of Harland C. Stonecipher, Chairman and Chief Executive Officer, 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

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

Board Of Directors

Harland C. Stonecipher
Chairman, Chief Executive Officer,
and President of the Company

Peter K. Grunebaum
Independent Investment Banker
and Corporate Consultant

John W. Hail
Founder of AMS Health Sciences, Inc.

Martin H. Belsky
Professor of Law
University of Tulsa College of Law

Thomas W. Smith
Founder of Prescott Investors
(Private Investment Management)

Orland G. Aldridge
Independent Insurance Agent

On May 31, 2005, our Chief Executive Officer certified to the New York Stock Exchange that he was not aware of any violation by us of the New York Stock Exchange corporate governance listing standards as of such date.

We have filed as an exhibit to our Annual Report on Form 10-K for the year ended December 31, 2005 the Sarbanes-Oxley Act Section 302 certifications regarding the quality of our public disclosure.

Shareholder Information

Shareholders Inquiries
Communications regarding lost stock certificates, change of address, etc., should be directed to:
UMB Bank, N.A.
Securities Transfer Division
P.O. Box 419064
Kansas City, Missouri 64141-6064
Investor Relations 800.884.4225

Corporate Headquarters
Pre-Paid Legal Services®, Inc.
One Pre-Paid Way
Ada, Oklahoma 74820-5813
www.prepaidlegal.com

Stock Transfer Agent
UMB Bank, N.A.
Securities Transfer Division
P.O. Box 419064
Kansas City, Missouri 64141-6064

Legal Counsel
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20 North Broadway
Suite 1800
Oklahoma City, Oklahoma 73102-8273

Independent Accountants
Grant Thornton, LLP
Suite 1200
One Leadership Square
211 N. Robinson
Oklahoma City, Oklahoma 73102-7148