

No. 06-739

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**In the Supreme Court of the United States**

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WALTER W. KELLEY, AS TRUSTEE FOR THE BANKRUPTCY  
ESTATE OF RICKY WAYNE BRACEWELL,  
*Petitioner,*

v.

RICKY WAYNE BRACEWELL,  
*Respondent.*

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**On Petition for a Writ of Certiorari  
to the United States Court of Appeals  
for the Eleventh Circuit**

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**REPLY BRIEF FOR THE PETITIONER**

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This case concerns a fundamental question in bankruptcy law: What interests constitute “property” (11 U.S.C. § 541(a)) to be included within the debtor’s estate? In some cases (such as the crop losses and consequent bailout payments at issue here), that question is somewhat complex, because interests that might have seemed worthless or at least contingent as of the commencement of the bankruptcy case gain value during the case. For more than four decades, *Segal v. Rochelle*, 382 U.S. 375 (1966), has supplied crucial guidance for resolving temporally difficult questions about what interests are part of the estate, instructing courts to take a functional approach by assessing whether an interest is “sufficiently rooted in the pre-bankruptcy past” to warrant inclusion in the estate. *Id.* at 380. The Eleventh Circuit’s split decision below, as well as a recent, sharply divided *en banc* opinion by the Fifth Circuit, definitively rejected *Segal*’s continued application. Pet. App. 12a (“[t]he *Segal* decision cannot mean what the *Burgess* dissenters said it did about the present Bankruptcy Code, because *Segal* was decided twelve years before Congress overhauled the Bankruptcy Code”); *In re Burgess*, 438 F.3d 493, 498 (5th Cir. 2006) (*en banc*) (“*Segal*’s ‘sufficiently rooted’ test did not survive the enactment of the Bankruptcy Code”), *quoted in* Pet. App. 12a. But see, *e.g.*, *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) (“When Congress amends the bankruptcy laws, it does not write ‘on a clean slate.’”). Eviscerating *Segal* has created a direct conflict with four other circuits on an issue that leading bankruptcy scholars recognize will have an “important effect \* \* \* on the scope of property of a debtor’s bankruptcy estate.” Br. Amici Curiae of Profs. Block-Lieb, Brubaker, Lipson, Rapoport, Rasmussen, Skeel, and Tabb (“Scholars’ Br.”) 4.

Aware that this Court would not jettison *Segal* on the grounds adopted below, respondent asserts that its vitality is not at issue here. Opp. 2. But to reach that conclusion—which is indispensable to the claim that the 4-2 conflict over

the continued application of *Segal* is “illusory” (*id.* at 1)—respondent urges a hopelessly narrow reading of what he calls *Segal*’s “specific holding” (*id.* at 11). That reading is irreconcilable with both the face of that decision and the widespread understanding that *Segal* established the “sufficiently rooted” test as an important tool for judges tasked with determining the extent of the debtor’s estate.

Alternatively, respondent asserts that *Segal*’s “sufficiently rooted” test adds nothing to the interpretation of § 541(a)(1). Opp. 11-12. In respondent’s view, § 541(a)(1) establishes the simple rule “that all *rights* that the debtor has as of the petition date—including *rights* that are contingent as of that time—are property of the bankruptcy estate,” which he then identifies as the same “principle the *Segal* Court \* \* \* was capturing when it said that a payment is part of the estate if it is ‘sufficiently rooted in the pre-bankruptcy past.’” *Id.* at 2 (emphasis added). That view clearly was not shared by the Eleventh and Fifth Circuits, which, before expressly declaring that “‘*Segal*’s “sufficiently rooted” test did not survive the enactment of the Bankruptcy Code,” necessarily recognized the impact that decision would have here. Pet. App. 12a (quoting *Burgess*, 438 F.3d at 498).

Moreover, respondent’s theory is simply incorrect, and in its own right is a radical narrowing of key Code terms. For starters, the plain text of § 541(a)(1) does not use the term “rights,” instead employing the more expansive term “interests.” No less important, *Segal* did not involve a “right”—even a contingent right—as of the time of petitioning. See *infra* p. 5. Rather, *Segal* employed the “sufficiently rooted” test to pull into the estate property that grew out of the debtor’s pre-petition activities but in which the debtor had no legal “right” before filing. Perhaps that is why respondent concedes that *Segal*’s “sufficiently rooted” test is “verbally distinct” from § 541(a)(1), even as he urges—paradoxically—that the two are “functionally equivalent.” Opp. 12. Perhaps that is also why respondent fails to confront an unbroken line of cases stretching back a century-and-a-half,

see *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204 (1983); *Williams v. Heard*, 140 U.S. 529 (1891); *Milnor v. Metz*, 41 U.S. (16 Pet.) 221 (1842), in which this Court consistently has taken a functional approach to deciding what interests are included in the debtor's estate. See Pet. 14-16; Pet. App. 29a-30a (Pryor, J., dissenting); *Burgess*, 438 F.3d at 510-512 (Jones, C.J., joined by Smith, Barksdale, Garza, DeMoss, Clement, & Owen, JJ., dissenting).

Beyond attempting an end-run around the circuit split, respondent's artificially narrow view of *Segal* serves another purpose: It allows respondent to ignore a long line of this Court's cases (discussed nowhere in the Brief in Opposition) holding that pre-Bankruptcy Code case law (such as *Segal*) is presumed, unless there is clear evidence to the contrary, to survive the Code's enactment and inform its application. See, e.g., *Midlantic Nat'l Bank v. N.J. Dep't of Env't'l Prot.*, 474 U.S. 494, 501 (1986); see also Pet. 16-17; Scholars' Br. 13-15. Here, the evidence is overwhelming—and (tellingly) not disputed by respondent—that § 541's drafters intended to leave *Segal* intact. See Pet. 17.

Finally, respondent's effort to obscure the importance of this case extends to his treatment of whether crop bailout payments (and similar interests) are included in the debtor's estate as "proceeds" under § 541(a)(6). Here, however, respondent concedes that "some number of district and bankruptcy courts have reached conclusions at odds" with both the decision below and the Fifth Circuit in *Burgess*. Opp. 16. Respondent's attempt to exclude the circuits from that conflict is unpersuasive; the Seventh and Tenth Circuits have squarely rejected the reasoning adopted by the Fifth and Eleventh Circuits here. See *infra* pp. 8-9. In any event, the acknowledged disarray among the district and bankruptcy courts is more than sufficient to justify this Court's review. Although this issue and those like it are potentially billion-dollar problems, they are likely to arise in circumstances (*i.e.*, just a few thousand dollars at a time) that will rarely justify costly litigation in the courts of appeals.

## I. The Courts Of Appeals Are Deeply Divided On The Continuing Applicability Of *Segal*'s "Sufficiently Rooted" Test

1. Faced with the unequivocal declaration by the Eleventh Circuit below and the Fifth Circuit in *Burgess* that “*Segal*’s “sufficiently rooted” test did not survive the enactment of the Bankruptcy Code” (Pet. App. 12a (quoting *Burgess*, 438 F.3d at 498)), respondent makes two basic attempts to evade the resulting conflict. First, respondent denies that such a thing as the “sufficiently rooted” test even exists, claiming that *Segal*’s “specific holding” is just about the timing of tax refunds. Opp. 11. Second, respondent suggests that, to the extent there is any significance to the “sufficiently rooted” “language” in *Segal* (*id.* at 10), it stands for nothing more than what is (in his view) apparent on the face of § 541(a)(1). Both arguments are demonstrably false.

As everyone but respondent seems to recognize (see Opp. 10), *Segal* established a “sufficiently rooted” test for evaluating whether interests that become fully choate after a debtor files for bankruptcy should be included within the estate on the basis of pre-petition events. See, e.g., *In re Shearin*, 224 F.3d 346, 351 (4th Cir. 2000); *In re Ryerson*, 739 F.2d 1423, 1426 (9th Cir. 1984). Even the majority opinions in the Eleventh Circuit below and the Fifth Circuit in *Burgess* candidly admitted (on the way to overruling *Segal*’s application post-Code) that *Segal* established such a test. Pet. App. 11a-12a; *Burgess*, 438 F.3d at 498. And certainly that fact was not lost on the eight dissenting judges in those cases, who complained about the majorities’ rejection of *Segal*’s “sufficiently rooted” test. Pet. App. 27a (Pryor, J., dissenting); *Burgess*, 438 F.3d at 512-513 (Jones, C.J., dissenting). Respondent is understandably eager to abandon those courts’ reasoning for rejecting *Segal*, see *infra* pp. 5-6, but he stands alone in claiming that *Segal* did not actually establish a “sufficiently rooted” test. Nor is his proposed formulation of *Segal*’s “specific holding” (“that the right to the tax refund at issue in that case arose pre-petition” (Opp. 11)) persuasive.

*Segal* is just about the timing of tax refunds only in the same way that *Lochner v. New York*, 198 U.S. 45 (1905), is just about the price of bread.

Respondent’s alternative solution—that the “‘sufficiently rooted’ phraseology” (Opp. 11) is “functionally equivalent but verbally distinct” from the text of § 541(a)(1) (*id.* at 12)—both mischaracterizes *Segal* and misreads the plain text of the statute. *Segal* did not hold “that all *rights* that the debtor has as of the petition date—including *rights* that are contingent as of that time—are property of the bankruptcy estate.” Opp. 2 (emphasis added). That is because the debtor in *Segal* had no “right” to the tax refund claim as of the petition date. *Segal*, 382 U.S. at 380 (“two key elements pointing toward realization of a refund existed [as of the petition date] \* \* \*, [but] under the statutory scheme no refund could be claimed” until after the tax year had closed and any other income or losses were calculated). Had that been the case, the claim would have become property of the estate by simple operation of the Bankruptcy Act. See 11 U.S.C. § 110(a) (1961). That the *Segal* Court did not simply rest upon that statutory provision refutes respondent’s claim (Opp. 10-11) that *Segal* “simply found the right to the tax refund at issue \* \* \* arose pre-petition” (*id.* at 11) and confirms the importance of the “sufficiently rooted” test to the result in that case.

Likewise, the statute itself does not include within the estate only those “rights” (contingent or otherwise) that exist pre-petition. Rather, § 541(a)(1) deliberately employs the much broader term “interests” to reach situations—such as the bailout payments at issue here—where a debtor’s legal right to future compensation is not yet established. Indeed, the hypothetical examples respondent offers to prove what properly belongs in the bankruptcy estate demonstrate the significance of the distinction between “rights” and “interests.” For example, respondent concedes that a debtor who buys a lottery ticket, files for bankruptcy, and then wins the jackpot could not insulate his winnings from creditors’ claims. Opp. 2. But, notwithstanding the fact that respon-

dent's chances of receiving a federal crop payment for pre-petition losses were far better than 1 in 146,000,000 (see [http://www.powerball.com/powerball/pb\\_prizes.asp](http://www.powerball.com/powerball/pb_prizes.asp)) on the petition date, he insists that the mere "hope or expectation [of a crop payment] is not enough to give rise to a cognizable property interest," even though payments were expressly based on pre-petition events. Opp. 8. In respondent's view, the salient difference between a debtor with a lottery ticket and a farmer who declares bankruptcy the day before the President signs a bailout bill into law is that in the former instance "the debtor held a *contractual right* to payment should certain contingencies occur." *Id.* at 6 (emphasis added). Perhaps that would be true if § 541(a)(1) actually employed the term "right" or "contract." It does not, and for good reason: Congress recognized (as did this Court in *Segal*) that in some instances an "interest" will be so tied to the pre-bankruptcy past to warrant inclusion in the estate.

Thus, the Fifth and Eleventh Circuits' approach is not merely "verbally distinct" from *Segal*'s "sufficiently rooted" test, but functionally opposed as well. Because respondent concedes (as he must) that "the *Segal* holding remains in force [in] the Second, Fourth, Sixth, and Ninth Circuits" (Opp. 11), the conflict over *Segal* is hardly "illusory."

2. Respondent's misguided focus on "rights" as opposed to "interests" requires him simply to ignore other decisions of this Court—both longstanding and modern—that apply a functional analysis in determining what constitutes property of the bankruptcy estate. Two venerable decisions of this Court—*Williams v. Heard*, 140 U.S. 529 (1891), and *Milnor v. Metz*, 41 U.S. (16 Pet.) 221 (1842)—reveal that this Court has long taken a flexible, fact-driven approach to such questions. In *Williams*, for example, the Court held that war claim premiums should be included in the estate even though the debtor had no pre-petition legal right to payment because "[t]here was \* \* \* a possibility that the government would see that they were paid. There was a possibility of their being at some time valuable." *Williams*, 140 U.S. at 541. That Con-

gress had not created a legal “right” by the time of petitioning did not control whether the war claim premiums should be included in the estate. *Ibid.* Instead, the dispositive consideration was whether the premiums grew out of and were closely connected to the debtor’s pre-petition interests. *Id.* at 540-541. Respondent does not even mention *Williams* or *Milnor*, much less explain how his analysis is consistent with those longstanding guideposts.

Likewise, this Court declined to adopt a “rigid” approach to defining the “interests” included in the bankruptcy estate after the Code’s enactment. In *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983), which respondent also fails to address, this Court included in the estate interests in property that, as of the petition date, had been seized by the government and *therefore were not even in the debtor’s possession.* *Id.* at 199, 209. The Court further noted that, “[a]lthough [§ 541(a)(1)] could be read to limit the estate to those ‘interests of the debtor in property’ *at the time of the filing of the petition,*” *id.* at 203, the provision was intended merely as a floor for what should be included in the estate, not as a ceiling. “[W]e view [the statutory words] as a [minimum for] what is included in the estate, rather than as a limitation.” *Ibid.* That understanding cannot be squared with respondent’s myopic focus on whether a “right” existed pre-petition.

3. As the *amici* bankruptcy scholars have observed, the ultimate question under both the old Bankruptcy Act and the present Bankruptcy Code is the meaning of the word “property,” and the lack of “a substantial change from § 70a of the Bankruptcy Act [to] § 541(a) of the Bankruptcy Code \* \* \* confirm[s] that Congress enacted at least as broad a definition of property in the [Code] as pre-existed in the [Act].” Scholars’ Br. 14; see also *Segal*, 382 U.S. at 379 (“the term ‘property’ has been construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed”). Under the Code as well as the prior Act, this Court has consistently

construed “property” broadly, repeatedly rejecting the specific argument that an “interest” (such as respondent’s crop losses) is not property because it appears valueless as of the commencement of the case. This Court has noted, for example, that “Congress’ meaning” for the word property “was quite broad,” including interests ““present or prospective,”” and has on that basis rejected a theory that exclusive interests are not property because they are of “no value.” *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207-208 (1988) (quoting *Northern Pac. Ry. v. Boyd*, 228 U.S. 482, 508 (1913)); see also *Bank of Am. N.T. & S.A. v. 203 N. LaSalle St. P’ship*, 526 U.S. 434, 454-455 (1999) (“It is to avoid just such [no-value] arguments that the law is settled that any otherwise cognizable property interest must be treated as sufficiently valuable to be recognized under the Bankruptcy Code.”). Respondent’s attempt to walk away from the rationale of the court of appeals—and substitute a theory that “property” and “interest” as used in the Code are the same as “rights”—is revolutionary in its own right, and is no reason to fail to review the evisceration by two courts of appeals of an important bankruptcy decision of this Court.

## **II. The Circuit, District, And Bankruptcy Courts Are Deeply Conflicted As To The Meaning Of “Proceeds” Under 11 U.S.C. § 541(a)(6)**

1. Respondent does not dispute that the lower courts remain in disarray as to the meaning of “proceeds” under § 541(a)(6). Opp. 16. Indeed, the specific conflict presented here—whether crop-related payments obtained pursuant to an act of Congress passed after the debtor filed for bankruptcy (but conditioned on pre-petition events) belong to the debtor’s estate—is well established, and has only deepened in recent years. See Pet. 18-25.

Instead, respondent claims that the conflict reaches only the district and bankruptcy courts and urges this Court to delay its resolution. Opp. 16-17. Respondent is mistaken as to the conflict’s scope and, in any event, wrong that the

acknowledged split in the district and bankruptcy courts should be allowed to persist. First, respondent mischaracterizes the Tenth Circuit's holding in *In re Schneider*, 864 F.2d 683 (1988). The *Schneider* court's "narrow" holding that proceeds from a payment-in-kind scheme are not "proceeds" under § 541(a)(6) does not "support[] the decision of the Eleventh Circuit" (Opp. 15) that proceeds from a crop bailout program are also excluded from the estate. Contrary to respondent's categorical approach, the Tenth Circuit appreciated the distinction between the payout in *Schneider* and the type of payout at issue here, explicitly noting that "[a]gricultural entitlement payments which result from the actual disposition of a planted crop"—as is the case here—"are proceeds of that crop," whereas "payments based on an agreement not to plant crops arise from accounts or general intangibles," and do not fall within the meaning of § 541(a)(6). *Schneider*, 864 F.2d at 685 (emphasis added); see Pet. 19.

Respondent further claims that *In re Schmaling*, 783 F.2d 680 (7th Cir. 1986), is inapposite because that case involved "state law." Opp. 13. To the contrary, the question presented there was whether payments-in-kind "constitute crop 'proceeds' under the Uniform Commercial Code." *Schmaling*, 783 F.2d at 681. As we have explained (Pet. 20 n.7), courts consistently have confirmed the interrelationship between "proceeds" under the UCC and "proceeds" under the Bankruptcy Code, concluding that the former category is actually *narrower* than the latter. Thus, it follows that payments held to be "proceeds" under the UCC are necessarily "proceeds" under § 541(a)(6). See 5 Collier on Bankruptcy ¶ 541.17 ("[T]he scope of section 541(a)(6) is not limited to [the UCC] definition and will extend beyond it."); see also *Burgess*, 438 F.3d at 516 (Jones, C.J., dissenting) (recognizing *Schmaling*'s applicability in Bankruptcy Code cases); *Schneider*, 864 F.2d at 686 (same); *In re Ring*, 169 B.R. 73, 75 (Bankr. M.D. Ga. 1993), *aff'd* 160 B.R. 692 (M.D. Ga. 1993) (same); *In re White*, 1989 WL 146617 at \*5 (Bankr. N.D. Iowa 1989) (unpublished) (same). The Seventh Circuit ultimately con-

cluded that the payments were not “proceeds” under the UCC because there was no crop grown, specifically contrasting payments-in-kind with “proceeds of an existing, failed crop.” *Schmalig*, 783 F.2d at 683.

2. Even if the conflict included only the bankruptcy and district courts—and it is not so limited, for it is inconceivable that the Seventh and Tenth Circuits could join the Fifth and Eleventh Circuits on this issue—respondent’s invitation to ignore the *undisputed* conflict in the bankruptcy and district courts (Opp. 16-17) is misguided. As a practical matter, those lower courts, which are responsible for applying these principles day-to-day, are no less in need of this Court’s guidance simply because the proceeds issue has yet to arise throughout the courts of appeals. Moreover, the fact of the matter is that federal bailout payments, while totaling billions of dollars in a particular year (some \$3.1 billion in 2003 alone, see U.S.D.A., Farm Serv. Agency, Fact Sheet: Agricultural Assistance Act of 2003, *available at* [http://www.fsa.usda.gov/Internet/FSA\\_File/disasact03.pdf](http://www.fsa.usda.gov/Internet/FSA_File/disasact03.pdf) (2003)), only infrequently give rise to disputes that justify extended litigation in the courts of appeals. In fact, individual crop bailout payments are capped at \$80,000 (see *ibid.*), so it is not surprising that debtors and trustees, having already traversed the bankruptcy and district courts, have seldom found it cost-effective to further litigate over such relatively small sums in the courts of appeals. Particularly in light of the participation of *pro bono* counsel here, this case presents the ideal (if uncommon) vehicle for resolving an issue of tremendous practical significance to the lower courts, as well as for correcting the larger conceptual flaws in the Eleventh and Fifth Circuits’ opinions.

#### CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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