BANKRUPTCY LAW NEWSLETTER

Published by Federal Bar Association Western District of Michigan Chapter

March, 1997

CURRENT TECHNOLOGICAL ISSUES

(OR "SURF'S UP!")

By: Robert E. Lee Wright

This article will serve as a report from the Technology Subcommittee of the Federal Bar Association's Bankruptcy Steering Committee. The Subcommittee was formed in June 1996 and has been working with the Bankruptcy Court on various technological issues, including the development of a Bankruptcy Court "Home Page" for the Western District which will soon be found on the World Wide Web. The Subcommittee has also considered such issues as the electronic filing of pleadings and documents, including the fax filing of pleadings, full document imaging/retrieval, interactive scheduling of motions and hearings, and additional issues raised by these technologies, such as collection of filing fees, time/date stamping of electronically filed pleadings, etc.

In order to acquaint those who are unfamiliar with the Internet, the following is a basic primer and glossary of terms. This is followed by a description of the contents of the Home Page for the Bankruptcy Court for the Western District of Michigan and a list of sites which may be of interest to bankruptcy lawyers.

THE INTERNET

The Internet was formed in the late 1950's and early 1960's by government and scholastic types in order to establish a technology infrastructure. Initially, it consisted of a series of electronic bulletin boards which permitted an author to post written material for review by anyone who could access the bulletin board. Access was free to anyone who could link their computer system, usually via

telephone wire, to the computer system on which the author published their articles and written materials. Although the Internet has evolved substantially since its inception, it is still essentially just a series of computers linked by wires to other computers.

The World Wide Web

The recent exponential growth in use of the Internet is attributable to the advent of the World Wide Web (the ubiquitous "www."). The World Wide Web is a collection of host computers which run special "server" software. In order to communicate with these "servers" you need to use software known as a "web browser." Popular web browsers include Netscape, Mosaic and proprietary software maintained by the on-line service companies such as America On-Line, Compuserve and Prodigy. Web servers store files, most of which are in a special format called HTML (Hyper Text Markup Language). These files are much more useful than the old gray documents which academics, scientists and academics used to post to their bulletin boards because they can incorporate text, graphics, movies and sound.

Links. HTML files also provide "links" to other sites and files which can be accessed by simply pointing to them with a mouse and clicking a button. These links are a wonderful creation because it allows you to navigate from place to place on the Web without knowing the precise, and very arcane, internet address of a particular site. Thus, if you were looking at the Home Page for the United States Bankruptcy Court for the District of Idaho: **http://www.id.uscourts.gov/**, and wish to view the general information which is highlighted in the table of contents, you would only need to move your mouse pointer to *General Information*, click the left button, and you will be instantly taken to a new address. Now on the General Information page, you will find the addresses for all of the court's locations. Clicking on the second topic on the Home Page titled: *Court Reference & Public Information* displays a page with additional links to *Court Fees, Weekly Court Calendars, Local Rules,* and court reference materials including case administrator assignments, bankruptcy information, a pro-se manual, a glossary of legal terms, general orders, etc. Clicking on the link for *Weekly Court Calendars* brings up calendars for motion days for all of the judges at all court locations for the upcoming week.

Links to Other Sites. In addition to linking pages within its own web site, almost all web sites provide links to other web sites which may be of interest or in some way related to the topic covered by their own web page. For instance, from the Idaho Bankruptcy Court's web page entitled: *Federal Resource Links* you may access bankruptcy decisions from the United States Supreme Court, the Federal Judicial Center Home Page, the Administrative Office of the U.S. Courts, the U.S. Court of Appeals of the Ninth Circuit, U.S. Sentencing Commission, the U.S. Code, the Federal Rules of Civil Procedure, the Federal Rules of Evidence, and even link to FedWorld, which is a federal information network containing hundreds of documents maintained free of charge for any taxpayer who wishes to look at them. Skipping from one site to another in this fashion is known as "surfing the net" or "wandering the web."

Internet Searches. Fortunately, you do not have to know the Internet address for each site you wish to visit. You may locate sites by conducting a search using one of the many popular free search services available via the Internet. Repeat: FREE search services. A particularly user friendly and fast service is provided by Alta Vista, which is located at: **http://altavista.digital.com/**.

Alta Vista provides help on formulating search queries, but using the example of the Bankruptcy Court for the District of Idaho, you may find it by just typing the words: **+"bankruptcy court" +Idaho** in the box provided for your search query. Use of the quotation marks around *bankruptcy court* will force Alta Vista to only report back those "hits" which contain the words *bankruptcy court* and in that exact order. Using the plus sign forces Alta Vista to include only those hits which include the search term following the plus sign. Without using the plus sign, you would receive a report from Alta Vista that several hundred thousand documents match your search request, since it would return any document that had either the words *bankruptcy court* or *Idaho*. Indeed, a search using only the word *bankruptcy* will return over one hundred thousand documents. Alta Vista will also recognize other search terms and will perform more sophisticated searches, but the use of quotations and the plus sign are the two most valuable when attempting to narrow a search. The next most useful is the "-" sign which will exclude documents with words you do not want.

Other popular search services include Excite, Info Seek and Yahoo! Many attorneys enjoy Yahoo! because of its hierarchical directory of Internet locations. For instance, Yahoo!'s Home Page, located at **http://www.yahoo.com/**, allows you to either search for particular terms, or explore Yahoo!'s collection of sites broken down into categories such as: *Arts and Humanities; Business and Economy; Computers and Internet; Education; Entertainment; Government;* etc. Under the heading of Government (i.e., clicking on the word *Government*) reveals some twenty-six subcategory listings, including *Judicial Branch, Law, Legislative Branch,* etc. Clicking on *Judicial Branch* brings up a submenu which includes *Federal Courts, State Courts* and *Supreme Court*. Clicking on *Federal Courts* brings up a listing of courts, which includes bankruptcy courts for the districts of New Mexico, Utah, and Idaho. (Soon it will include the Western District of Michigan!) Clicking on *Supreme Court* brings up links to *Court Decisions, Biographies of the Justices,* and even an *Oral Argument* page which permits you to hear unedited oral arguments from the Supreme Court via audio files.

Bookmarks. Once you have found the location of these search tools, you should mark them for easy retrieval in the future. Almost all of the Internet software packages include a "bookmark" feature which allows you to add a favorite web site to a list of locations which you frequently visit. Keep experimenting with the various search services available until you find one that suits you. Remember to bookmark the search service home page and any particularly helpful home pages, such as ICLE's home page or ABI's home page. See suggested sites listed below. Most of all, do not fear the Internet. You cannot break anything and can explore at your own pace without worrying about doing it incorrectly. The following terms are explained in more detail above, but these short definitions may be useful as you explore.

GLOSSARY OF TERMS

Internet: Often called the "information Superhighway," the Internet is a global network of individual computers and computer networks.

World Wide Web: The Web, W3, or WWW, is one lane on the Information Superhighway; it allows people to navigate from place to place along the Internet using "hyperlinks." It is a full, multi-media interface, allowing the integration of text, graphics,

sound and video.

Uniform Resource Locator (URL): The address that points to any location or resource on the Internet.

Home Page: Similar to the front page of a newspaper or newsletter, this is the starting point for any organization or company WWW site on the Internet.

Hyperlink: Highlighted text or graphic in a WWW site that, when selected, takes you to other areas, sites or sections in a document. With hyperlinks, you can explore many pages underneath the Home Page, and you can link to other WWW sites.

Browser: Software that allows you to view WWW information. Netscape and Mosaic are among the most popular browsers.

THE NEW HOME PAGE FOR THE WESTERN DISTRICT OF MICHIGAN

April 1, 1997 is the target date for the arrival of the Bankruptcy Court's new Home Page. The Home Page is still under construction as of this writing, but it is anticipated that initially it will contain at least some of the following information:

- General information about the Court: Hours, locations, directions, etc.
- Court personnel directory, with telephone numbers
- Local Rules
- Local Forms
- Fee schedule and payment instructions
- Court calendars
- Opinions
- Access instructions:
  - How to retrieve files from archives
  - How to access VCIS and Pacer
- Frequently asked questions, including basic information regarding various chapters of the Bankruptcy Code
- General information:
  - O.U.S. Trustee personnel names and telephone numbers
  - FBA information, etc.
- Links to other sites

Although the Court has been struggling with the notion of posting motion day calendars on the Internet, for fear that attorneys or parties will rely upon them to their detriment, the Subcommittee has urged the Court to provide the schedules with a disclaimer that hearings may be adjourned without notice.

The address for the Home Page for the Western District of Michigan will be: www.miw.uscourts.gov

The Bankruptcy Court is also grappling with other issues raised by the electronic age, such as document imaging which would make all pleadings accessible, including schedules, motions, briefs, orders, etc., making its database of cases searchable via the Internet instead of Pacer, including written opinions and making them searchable, electronic noticing of bankruptcy filings, hearings, etc. If you have any ideas you would like to share with the Subcommittee, please send them to Robert Wright at Miller, Canfield, Paddock and Stone, P.L.C. or, via e-mail to: **wright.r@mcps.com**.

OTHER SITES OF INTEREST TO BANKRUPTCY LAWYERS

Court Sites:

Yahoo!'s court page: **http://www.yahoo.com/Government/Judicial_Branch/**

Federal Court's Home Page: **http://www.uscourts.g**

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Federal Court Locator:

http://www.law.vil.edu/Fed-Ct/fedcourt.html

Directory of Electronic Public Access
Services to Federal Courts:
http://www.uscourts.gov/PubAccess.html

Bar Associations and Groups:

Michigan ICLE's Home Page:
http://www.icle.org
(this is a new address)

American Bankruptcy Institute
Home Page (ABI World):
http://www.abiworld.org/

American Bar Association
Home Page:
http://www.abanet.org/

Internet Lawyer Home Page:
http://www.internetlawyer.com

Grand Rapids Bar Association:
http://www.grbar.org

Miscellaneous Government Sites

The Internal Revenue Service
Home Page:
http://www.irs.ustreas.gov/plain/ (text only version)

The U.S. House of Representatives
Internet Law Library:
http://law.house.gov/fast.htm

The National Bankruptcy Review Commission
Home Page:
http://www.nbrc.gov

The U.S. Bankruptcy Code:
http://www.law.cornell.edu/uscode/11/

U.S. Supreme Court
Bankruptcy Decisions:
http://www.law.cornell.edu/syllabi?bankruptcy

Miscellaneous Legal Sites

Hieros Gamos -- the comprehensive
legal site:
http://www.hg.org/hghome.html

The Seamless Web Site:
http://www.seemless.com

FindLaw -- Internet
legal resources:
http://www.findlaw.com

InterNet Bankruptcy Library:
http://www.bankrupt.com

The National Law Net:
http://www.lawsites.com

The Uniform Commercial Code Locator (Cornell Law School):
http://www.law.cornell.edu/lii.table.html

A number of law firms have developed home pages with links to other legal resources, including the author's:
http://www.millercanfield.com/links.html.

* Mr. Wright chairs the Technology Subcommittee and is immediate past chair of the Bankruptcy Steering Committee. He is a principal of Miller, Canfield, Paddock & Stone, in the firm's Grand Rapids Office where he practices in the areas of litigation and bankruptcy.

RECENT BANKRUPTCY COURT DECISIONS

The Western District cases were summarized by Dean Reitberg.

Dischargeability Under §523(a)(2)(A) and (a)(4)

Should debts arising from alleged violations of state and federal securities laws be deemed per se nondischargeable under 11 U.S.C.§§523(a)(2)(A) and (a)(4) was the principal legal issue framed by the Honorable James D. Gregg in the case of Kinsler, et.al v Pauley (In re Pauley), (Bank. W.D. Mich. February 24, 1997).

In a thorough review of both the required elements of proof of claim under these sections and the 6th Circuit case law in the area, Judge Gregg concluded that "debts arising from securities fraud are not *necessarily* excepted from discharge in bankruptcy; rather, plaintiffs must prove all the elements required to establish actual fraud under §523(a)(2)(A) or fraud or defalcation while acting in a fiduciary capacity under §523(a)(4)" (emphasis in original).

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The issue facing the Honorable Laurence E. Howard in In re Huff, (Bankr. W.D.Mich, April 3, 1997), was whether a Chapter 11 Debtor, whose plan was confirmed prior to January 27, 1996, was required to pay quarterly fees to the United States Trustee pursuant to 28. U.S.C. §1930(a)(6), as recently twice amended. Sustaining the United States Trustee's objection and denying the Debtor's petition for the entry of a final decree, the Court followed nine reported decisions, agreeing that through the language of the second amendment "Congress has appropriately specified its intent and that 28 U.S.C.§ 1930(a)(6) now properly applies retroactively to Debtors whose Chapter 11 Plans were confirmed prior to January 27, 1996".

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In a Chapter 7 case where the attorney for the Debtor filed a motion for the allowance of his attorney fees and expenses incurred after the filing of the Chapter 7 petition, the Honorable Laurence E. Howard, having taken the matter under advisement, rendered a bench opinion sustaining the United States Trustee's objection to the motion in In re Helen Diane Phairas, (Bankr. W.D.Mich., unpublished, order dated December 29, 1996). The Court found that the 1994 Amendments to the Bankruptcy Code, applicable to cases cmonneced after October 22, 1994, deleted the reference to awards to "Debtor's attorney" in 11 U.S.C.§330(a)(1), and therefore concluded that "no statutory bases exist for awards of fees and expenses for Debtors' attorneys from Chapter 7 estates in cases commenced after October 22, 1994."

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The Supreme Court and Sixth Circuit cases were summarized by John A. Potter.

In Re: DENNIS AMIEL CALVERT, Debtor. BAY AREA FACTORS, a division of DIMMITT & OWENS FINANCIAL, INC. , Appellant, v DENNIS AMIEL CALVERT, Appellee. No. 96-5141, 105 F. 3d 315; 1997 U.S. App. LEXIS 1311; 1997 FED App. 0035P (6th Cir.); Bankr. Rep. (CCH) P77,248, January 28, 1997, Filed.

PRIOR HISTORY: ON APPEAL from the United States District Court for the Western District of Tennessee, 95-02270, Odell Horton.

DISPOSITION: REVERSED and REMANDED.

Bay Area Factors, appealed the District Court's order affirming the Bankruptcy Court's denial of its Motion for Summary Judgment in this action to determine the dischargeability of a debt under 11 U.S.C.§523(a). On appeal, the Court was asked to determine whether a default judgment obtained in state court, where the Defendant did not defend the suit, has collateral estoppel effect against the Debtor in a subsequent bankruptcy proceeding where the dischargeability of the debt is at issue. The Court concluded that collateral estoppel applies to true default judgments in bankruptcy dischargeability proceedings in those states which would give such judgments that effect.

On December 11, 1991, Bay Area Factors ("BAF") filed a complaint against Dennis Amiel Calvert, and numerous other Defendants, in the Municipal Court of the State of California. In its complaint, BAF sought to recover

against Calvert for, inter alia, intentional misrepresentation, fraud and deceit, and breach of fiduciary duty in connection with the sale of food products to Frontier Sales, Inc. Because Calvert failed to respond to the complaint, the California State Court entered a default judgment, on March 11, 1992, against Calvert in the amount of $26,829.59. In an attempt to enforce the judgment in Tennessee, the default judgment was enrolled in the State of Tennessee on October 13, 1992, by order of the Shelby County, Tennessee Circuit Court for the Thirtieth Judicial District at Memphis. Calvert also failed to appear in or defend this action to enfore the California state court judgment.

On January 4, 1994, Calvert moved to join his wife's Chapter 7 petition in Bankruptcy proceedings pending in Bankruptcy Court. The motion was granted. On June 20, 1994 BAF filed an adversary proceeding in the Bankruptcy Court against Calvert seeking a nondischargeable judgment against Calvert for $26,829.59, the amount of the State Court judgment. The Bankruptcy Court, on July 25, 1994, discharged Clavert from all dischargeable debts but reserved the question of the dischargeability of the debt owed to BAF. On Spetember 27, 1994, BAF filed a Motion for Summary Judgment arguing that, pursuant to the doctrine of collateral estoppel, the California State Court judgment of default precluded Clavert from relitigating the issues of intentional misrepresentation, fraud and deceit, and breach of fiduciary duty in the Bankruptcy proceedings.

On February 13, 1995, the Bankruptcy Court denied BAF's Motion for Summary Judgment, refusing to apply the doctrine of collateral estoppel to the dischargeability issue in this Bankruptcy proceeding. In the Bankruptcy Court's view, the prior default judgment did not satisfy the "actually litigated" requirement for application of the doctrine of collateral estoppel. Recognizing the split of authority among District and Bankruptcy Courts and noting that the question was, as yet, unresolved by this Court, the Court elected to adopt an equitable approach in view of the fact that neither party entered any evidence in to the record in the California State Court proceedings and in light of the policy that Bankruptcy proceedings allow a Debtor an opportunity for a "fresh start".

On March 15, 1995, BAF moved for an interiocutory appeal to the District Court pursuant to 28 U.S.C. §158(a). The United States District Court for the Western District of Tennessee granted BAF's motion for leave to file an interiocutory appeal and affirmed the Bankruptcy court's decision denying BAF's Motion for Summary judgment. The District Court was persuaded that the policy reasons cited by the Bankruptcy Court warranted an exception to the doctrine of collateral estoppel in Bankruptcy cases. The District Court, therefore, adopted the opinion and order of the Bankruptcy Court. However, it certified the case as appropriate for interlocutory appeal to this Court. A panel of this Court, on April 1, 1996, concluded that BAF met the criteria for interlocutory review under 28 U.S.C.§1292(b) and granted leave to appeal.

The Court's determination of the collateral estoppel effect of a state court default judgment in Bankruptcy dischargeability proceedings began with the Full Faith and Credit Statute, 28 U.S.C.§1738, which requires the federal courts to give full faith and credit to the judicial proceedings of state courts. See Migra v. Warren City Sch. Dist. Bd. Of Ed., 465 U.S. 75, 81, 79 L. Ed. 2d 56, 104 S. Ct. 892 (1984).

Further, the United States Supreme Court has noted in the context of issue and claim preclusion that §1738, directs a federal court to refer to the preclusion law of the State in which judgment was rendered. "It has long been established that §1738 does not allow federal courts to employ their own rules... in determining the effect of state judgments. Rather, it goes beyond the common law and commands a federal court to accept the rules chosen by the State from which the judgment is taken." Marresse v American Academy of Orthopaedic Surgeons, 420 U.S. 373, 380, 84 L. Ed. 2d 274, 105 S. Ct. 1327 (1985) (quoting Kremer v Chemical Constr. Corp., 456 U.S. 461, 481-82, 72 L. Ed 2d 262, 102 S.Ct. 1883(1982)).

In Marese, the Supreme Court, in accordance with the Full Faith and Credit Statute, instructed lower federal courts faced with the question of whether to give full faith and credit to a state court default judgment to "consider first the law of the State in which the judgment was rendered to determine its preclusive effect." Marrese at 375. If

the state court would not give preclusive effect to a default judgment, the analysis is complete. If, however, the state would accord the judgment preclusive effect. Marrese instructs that the federal court give preclusive effect to the judgment unless Congress has expressly or impliedly created an exception to §1738 which ought to apply to the facts before the federal court. Marrese at 386.

The Court then determined that California courts have held that collateral estoppel bars relitigation of an issue on which a party has obtained a default judgment. According to California law, " a party who permits a default to be entered confesses the truth of all the material allegations in the complaint. A default judgment is as conclusive upon the issues tended by the complaint as if rendered after an answer is filed and a trial is held on the allegations." In re Naemi, 128 Bankr. 273, 278 (Bankr. S.D. Cal. 1991)(citing O'Brien v Appling, 133 Cal. App. 2d 40, 42,283 P.2d 289(1995)). See also In re Green, 198 Bankr.564, 566 (B.A.P. 9th Cir. 1996); Four Star Elec. Inc. v F&H Constr., 7 Cal. App. 4th 1375, 1380,10 Cal. Rptr. 2d 1 (1992); Mitchell v Jones, 172 Cal. App. 2d 580, 342 P.2d 503, 507 (1959).

The Court then reasoned that because the state in which the judgment was rendered would give the default judgment preclusive effect, Marrese instructs that the federal court must then determine whether an exception exists to §1738. It then noted that in Marrese the Court held that the fact that a claim, such as the one in the case at hand, is within the exclusive jurisdiction of the federal courts does not suggest that an exception exists to §1738.

In the absence of any indication in the Bankruptcy Code or legislative history suggesting that Congress intended an exception to §1738 apply to true default judgments and with no principled distinction between cases where a defendant participates in part in defense of the state court suit and cases where the defendant does not respond at all, the Court concluded that collateral estoppel applies to true default judgments in bankruptcy dischargeability proceedings in those states which would give such judgments that effect.

IN RE: JOHNSON'S DAIRY, INC., and JAMES JOHNSON and JOHN JOHNSON, Successor Co-Trustees of Johnson's Dairy, Inc. Defined Benefit Pension Plan and Trust, Plaintiffs-Appellants, v Western Reserve Life Assurance Company of Ohio, Defendant-Appellee. No. 95-5984, 1997 U.S. App. LEXIS 2860; 1997 Fed. App. 0069P (6th Cir.) February 20, 1997, filed.

PRIOR HISTORY: ON APPEAL from the United States District Court for the Eastern District of Kentucky. 94-00267, Henry R. Wilhoit, Jr. District Judge.

DISPOSITION: Reversed and Remanded

Johnson's Dairy hired Western Reserve Life to manage its pension funds. An agent of Western Reserve, David Lambert, was the person assigned to the account. Lambert embezzled money, including most of Johnson's Dairy's pension funds. In 1986, Lambert paid back $243,201.73, which was a large portion of the embezzled money. After that payment, Lambert declared bankruptcy. The payment to Johnson's Dairy was determined to be a "preferential payment" by the Bankruptcy Court in 1994, and the Dairy was required to repay the embezzled money to the Trustee. The Dairy then sought reimbursement for this payment from Western Reserve Life which was jointly liable with Lambert for Lambert's defalcation. It argued that it was entitled in restitution to repayment of the money paid to the Bankruptcy Trustee as indemnity.

The Court reasoned that the Restatement of Restitution provides: "A person who, in whole or in part, has discharged a duty which is owed by him but which as between himself and another should have been discharged by the other, is entitled to indemnity form the other, unless the payor is barred by the wrongful nature of his conduct." RESTATEMENT OF RESTITUTION § 76 (1937) (General Rule). This indemnity principle clearly applies in the instant case. The Dairy, which was not at fault, paid the Bankruptcy Trustee the amount demanded because of the fault of the agent of Western Reserve, according to the Complaint. It is elementary that under general agency and tort law, Western Reserve is liable to the Dairy for the torts of its agent, Lambert, in the scope of employment. But for embezzlement of Western Reserve's agent, there would have been no loss and no preferential payment in Bankruptcy, and the Dairy, and innocent party,

would not have been required to make the repayment. Since the Dairy did not know that it would have to refund the payment to the Trustee until 1994, it did not know it had a cause of action until that time. Since the Dairy was repaid $243,000.00 of the embezzled money by Lambert in 1986, it had no claim at that time against the employer because the injury had been cured by Lambert's repayment of the embezzled funds. The Dairy had possession of the money until 1994, when the Bankruptcy Code ordered the Dairy to repay the money to the Trustee. The case law in Kentucky does not address the specific issue in this case, and there is no precedent from a Kentucky court which we find helpful on this issue. But we have no reason to believe that Kentucky would not apply well-established general principles of restitution in indemnity cases, as found in RESTATEMENT OF RESTITUTION §76 (1937). The Dairy has discharged a duty cured in reality by Western Reserve. As between the Dairy and Western Reserve, in light of Western Reserve's legal obligation to reimburse the Dairy for the loss of its pension funds due to the embezzlement by Lambert, Western's employee, Western Reserve must compensate the Dairy for its payment of the bankruptcy preference, assuming that the facts are as set out in the complaint summarized above. To require the loss to lie with the Dairy is unjust and violates principles of indemnity declared in the law of restitution and unjustly enriches the insurance company at the expense of the Dairy and its pensioners.

The judgment of the District Court dismissing the complaint is reversed and the case remanded for trial on the merits.

DISSENT BY: PATRICK J. DUGGAN

IN RE: BAKER & GETTY FINANCIAL SERVICES, INC., Debtor. WESBANCO BANK BARNESVILLE, Plaintiff-Appellant/Cross-Appellee, v CARL D. RAFOTH, Trustee, Defendant, CUSTOMER CREDITORS, Defendant-Appellee/Cross-Appellant, MARK HOCEVAR, THERESA M. FIRSSORA, Defendants. Nos. 96-3030/96-3077, 106 F.3d 1255; 1997 U.S. App. LEXIS 2273; 1997 Fed App. 0054P (6th Cir.) February 12, 1997, filed.

PRIOR HISTORY: ON APPEAL form the United States District Court for the Northern District of Ohio. 95-00089, John M. Manos, District Judge.

DISPOSITION: AFFIRMED.

Wesbanco Bank of Barnesville, Ohio ("Wesbanco") appealed a judgment by the District Court, in which the court affirmed an earlier decision of the Bankruptcy Court, instructing the Trustee to distribute the assets of Baker & Getty Financial Services, Inc., Bake & Getty Diversified, Inc., Bake & Getty Securities, Inc., Philip Cordek and Suzan Cordek, collectively known as the "Debtors", pursuant to the stockbroker liquidation provisions of the National Bankruptcy Review Act of 1987, 11 U.S.C.§741-752 (1978). Wesbanco contended that the District Court, by so ruling, erred in determining that the Debtors were "stockbrokers" under 11 U.S.C.§101(53A). "Customer Creditors", investors who entrusted money with the Debtors for the purpose of purchasing stock, responded that the District Court correctly classified the Debtors as stockbrokers. In addition, Customer Creditors cross-appealed a marginal entry order by the District Court, in which the District Court refused to strike references to the deposition of testimony of Daniel Schwenker and Philip Cordek from the record on appeal. The Court AFFIRMED the District Court's order characterizing the Debtors as "stockbrokers" and applying the stockbroker liquidation provisions and, therefore, did not decide the issue raised by Customer Creditors in the cross-appeal.

In August 1985, Philip Cordek and Steven Medved formed Baker & Getty Financial Services, Inc. ("BGFS"), a stock brokerage and financial services firm. Medved and Cordek assumed the primary duties of organizing the business after its incorporation. By December 1985, Medved formed Baker & Getty Diversified, Inc. ("BGD") to obtain funds from various institutions and in turn loan the funds to BGFS, BGD also developed real estate investment opportunities for the customers of the brokerage firm. In May, 1986, Baker & Getty Securities, Inc. ("BGS") was formed to replace BGFS and BGD because of problems encountered regarding the licensing procedures for BGFS as a securities firm. The three Banker & Getty corporations are collectively referred to as "B&G".

Throughout 1985 and 1986, B&G solicited customers to purchase securities. B&G advertised itself as a licensed broker-dealer and

as a member of the Securities Investor Protection Corporation, and, in addition, B & G encouraged its stockbrokers to tell prospective customers that B&G was a full-service brokerage firm, capable of conducting transactions inhouse. In truth, however, B&G was neither a licensed broker-dealer nor a member of the Securities Investor Protection Corporation. Instead, B&G employed Mutual Services, Inc. ("Mutual Services"), a licensed broker-dealer, to conduct trades through a clearing house, Mesirow and Company Incorporated ("Mesirow"). Typically, B&G stockbrokers, who were also registered representatives of Mutual Services, placed orders with Mutual Services, and Mutual Services cleared the trades through Mesirow. After executing a trade, Mutual Services provided confirmation slips to both the investors and B&G stockbrokers, and commission checks to B&G stockbrokers. Thus, although investors who purchased stock from B&G licensed stockbrokers, Daniel Schwenker, David Perham, and Phil Hammond, received valid securities, they received them without knowledge of B&G's actual status.

At the same time Schwenker, Perham and Hammond were conducting legitimate stock transactions, Philip Cordek was conducting illegitimate transactions. To attract business, Cordek told investors that his uncle, who resided in New York, had access to large blocks of common stock available for sale at a discount. Cordek told investors that he would purchase stock at a discounted price and then quickly sell it, thereby allowing the investors to make a substantial return on their investment. Relying on Cordek's representations, Customer Creditors paid various sums to B&G in order to take advantage of the alleged investment opportunities. Cordek in turn gained access to the funds as the sole signatory on the B&G bank accounts.

Instead of purchasing the stocks as promised, however, Cordek pocketed the money and then paid returns to original investors by taking from the principle sums contributed by new B&G investors. The result was a classic "Ponzi" scheme, an investment scheme in which investors are promised excessive returns on investments and where, typically, initial investors are paid the promised returns to attract additional investors. In January and February 1986, Cordek purchased stock for himself through Perham and Mutual Services, Inc. with the money received from the "Ponzi" scheme. By November, 1986, Customer Creditors had lost approximately $3 million.

Meanwhile, in August of 1986, Cordek and Byron Rice, a long-time customer of WesBanco, approached the President of WesBanco, Charles Bradfield, to obtain a loan. Cordek and Rice borrowed $1.1 million to invest in the bond market. n3 WesBanco requested $200,000 in collateral to be presented at the closing; however, it only perfected its interest in collateral of the value of $55,000. n4 On the due date for the $1.1 million promissory note, Cordek told WesBanco that he could not make the payment because he had not sold the bonds purchased with the loan money. However, Cordek testified that, in truth, he sold the bonds for a loss and deposited the proceeds of the sale into his personal account. Later, WesBanco recovered $245,800 from B&G's accounts with the bank and $237,378 from Rice on the promissory note.

On January 22, 1987, three defrauded individuals filed involuntary bankruptcy petitions against BGS, BGD and BGFS. The petitions were not contested, and the Bankruptcy Court entered an order for relief against the three corporations on February 17, 1987. On April 28, 1987, Cordek and his wife were joined as affiliates. Then, on May 26, 1987, the Bankruptcy Court entered an order substantively consolidating the estates of B&G with those of Philip and Suzan Cordek. Matter of Baker & Getty Fin. Servs., Inc., 78 Bankr. 139 (Bankr. N.D. Ohio 1987). The Bankruptcy Court substantially consolidated the estates of the Debtors because of unrestricted and extensive commingling of Philip Cordek's personal assets with B&G's corporate assets. WesBanco, which had been a creditor of Philip Cordek, individually, but not of B&G, then became a creditor of B&G. Thus, WesBanco would not have been a creditor of B&G at all had it not been for Customer Creditors' efforts to substantively consolidate the estates of the Cordeks with the B&G estates.

After seven years of contested proceedings, the Trustee began to focus on the distribution of the recovered assets. On July 1, 1994, the Trustee filed a motion for instructions from the Court as to the applicability of the stockbroker liquidation sections of the

Bankruptcy Code, 11 U.S.C.§741-752. In particular, the Trustee wanted to know whether or not he should distribute the assets of the estate under the general subchapter, 11 U.S.C.§726, or the subchapter for liquidation of a stockbroker, 11 U.S.C.§741-752. Under an 11 U.S.C.§726 distribution, WesBanco, as well as the other general creditors, expected to receive approximately 60% to 70% of its total claim upon final distribution. Under 11 U.S.C.§§741-752, however, WesBanco would receive no return on its claim, while Customer Creditors would receive a full return. After holding a full evidentiary hearing, the Bankruptcy Court concluded that the assets of the Debtors be distributed under the stockbroker liquidation provisions, 11 U.S.C.§§ 741-752. There is no dispute that the Debtor defrauded investors. Further, from the evidence, the Court concluded that the Debtor had effected transactions in securities.

The first issue before the Court: whether the Bankruptcy Court appropriately determined that the Debtors were stockbrokers under 11 U.S.C.§101(53A) and, therefore, subject to the stockbroker liquidation provisions of 11 U.S.C. §§ 741-752. For a Debtor to be classified as a stockbroker (1) the Debtor must have customers, and (2) the Debtor must be engaged in the business of effecting transactions in securities. If B&G fell short of either requirement, then the assets of the estate must be distributed in a general liquidation pursuant to 11 U.S.C. §726. In re: Berry, 22 Bankr. 950 (Bankr. N.D. Ohio 1982).

The facts in the record indicate that B&G effected securities transactions, albeit with the aid of Mutual Services. In particular, B&G enticed customers to invest their money through B&G Investors, lured in by B&G's corporate offices and advertisements representing B&G as a licensed broker-dealer, placed money inthe hands of B&G stockbrokers for the purpose of purchasing stock. B&G stockbrokers told investors that B&G was a full service brokerage firm, capable of conducting securities transactions in-house. B&G stockbrokers, who were also registered representatives of Mutual Services, placed orders for trades through Mutual Services. All the while, B&G had taken steps to substitute itself in the position of Mutual Services by applying for licensing as a broker-dealer with the Securities and Exchange Commission. Because B&G's stockbrokers were registered representatives of Mutual Services, they could use Mutual Services to execute trades, yet maintain the strong client base should B&G become a licensed broker-dealer. First, B&G was responsible for soliciting investors, without which there would have been no securities transactions. Second, B&G's stockbrokers, as registered representatives of Mutual Services, executed transactions in securities. See In re: Berry, 22 Bankr. 950, 952 (Bankr. N.D. Ohio 1982). Finally, from the beginning, B&G operated with the intention that it replace Mutual Services upon licensing. The Court then concludes, therefore, that B&G's activities effected transactions in securities.

Accordingly, the District Court properly determined that the stockbroker liquidation provisions under 11 U.S.C.§§741-752 governed the distribution of the assets in the Bankruptcy estate. Having determined that B&G was a stockbroker pursuant to 11 U.S.C.§101(53A), the Court AFFIRMED the District Court's order instructing the Trustee to distribute the assets of the Bankruptcy estate according to the stockbroker liquidation provisions of 11 U.S.C.§§741-752.

STEERING COMMITTEE

The next Steering Committe meeting will be April 25, 1997 at the Peninsular Club in Grand Rapids at noon.

BANKRUPTCY NEWS

The following is a summary of future events:

FBA Bankruptcy Section Kickoff Cocktail Party - May 7, 1997 4:30p.m. to 6:30p.m., Fifth floor of the Peninsular Club.

Conference of the Sixth Judicial Circuit - May 14-16, Nashville, Tennessee.

FBA Bankruptcy Seminar - June 27th and 28th, Boyne Highlands, Harbor Springs, Michigan.

ANSWERS TO FINAL EXAMINATION

The answers to the Final Examination written by Judge James D. Gregg and Eric Richards, Esq. are as follows:

A.1	Yes; §506(a)
A.2	Yes; §362(d)(1)
A.3	Yes; §541(a)(1)
A.4	Yes; 28U.S.C.§157(b)(2)(D)
A.5	No; §362(b)(1)
A.6	No; §1111(a)
A.7	Yes; §1121(c)
A.8	No; §362©
A.9	No; §541(c)(2)
A.10	Yes; §105(a)
A.11	Yes; §507(a)(7) or §507(a)(8)
A.12	No; §327(a)
A.13	Yes; §362(d)(2)
A.14	No; §1126(f)
A.15	No;§362(b)(5)
A.16	Yes; §363(c)(2)
A.17	Yes; §1125(a)
A.18	No; 28U.S.C.§1334
A.19	No; §1129(a)(9)(c)
A.20	Yes; §506(b)
A.21	Yes; §330(a)(1)
A.22	No;§1126(c)
A.23	Yes; §109(d)
A.24	No; 28 U.S.C.§1334 and 28 U.S.C.§157(b)(5)
A.25	No; §1129(b)(1) and §1129 (a)(10)

Part B --Essay Question
Model Answer

Please see insert.

EDITORIAL

Those of us who have practiced in Bankruptcy Court have all seen or experience a case where an individual represents himself/herself because they cannot afford an attorney. These situations come up most frequently in Adversary Proceedings. As a result of these types of cases, the Steering Committee was approached by the Court which expressed a concern regarding these litigants. After researching the matter, the Steering Committee voted to institute a *Pro Bono Program*, which is being supported by all of our Judges. You should, under separate cover, seen a flyer on this. You should also know that the Steering Committee is doing a "Kickoff" reception regarding the Program. This is a project in which all bankruptcy attorneys should participate. With a large pool of attorneys to draw from, the request to represent a litigant who would otherwise not have a lawyer, would be minimal.

By now everyone should have received correspondence from Patrick E. Mears briefly outlining the program with an invitation to the Kickoff Cocktail Party. Enclosed with the Newsletter is a reminder of the event.

LOCAL BANKRUPTCY STATISTICS

The following is a summary of the number of bankruptcy cases commenced in the United States Bankruptcy Court for the Western District of Michigan (Lower Peninsula) during the months of February and March, 1997. These figures are compared to those made during the same period one year ago and two years ago.

Bankruptcy Chapter	February of 1997	February of 1996	February of 1995
Chapter 7	681	515	367
Chapter 11	6	8	5
Chapter 12	1	0	2
Chapter 13	224	214	135
Totals	912	737	509

Bankruptcy Chapter	January - February of 1997	January - February of 1996	January - February of 1995
Chapter 7	1235	1070	811
Chapter 11	12	17	12
Chapter 12	2	1	2
Chapter 13	476	430	295
§304			1
Totals	1725	1518	1121

Bankruptcy Chapter	March of 1997	March of 1996	March of 1995
Chapter 7	781	555	444
Chapter 11	6	6	7
Chapter 12	2	0	0
Chapter 13	282	216	160
Totals	1071	777	611

Bankruptcy Chapter	January - March of 1997	January - March of 1996	January - March of 1995
Chapter 7	2016	1480	1122
Chapter 11	18	23	19
Chapter 12	4	1	6
Chapter 13	758	621	397
§304			1
Totals	2796	2125	1545

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PART B -- ESSAY QUESTION
(MODEL ANSWER)

1. CLASSIFICATION ISSUE #1. Class I is improper because law firm is an administrative claimant and therefore not a class, but it doesn't matter because class is unimpaired. See §1123(a)(1) (contents of plan) and §503(b)(2) (administrative expenses) and §330(a)(1)(A) (compensation of attorneys).

2. CLASSIFICATION ISSUE #2. Class II is also improper because a priority tax claim is not a class, but it doesn't matter because Class II didn't vote. See §1123(a)(1) (contents of plan) and §507(a)(8)(B) (priority tax claims).

3. CLASSIFICATION ISSUE #3. Class V is improper because Dolly Madison S&L and J.P. Jones are not substantially similar. See §1122(a) ("a plan may place a claim or interest in a particular class only if such claim or interest is substantially similar to the other claims or interest of such class."); In the Matter of Martin's Point Ltd. Partnership, 12 B.R. at 727 (cp 270) (claims need only be "substantially similar" not identical).

4. CLASSIFICATION ISSUE #4 / DISSIMILAR TREATMENT. Class V provides for different treatment of claimants within the same class. See §1123(a)(4) ("a plan shall -- provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest.")

5. CLASSIFICATION ISSUE #5. Class V includes J.P. Jones, but she does not hold a valid allowed claim against the debtor partnership, and therefore, she should not be included in the plan. See §502 (allowance of claims).

6. PLAN DOES NOT COMPLY WITH CODE. Rosebud law firm receives all $100,000 in fees owed as priority administrative, even though $50,000 incurred prepetition, and thus should be classified as unsecured claim. See §1129(a)(1) ("The plan complies with the applicable provisions of this title."); §507(a)(1) (priorities); and § 503(b)(2) (administrative expenses).

7. PROPONENT DOES NOT COMPLIES WITH CODE. Conflict of interest between debtor and its counsel, Rosebud which holds prepetition claim. See §1129(a)(2) ("The proponent of the plan complies with the applicable provisions of this title."); See also §327 (debtor's attorney must be disinterested); In re Watervliet Paper Co., 96 B.R. at 774 (cp106) (debtor's counsel must waive pre-petition claim in order to represent debtor in bankruptcy case). But cf. In re The Landing Associates, Ltd, 157 B.R. at 811 (cp 325) (minor violations that have been cured do not justify denial of confirmation).

8. LACK OF GOOD FAITH. Class IV payment to Flowers is not reasonably necessary and may be contrary to public policy. See §1129(a)(3) ("The plan has been proposed in good faith and not by any means forbidden by law."); In re Gregory Boat, 144 B.R. at 367 (cp316) ("Good Faith" requirement satisfied where proposed treatment is reasonably necessary to success of reorganization); In re The Landing Associates, Ltd, 157 B.R. at 812 (cp326) ("Good Faith" means (1) "legitimate and honest purpose to reorganize" and (2) "reasonable hope of success.").

9. FAILS TO IDENTIFY INSIDERS. Plan does not disclose Pillory Nelson's affiliation with Rosebud law firm. See §1129(a)(5)(A)(i) (proponent has disclosed identity and affiliations of new management) and (B) ("the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.").

10. MANAGEMENT NOT IN BEST INTEREST OF CREDITORS. There is no showing that the existing partners can operate a rafting company. See §1129(a)(5)(A)(ii) ("the appointment . . . of such individual is consistent with the interests of creditors and equity security holders and with public policy;")

11. BEST INTEREST OF CREDITORS / LIQUIDATION TEST. Plan apparently meets liquidation test because S&L will receive $510,000 plus interest under plan, but would only receive $500,000 minus cost of foreclosure. See §1129(a)(7)(A)(i) and (ii) ("With respect to each impaired class of claims or interests, each holder of a claim or interest of such class -- (i) has accepted the plan; or (ii) will receive under the plan on account of such claim or interest property of a value, as of the effect date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date.") (liquidation test); In re The Landing Associates, Ltd, 157 B.R. at 819 (cp333) (even though oversecured, bank actually better off under plan than liquidation).

12. REQUIRED PRIORITY CLAIMS. Class II tax claims are not paid within six years of assessment, therefore violates §1129(a)(9)(C) (with respect to §507(a)(8) priority tax claims, deferred payments, "over a period not exceeding six years after the date of the assessment of such claim . . ."); In re Gregory Boat, 144 B.R. at 364 (cp313)(deferred cash payments need not be periodic or equal under 1129(a)(9)(C)).

13. ACCEPTANCE OF PLAN ISSUE #1. Class I administrative claimant not impaired therefore conclusively deemed to have accepted. See §1126(f) (unimpaired class is conclusively presumed to have accepted); but may not matter since admin. claims not a proper class. See supra §1123(a)(1).

14. ACCEPTANCE OF PLAN ISSUE #2. Class III is impaired and voted against the Plan, and therefore, the plan does not comply with subsection (8). See §1129(a)(8)(A) and (B) ("With respect to each class of claims or interests -- (A) such class has accepted the plan; or (B) such class is not impaired under the plan.").

15. ACCEPTANCE OF PLAN ISSUE #3. Classes II and V did not vote, and therefore have NOT accepted. See §1126 (acceptance of plan); In re Friese, 103 B.R. at 92 (cp318) (impaired class that does not vote is NOT deemed to have accepted).

16. ACCEPTANCE OF PLAN ISSUE #4. Class IV (Juniper Flowers) is impaired and voted to accept. See §1129(a)(10) ("If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan, determined without including any acceptance of the plan by an insider.").

17. ARTIFICIAL IMPAIRMENT. Juniper Flower's claim in Class IV was reduced by only one penny, but this may be enough to show that claim was "impaired." See §1124(1) (A class is impaired unless the plan leaves the plan leaves each claim "unaltered"); In re L&J Anaheim Associates (Anaheim v. Kawasaki Leasing), 995 F.2d at 943 (cp290) (claim is "impaired" even though creditor's position was improved under the plan).

18. CRAMDOWN. Cramdown may be possible because Class IV (Juniper Flowers) has voted to accept. See §1129(a)(10) and 1129(b)(1) (If all requirements of subsection (a) are met, other than subsection (a)(8) (unanimous approval), then the court, on the request of the proponent of the plan, shall confirm the plan if, the plan does not discriminate unfairly and is fair and equitable); In re Polytherm Industries, 33 B.R. at 838 (cp287) (no impaired class accepted therefore no cramdown).

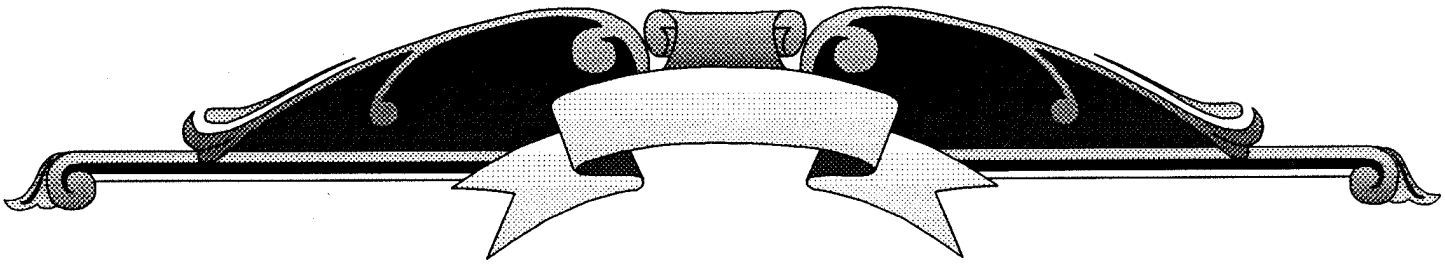
19. SECURED CREDITOR CRAMDOWN / NEGATIVE AMORTIZATION. Class II is class of secured claims held by S&L which has not accepted the plan, but treatment is fair and equitable. See §1129(b)(2)(A) ("fair and equitable" means -- (i)(I) creditor retains liens AND (i)(II) creditor receives deferred cash payments at present value; OR (ii) if sold, retains lien on proceeds; OR (iii) creditor receives "indubitable equivalent" e.g., surrender of property); In re The Landing Associates, Ltd, 157 B.R. at 821 (cp335) ("Simply put, the holder of an allowed secured claim must receive the present value of its claim on the effect date of the plan."); Great Western Bank, 953 F.2d at 1177-78 (cp341-42) (negative amortization is not impermissible per se).

20. UNSECURED CREDITOR CRAMDOWN / ABSOLUTE PRIORITY RULE. Dolly Madison S&L only receives $10,000 on its unsecured claim of $100,000 in Class IV, but partners still retain ownership in Class VI. This violates the absolute priority rule that unsecured creditors must be paid before shareholders receive anything, i.e., current shareholders receive no distribution if company is insolvent. See §1129(b)(2)(B)(i) and (ii) ("fair and equitable" means -- (i) creditor must be paid in full OR "(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property."

21. NEW VALUE EXCEPTION TO ABSOLUTE PRIORITY RULE. Partners contributed additional $50,000 apiece, therefore entitled to retain ownership interest. See In re U.S. Truck, 800 F.2d at 589 (cp345) (additional capital contribution was "essential" therefore retention of ownership by current shareholder did not violate absolute priority rule); In re Bonner Mall Partnership, 2 F.3d at 918 (cp362) (recognizing continued viability of new value exception to absolute priority rule).

22. FEASIBILITY PROBLEM. Total contribution of $200,000 from partners is not sufficient to cover immediate payments of $209,999. Proceeds from rafting company speculative and may not be sufficient to pay long term debt of $600,000. See §1129(a)(11) ("Confirmation is not likely to be followed by the liquidation, or the need for further reorganization."); In re U.S. Truck, 800 F.2d at 589 (cp345) (six factors: adequacy of capital, earning capacity, economic conditions, management ability, management continuity, and "other related matters."); In re The Landing Associates, Ltd, 157 B.R. at 819 (cp333) ("A plan is feasible if it offers a reasonable assurance of success.")

23. IMPAIRMENT PROBLEM. Plan does not identify which classes are impaired or unimpaired under the plan. See §1123(a)(2) and (3).



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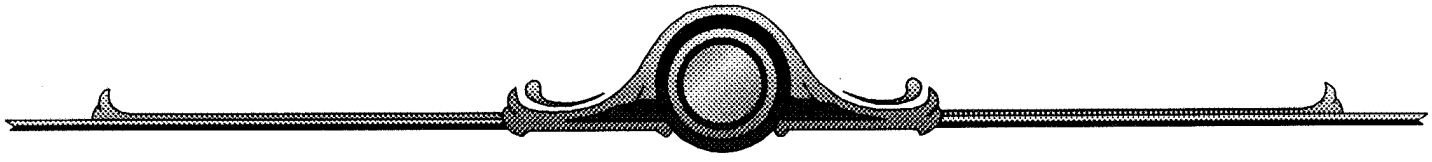

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