



**Pre-Paid
Legal
Services, Inc.**

Portrait of a Pyramid in Collapse

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Preface and 2008 Update

This report was prepared in December, 2007 and, therefore, used the latest 10K data available at that time, the 2006 report to the SEC and those previous to that date. A review of the 2007 10K and the data for the first quarter of 2008 show a continuation and acceleration of decline of Pre-Paid Legal Services Inc. that this report documents and interprets.

To examine this trend of financial decline, the report focuses primarily on data of Pre-Paid's "sales" force, which is the driver of its marketing. Pre-Paid does no national advertising. Marketing is ultimately borne by the sales people individually. The sales force is also the core of the company's *revenue*. Their own purchases alone constitute about a third of all company revenue. Each "Associate", on average, recruits only a handful (less than four) actual "customers" (called Members). The "Members" are directly connected to the salespeople as family, friends or neighbors, as the "one-to-one" model dictates. Therefore, as the trend of recruiting salespeople goes, so goes the company. That trend is clearly negative now. The reasons are fundamental, not cyclical, and therefore not reversible.

This report presents the mathematical and demographic basis for Pre-Paid Legal's inevitable and fully anticipated slide toward saturation and decline. It details and explains the flawed and fraudulent business model – an endless chain recruitment scheme – that the Pre-Paid employs, which leads to this inexorable status.

This business model propagates, as all such pyramid schemes must, a pervasive campaign of deception to enroll investors, called "Associates", in its "income proposition." This proposition is based on promised commissions that are said to flow from an endless chain of new investors. The commission plan links revenue from each Associate's recruits and those they in turn recruit down an endless chain. The higher one rises on the chain through recruitment, the greater the commission rates as formulated in Pre-Paid's complex play plan.

Since such a model is mathematically impossible, i.e., if each person recruits 5 and this is continued successively, the population of the earth is exceeded in just 13 levels of the chain, and Pre-Paid is generally restricted – by the nature of its legal services product – to North America, market saturation is inevitable.

For nearly all new recruits, this saturation point was effectively reached years ago, however, by churning nearly half its entire investor base (Associates) and the few customers each of them generates each year, the *scheme itself* has been able to endure. The *Associates'* market for enough new Associates is saturated, but the market *of Associates for the company* has remained viable. The company's continuation is, and has always been, based on upon the revenue gained from the "failed" investors and a massively churning customer base who are related to the failed investors (Associates). Yet, now the market *of Associates for Pre-Paid's promoters* is finally saturated. Enrollment declines are now the trend.

The total number of Pre-Paid Associates declined in number from the previous year in 2003, 2006, again in 2007, and the first quarter of 2008 shows an accelerating decline. Pre-Paid Legal recruited 24,197 fewer new "Associates" in 2007 than in 2006. Total Associates at the end of 2007 declined by 2,138, representing a 0.5% decline from the year before and an approximately 6% decline from its peak in 2005.

Over the 12 months of 2007 Pre-Paid Legal recruited 148,802 new Associates while 150,940 quit the scheme by the end of the year.

The declining recruitment is especially lethal to PPD because its' revenue vitally relies upon money invested by the new recruits. It is also critical because an enormous number of Associates are required to gain any market growth at all. Few of the Associates ever succeed in recruiting even one other Customer or Associate. They quit the scheme at a rapid rate or, if they remain, they "fail" in building a required "downline" due to the market saturation they face.

Pre-Paid Legal reported in the 2007 10K that only 90,123 of its Associates sold at least one membership, of which 49,117 (55%) made first time sales. The bulk of its sales are, therefore, carried out by the "last ones in". Fewer recruits translates to a compounding reduction in recruiting activity.

To put the picture of Pre-Paid's recruitment mandate in starker perspective – and the compounding consequences of a decline – PPD had 444,499 Associates at the end of 2006 and during 2007 brought in 148,802 new "sales" people for a total of 593,301. But only 90,123 or 15% of this group made even one sale in 2007. The company needed seven Associates for each one that made sales during the year. And more than half of those making sales were making their *first* sales, that is, they were among those initially joining the scheme. During all of 2007, 503,178 of the Associates – 85% – either quit or did not make even one sale.

Pre-Paid Legal's data for the first quarter of 2008 further confirm the pattern of decline. It reported to the SEC that "during the 1st quarter of 2008, new sales associates enrolled decreased 16.9% compared to the first quarter of 2007. On a sequential quarterly basis, new associates enrolled decreased 28.4%."

The "product" that Pre-Paid markets – a kind of insurance for certain legal services – is secondary to the driver of the income promise. When Pre-Paid's "insurance" product is examined in the context of the legitimate legal services market place its marketing scheme is revealed to be anomalous; consumer reactions (massive cancellation rates) are unique in this field; and its product is exposed as lacking in value and substance. The program endures on the basis of its ability to lure consumers with a false income promise and a highly misleading presentation of its services and their actual value.

In addition to its adroit and extensive use of deception to enroll consumers, Pre-Paid Legal has also enjoyed a period of virtual immunity from prosecution against chain selling and deceptive trade practices by state and federal regulators in recent years. This government inaction has bolstered its ability to survive lawsuits brought by consumers who claim they were harmed.

Yet, even in this recent environment of little government oversight, public confidence in Pre-Paid Legal is waning. Reports in the *Wall Street Journal*, *thestreet.com* and other media about Pre-Paid operations and the news and details of the many lawsuits that have been brought against it are having their inevitable impact. This effect, like the mathematical factors of saturation, will likely compound.

If the current climate at the Federal Trade Commission of laxness toward pyramid selling schemes and deceptive trade practices changes or if the Securities & Exchange Commission examines Pre-Paid's basic business model – and its consequences for shareholders – more closely, Pre-Paid Legal faces extraordinary challenges.

Date: December 9, 2007
To: Fraud Discovery Institute
From: Robert L. FitzPatrick
Re: Analysis of the Business Model and Practices of Pre-Paid Legal Services, Inc.

I. Overview and Conclusion

This report on Pre-Paid Legal Services, Inc. (referred to as PPL or Pre-Paid Legal) has been prepared for Fraud Discovery Institute (FDI)¹ as part of its wider inquiry into the business practices and business model of large multi-level marketing (MLM) companies that are traded on major stock exchanges. I also recently prepared analyses for FDI on Usana Health Sciences and Herbalife International. My credentials as an author, corporate consultant, business analyst and expert witness in multi-level marketing and pyramid scheme courts cases are included at the end of this report.

I conclude that, while each of these three companies – Usana, Herbalife and Pre-Paid Legal – has a different façade of products, in essence, all three companies are one and the same – pyramid marketing schemes.² The one key distinction among the three that I observe is that Pre-Paid Legal is at the stage of *imminent collapse*, while Usana and Herbalife may be able to prolong the life of their pyramids by geographic expansion, though even these companies have been severely hindered in satisfying their insatiable need for new investors by the recent ban on MLM in China.³

Pre-Paid Legal's status as a pyramid facing *imminent collapse* is not result of a single factor, such as the recently proposed "Business Opportunity Rule" which some financial analysts have cited as a primary reason for a "sell" recommendation to their clients on PPL.

Nor is the collapse scenario strictly an outcome of PPL's deteriorating financial condition showing higher debt, sales of stock by insiders, and the increasing use of company funds to sustain its stock price, though these are obvious negative indicators.⁴

¹ <http://www.frauddiscovery.net/index.html>

² The term "pyramid marketing scheme" is used in this report within the meaning of the "Business Opportunity Rule." recently proposed by FTC.

"The proposed Business Opportunity Rule would also address the sale of other business arrangements that are currently outside the scope of the Franchise Rule, but have been shown by the Commission's law enforcement experience and complaint data to be sources of prevalent and persistent problems. *Two important types of fraudulent or deceptive opportunities that would fall within the proposed Rule's coverage are work-at-home schemes and pyramid marketing schemes.*" (italics added) Federal Register / Vol. 71, No. 70 / Wednesday, April 12, 2006 / Proposed Rules, 19059

³ In 2005, the government of China passed a law that outlaws the payments of commissions on purchases made by "downline" recruits in MLM schemes. Traditional direct selling, based on retail selling to the public, not endless chain recruiting, was approved and now flourishes in China.. Most MLM companies believed China would legalize US-style recruitment.

See <http://www.pyramidschemealert.org/PSAMain/news/ChinaoutlawsMLM.html>

⁴ An example of a prediction of PPL's collapse based on specific external factors and technical financial indicators is the well researched published analysis, issued November 16, 2006 by Austin, Texas-based Tejas Securities Group. The report recommended that investors sell their Pre-Paid stock holdings, based primarily on the expected impact of the proposed FTC Rule. "Our negative view is supported by a potential new FTC rule that will severely impact the Company's revenue base, a fundamental decline in operating results, and the

The collapse is also not due to the financial losses suffered by the majority of all consumers who sign up as “Associates” or the extreme rate of cancellations by PPL “members”. These same loss and churn rates apply to all pyramid marketing schemes.

My assessment is based on years of observing the behavior of multi-level marketing companies and their vexing ability to enroll consumers into their income schemes, while inflicting 90-99% loss rates on them year after year. I have examined, researched and analyzed and in some cases testified in court as expert witness against dozens of multi-level marketing companies. I have studied their pay plans, organizational structures and statistically calculated their commission payouts. I have attended meetings, interviewed critics, victims, devout followers and recently solicited prospects into MLM schemes, in addition to meeting with regulators, journalists, attorneys, and financial analysts in many countries who deal with these types of schemes.⁵

As a business analyst focused for more than 10 years on the multi-level marketing sector (Worldwide, there are only a few people who have studied this area of business.) I have come to see their stages of development, learn the code of their pay plans, recognize patterns of behavior, and to identify which ones will grow quickly, which ones will fail quickly and which ones are more likely to attract anti-fraud law enforcement action.

In addition to the jeopardy of law enforcement, all such companies have one great vulnerability – public awareness of their deceptions and manipulations and increasing critical inquiry into their operations. *Pre-Paid Legal is now meeting this fate.*

Short of a prosecution by the Federal Trade Commission (FTC), which can cause total and immediate collapse, it takes a prolonged series of exposures for American consumers to doubt a multi-level marketing scheme that is large, growing and profitable. Even the probable collapse caused by government regulatory action is often not due to penalties imposed but by the subsequent *loss of public confidence* that the prosecution provokes.

Faith maintains the MLM scheme, not financial results for the salespeople (as the trail of victims manifestly shows) or a market need that its product meets (as the massive churning and cancellations reveal).

Amway, the oldest of the MLM schemes, has suffered the kinds of exposures that PPL is now experiencing but over a much longer time frame. The time periods between lawsuits, media exposures or prosecutions has allowed Amway to endure. However, the pressure is growing.⁶

potential for covenant violations under the Company’s \$80MM credit facility. Furthermore, we view recent attempts by insiders to sell large stock positions back to the Company under its stock repurchase plan as a negative sign.”

⁵ In 2005, I was invited to Sri Lanka to lead an international seminar on combating multi-level marketing pyramid schemes. Sri Lanka and other participating countries in the seminar had no laws against such schemes and had not until recently experienced them on a large scale.
See <http://www.pyramidschemealert.org/PSAMain/news/srilanka.html>

⁶ From time to time, Amway has suffered extremely negative media exposés. The most recent was a devastating investigative report, including hidden cameras on *NCB Dateline*. However, the investigations seldom lead to government inquiries in the USA or followup media report. See “In pursuit of the almighty dollar, Dateline investigation: Inside story of business that attracts people with promise of easy money” by Chris Hansen NBC News, May 7, 2004. (<http://www.msnbc.msn.com/>)

Amway is finally faltering. It is actually on trial now in the UK for fraud. The government of England is trying to expel it from the country. One large state in India has raided Amway offices and is seeking to shut it down. It's business model is now banned in China where it had invested massively for much needed new territory. And it faces class action law suits both from bottom level distributors and its "top gun" insiders, both charging it with fraud. Amway even went so far as to change its business operation name to "Quixtar" and the parent company's name to "Altacor" in order evade rising public skepticism in North America where sales flattened and declined.⁷

Pyramid marketing schemes are *faith-based*:

- Faith of the followers that the "unlimited" income promise, based on endless-chain recruiting, really is "limitless", and that they are "at the right place at the right time" perhaps for the first time in their lives;
- Faith that the proclaimed integrity of the leaders is genuine and that they are not getting rich at the expense of the followers;
- Faith that the espoused mission of the MLM really is to help the little guy achieve "financial freedom" and escape "wage slavery", and to help the followers shed their "loser" mentality that has been limiting their vision and success;
- Faith in the power and value of the MLM product, often touted as a near miracle of science or a brilliant new idea that no one else thought of and which cannot be offered in stores or in the open market.

When these wane, the scheme is nearly finished. MLMs require continuous *momentum*. They need to be able to tell prospects that they are "catching the wave." Pre-Paid Legal has lost momentum. And, due to the nature of its product offering, it has no other countries to run to, as Amway, Herbalife and Usana have.

Pyramid schemes, disguised as "direct selling" companies and politically protected from law enforcement, enjoy all the respect of real businesses plus the nefarious advantages of deception and trickery reserved to frauds. This combination makes for astonishing ability to produce cash and attract followers. The fake image is often polished further with celebrity endorsements, sports event sponsorships and the theater of spectacles. Pyramid marketing schemes have been termed by other MLM analysts the "perfect scam."

They wrap themselves in treasured American values of entrepreneurship, family, and independence. Many claim to have a spiritual or Christian foundation. They position themselves as the rightful heirs of the venerated tradition of Yankee Peddler and classic door-

The full video can be seen http://www.merchantsofdeception.com/files/dateline_quixtar.wmv. Additionally two widely read books are now on the market, see <http://www.merchantsofdeception.com> and <http://www.mlmsurvivor.com/BookCorner/smokeandmirrors.htm>

⁷ For a description of the Amway's coming collapse, see <http://www.pyramidschemealert.org/PSAMain/news/TopGunsSueQuixtar.Amway.html>.

Amway expended great effort promoting the idea that Quixtar is a "new" company, though its leaders, products and pay plan were the same as Amway. The consumer education group, *Pyramid Scheme Alert*, has received many consumer inquiries about Quixtar most of which said they were told that Quixtar was a new company, unrelated to Amway. Many said they would have nothing to do with Amway but were interested in Quixtar based on its claims and promises.

to-door sales. And they also present a populist image as saviors of the little guy that has been mistreated by Corporate America and ignored by Washington. When regulators threaten them they can forcefully tell the believers that it is an expected response by corporate competitors or power-hungry bureaucrats fearful of MLM's power to free people from jobs and government support.

MLM meetings are like religious revivals. Some followers take on the characteristics of cult members, constantly repeating aphorisms, obsessively recruiting, adopting a seemingly new personality and associating only with fellow devotees. Anyone who attends MLMs meetings will attest to the remarkable similarity of their presentations, rhetoric, participant responses, sales techniques, claims and promises. This is true whether the product is legal services, vitamin pills, soap or fruit juice.

Pre-Paid Legal faces loss of faith in its legal services product, which is evaluated as over-priced, misleadingly presented and of very limited usefulness, and its income plan, which is revealed to be illusory due to devastating chargebacks, massive dropout rates, and absurdly low income averages. The adverse publicity of lawsuits, jury awards to victims, and investigations by state Attorneys General further tarnish the image of the company and its leaders and is causing more consumers to hesitate or even to speak out against it.

The remarkable marketing power of PPL's (and other MLMs') deceptive promises has punished short sellers, confounded journalists and disheartened regulators. The vulnerability of consumers to join PPL's scheme without doing due diligence, the silence of those who lost money and quit, and PPL's ability to continue to sell a product of undetermined value while also fending off legal challenges and maintaining high stock prices have amazed financial analysts.⁸

Lack of knowledge about the nature of multi-level marketing – one of the least analyzed sectors of the securities market – has led some analysts into prematurely predicting PPL's demise. Their technical assessments were correct, but their lack of understanding about the nature of PPL, the spell that its message (a standard MLM spiel) can cast, and the political protection from investigation that MLM businesses currently enjoy weakened their sense of timing.

⁸ Well respected financial advisor, Peter Cohan, has previously called for PPL to be shut down by the government, called the company a "pyramid scheme", and described PPL's founder, Harland Stonecipher as a practiced liar. ("Pre-Paid Legal is in need of better reality, not better stories", July 28, 2003, <http://petercohan.com>.) Yet, as the PPL stock maintained its price and PPL vanquished legal challengers, he was quoted, "This is like a Teflon company," said Peter Cohan, a Massachusetts investment strategist with no position in the stock. "It's almost comical."

II. Sales Associate Saturation

In addition to the decline in consumer confidence in PPL’s promises, products, and leadership, there is another force insidiously at work against PPL – mathematics. A fundamental and inescapable fact about pyramid schemes is that they can operate only as long a new investors can be found to reward earlier ones, and an ever-growing number must be found each year. The limits of PPL’s expansion can be seen clearly in the following charts based on PPL’s SEC filings.

Pre-Paid Legal’s Historical Sales Rep Recruitment

Year	Associates Recruited During the Year	Active Associates at end of year	Annual Rate of Growth	Total Associates 12/31/95 to 12/31/2000 (total recruited + those already enrolled at 12/31/95)
1995		78,281		
1996	69,789	110,350	41%	
1997	58,121	123,470	12%	
1998	75,737	159,268	29%	
1999	92,644	204,137	28%	
2000	97,617	242,085	19%	
Total	393,908			472,189

209.3% growth in sales reps in five years from end of 1995 to end of 2000

25.5% annual growth rate in sales reps from end of 1995 to end of 2000

Year	Associates Recruited During the Year	Active Associates at end of year	Annual Growth Rate	Total Associates 12/31/95 to 12/31/2006 (total recruited + those already enrolled at 12/31/95)
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1996	69,789	110,350	41%	
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1999	92,644	204,137	28%	
2000	97,617	242,085	19%	
2001	122,192	286,488	18%	
2002	155,663	341,116	19%	
2003	108,557	329,600	-3%	
2004	107,552	343,696	4%	
2005	242,223	468,365	36%	
2006	172,999	444,499	-5%	
Total	1,303,094			1,381,375

55.1% growth in five years from end of 2001 to end of 2006

9% annual growth rate in sales reps from end of 2001 to end of 2006

Key Data and their Meaning:

- Just since the end of 1995, nearly 1.5 million people in the US and Canada have worked *as salespeople* for Pre-Paid Legal.
- Over 900,000 of these people who pursued the “opportunity” quit the scheme during this time.
- The annual rate of growth between the years up to 2001 and since has slowed tremendously, from 26% to 9%. The decline began as exposures, analysis, lawsuits and regulatory investigations began.
- Pre-Paid’s massive cancellation rate among new recruits requires that the “upline” maintain constant new recruitment in order to replenish funds lost to terminations, which trigger commission chargebacks.
- Unlike conventional businesses with stable customer bases, PPL must replenish nearly half its recently gained customer base every year.
- Recruits at the bottom, in order to be profitable, must significantly grow the total base. They must be able to see *momentum and growth*. If they see little or no growth, they will foresee their own inevitable failure and the company will have more difficulty sowing false hope in its pyramid model.
- At the end of 2006, more than 1.3 million households already had worked for PPL as sales Associates, The total number of households in the US in 2006, according to the US Census Bureau, is 110 million. Over 1% of the households of the entire current American population has already *worked* for PPL!⁹
- There are only 99 possible households in America for every one that is or has already been a PPL Sales Associate!

⁹ PPL’s sales are limited by its ability to recruit salespeople far more than by the size of the market of customers. But it offers no information to investors about the size of the market *for salespeople*. How many consumers are in that market? And how many customers do the salespeople need for most to even have a chance at profitability? PPL also does it account for the spreading negative influence of failed “Associates.” Instead, PPL obscures its obvious and inevitable march to saturation of the sales Associate market. It only informs shareholders about “memberships” as a percentage of total market potential, which it defines as 100 million households in the USA and Canada. In its 2006 10K, PPL stated that it currently had 1.5% share and an additional 6% of households have previously purchased (but no longer own) PPL policies. However, already, about 1.5% of the total market of potential *buyers* have already become *salespeople* for PPL! About one million of them quit the scheme and stopped using the product.

III. Declining Consumer Confidence in Pre-Paid's "Opportunity"

At some undefined point, which some estimate to be in the mid-1980's and others into 1990's, the term "Amway" became identified in the minds of millions of people with either outright scam or at least with a bothersome individual who lures friends or relatives to meetings to hear about an "opportunity" widely known (but not to the sponsor) as a waste of time and money. The tactic, apparently taught by Amway, of inviting people to hear about the opportunity, without ever mentioning the Amway name, became part of American lore. The syndicated comic strips, *Jump Start* and *Dilbert*, among others, have done parodies on the nearly universal experience of being invited to what was presented as a social gathering but turned out to be a high pressure MLM (usually Amway) recruitment meeting.



Churning, Chargebacks and Recruiting

Similarly, the undisclosed realities of Pre-Paid Legal's income opportunity and the weaknesses of its core product have begun to leak out into the mainstream.

The opening may be dated to *The Wall Street Journal* article, January 17, 2001 "Pre-Paid Legal's Accounting for Commissions Draws Fire" by Jonathan Weil. The article revealed much more than a accounting irregularity. It exposed PPL's pyramid proclivity for borrowing from the future and obscuring its ultimate liabilities linked to continued recruiting.

The article reported that to lure new recruits PPL paid its salespeople a three-year advance commission on sales and then claimed these payments as assets, not expenses. The classification of those payments as assets had obvious positive effects on the balance sheet and PL statement.

Moreover, the company sought to obscure the massive liability of cancellations. As the cancellations occurred, the company sought to recover the advance payments with "chargebacks", effectively seeking refunds from the sale associates out of their future commissions. However, with more than half of the sales force quitting the business within a year or having no future sale commissions to charge against, many of these refunds were not recoverable.¹⁰

PPL claimed the money for these non-recoverable chargebacks was covered by "lost" commissions from the sales people who quit. The amount that PPL owed to the Associates, as long as they remained active but was lost by them if they quit, somehow exactly matched up

¹⁰ *The Wall Street Journal* quoted Douglas Carmichael, an accounting professor at Baruch College in New York, "Their accounting doesn't portray economic reality. And economic reality is going to catch up with them one way or another. So it's a stock to avoid."

with amount of commissions payments that PPL could not recover due to cancellations and the rapidly churning sales force.¹¹ Many that quit walked away from commissions on the few sales they may have made. It turns out that the vast majority of all PPL “sales” are made only by a small fraction of the newest recruits, the same group in which about half quit within a year.¹²

In pointing out the boon to PPL of unpaid commissions *The Wall Street Journal* put a spotlight on the extreme rate of PPL drop outs, that is the internal operation of the business, not just its accounting. Why would so many quit so fast, especially if they had commissions still coming to them? What was there about the PPL product that resulted in so many buyers abandoning it? Was this the norm in the prepaid legal services industry?

Focused primarily on the plight of PPL’s *shareholders*, *The Wall Street Journal* did not probe further into the extremes of recruiting and quitting among PPL “Associates” and “Members.”¹³ However, many others did.

Pre-Paid Legal was subsequently besieged by private and class action lawsuits based on charges of misrepresentation of its product, misrepresentation of income potential, an “unconscionable” contract that led most Associates into loss positions, withholding of information on rates of cancellations and chargebacks, misleading shareholders, and accusations that the PPL operation was just a pyramid scheme based on endless chain recruiting. Pre-Paid Legal arguably has been sued more times and for more reasons related to deception than any other MLM in the world.¹⁴

The most damaging facts about Pre-Paid Legal’s “opportunity” are the churning rates and chargebacks, placing a recruit on a treadmill of recruiting to gain an elusive profit.¹⁵

¹¹ This balancing act between unrecoverable commission advances and the “lost commissions” of the newly recruited salespeople who subsequently quit is still PPL’s key to viability. From the 2006 10K, “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.”

¹² The pattern of most PPL “sales” being generated by the “last ones in” is a hallmark of the endless chain model. In 12 months between the end of ’05 and ’06, PPL had 641,364 Associates (468,365 at the end of ’05 plus 172,999 new Associates recruited during ’06). Yet, according to the 2006 10K, “During 2006, we had 90,206 sales associates who personally sold at least one Membership, of which 49,955 (55%) made first time sales.” **Translation:** Only 14% of all the “sales” Associates ever made a sale in 2006 and of those, over half were made by the newest enrollees (the last ones in).

¹³ *The Wall Street Journal* allowed PPL’s COO, Randy Harp to claim ignorance of any reasons for the massive churning rates among PPL’s sales associates, even those that were owed commissions. To continue receiving commissions an Associate only has to continue making the small monthly charge to keep his/her own PPL service in force. Yet, Harp acknowledged that PPL associates abandon “thousands, or hundreds of thousands, of dollars” of commissions “Why would any associate walk away from so much easy money?” Mr. Harp was asked by WSJ. To which he replied, “I don’t know why they do but it happens every quarter.”

¹⁴ PPL’s 2002 10K disclosed, “Beginning in the second quarter of 2001 and through December 31, 2002, multiple lawsuits were filed against the Company, certain officers, employees, sales associates and other defendants in various Alabama and Mississippi state courts by current or former members seeking actual and punitive damages for alleged breach of contract, fraud and various other claims in connection with the sale of memberships.” The report noted 28 cases filed in Alabama and 14 in Mississippi. Others were filed in Oklahoma, where PPL is based.

¹⁵ See “Ex-agents feel misled by Pre-Paid - Class-action lawsuit seeks relief of debt” by Melissa Davis 04/28/2002, *Daily Oklahoman*, “Coker was a volunteer deputy sheriff, policing his suburban Houston

The churning and chargebacks are the tarnished flip side of the shiny coin of “advances” that PPL pays on new sales. The advances would seem to enable the Associate to generate fast money and positive cash flow against the requirements of owning a PPL policy and paying out about \$30 a month.

On the Pre-Paid Legal website, the fact that chargebacks occur is repeatedly stated and a hypothetical chargeback rate schedule is presented. But, the actual historical rates of cancellation – which determine and predict chargeback costs – are not shown.¹⁶ Only in its 10K report to the SEC did PPL disclose the actual math of the chargeback scenario. Yet, even in this technical and legal format PPL does not spell out reality in intelligible terms. The brutal truth is couched in confusing data of “lapse rates” (shown below from the 2006 10-K).

Lapse Rates

As of December 31, 2006			
Yearly Lapse Rate	Yearly Retention	End of Year Memberships	Membership Year
		100.0	0
49.4%	50.6%	50.6	1
31.6%	68.4%	34.6	2
23.4%	76.6%	26.5	3
18.3%	81.7%	21.7	4
13.0%	87.0%	18.8	5
10.1%	89.9%	16.9	6
7.9%	92.1%	15.6	7

The actual rate of cancellations is found in the “End of Year Memberships” column. Starting with 100, at the end of the 3rd year only 26 members are left enrolled.

Rather than illustrating the progressively growing number of cancellations among new customers – which is relevant to expected income of the Associates – PPL shows the increasing rate of retention among those who remain.

So, instead of stating plainly that within the first three years cancellation rates of new sales progress from 50% to 67% to 74%, PPL reports increasing retention rates, showing that in the third year 76.6% do not lapse. True, but that “retention rate” would only apply to last 3

neighborhood, when he discovered Pre-Paid in 1995. Swayed first by the company's product - and then by its business opportunity - Coker began marketing Pre-Paid on a part-time basis. A talented salesman, Coker swiftly rose to prominence within the company, achieving the rank of area coordinator, bronze executive director, motivational speaker and national trainer. He was largely responsible for building the Pre-Paid market in Houston and, at the height of his career, collected a \$19,000 check for a single month's work. Today, Coker stresses that he earned only \$527.78 of that \$19,000 check. The rest was an advance, which he was expected to repay, with interest, if his Pre-Paid customers canceled their memberships before the end of three years - as 71 percent of the company's customers do.”

Coker went on to claim in this article that many of PPL’s “successful” sales people were just living on revolving cash flow of PPL advances that are later wiped out by PPL chargebacks and then replaced by new advances. They can’t get off the treadmill, he asserted.

¹⁶ Not only does PPL’s website not explain the devastating impact of chargebacks, it leads the recruit into believing that they are relatively minor factor.

“What makes Pre-Paid Legal's compensation plan so powerful?

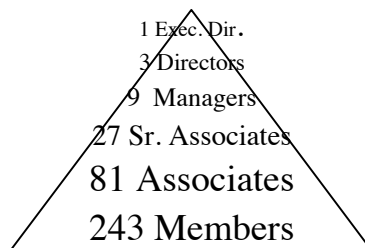
Advance Commissions**- On a \$26 membership sale, we pay out up to a total of \$245.50. How can we do this? Our customers stay with us year after year after year. We have a solid financial base with millions in corporate assets.” (http://wserver0.prepaidlegal.com/newCorp2/bus_opp/how_3.html)

remaining out of an original 10 that would have been sold. Seven would have already cancelled.

The PPL salesperson would be foolish to have spent the “advance” because much of it would be owed back to PPL in short order. And if he/she had projected ongoing earnings and made purchases accordingly, those expectations would be dashed and financial troubles would ensue.

If the commission is a constantly disappearing commodity and the advances turn out to be bad loans, (PPL in the past actually charged interest – unknown to most Associates – on the advances, so when chargebacks were applied, they included interest charges as well), how do the PPL Associates get ahead of the cancellation curve?

They must get high enough on the PPL pyramid where cash flow becomes more positive and the personal effort to recruit is borne by *others*. Only in these high places does the recruiting time and cost not outweigh the chargeback expenses. Rising to those rare seats in the upper ranks requires diligent recruiting in a classic pyramid scheme fashion. Progressively higher positions require a specified number of others in lower positions to have been recruited.



Above this basic 3 x 3 matrix of levels, the PPL Pyramid extends further upward and outward with as many as 10 levels of “Executive Directors” from Bronze through Platinum. Each Platinum Level Director can have 10 “legs” of “Executive Directors” directly below.

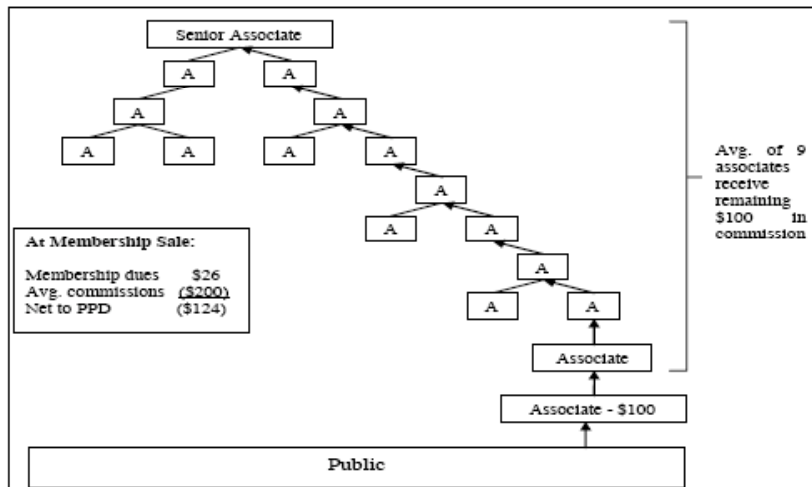
IV. Secrets of the PPL Pyramid

PPL does not disclose to prospective Associates or to shareholders key information needed to know whether the business proposition it offers to prospective Associates – the engines of PPL’s model – is viable. Most new Associates sign PPL contracts without knowing:

- Historical dropout rates (failure) of Sales Associates
- Historical cancellation rates of Members
- Actual rate of chargebacks based on historical cancellation rates.
- Average incomes of all Associates over an extended period of time.
- Average costs of Associates to maintain their Associate business.
- Average number of sales per Associate (sales productivity) over an extended period of time.
- Ratio of Associates to Members (retail customers)
- Percentages of total commission payout made to upper levels of sales chain (spread of total commissions among the levels of the sales chain). No figures are given that break out the payments by percentiles of the total sales organization.
- In fact, most consumers sign up without having examined the actual PPL policy that they will be purchasing for themselves and selling to close friends and/or relatives.

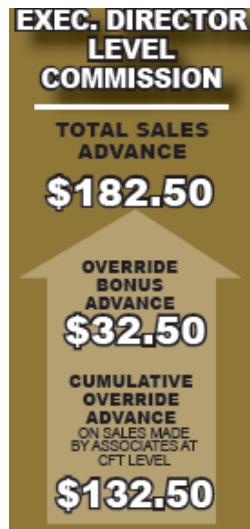
In a published 2006 analysis of Pre-Paid Legal, Tejas Securities, Inc. tried to graphically illustrate the complex web of payments that flow upward from a new sale made at the bottom of the PPL Pyramid.¹⁷

Table I – Sales Organization Schematic



Source: Company filings

Without the basic information that PPL has withheld, the new Associate has no idea how much of total payments actually reach the people making sales and how much is transferred to the top. If the majority goes to the few at the top, the opportunity below diminishes. At Usana, for example, 72% of all commissions were awarded to the top 3% of the chain. Herbalife showed an even more extreme money transfer pattern. In 2006, 84% of all commissions paid by the company were transferred to less than one percent (.76%) of the entire distribution channel, the group positioned each year at the top of the pyramid.



Personal advances and “override” advances increase greatly if an Associate can recruit enough to move to higher positions on the pyramid hierarchy.

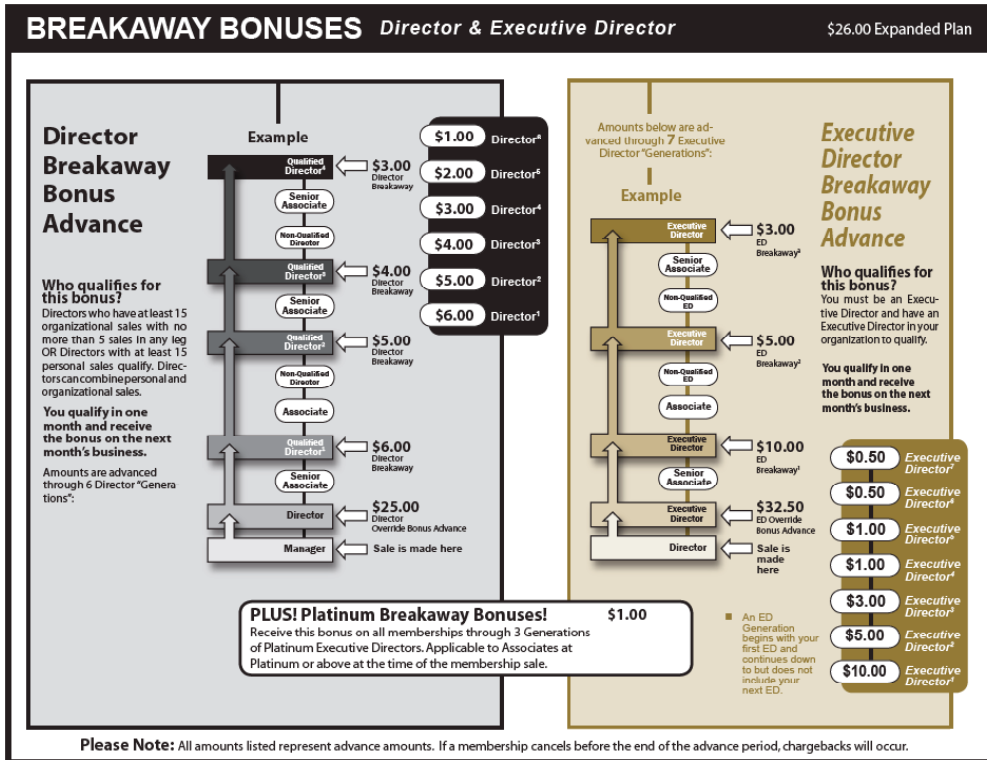
<https://wsecure.prepaidlegal.com/pdf/52532.pdf>

The advances increase as one moves up the chain and they compound as the base of the “downline” expands. When a sale is made at the bottom – and most sales are made by those at the very bottom – as many as nine other people get paid. Other analyses have shown that

¹⁷ <http://www.tejassec.com/>

about half as much of total commission go to the “upline” as do to the person making the sale, per sale. Deciphering this math would be utterly impossible for a new recruit and, as noted, the implications of chargebacks, cancellations and Associate drop outs are not known to the recruit.

PPL, unlike many other major MLMs, does not reveal to shareholders or consumers how much of the total payment are transferred to each level. However, the existence of the additional “breakaway” advance shows a major payment to those at the pinnacle of the pyramid. As shown below, this payment accrues from “7 Executive Director Generations.”



The Breakaway Payments Send exponentially compounded commissions from the downline to PPL Recruiters at the top of the Pyramid

How Many PPL Associates Are (or Could Be) Successful?

The mean average gross income of PPL Sales Associates in 2006: ----- \$5.48 p. wk.

Mean average after deducting direct costs for PPL “sales tools”: ----- \$4.32 p. wk.

% of Associates that could possibly earn a gross income of \$40,000 per yr: ---- 0.7% (7 per thousand)¹⁸

¹⁸ The mean average is the total commissions paid by PPL in 2006 divided by the total number of vested Associates it reported at the end of 2006 (SEC, 10-K filings)

If 0.7% of PPL Associates earned \$40,000 all others would have to earn *nothing*. Since, of course, tens of thousand earned *some* commission, however small, the actual number of potential \$40,000 earners would be far fewer than 7 per thousand. (Mean average of \$285 divided by \$40,000 = .007. Total number of Associates

V. PPL's Business Model: Without Peer

It is generally considered beneficial to have few competitors, but to have none at all is seldom a positive or long term situation to be in. It indicates that the product's market is exhausted and all others have left the field or the product is virtually unknown or the product is unmarketable at a profit.

Pre-Paid Legal is the only known company in the country whose core business is to market legal insurance programs directly to individuals. All others market primarily to groups, such as companies or labor unions and they sell through their own sales forces, independent insurance brokers, or brokers specialized in group benefits.¹⁹

A survey released in July 2005 by the American Prepaid Legal Services Institute entitled, "Report of the 2004 Survey of Legal Service Plan Characteristics" showed that of the surveyed plans 90% of persons who have legal service benefits are covered by a plan sponsored by an employer, a trade union or both. Over 75% of those eligible for legal benefits are enrolled automatically by virtue of their employment or union membership status, the survey found.²⁰

PPL's Peerless Product:

- Offers flat annual payment to law firm providers regardless of claims made rather than actual reimbursements for services rendered.
- Offers significantly less coverage than most group plans
- The only one marketed primarily to individuals rather than groups
- Has an unprecedented high cancellation rate, unheard of in the rest of the industry
- Limits services to a small number of authorized law firms, about one per state, versus thousands normally available in plans offered by others in the industry.
- The only one sold through the multi-level marketing model – sales by untrained consumers, 50% of whom quit the business within a year.

PPL's anomalous status is further defined by the fact that, of all the companies selling prepaid legal services, it is the largest yet it has a cancellation rate among policy holders that is unseen among any of the others. Half of all PPL members on average quit the plan after the first year, and two-thirds cancel within two years. In an in-depth analysis of PPL, *Barron's* magazine reported, "MetLife's Hyatt Legal Plans unit, the leading provider of group legal services, has an annual group attrition rate of just 1%."²¹

(444,495 x .007 = 3,167 Associates, which is .7% of the total. To test this, multiply 3,167 x \$40,000. It equals the total commission payout of \$126.7 million, meaning that all other Associates would have to earn \$0.)

¹⁹ PPL is even anomalous within the MLM sector. The vast majority of all MLM products sales, like those of Usana and Herbalife, are in the "pills, potions and lotions" sector, products that are unregulated but which lend themselves to seductive claims of efficacy in restoring youth, curing or preventing every known disease or generally restoring "energy." Such products have worldwide appeal and carry little burden of proof of value. PPL's product, in contrast, is regulated in some states as "insurance" and is highly dependent on US and Canadian laws and customs.

²⁰ <http://www.aplsi.org/news/documents/2004CensusReport-July2005.pdf>

²¹ "Law and Disorder" By Andrew Bary, *Barron's* April 26, 2006

Over a two year time frame, 98% of Hyatt's policies are still in force, but only 33% of PPL's? The *Barron's* writer ventured, "This suggests members don't see a lot of value in the plans."

Bill Brooks, CEO of Hyatt, distanced his company's product and sales approach from PPL's. "Pre-Paid's concept is different from ours," he was quoted in *Barron's* "Ours is based on the delivery of legal services, and theirs has been [based on] the building of a sales network. Theirs is a marketing success."

Hyatt CEO Brooks' observation that the focus of PPL is to "build a sales network" as opposed to "delivering services" aligns with the conclusion of this report that PPL's true product is an "income opportunity", not legal services, and that its actual market is those seeking an income – prospective "sales people."²²

Any analysis would have to questions why PPL needs 440,000 sales people. Per salesperson, on average, this enormous sales force delivers just \$233 of value in services to the PPL "membership." The money that the salespeople themselves pay in to PPL in fees is equal to *all* benefits that PPL delivers to the *entire* membership, including the salespeople that have their own PPL policies.²³ And on average, the PPL salespeople pay more to PPL in fees than they earn in commissions. (see box below)

The deceptive tools employed by PPL to build its sales network – the promotion of an endless chain, misleading income representations and the withholding of key information needed to evaluate the product's value or the income potential – have already been partially addressed in this report.²⁴

²² In a 2002 article, *Forbes* Magazine also questioned whether MLM was in the insurance or the pyramid recruitment business ("Legal Trouble" by Elizabeth MacDonald, 06.19.02) "This is a curious business, selling legal insurance--it is more selling than insurance. The customer forks over on average \$251 a year for the coverage. Only \$83 goes to pay for supplying lawyers to customers. The rest goes to overhead and profits. As for the selling part, Pre-Paid looks like a knockoff of Amway... But what's the hot sales item here--the legal coverage or the right to sell other people this insurance?"

²³ Based on the number of Associates to non-Associate members and calculating that percentage as a corresponding percentage of revenue (Associates are also Members and pay the same price for PPL services as non-Associate Members do.)

²⁴ In 2001, the Wyoming Attorney General's office ordered PPL "to pay a fine and to change its marketing tactics. "The Wyoming attorney general's office said Pre-Paid misled people into believing they could easily make a six-figure income, when the opposite is true. In a conference call last summer, Pre-Paid recognized only 18 independent sales agents - out of nearly 250,000 - for earning more than \$100,000 in a 12-month period. The vast majority of Pre-Paid agents - roughly 95 percent - earned less than \$1,400 last year, and 70 percent earned nothing at all." ("Ex-agents feel misled by Pre-Paid - Class-action lawsuit seeks relief of debt" by Melissa Davis 04/28/2002, *The Daily Oklahoman*)

"When we discovered that Pre-Paid was using prohibited income representations to promote their multilevel marketing program, we warned them that the representations were prohibited by Wyoming law," explained Christopher Petrie, Senior Assistant Attorney General in charge of the Attorney General's Consumer Protection Unit. "The income representations continued on Pre-Paid's web site, including an audio recording of a conference call hosted by the company's CEO that was added to the site after they were warned." (<http://attorneygeneral.state.wy.us/CPU1PR113001.pdf>)

Is Pre-Paid Legal's Real Business to Recruit "Salespeople" or to Deliver Services?

- % of total PPL revenue gained directly and only from Salespeople: ----- 29%
- Average PPL Benefits delivered in total per Salesperson: ----- \$327 per yr.
- Average PPL Benefits delivered to Members (non-Salespeople) per Salesperson: ----- \$233 per yr.
- Revenue directly gained by PPL per Salesperson: ----- \$329 per yr.
- Commission Earned Per Salesperson: ----- \$285 per yr.
- Average Costs per Salesperson for "Sales Tools" purchased directly from PPL:----- \$60 per yr.
- Average Income Per Salesperson after costs paid to paid to PPL for "sales tools" ----- \$224 per yr.

✓ *On average, PPL Salespeople pay in to PPL more than they earn.*

✓ *The Salespeople's direct payments cover all of PPL's costs to deliver its insurance services to all members.*

✓ *The average weekly income of PPL Salespeople after direct costs for sales tools is \$4.31 a week*

✓ *Average weekly benefit delivered per Salesperson to PPL Members (non-salespeople) is \$4.48 a week.*

Uncovering PPL's Coverage

What about the PPL product itself? The *Barron's* article offered the litany of allegations that others have also charged in courtrooms and on the internet, contributing to what I observe as the growing loss of public confidence in PPL.

- *Extremely limited availability of attorneys.* PPL offers less than one approved law firm per state for its members to use. Hyatt, for example, contracts with over 4,000. Most other providers similarly have vast networks for approved law firms for their members to choose from.
- *Inadequate or misleadingly described coverage.* Unlike most other pre-paid legal service providers, PPL pays only a flat fee to its attorneys of just \$80 per policy holder, regardless of the legal services. As the *Barron's* article stated, "You don't have to be an attorney to realize that \$80 doesn't buy a lot of legal services these days, when lawyers routinely bill at \$200 or more per hour." *Barron's* concluded that Pre-Paid resolves this seeming mathematical conundrum at the expense of the policy holder. "Pre-Paid's solution is to limit benefits," the *Barron's* analysis stated.
- *Benefits are limited, the article notes, but the claims of the sales people taught by Pre-Paid Legal are not.* *Barron's* reported that "Pre-Paid says its basic plans offer 'valuable benefits that cover the most common legal needs.' Yet, the plans provide little or no coverage for such common legal needs as divorce, child custody, bankruptcy, drug- and alcohol-related matters, and nearly all criminal charges. The basic plan initially offers 60 hours of annual trial-defense services, but only 2.5 hours is available for pre-trial work, when most legal work gets done. The trial benefit covers civil matters and "job-related"

criminal charges, but little else. Pre-Paid law firms offer to provide services beyond the scope of the plan at a 25% discount to their average billing rate.”

Salespeople over-selling their products is certainly not unique to Pre-Paid Legal, but consumers charge that PPL’s misrepresentations are calculated and pervasive and that the chief trickster is the PPL CEO himself, Harland Stonecipher.

After warnings were issued, the Wyoming Attorney General noted that his office decided to prosecute PPL when it heard a (misleading) audio recording of a conference call *hosted by the company’s CEO*.

And, after winning a multi-million damage award in Mississippi against PPL, former U.S. Attorney Brad Pigott attributed the jury decision to his ability “to use the company’s own words against it.” In an article in *thestreet.com*, Pigott explained that “he showed the jury a video with *Pre-Paid’s CEO* misrepresenting the company’s product” In a related article, *thestreet.com* reported, “... jurors reportedly viewed videos produced by the company... (in which) Stonecipher claimed that Pre-Paid customers ‘never have to reach for their wallets to pay a lawyer in any legal proceeding,’... But among the most damaging statements from the videos was Stonecipher’s spirited declaration, *Three cheers for greed*, made while he tore \$100 bills in half as part of a speech to thousands of Pre-Paid sales associates.”²⁵

Referring to the same jury award in the *Barron’s* analysis, Pigott stated, “... the bulk of the Pre-Paid legal benefit amounts to telephone access to a lawyer. “It’s true that in some circumstances there can be some value to talking to a lawyer on the phone, but that doesn’t even begin to amount to the delivery of comprehensive and unlimited legal services that the Pre-Paid sales pitch typically represents.” Pigott said that “after the jury viewed the Stonecipher videotape and other marketing instructions to the sales force, “it was hard to deny that the company teaches the sales force to say those (misleading) things.”

²⁵ <http://www.thestreet.com/pf/stocks/melissadavid/10253221.html>

VI. Summary of Pyramid Indicators

Pre-Paid Legal shares fatal defects and red flag characteristics of the pyramid marketing scheme with Usana and Herbalife:

- It sells an exaggerated or overpriced or misrepresented product that would not survive on its own in the competitive, open market. “Sales” are inextricably linked to and reliant upon the schemes’ promotions of an enticing but false “income opportunity.” As one financial analyst noted, PPL “has no peer.” All other competitors primarily sell legal insurance programs to groups and corporations, not to individuals. Not one other sells through a MLM model. The anomalous nature of PPL’s business indicates that PPL could not sell its own product without attaching the endless chain income promise.
- The Pre-Paid Legal “income opportunity” that is offered to “Associates” is a formula of bonuses and commissions related to the position of the participant on the PPL hierarchy. Higher levels receive more payments per sale. Recruiting new participants into the money plan is critical to rising on the chain. Recruiting is the only feasible means for the participant to recoup initial and ongoing investments. Only a tiny percentage of participants are able to recoup investments under the money transfer system. The vast majority of participants cannot, by the plan’s design earn a profit.
- PPL faces jeopardy from government prosecution.²⁶ The disclosure requirements in the recently proposed FTC *Business Opportunity Rule* would likely cripple the Pre-Paid Legal operation.²⁷ The ban on the multi-level marketing model in China was a crushing blow to Usana and Herbalife and reveals that other countries are awakening to the flaws inherent in the MLM model. And the current United Kingdom trial of Amway, the oldest and largest of all MLMs, further sheds light on the global nature of these scams. The government of England is seeking to expel Amway from the UK. In the US, multi-level marketing has enjoyed a seven-year period of virtual immunity under our current Administration, a recipient of great financial support from MLM lobbying. This immunity era will likely end soon, with grave consequences potentially for all in the MLM business.
- PPL is a target of class action lawsuits that are remarkably similar to class action lawsuits against Usana and Herbalife. The use of deception and the perpetration of a pyramid scheme model make Pre-Paid Legal perpetually vulnerable to such consumer lawsuits.
- Pre-Paid has no true retail customer base or stable sales force but, like Usana and Herbalife, relies instead on the investments of “distributors” for revenue (called Associates at PPL). The vast majority of these business investors are doomed to lose,

²⁶ From its Q-3, 2007 10-Q filing to the SEC, PPL reports, “On March 23, 2007 we received a Civil Investigative Demand from the Federal Trade Commission requesting information relating to our Identity Theft Shield and ADRS Program. We are working with the Federal Trade Commission to resolve the matter. The ultimate outcome of the matter is not determinable.”

²⁷ In response to the proposed rule, PPL’s General Counsel Keri C. Prince and Margaret Feinstein of Dickstein Shapiro LLP wrote the FTC July 17, 2006, “As a whole, the disclosures required by the Proposed Rule place an extraordinary burden on legitimate sellers that is not justified by an increased protection for consumers, especially where a significant amount of public information about the company is available through securities filings and the company already has a thirty day refund policy. The disclosure requirements, combined with the seven calendar day waiting period, will adversely impact legitimate direct sellers like Pre-Paid and the legions of individuals who participate in them.”

historically do lose, and the newest recruits are churned at rates of at least 50% annually. Usana and Herbalife churn at even higher rates, owing to their tangible products and higher up front costs.²⁸

- The true and real “product” offering of all three is a misrepresented “income opportunity” that is based on endless chain recruiting. This income opportunity offering, shared in common, places all three companies into one and the same economic sector – pyramid marketing schemes. Proper financial analyses of these companies should be based on their true product offering – an endless chain money making scheme, not on weight loss pills, vitamins or legal “insurance.” Business analysts who classify them on the basis of their product distinctions miss the true nature of the business and are subject to significant misjudgment on their future prospects.
- Finally, all three engage in extensive, systematic deception about their products and income promises. The pyramid design of the business requires – in a manner similar to a lottery – a massive loss rate among the “players”. The plan is based on a money transfer in which the “products” serve as a medium to camouflage the true business of investor (distributor) recruitment. The potential of commissions gained from new recruits, is falsely presented, and by design, the scheme inflicts massive losses on participants.
- The enemies of these companies are not competitors, trends in their product sectors or general market downturns, as with legitimate businesses. Rather Pre-Paid Legal’s, Usana’s and Herbalife’s foes are:
 - √ media exposure that delves into their actual operations
 - √ consumer awareness of the untenable model, churn rates, lack of retailing potential, true business costs and average losses among participants
 - √ proper government regulation against endless chain scams, a scourge of the modern marketplace.

VII. Pre-Paid Legal’s Sleaze Factor

Beyond the specific factors of misrepresenting its product product, misleading income claims and an untenable business model, PPL’s image to consumers has also been damaged by news and accusations of corporate and personal malfeasance.

- **Accounting Irregularities.** Financial analyst Peter Cohan, summarized two SEC actions against PPL and their consequences.²⁹ “In 1994,” he wrote, “Pre-Paid wanted to do a public stock offering, however the SEC said no unless Pre-Paid expensed its customer acquisition costs instead of amortizing them. Pre-Paid fought the change but ultimately capitulated – devastating its balance sheet. Stockholders’ equity fell 90% to \$2.4 million; assets declined 69% to \$11.1 million; and 1993 net income of \$306,000 became a net loss of \$613,000.” In 2001, Cohan reported, “the SEC again forced Pre-Paid to restate its results. Pre-Paid went from treating sales agents’ commissions as an asset which it amortized, to expensing them immediately. Pre-Paid slashed its 2000 per-share earnings 42% to 81 cents and its 1999 results 66% to 57 cents.”

²⁸ PPL’s lower initial churn rate is also attributable to the “advances” which, *only later*, do the Associates discover are devastated by chargebacks.

²⁹ “Pre-Paid Legal is in need of better reality, not better stories”, July 28, 2003, <http://petercohan.com/>.

- ***Shady sales characters in the upline.*** Writer Melissa Davis of *TheStreet.com*, who has tracked PPL closely for some time and previously worked for an Oklahoma newspaper, where PPL is headquartered, chronicled some of PPL's "colorful workforce."³⁰
 - √ Among them is Tommy Vu, "the 1980s infomercial star widely sued by disgruntled students of his \$15,000 real-estate sales 'boot camp.'"
 - √ Then there is Marshall Sylver, whom Davis described as a "former Las Vegas Strip hypnotist with his own background in mind control." Pre-Paid listed Sylver as its No. 2 recruiter in late 2000, Davis wrote, and was "the target of a Nevada attorney general probe for allegedly bilking consumers through a "Millionaire Mentorship Program" he operated out of his mansion."
 - √ She reported that the No. 1 recruiter that year at PPL was the National Audit Defense Network (NADN), also based in Las Vegas. In 2001, the Better Business Bureau of Southern Nevada fielded more consumer complaints against NADN than against any other company. Both the Nevada attorney general and the Federal Trade Commission sued NADN, Davis reported.
 - √ David C. Draney was ranked among Pre-Paid's top recruiters in 2002. According to Davis, Federal prosecutors indicted Draney and 12 others for raising millions of dollars through the sale of bogus securities.
 - √ The two most visible of PPL's top recruiters are Paul J. Meyer, reportedly responsible for half of Pre-Paid's business and Fran Tarkenton, retired professional football player and former Pre-Paid director. Davis reported that Myer "came to Pre-Paid in 1998 with three FTC reprimands and one of the stiffest penalties ever imposed for overstating income opportunities" and Tarkenton "paid six figures to settle charges brought against him in 1999 by the SEC for alleged fraud relating to an Internet software company."
- ***Questionable Insider Stock Transactions.*** A Nov. 16, 2006 published analysis of Pre-Paid Legal by Tejas Securities Group, Inc, noted that "Last week, insiders attempted to sell \$27.4MM of stock at a price of \$42.91, or 37 cents shy of the highest level during 2006. We find it troubling that the sales were announced at 5:09pm on Friday afternoon of a holiday weekend. These shares were purchased by the Company itself as part of its stock repurchase program. We believe that these insiders would not have been able to complete these sales in the open market without significantly impacting the share price... Rule 144 "dribble out" restrictions would have restricted sales during a 90 day period to far less than last week's attempted transaction... the seller of 125K shares, Harland Stonecipher (Chairman, CEO and President) has earned over \$2MM per year for each of the last three years in salary and bonuses. Furthermore, he disposed of another 111K shares in March 2006."

³⁰ "Pre-Paid Legal's Colorful Workforce" by Melissa Davis, 07/04/2002
<http://www.thestreet.com/stocks/melissadavid/10030240.html>

Appendix

I. MLM: A Black Hole of Financial Analysis

While elements of the financial community invest in publicly traded MLM companies, many analysts are quite unfamiliar with the MLM business model. Most appear to treat MLM companies such as Pre-Paid Legal as “door to door” or “direct selling” companies, a model that has virtually disappeared in the modern and digital era.

Strangely, few analysts ever inquire about the end-user markets of these companies, that is, they seldom investigate who is ultimately buying the products. Few inquire into the incomes and activities of the typical MLM salesperson, presumably the engine of the MLM model. And even fewer investigate the extraordinary churning rates among consumers who invest their time and money in the MLM business as “distributors.” Fundamental questions are seldom asked such as why would consumers buy MLM goods over products in stores and why do they so quickly and in such massive numbers stop buying them and never purchase them again?

MLM is not taught in business schools, seldom examined in the news media, and MLM companies use no mass media for marketing which might reveal their true nature. They are a black hole in the business world and an anomaly within the securities marketplace. Even the legality of MLM regarding pyramid scheme fraud is not understood by analysts, despite a history of significant prosecutions of MLMs by the FTC and the banning of the model in China. Analyst interpretations and abilities to evaluate SEC filings by these companies can, therefore, be technically accurate yet fundamentally erroneous.

The largest and oldest of US-based MLMs, Amway, is on trial right now in England for operating as a deceptive fraud.³¹ *The Times* reported government findings that 71% of Amway’s UK sales people earned no commissions at all; of the 30% that earned some commission, 2/3rds of them earned on average just \$27 (£13.53) *a year*. UK authorities discovered that 75% of all commissions paid by UK Amway were transferred to just 101 salespeople positioned at the top of the Amway UK pyramid, representing only one-fourth of one percent. The Amway “income” figures revealed in the UK are gross revenue numbers before normal business costs. Therefore, the actual loss rates of UK Amway salespeople tracks closely to data presented in a widely read and translated statistical study by *Pyramid Scheme Alert* showing 99% loss rates among distributors (consumers) in major MLMs, in including Amway, operating in the USA.³²

Amway is the prototypical business model on which Herbalife, Usana and Pre-Paid Legal operate. The government of England is seeking to ban this American icon from their country. Yet, not one word of inquiry can be found among American financial analysts in which the dots are connected.³³

³¹ See “Marketing Group Merely ‘Selling a Dream’” by David Brown, *The Times*, November 27, 2007.

³² See <http://www.pyramidschemealert.org/PSAMain/news/MythofIncomeReport.html>

³³ One possible reason for this analyst blind spot is the seven-year silence that has prevailed in law enforcement on multi-level marketing, giving the business a new aura of legitimacy. Few analysts are aware of the powerful political influence of the MLM industry, which might provide this recent immunity. Recently, however, the political influence of the Amway Corporation has gained notoriety.

MLMs such as Herbalife, Usana and Pre-Paid Legal fatefully depend for revenue upon “endlessly” expanding their *sales forces*, the sales persons serving as unwitting end-users. In fact, almost no MLM salespeople earn a net profit from “door to door” or “direct” selling. The few that do earn any profit do so from pyramid fund transfers gained from the investments of later recruits, not from retail sales. The future viability of MLM companies – the key factor for analyst evaluations – can, therefore, be grossly misunderstood by those who do not grasp the “endless chain” nature of the model and the lack of profitable retail selling opportunities for the distributors.

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- It was reported that the founder of the politically powerful military contracting firm of Blackwater, Eric Prince, is married to the sister of Dick DeVos, the son of the founder of Amway.
 - In 2006, Dick DeVos ran unsuccessfully for the governorship of Michigan.
 - According to the consumer watchdog group Common Cause, Amway and affiliated donors made soft money contributions to the Republican National Committee totaling \$4,147,000 between January 1, 1991 and June 30, 1997
 - In 2000, Amway “soft money contributions to the Republican National Party totaled \$1,138,500.
 - In 2004, the 527 “Progress for America” received money from Amway. “The latest crop of donors includes Amway founders Richard DeVos and Jay Van Andel, who each chipped in \$2 million.” (Newsweek, “The Secret Money War,” September 20, 2004.)
 - In 1999, the inaugural fundraising event for the Republican Majority Issues Committee (RMIC) was held aboard the DeVos family yacht. The RMIC, a "527" organization, was founded by Rep. Tom DeLay (R-Texas). The committee declared its intention to "identify, educate, and mobilize conservative voters in key House races." (http://www.motherjones.com/news/special_reports/mojo_400/12_devos.html)
 - Describing the events at the 2000 Republican Convention in Philadelphia, the *New York Times* wrote, “For the party’s top underwriters, there will be an array of gold-plated events in Philadelphia, including cocktails with Gen. Colin L. Powell and an evening cruise on the Delaware River aboard the ‘Enterprise,’ the yacht owned by Richard M. DeVos, the Amway founder.
 - At the 2004 Republican National Convention in New York insiders were feted aboard Dick and Betsy DeVos’ yacht, as well as Jay Van Andel’s lavish 169- footer.” (Kathleen Gray, *Detroit Free Press*, 9/2/04)

II. Short History of Multi-Level Marketing, Pre-Paid's Business Model

Multi-level marketing, also called network marketing, is a new business model that emerged in the 1970's. It developed as traditional direct selling, sometimes called "single-level", was waning. The explosion of new retail outlets, big box stores, mail order catalogues, global trade and more efficient distribution made the "door to door" sales person a dinosaur of commerce. Later, the worldwide web further rendered the old system useless for any but small, specialized sectors of products.³⁴ Almost everything became available to nearly everyone easily and inexpensively from multiple channels. At the same time work patterns of American households and concerns about personal security made sales in the home impractical.

In MLM, every salesperson can recruit others in a potentially "endless chain" and can receive commission overrides on the all purchases and sales made by the entire "downline." The model blatantly resembles a pyramid scheme and its pay plan appears to transfer funds from the newest recruits to earlier ones. The companies call themselves "direct selling" businesses, however, most commission plans are based upon downline *purchases*, not retail sales. Most MLMs have little or no retail sales and virtually no MLM participant earns a net profit from "direct selling" to end-users.

The largest and perhaps oldest company of this type, Amway, was charged with pyramid scheme fraud by the Federal Trade Commission in 1975. A favorable ruling on this case by an Administrative Law Judge of the FTC in 1979 allowed Amway to continue operating. The decision was based, however, on the presumption that at the outside the chain of salespeople was a base of retail customers that accounted for most Amway revenue. The retail customer base was understood to be the MLM company's ultimate revenue source, not the inventory investments of the salespeople. It was also presumed that the average salesperson had a reasonable opportunity to retail products profitably and that most that earned a profit did so from retailing. The FTC decision took as fact that Amway was fundamentally a retail-based business and that retail profit was the prime source of revenue for its salespeople, not recruiting other salespeople.

Today, Amway itself acknowledges that less than 20% of its products are ever retailed. Top Amway insiders who are now suing Amway for operating a pyramid scheme claim that less than 5% of the products are ever retailed.³⁵ Whatever Amway may have been in 1979, today it is a recruitment scheme with no market for its products other than its own salespeople. Profit to the "salespeople" can be gained only by recruiting other salespeople, exactly as the Administrative Law Judge said Amway could *not* legally operate.³⁶

³⁴ Areas in which "direct" or in-the-home selling remains a viable model include real estate, home improvements, certain financial and insurance services, funeral and cemetery plot sales, and some specialized, highly personal or unique household items, mostly purchased and utilized by women and sold through "party plans." Additionally, some traditional direct sellers such as Avon are able to maintain the model based on years of focused and well developed brand equity.

³⁵ See <http://www.pyramidschemealert.org/PSAMain/news/TopGuns.vs.Quixtar.pdf>

³⁶ The ruling on Amway stated, "The Amway Sales and Marketing Plan is designed to move products manufactured by or for Amway through a network of distributors to retail customers," It noted that "The Amway Sales and Marketing Plan provides incentives for sponsoring which are based on sales of products to consumers," and that "Amway literature emphasizes that retail selling is an essential part of the Amway Sales and Marketing Plan." It concluded, "The Amway system is based on retail sales to consumers... Amway is not in business to sell distributorships..."

In the climate of de-regulation and less government oversight of business in the decade of the 1980's that followed, MLM devolved into the recruitment-based model that the FTC had sought to prevent with its prosecution of Amway. Many new MLMs were spawned, cloning Amway's structure, rhetoric, and pay plan. Nearly all are based on endless chain recruiting, not retailing, and they generate their profit for owners and shareholders and pay commissions to top level distributors from the *purchases* of new "salespeople", not from retail sales to end-user consumers.

MLM companies, with Amway as the largest member, came to dominate and shape the agenda of the Direct Selling Association (DSA), now an aggressive political lobbyist to prevent federal law enforcement against MLMs.³⁷ Usana, Herbalife and Pre-Paid Legal are DSA members and are part of the legacy of the direct selling's degradation to the pyramid recruitment model that Amway pioneered.³⁸

The offer of an "extraordinary income" opportunity based on the magic of "exponential expansion" has great emotional appeal and effectively exploits a crying need among a fast growing number of people today.

Consumer debt, job insecurity, outsourcing, globalization, obsolescence, coupled with rising costs for health care, housing, energy and education foment a desperate need for new or additional income for millions of households. MLMs, such as PPL, Usana, Amway and Herbalife, appeal to this great need by promising financial salvation with their "system."

MLM's camouflage of product "sales" backed up by powerful legal defense, PR, and Washington-based lobbying make it very difficult for a consumer to spot the fatal flaws. Individual consumers are helpless to act against it if they do discover the sham. Organized protests from consumers that have been financially damaged is understandably thwarted by the victims' shame, fear and inability to commit greater time in righting a wrong. The legal system turns out to be a last refuge for restitution and the class action case the final court of appeal. This remedy has inherent weakness, takes years to process and seldom produces anything more than a meager settlement for members of the class. The MLM is usually allowed to continue its recruiting rampage and the facts of the cases are sealed.

Despite MLM's seemingly protective shield against exposure, legal challenge and government regulation, it is piling up a list of grievances, questionable actions, and exposed irregularities that even the most desperate and uninformed consumer might notice.

³⁷ The sudden shift in 2001 at the FTC away from enforcement against pyramid marketing schemes dates to the presidential appointment of Timothy Muris to head the FTC in 2001. Muris' last job before chairing the federal agency that regulates multi-level marketing was as an attorney with the antitrust division of the firm Howrey, Simon, Arnold and White, LLP. The antitrust division of Howrey counts among its largest clients the Amway Corporation.

³⁸ Whether or not Amway was retail-based in 1979, today it most certainly is not. In a class action suit filed by some of Amway's top insiders, the plaintiffs assert – and they were in positions to know this definitively – that only about 4% of Amway's products are ever retailed. They charge that Amway's products are priced too high to be profitably retailed and that the company's revenue is based almost entirely on the investments of the distributors, the majority of whom are churned annually. These "Top Gun" insiders charge that Amway is operating an illegal pyramid scheme – essentially the same charge brought by the Federal Trade Commission 30 years ago.

III. Legal Plans Source List from *Benefits Selling Magazine*, Nov., 2007

(<http://www.producersweb.com/r/bsmag/d/main>)

Benefits Selling noted that the list represents only those companies that chose to participate and edited for space

Aegis Administrative Services Inc.
www.aegisadmin.com
888-881-2307

ARAG
www.ARAGgroup.com
800-888-4184, ext. 215

CLC Inc.
www.clclegalplans.com
800-541-9701

ComPsych Corp.
www.compsych.com
800-851-1714

Group Benefit Services Inc.
www.gbsitpa.com/www.gbs-
tpa.com
800-995-3569

HR Consulting Group Inc.
www.hrconsultinggroup.com
801-765-4417

Hyatt Legal Plans Inc., a MetLife
company
www.legalplans.com
800-423-0300

Legal Access Plans
www.worksitelegalaccess.com
713-785-7400

Legal Club of America
www.legalclub.com
800-852-6829, ext. 103

Liberty Legal Inc.
www.teamlibertyplans.com
317-916-0722

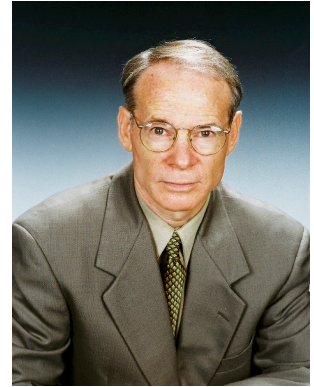
Pre-Paid Legal Services Inc.
www.prepaidlegal.com
580-436-1234

The Retirement Planning & Employee
Benefits Group Inc.
www.OurVoluntaryBenefits.com
512-331-0222

United Legal Benefits
www.unitedlegalbenefits.com
410-769-9770

IV. Robert FitzPatrick Credentials

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Robert L. FitzPatrick is an expert in examining and revealing deception and fraud in bogus home-based businesses. He is an author, teacher and internationally recognized authority in multi-level marketing schemes and pyramid sales fraud. He is a catalyst and leader in the international effort to end the pervasive fraud in the multi-level marketing business.

He is the author of *False Profits*, the first book to critically examine the multilevel marketing industry. He was featured on *NBC Dateline*, *ABC World News*, and he was interviewed by correspondent Mike Wallace on *CBS 60 Minutes*. He has been interviewed live on *NBC Today* show, Canada's *CBC National News* and on several BBC radio news programs aired in the UK. He has been quoted in many newspapers, including the *Wall Street Journal*.

False Profits was a featured resource at the 2003 annual meeting of the Association for Professional and Practical Ethics. The related booklet, *Pyramid Nation* by Robert FitzPatrick, has been translated to Chinese and used by government regulators in writing China's first laws on pyramid schemes. His essay, "The 10 Big Lies of Multi-Level Marketing", has been translated into four languages and posted on numerous websites.

In June 2005, Robert FitzPatrick was asked by the Central Bank of Sri Lanka to address banking representatives from that country as well as India, Bangladesh, Bhutan, Maldives and Nepal in Sri Lanka's capital, Colombo. The Sri Lanka presentation was later published as part of a national consumer education campaign against pyramid schemes.

Robert FitzPatrick has conducted seminars for staff of Federal Trade Commission, state Attorney General's offices, US Postal Inspector and members of the White Collar Crime Center in Richmond. He was a featured speaker at the 2006 annual meeting in San Francisco of the Association of Certified Fraud Specialists and the 2003 of the National Association of Consumer Protection Investigators. He has developed informational resources for consumers, journalists, academics and regulators including a multi-media PowerPoint presentation and a statistical analysis of the losses suffered by participants in multi-level marketing schemes. He also published a widely read booklet on the landmark federal case brought against the Amway Corporation.

Robert FitzPatrick founded and serves as president of Pyramid Scheme Alert, the first international association to expose and prevent pyramid scheme fraud. PSA's website, <http://www.pyramidschemealert.org>, is visited each month by thousands of consumers, regulators and journalists worldwide. He personally responds to hundreds of consumer and news media inquiries. He has served as consultant and expert witness for Attorney General or State Attorney offices in four states, the US Dept. of Justice, and in numerous cases involving distributor fraud and pyramid schemes.

Since 1983, he organized and managed national trade associations that advocated the interests of independent distributors in three industries and spoken at industry conferences in Canada, England and the US. He organized international conferences in Brasschaat, Belgium and Guadalajara, Mexico, for manufacturers and distributors in the digital and litho printing industry. As a strategic consultant, he has provided guidance and executive coaching in the field of manufacturer/distributor relationships where factors of trust, integrity and sensitive communications are critical to the business. His corporate clients include Fujifilm, DuPont, Epson, and many others. Robert FitzPatrick's CV can be found at <http://www.falseprofits.com/FitzPatrickCV07.doc.pdf>