Creditors' Rights & Bankruptcy Section Newsletter

Greetings:

Each year brings with it new challenges and a re-examination of some recurring problems. One issue that is always at the forefront is delinquent student loan debt. This newsletter addresses a case in which a bankruptcy court attempts to apply some "tough love" to achieve an equitable result, although not the result the debtor would have preferred. We also address the strange concept of proffers of testimony in evidentiary hearings and provides some practice tips you may find helpful. Finally, we address a recent decision out of the Fifth Circuit which deals, yet again, with a trustee's attempt to stick his hands into a secured lenders collateral cookie jar and comes out wanting. Hope you enjoy this month's palate of articles!As always, let us know how we can assist you in your credit and collection needs. If you have any ideas for future article or questions that need addressing, give us a call.

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Bruce W. Akerly leads the firm's Creditors' Rights & Bankruptcy Practice Group. He has extensive experience in commercial litigation, bankruptcy, financial restructuring, and creditors' rights.

Quote of the Month:

"Your future depends on many things, but mostly on you." - Frank Tyger

Self-Deprecating Lawyer Joke of the Month:

Proud mother: "My son is a brilliant lawyer. He can look at a contract and tell you immediately whether it is oral or written."

What is a Proffer and How can it be Used in Bankruptcy Cases?

Authored by Bruce W. Akerly, Partner

Bankruptcy Court is a federal court. For anyone who does not regularly practice in this forum it can be a hair raising experience. Non-adversarial proceedings in Bankruptcy Court, called contested matters, are governed by the Federal Rules of Civil Procedure (FRCP) and Federal Rules of Evidence (FRE) and often take place quickly (sometimes within days, weeks or months of the filing of a motion) and involve what resemble mini-trials. Because of the volume of activity in Bankruptcy Court and the importance placed on a fair, just, equitable and prompt resolution of cases, evidentiary hearings can be problematic when it comes to establishing an adequate record, particularly when an appeal is contemplated. This requires an exceptional effort on the part of counsel to present evidence in an effective and efficient manner, yet sufficient enough to preserve error. In this regard, due to the existence of constraints on time, many Bankruptcy Courts permit counsel to resort to using proffers of witness testimony in their case-in-chief.

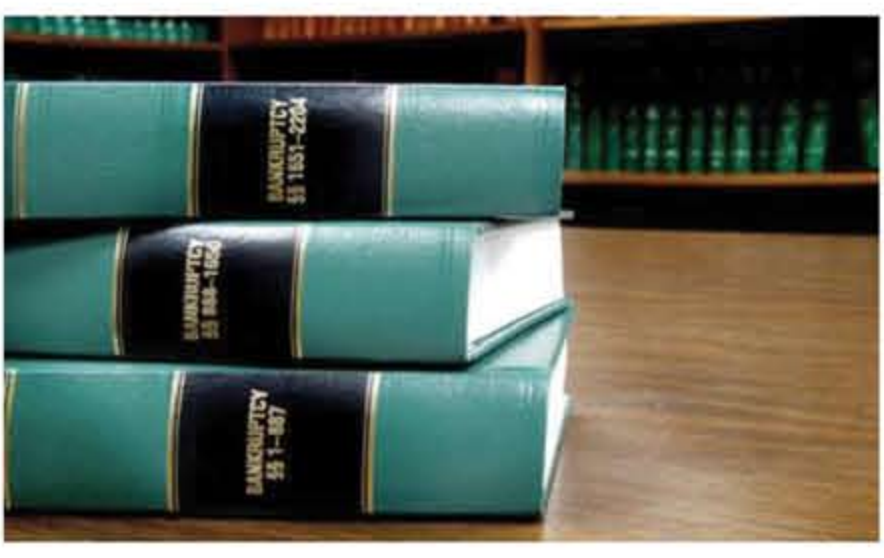
A proffer is the term used to describe the process where an attorney presents direct testimony of a witness in summary fashion in lieu of actual testimony. Mostly it is accomplished by the attorney stating for the record what he/she expects the witness would say and then "proffering" that testimony. In some instances, a written proffer is filed in advance of a hearing giving parties-in-interest notice of the intention to present the testimony by proffer. These written statements are sometimes verified by the witness, lending them further credibility. In most instances when a proffer is made, the witness must be present in the courtroom. See, e.g., In re *Adair*, 965 F.2d 777 (9th Cir. 1992); *Lewis v. Zermano* (*In re Stevinson*), 194 B.R. 509 (D. Colo. 1996). Following the proffer, the court will swear the witness in and ask if they accept the proffer as their testimony. The court will then ask if anyone desires to cross-examine the witness. If not, the proffered testimony is accepted into the record as if the witness actually testified.

The concept of an attorney proffer of evidence appears to be a relatively recent phenomenon. There is no provision dealing with proffers in the federal rules. A few courts have addressed the issue of written proffers. *Adair, infra.* Rule 43(a) of the FRCP, which applies in bankruptcy matter pursuant to Fed. R. Bankr. P. 7043, provides: "In all trials the testimony of witnesses shall be taken *orally in open court*, unless otherwise provided by an Act of Congress or by these rules, the Federal Rules of Evidence, or other rules adopted by the Supreme Court." (Emphasis added). Rule 611(a)(1)-(2) of the FRE provides that "[t]he court should exercise reasonable control over the mode and order of examining witnesses . . . so as to . . . make those procedures effective for determining the truth . . . [and] avoid wasting time . . . ." In *Adair, infra*, and *Lewis v. Zermano (In re Stevinson)*, 194 B.R. 509 (D. Colo. 1996), the courts dismissed due process challenges to the use of proffers finding, under the facts of these cases, use of a proffer was a permissible "mode" of presenting direct testimony under FRE 611 and thus did not violate FRCP 43(a) or the challengers' due process rights when the witness is available to be called to the stand. *Adair*, 965 F.2d at 780; *Stevinson*, 194 B.R. at 513.

Practice Tips

There is no authority indicating an absolute right to proffer testimony. Be ready with a live witness in case the court decides otherwise. When the court has limited time available, consider using proffers to save time. Attorneys desiring to present testimony by proffer should be sure that they are presenting testimony on all essential elements as to which their client has the burden. Make sure your witness is aware of your intent to offer their testimony by proffer and agree to its truthfulness. Ask the court to permit the proffer, make the proffer and then ask the court to accept the proffer. You may also want to ask the court to ask if anyone present objects to the proffer of testimony. Finally, remember that the court is the trier of fact and a proffer does not afford them the ability to actually observe the witness testifying and assess their credibility. In a situation involving credibility you may want to avoid use of proffers.

Attorneys against whom proffers are offered should carefully review written proffers or listen to the oral proffers to determine if there is a need for cross-examination. Do not accept a proffer is there are questions of foundation to testimony. Expert testimony should not be offered by proffer. If you have advance notice of proffered testimony seek to take the oral deposition of the witness. Also, consider offering deposition testimony in cross of a proffer.



What's On Your Mind?

If you have an issue or question you would like addressed in a subsequent e-newsletter, please let us know and we will attempt to do so.

Charging Secured Interests in Bankruptcy - Timing is Everything, or is it?

Authored by Bruce W. Akerly, Partner

In bankruptcy cases, distributions are made according to priorities established in section 507 of the Bankruptcy Code. Generally, administrative expenses (e.g., expenses incurred by a trustee in fulfilling their duty in the case) have priority over most other claims in bankruptcy. However, it is equally accepted that administrative claims cannot be satisfied from collateral pledged to secure a debt owing to a lender. The administrative claimant must look to unencumbered assets of the bankruptcy estate for satisfaction of such claims. There is, however, a narrow exception to this rule, found in section 506(c) of the Bankruptcy Code which provides that a "trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim, including the payment of all ad valorem taxes with respect to the property." In viewing whether section 506(c) is limited to expenses which were incurred by a trustee with a specific and exclusive intent to benefit the secured creditor, the Fifth Circuit has held that an expense that was not incurred primarily preserve or dispose of encumbered property is not capable meeting the requirement of being incurred primarily for the benefit of the secured creditor. This principal was recently re-affirmed by the Fifth Circuit in *Southwest Securities, FSB v. Segner*, No. 14-41463; however, the court went further and adopted the inverse position, i.e., an expense incurred primarily to preserve or dispose of encumbered property does not meet the requirement. The key is whether the expense was necessary to the preservation and disposal of the secured creditors' encumbered property. If, as in Southwest Securities, a trustee holds an asset longer than is necessary to determine and realize its value, and the value turns out to be less than the creditors' secured interest, the creditor can challenge the necessity of the costs incurred by the trustee in disposing of the collateral. The key is temporal reasonableness of the trustee's action; however, whether the secured creditor received a direct and quantifiable benefit from the trustee's actions will, as noted in *Southwest Securities*, be of equal import.

Bankruptcy Court Finds for an Expanded Meaning of "Educational Benefit" Under §523(A)(8)

Authored by Christopher A. Klement, Associate

A bankruptcy court in south Florida recently acknowledged an expanded meaning for "educational benefit," as used in 11 U.S.C. §523(a)(8), the "student loan exception." In *American Airlines Federal Credit Union v. Cardona*, the court begrudgingly held that an "education line of credit" was not dischargeable in a bankruptcy proceeding. The decision largely centered on the meaning of "educational benefit." The court's order, which granted the lender's motion for summary judgment, recognized that the meaning of "educational benefit" has become broader since the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act in 2005.

The debt in question was a line of credit called an "Education Line of Credit." Despite the name, the debtor argued that the LOC had a different nature than a true student loan. To illustrate the difference, the debtor offered that the LOC had a higher interest rate (variable 10.75%), relied on the debtor's creditworthiness, and was secured by collateral. Furthermore, the debtor claimed that—as an undifferentiated unqualified loan—the LOC's proceeds had an unlimited use.

In response, the lender argued that the title "Education Line of Credit" illustrated the LOC's intended educational purpose, and in fact, the debtor used the LOC exclusively for that purpose.

Reluctantly, the court agreed with the lender. In reaching its decision, the court stated that when "the delineated purpose of the loan is for education...and the use of the funds is consistent with the delineated purpose...those funds do constitute 'funds received for an educational benefit.'" In determining the delineated purpose, the court found that the purpose could be expressed in the title of the loan or in the application for the loan or extension of credit.

However, the decision did reject an argument from the lender that simply the use of a loan or line of credit to pay for an education benefit made that portion of the debt automatically non-dischargeable. With this limitation, the court seemed to reinforce the standard to determine "educational benefit" as delineated purpose and actual use. Yet, it is unclear whether a clearly delineated purpose would have been enough on its own to make the debt non-dischargeable.