IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NORTH CAROLINA
WESTERN DIVISION
No. 5:23-CV-00170-D

MARCUS C. PURDY AND AMANDA J. PURDY,	)
Appellants.	)
v.	)
MICHAEL BURNETT, TRUSTEE AND BRIAN CHARLES BEHR, BANKRUPTCY ADMINISTRATOR	)
Appellees.	)

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF NORTH CAROLINA

BRIEF OF APPELLANTS

Travis Sasser
SASSER LAW FIRM
2000 Regency Parkway, Suite 230
Cary, NC 27518
Tel: (919) 319-7400
Fax: (919) 657-7400
travis@sasserbankruptcy.com
NC State Bar No. 26707
Attorney for Debtors-Appellants

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BRIEF OF DEBTORS-APPELLANTS

Marcus and Amanda Purdy filed a chapter 13 bankruptcy case, but this did not prevent them from financing the purchase of a family residence. Two patently invalid local rules of bankruptcy procedure state that prior court approval is required. The invalidity of the two local rules is based on unconstitutional nonuniformity, the abridgment of substantive rights and exceeding the boundary of procedure. The Bankruptcy Court for the Eastern District of North Carolina cannot enact its own bankruptcy laws. The Purdys' purchase of a residence was legally permitted, and no harm resulted from their personal housing decision. No court order or chapter 13 plan provision was violated by the purchase. The Bankruptcy Court erred in dismissing the case when there was no default on the terms of the confirmed plan but simply because the Purdys chose to finance the purchase of a family home. The Bankruptcy Court abused its discretion when it dismissed the case.

BASIS OF BANKRUPTCY AND APPELLATE JURISDICTION

On March 21, 2023, the United States Bankruptcy Court for the Eastern District of North Carolina granted the Trustee's Motion to Dismiss the case. The Bankruptcy Court's Order is immediately appealable under 28 U.S.C. §158(a)(1), which permits the appeals of "final judgments, orders, and decrees…of bankruptcy judges entered in cases and proceedings."

STATEMENT OF THE ISSUE PRESENTED

Whether the Bankruptcy Court erred in dismissing the chapter 13 case.

STANDARD OF REVIEW

This Court reviews a bankruptcy court's conclusions of law *de novo* and findings of fact for clear error. *In re Meredith*, 527 F.3d 372, 375 (4th Cir. 2008). When a question on appeal involves issues of both law and fact, the lower court's legal conclusions are reviewed *de novo*, while any findings of fact will be reversed when they are clearly erroneous. *Matter of Richman*, 104 F.3d 654, 656 (4th Cir. 1997) (citing *In re Varat Enterprises, Inc.*, 81 F.3d 1310, 1314 (4th Cir. 1996)).

The Fourth Circuit held that a court abuses its discretion when it acts arbitrarily or irrationally, fails to consider judicially recognized factors constraining its exercise of discretion, or when it relies on erroneous factual or legal premises. *L. J. v. Wilbon*, 633 F.3d 297, 304 (4th Cir. 2011).

STATEMENT OF THE CASE

On October 7, 2019, the Purdys filed a chapter 13 case. The Bankruptcy Court appointed John F. Logan as trustee on October 9, 2019[1]. On March 9, 2020, the Purdys submitted an amended plan that was confirmed by the Bankruptcy Court on April 10, 2020. On August 23, 2022, the trustee filed a Motion to Dismiss the case.

[1] In North Carolina and Alabama, the bankruptcy court appoints the chapter 13 trustee. In the judicial districts of the other 48 states, the trustee is appointed and supervised by the U.S. Department of Justice. The position of Bankruptcy Administrator only exists in the judicial districts of North Carolina and Alabama.

On August 26, 2022, the Purdys opposed the trustee's Motion. On September 27, 2022, a hearing was held in Raleigh. On January 3, 2023, the Bankruptcy Court replaced John F. Logan with Michael Burnett. On March 21, 2023, the Bankruptcy Court entered an order dismissing the case with a bar to refiling. On April 3, 2023, the Purdys filed a Notice of Appeal. On April 13, 2023, the Bankruptcy Court issued a Memorandum Opinion in support of the Order Dismissing Case and Barring Future Petitions.

STATEMENT OF THE FACTS

On October 7, 2019, Marcus and Amanda Purdy filed a joint chapter 13 bankruptcy case. On October 9, 2019, the Bankruptcy Court issued an ORDER AND NOTICE TO DEBTOR. This ORDER AND NOTICE TO DEBTOR is a standard document issued in all cases and provides an explanation to lay persons about various matters regarding chapter 13 including the existence of certain local rules of bankruptcy procedure. The ORDER AND NOTICE TO DEBTOR document does not distinguish which portions of the document are an ORDER and which portions are a NOTICE. At the time the chapter 13 case was filed, the Purdys rented their residence. On March 9, 2020, the Purdys submitted an amended plan proposing to pay $1,300.00 per month for 60 months. The plan provided that the bankruptcy estate property would vest back with the Purdys upon confirmation pursuant to 11 U.S.C.

§1322(b)(9)[2], section 7.1 of the plan and §1327. On April 10, 2020, the Bankruptcy Court confirmed the plan and the bankruptcy estate was terminated. On February 12, 2021, the plan was modified in part because a 2015 Chevy Impala was totaled and the ongoing payments were decreased to $893.00 per month. In the fall of 2021, the Purdys decided to purchase a residence in Johnston County, North Carolina, instead of renting in Wake County, North Carolina. The Purdys qualified for a VA loan because of Mr. Purdy's military service. On December 8, 2021, the Purdys filed a Motion with the Bankruptcy Court seeking approval for the loan and purchase pursuant to two invalid local bankruptcy rules of procedure. On December 16, 2021, the trustee docketed a response of no opposition. Nonetheless, on December 21, 2021, the bankruptcy court scheduled a hearing on the Motion. After a hearing on January 5, 2022, the Bankruptcy Court denied the Motion. The Purdys purchased a home on January 25, 2022. On August 23, 2022, the trustee filed a Motion to Dismiss the chapter 13 cases pursuant to §1307(c). The Motion alleged that the Purdys had violated local rules, court orders, and a plan provision. A hearing was held on September 27, 2022. The Bankruptcy Court dismissed the case on March 21, 2023 and included a bar to refiling. The Purdys filed a Notice of Appeal on April 3, 2023.

[2] Henceforth, references to Title 11 of the United States Code will be abbreviated. For example, 11 U.S.C. §1322 will be §1322.

The Bankruptcy Court issued a Memorandum Opinion in Support of Order Dismissing Chapter 13 case and Barring Future Petitions on April 13, 2023.

SUMMARY OF THE ARGUMENT

The Purdys financed the purchase of a family home instead of renting during the pendency of their chapter 13 case. This was a personal decision that is allowed under substantive law. The home purchase violated two patently invalid local bankruptcy rules of procedure. The local rules are invalid because they are unconstitutionally nonuniform, they abridge or modify substantive rights and they exceed the boundaries of procedure. Even if the local rules are valid, there was no evidence of harm. No plan provision was violated and no court order was violated. The Bankruptcy Court abused its discretion in dismissing the case and should be reversed.

ARGUMENT

THE BANKRUPTCY COURT ERRED IN DISMISSING THE CASE AS THERE WAS INSUFFICIENT CAUSE FOR DISMISSAL UNDER 11 U.S.C. §1307(C)

The Bankruptcy Court erred in dismissing the case because the Purdys were permitted to finance a purchase of a residence without court approval. The trustee's Motion was brought under §1307(c) and Federal Bankruptcy Rules 1017(f)(2) and 9013. Bankruptcy Rule 9013 requires that a Motion "shall state with particularity the grounds thereof, and shall set forth the relief or order sought". The Chapter 13

Trustee's Motion to Dismiss Case with Prejudice alleged that the Purdys willfully and knowingly violated E.D.N.C. LBR 4002-1(g)(5) and (g)(6) which shall hereafter be referred to as "The Local Rules" and court orders where the Bankruptcy Court failed to grant permission under The Local Rules.

The Local Rules provide as follows:

> CHAPTER 13 – DEBTOR DUTIES. The following shall apply in chapter 13 cases.
> ….
>
> (5) Post-Petition debt. After the filing of the petition and until the plan is completed, a debtor shall not incur additional debt of $10,000 or more without prior approval from the court. The debtor shall file an application to incur debt with a fourteen-day notice to the chapter 13 trustee. If no objection is filed, the court may approve the application without a hearing.
>
> (6) Post-Petition purchases. After the filing of the petition and until the plan is completed, a debtor shall not purchase any item of property of $10,000 or more with non-exempt assets without prior approval from the court. The Debtor shall file an application to purchase property with a fourteen-day notice to the chapter 13 trustee. If no objection is filed, the court may approve the application without a hearing.

The Local Rules are invalid since they violate the U.S. Constitution, 28 U.S.C. §2075 and Fed R. Bankr. P. 9029. In article 1, section 8, the U.S. Constitution empowers the democratically elected *Congress* to establish uniform laws on the subject of Bankruptcy. (Emphasis added.) "Nothing in the language of the Bankruptcy Clause…suggests a distinction between substantive and administrative laws." *Siegel v. Fitzgerald*, 142 S.Ct 1770, 1773 (2022). It is not enough that

substantive law be uniform, it is also necessary that procedural aspects of bankruptcy also be uniform. The U.S. Constitution does not permit unelected Article I bankruptcy judges to enact nonuniform bankruptcy laws or procedures. Whether The Local Rules are deemed substantive or procedural, they are different than those found in some other jurisdictions. As such, they are invalid under the U.S. Constitution. Although the U.S. Constitution explicitly constrains the U.S. Congress, it is logical that Article I judges from a single judicial district are also so constrained. The Local Rules date back to December 1, 1983, when the E.D.N.C. bankruptcy judges were Thomas Milton Moore and A. Thomas Small. Judge Moore explained his position on local bankruptcy rules during U.S. Senate testimony:

> Also keep in mind that the court in each district has its own local rules. These rules vary from district to district. This is true with any court system. Differences in judges, geographic area, trustees, practitioners, and types of cases *all* necessitate minor differences in procedures. (Emphasis added.)
>
> *The U.S. Trustee System*, U.S. Senate Subcommittee on Courts, Committee of the Judiciary. Chairman Senator John P. East. March 25, 1986. 10:35 a.m. Thomas Milton Moore. Page 188.

Although there are no advisory notes or caselaw from the 1980s to explain the basis or rationale of The Local Rules, Judge Moore's prepared Senate testimony is revelatory. With the multivarious factors Judge Moore cites, it is no surprise that some of the E.D.N.C. bankruptcy local rules are nonuniform. In *Siegel*, the Supreme Court found a brief disparity of quarterly fees collected was unconstitutionally nonuniform and held that the Bankruptcy Clause "… does not permit arbitrary

geographically disparate treatment of debtors." *Seigel*, 1781. The issue in this case is much more important and long lasting than the issue in *Seigel*. There are thousands of chapter 13 cases pending in the E.D.N.C. and over one hundred thousand cases have been filed since 1983. The Local Rules will never change unless a higher court intervenes. The Local Rules are beyond the reach of any political process. Whereas citizens in this democratic republic normally have the right to participate in the political process (e.g. write to their Congressperson, vote, organize, etc.), there is no way to persuade unelected bankruptcy judges whose terms span multiple turnovers in the other two branches. Chapter 13 debtors in the E.D.N.C. are being subjected to limitations on their freedom that are not in place in many judicial districts. It is unconstitutionally nonuniform but also profoundly unfair. Because The Local Rules are unconstitutional, the Bankruptcy Court dismissal of this case should be reversed.

The enabling legislation for local bankruptcy rules is 28 U.S.C. § 2075 (Rules Enabling Act), which provides:

> The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure in cases under title 11.
>
> Such rules shall not abridge, enlarge, or modify *any* substantive right. (Emphasis added.)

The Local Bankruptcy Rules abridge and modify a chapter 13 debtor's freedom of contract and their ability to participate in the open credit economy. "North Carolina follows a 'broad policy' which generally accords contracting parties

'freedom to bind themselves as they see fit.'" *Severn Peanut Co. v. Indus. Fumigant Co.*, 807 F.3d 88, 91 (4th Cir. 2015) (quoting *Hall v. Sinclair Refining Co.*, 242 N.C. 707, 89 S.E.2d 396, 397-98 (1955)). "Its courts recognize that 'the right of private contract is no small part of the liberty of the citizen.…'" *Id.* (quoting *Calhoun v. WHA Med. Clinic, PLLC*, 178 N.C. App. 585, 632 S.E.2d 563, 573 (2006)). If there was an exception to the customary freedoms associated with citizenry for individuals in chapter 13 cases it would be clear in the Code. "Congress does not hide elephants in mouseholes by altering the fundamental details of a regulatory scheme in vague terms or ancillary provisions. *Sackett v. EPA*, 2023 U.S. LEXIS 2202 (2023). If a chapter 13 debtor did not have unrestrained financial autonomy that non-debtors enjoy then those limits would be clearly set forth in the Bankruptcy Code[3]. If being a debtor in a pending chapter 13 case prevented a home purchase then no local rule of bankruptcy procedure could ever allow it because that would be an impermissible *enlargement* of a substantive right. (Emphasis added.) No policy rationale, longevity, similarly misguided rule from another jurisdiction or appeals to equitable powers can justify an abridgment of rights based on a local rule of bankruptcy procedure. The longevity of The Local Rules is only a testament to the ongoing unchecked exercise of raw judicial power. The invalidity of The Local Rules can be

[3] Henceforth, references to the Bankruptcy Code will be abbreviated to "Code" or "the Code".

understood by those who are versed in basic civics and the ability to observe that many citizens seek to finance the purchase of a home or vehicle and those purchases and loans often exceed $10,000.00. The maintenance of the separation of powers of the three branches is embodied in the Rules Enabling Act. Congress makes the law and the judicial branch interprets that law. If a citizen is being deprived of a right to do something as common and basic as financing the purchase of a residence or vehicle, then their rights have been abridged and modified. As such, The Local Rules are invalid, and the Purdys were permitted to finance the purchase of a residence without obtaining approval from the Bankruptcy Court. The Bankruptcy Court erred in dismissing the case for failing to comply with invalid local rules and orders that failed to grant permission under the invalid local rules when no permission was legitimately required under substantive law.

The United States Bankruptcy Court for the Eastern District of North Carolina has enacted local rules of procedure pursuant to Fed. R. Bankr. P. 9029, which provides as follows:

> **Local Bankruptcy Rules; Procedure When There is No Controlling Law**
>
> (a) Each district court acting by a majority of its district judges may make and amend rules governing practice and procedure in all cases and proceedings within the district court's bankruptcy jurisdiction which are consistent with—but not duplicative of—Acts of Congress and these rules and which do not prohibit or limit the use of the Official Forms. Rule 83 F.R.Civ.P. governs the procedure for making local rules. A district court may authorize the bankruptcy judges of the district, subject to any limitation or condition it may prescribe and the requirements of 83 F.R.Civ.P., to make

> and amend rules of practice and procedure which are consistent with---but not duplicative of—Acts of Congress and these rules which do not prohibit or limit the use of the Official Forms. Local rules shall conform to any uniform numbering system prescribed by the Judicial Conference of the United States.

On October 8, 1987, an order was issued by the Honorable W. Earl Britt which delegated the rule-making authority from the E.D.N.C. District Court to the E.D.N.C. Bankruptcy Court.[4] The original iteration of The Local Rules was issued

[4] The order provides: This matter is before the court at the request of the bankruptcy judges of this district, and

It appearing to the court that it is in the best interest of the administration of justice in this court and the bankruptcy court for the rule-making authority provided by Bankruptcy Rule 9029 to be delegated to the bankruptcy judges of this district; now therefore,

IT IS ORDERED, ADJUDGED AND DECREED that all bankruptcy rules of practice and procedure heretofore adopted by the United States District Court, Eastern District of North Carolina are hereby revoked, and

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the bankruptcy judges of this district are hereby authorized, subject to the requirements of Rule 83 of the Federal Rules of Civil Procedure to make rules of practice and procedure not inconsistent with the Bankruptcy Rules, consistent with the authority of the district court to modify or abrogate any rules so adopted as appears appropriate.

December 1, 1983[5], and amended in 1995[6], 2004[7] and 2008[8] until the current version was enacted in 2019. Pursuant to Federal Bankruptcy Rule 1001, the Bankruptcy Rules govern procedures in cases under Title 11 and the "rules shall be construed to secure the just, speedy, and inexpensive *determination* of every case and proceeding." (Emphasis added.) Federal Bankruptcy Rule 9030 provides that bankruptcy rules are not be construed to extend the jurisdiction of a court. The Local Rules are invalid as they exceed what is procedural.

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[5]The debtor shall not purchase additional property or incur additional indebtedness for an amount in excess of FIVE HUNDRED DOLLARS ($500) without prior approval of the trustee and an order of the Court.

[6] OBTAINING CREDIT: The debtor shall not purchase additional property or incur additional indebtedness for an amount in excess of ONE THOUSAND DOLLARS ($1,000.00) without prior approval of the trustee and an order of the court.

[7]OBTAINING CREDIT: The debtor shall not purchase additional property or incur additional debtor of $5,000.00 or more without prior approval from the court. The debtor must give notice of the application to purchase additional property or to incur additional debt to the chapter 13 trustee, who must respond within five days of receipt of the notice. If no objection is filed, the court may approve the application without a hearing.

[8] OBTAINING CREDIT. The debtor shall not purchase additional property or incur additional debt of $7,500 or more without prior approval from the court. The debtor must give notice of the application to purchase additional property or to incur additional debt to the chapter 13 trustee, who must respond within five days of receipt of the notice. If no objection is filed, the court may approve the application without a hearing.

The Supreme Court of the United States addressed the procedure versus substance question in the case of *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.* where it held:

> We have long held that this limitation means that the Rule must really regulat[e] procedure,--the judicial process for enforcing rights and duties recognized by substantive law and for justly administering remedy and redress for disregard or infraction of them. The test is not whether the Rule affects a litigant's substantive rights; most procedural rules do. What matters is what the Rule itself *regulates:* If it governs only "the manner and the means" by which the litigants' rights are enforced, it is valid; if it alters the rules of decision by which the court will adjudicate those rights, it is not.

559 U.S. 393, 407 (2010) (citations, brackets, quotation marks omitted). The Fourth Circuit Court of Appeals in *Associated Dry Goods Corp. v. EEOC* stated the following:

> The courts look rather at the actual function and effect of the rule or regulation in question in resolving whether it is substantive or procedural. If a regulation or rule enforces rights or imposes definite obligations on the parties, it is ordinarily considered substantive. If however, it really regulates procedure, i.e. the matter in which an administrative agency carries out its administrative function and responsibilities, the rule is to be deemed procedural. The distinction thus phrased seems to be implicit in the authoritative declaration of the Supreme Court in *Sibbach v. Wilson & Co.*:
>
> > The test must be whether a rule really regulates procedure,--the judicial process for enforcing rights and duties recognized by substantive law and for justly administering remedy and redress for disregard or infraction of them.

720 F.2d 804, 809 (4th Cir. 1983) (quoting *Sibbach v. Wilson & Co.*, 312 U.S. 1, 14 (1941)). A law review article explains it thus:

> "…a rule of practice or procedure concerns the method a court uses to adjudicate matters presented to it. Such a rule may not prescribe the rules that govern how a court determines a matter on its merits. Neither may a rule of procedure address whether a court may adjudicate a matter at all or exercise authority over particular persons or property—although it may prescribe the process a court uses to determine its authority in a given case."
>
> A Benjamin Spencer, *Substance, Procedure, and the Rules Enabling Act*., 66 U.C.L.A. L. Rev. 654 (2019)

As it relates to The Local Rules, the E.D.N.C. Bankruptcy Court is dictating what actions are brought into the adjudicative process instead of regulating how the adjudicative process functions. The Local Rules are unconnected to any Code provision or Federal Bankruptcy Rule provision. The Local Bankruptcy Rules function as substantive law driven by policy unrelated to what is set forth in Federal Bankruptcy Rule 1001 or Federal Rule 4002 and thus are not valid. The Local Rules are not based on any policy underpinnings found in legislative history but rather the whims and idiosyncrasies of E.D.N.C. bankruptcy judges. The Local Rules were simply created out of thin air by two E.D.N.C. bankruptcy judges in 1983. At implementation, the effect of The Local Rules was to increase the power of the two bankruptcy judges and that effect remains. To state the obvious, two bankruptcy judges in Wilson, North Carolina issuing a rule is far different from the passage of a law in both Houses of Congress and presentment to the President. It is also different

than the Federal Bankruptcy Rules Committee[9] vetting and recommending a rule with detailed Advisory Committee Notes to the U.S. Supreme Court.

As further evidence of the E.D.N.C. Bankruptcy Court's pattern of exceeding the boundaries of local bankruptcy rules of procedure, there is E.D.N.C. LBR 4002-1(g)(4) which provides:

> **(4) Disposition of property.** After the filing of the petition and until the plan is completed, the debtor shall not dispose of any non-exempt property having a fair market value of more than $10,000.00 by sale or otherwise without prior approval of the trustee and an order of the court.

E.D.N.C. LBR 4002-1(g)(4) is nonuniform, abridges substantive rights, is not procedural, is inconsistent with the Code and is duplicative and inconsistent with the Federal Bankruptcy Rules. "A local rule of bankruptcy procedure cannot conflict with the Federal Bankruptcy Code." *Specialized Loan Servicing v. Devita*, 610 B.R. 513, 524 (E.D.N.C. 2019). Like The Local Rules, the first iteration of E.D.N.C. LBR 4002-1(g)(4) was issued on December 1, 1983. The limitations of local rules of bankruptcy procedure were not property observed in the context of chapter 13 at that time and that problem still exists. This Court should overturn the Bankruptcy Court and find that The Local Rules are substantive and not procedural and as such invalid and as such the violation of invalid local rules is not basis to dismiss the Purdys' case.

[9] The Bankruptcy Rules Committee has fifteen members and has members with various stakeholder affiliations along with liaisons.

The Bankruptcy Court erred in admitting into evidence and relying upon a forged letter submitted as part of the loan application process. The Purdys did not contest that The Local Rules were violated so the details of how that occurred were irrelevant. The trustee's Motion to Dismiss made no reference to the letter. Such an allegation was required under Federal Bankruptcy Rule 9013 if the trustee was seeking relief based on the letter. There was no evidence that the forged trustee letter was relied upon or that the letter had any impact on the bankruptcy case. At most, the letter might have damaged the mortgage lender if that mortgage lender planned to file a claim pursuant to §1305. There was no evidence of why the lender sought the trustee letter and no evidence the lender planned to file a §1305 post-petition claim in the case. The Purdys objected to the admission of the letter at the hearing. See hearing transcript pages 38-40, lines 24 on page 38-line 7 on page 40. The Bankruptcy Court abused its discretion in basing any part of its decision on the letter. Although Ms. Purdy did submit the letter, that could only have impacted the lender's underwriting process and had no impact on the bankruptcy case itself or the parties to the bankruptcy case. There is no reason why the methodology by which the Purdys violated The Local Rules (which are invalid) should be material. The dismissal of the case does not help the mortgage lender and likely harms it. If the case is dismissed, then the mortgage lender will have to compete for the Purdys' disposable income from the creditors that were being provided for in the chapter 13 plan. The

mortgage lender assumed that the confirmed chapter 13 plan (a binding contract) would be complied with. The letter was unrelated to the bankruptcy case. The trustee was not damaged by the letter. No creditor was damaged by the forged letter. During the course of a plan lasting up to five years, a chapter 13 debtor may have all manner of financial and personal dealings. Chapter 13 is a legal process whereby pre-petition debts are reorganized. Once the plan is confirmed, the role of the bankruptcy court is greatly reduced. Post-confirmation, the role of §1307 relates to performance under the plan, and it is not an open-ended license to dismiss cases for various financial dealings that occur through the duration of the repayment term but are unrelated to the plan itself. The Bankruptcy Court erred in admitting the letter into evidence and relying on that in the order dismissing the case with a bar to refiling, and as a result, the dismissal should be reversed.

The Bankruptcy Court's dismissal with a bar to refiling is excessive for merely violating local rules of bankruptcy procedure. E.D.N.C. LBR 9011-3 provides that:

> **(a) Failure to comply with local bankruptcy rules.** If any attorney or party willfully fails to comply with any Local Bankruptcy Rule of this court, the court, in its discretion, may impose sanctions.

The Bankruptcy Court's dismissal with a bar to refile in this case is beyond that of a sanction. The 1993 Advisory Committee Note to Civil Rule 11 lists a variety of sanctions available for a Rule 9011 violation. These include striking the offending paper; issuing an admonition; reprimand or censure; requiring participation in

seminars or other educational programs; ordering a fine payable to the court; and referring the matter to disciplinary authorities or agencies. The dismissal remedy in this case is bootstrapping a violation of a local bankruptcy rule into the substantive remedy of dismissal with a bar to refile. Dismissal is a remedy that should be reserved for cases of "real misconduct" and "serious abuses". *Janvey v. Romero*, 883 F.3d 406, 412 (4th. Cir. 2018). Even assuming The Local Rules are valid, the Bankruptcy Court's remedy is excessive for merely violating local rules of bankruptcy procedure. In this case, the Purdys financed the purchase of a family house which was permitted and encouraged (e.g. the residential mortgage interest deduction allowed under the Internal Revenue Code) under law. The trustee did not oppose the Purdys financing their home purchase. The Purdys agree that under §1305 the trustee has supervision over post-petition consumer claims where the holder of such a claim knew or should have known that prior approval by the trustee of the debtor's incurring the debt was practicable and was not obtained and where the debt relates to property or services necessary for the debtor's performance under the plan. No creditor is required to file a claim in a case. Section 1322(b)(6) allows, but does not require, a plan to provide for a §1305 claim that is allowed. Post-confirmation, a plan would have to be modified to address a §1305 claim which is a process governed by §1329 and Federal Bankruptcy Rule 3015(g). As such, a post-petition claim would require a creditor to file a claim, and a debtor that wants to

provide for the claim and this would be subject to any party to the case being permitted to object and be heard in relation to the claim being provided for. However, the issue in this case has nothing to do with the submission of a post-petition claim or property necessary for the Purdys' performance under the plan. Rather, the Purdys financed the purchase of a home and have paid the mortgage loan directly, in the same way as any chapter 13 debtor pays post-petition obligations directly including vehicle loans, student loans, credit card obligations, personal loans, etc. There was no allegation or evidence presented that the Purdys' home purchase was necessary for their performance under the plan. The purchase was discretionary and would not qualify under §1305. There is no reason for the mortgage lender to file a claim into the case. There was no evidence presented that the mortgage lender planned to file a post-petition claim into the chapter 13 case. The VA home loan is an earned benefit of Mr. Purdy's military service. The Bankruptcy Court found that the proposed purchase did not appear to be in the Purdys' best interest. The Purdys are rational adults who are able to determine what is in their own best interest. The role of the bankruptcy judge is to adjudicate disputes between parties about issues arising under the Code not to serve as a personal financial coach or gatekeeper on life choices. The role of the bankruptcy judge is not to protect debtors from themselves. Defenders of E.D.N.C. LBR 4002-1(g)(5) have often explained it in terms of paternalism. Former E.D.N.C. Bankruptcy Judge

Stephani Humrickhouse explained that "…Local Rule 4002-1(g)(5) is therefore consistent with 'Act of Congress," as it works to ensure that a chapter 13 debtor is financially able to complete his plan and receive a discharge." *In re Butala*, 2018 Bankr. LEXIS 2606 (Bankr. E.D.N.C. 2018). If the primary goal of E.D.N.C. LBR 4002-1(g)(5) is paternalism, then dismissal of the case with a bar to refile is an abuse of discretion where there is no evidence of damage to any party. E.D.N.C. Judge Flanagan ruled that E.D.N.C. LBR 4002-1(g)(5) was procedural and did not abridge substantive rights. *Higgins v. Logan*, 635 B.R. 776, 782 (E.D.N.C. 2021). In *Higgins*, Judge Flanagan incorrectly found that E.D.N.C. LBR 4002-1(g)(5) effectuates §1305. *Id* at 779. Under §1305, certain post-petition claims are restricted by prior trustee approval. In contrast, The Local Rules control a debtor's ability to make purchases and incur debt. These are two completely different concepts. The legislative history to §1305 explains:

> Clause (3) is based on 606(1) of the present Act and Proposed Rule 13-305(3). Together with clause (2) of subdivision (c), it outlines a procedure now followed in some districts to enable the debtor to obtain on credit property or services needed to assure performance under the plan when he cannot so obtain them unless the claims thereof are brought under the plan. Normally such credit is to be obtained only with the prior approval of the administrator, but it is recognized in clause (2) of subdivision (c) that this will not in all instances be feasible, particularly for emergency medical services.
>
> B Collier on Bankruptcy App. Pt. 4(c). *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 137, 93rd Congr. 1st Sess. (1973).

Section 1305 was intended to *enhance* a chapter 13 debtor's ability to incur debt, not limit it. (Emphasis added.) Section §1305 allows for a deviation from the normal rule that only pre-petition claims are addressed in a chapter 13 plan. Prior to *Higgins*, the E.D.N.C. Bankruptcy Court holdings that considered the foundations of E.D.N.C. LBR 4002-1(g)(5) never found that it was implementing §1305.[10] Although *Higgins* was wrongly decided generally, the holding correctly recognized that The Local Rules are simply rules of local bankruptcy procedure and do not limit a chapter 13 debtor's rights. A violation of a local rule of bankruptcy procedure without evidence of damage is insufficient to justify a dismissal with a bar to refile.

Chapter 13 bankruptcy is a reorganization in which debtors are permitted to retain their assets in exchange for repaying various debts through a plan. The confirmation of a plan is res judicata as to a debtor's good faith in filing the case and with regards to the plan. Section 1307 allows a court to dismiss a chapter 13 case for a number of reasons including "for cause". Other than a payment default under the

[10] "Section 1305(a)(2) allows a creditor to file a post-petition claim based on post-petition 'consumer debt…that is for property or services necessary for the debtor's performance under the plan' and §1328(d) provides that a §1305(a)(2) claim for post-petition debt may not be discharged. The court acknowledges that neither of these statutes, nor any other provision of the Bankruptcy Code, specifically requires a debtor to affirmatively seek authority from the court in order to incur debt post-petition". *In re Butala*, 2018 Bankr. LEXIS 2606 (E.D.N.C. Bankr. 2018). "In other words, Local Rule 4002-1(g)(5) accomplishes a broader objective than 1305, but the purposes behind both are complementary." *In re Ripley*, 2018 Bankr. LEXIS 310 (E.D.N.C. Bankr. 2018).

plan, it is extremely rare for a case to be dismissed post-confirmation. In this case, the Purdys merely purchased a home which they were permitted by law to do. No harm resulted from the purchase. In fact, significant harm would have resulted from the sale not occurring since the Purdys would not own a home and the sellers would have lost the $20,000.00 they had put down on the house they were planning to purchase.[11] Had the sale not occurred through various real estate professionals such as agents, loan officers and attorneys would not have been paid for work they had done. The Purdys could have faced legal consequences for their failure to comply with the contract from the sellers and the real estate agents. The Bankruptcy Court found that the home purchase eschewed the order and dignity of the bankruptcy proceedings, but there is no evidence of that. The chapter 13 case functioned exactly as it was intended to. What undermines the order and dignity of bankruptcy proceedings is when unelected bankruptcy judges issue local rules of bankruptcy procedure which are substantive and abridge rights and then apply those rules despite

[11] See court transcript page 37, lines 11-22.
Amanda Purdy: There---there was no time. Like, I was about to cost innocent people $20,000, so that is why I did what I did that you're about to present. There was no ill motive. It was all about saving innocent people $20,000 for accidently having the misfortune of getting wrapped up with us.
Q. Who were the innocent people?
Amanda Purdy: The sellers of the home, who had already put $20,000 down on their future purchase, who would have lost all of that money if we did not proceed. So I didn't want to do the things that I did. I didn't want to violate orders. I could not live with costing innocent people $20,000 of their down payment of due diligence money.

there being no opposition from any party to the case. No court order was violated. Failure to obtain approval from the court based on invalid local rules is not the same as being prohibited from taking an action. No party ever sought or obtained an order preventing the Purdys from financing a home purchase. Rather, the Purdys sought permission from the court pursuant to The Local Rules. Although the Bankruptcy Court denied the permission, that permission was never needed in the first place because The Local Rules are not valid. The ORDER AND NOTICE TO DEBTOR was simply a notice of the existence of E.D.N.C. LBR 4002-1(g)(5) and (g)(6). No plan provision was violated as no bankruptcy estate existed upon confirmation of the plan pursuant to §1327. Even if the funds necessary to satisfy their monthly housing expense were deemed to be estate property, the expenditure was in the ordinary course and did not require any prior notice or a court order. An involuntary dismissal is a harsh sanction, and it should be resorted to only in extreme cases. The Bankruptcy Court erred in dismissing the case with a bar to refile "for cause" where it was based on a mere failure to follow two invalid local rules of bankruptcy procedure.

The Bankruptcy Court included its own invalid local rules into a standardized sua sponte document which is the same as that which is issued in every chapter 13 case in E.D.N.C. It is titled ORDER AND NOTICE TO DEBTOR. A portion of this document reads as follows:

(11) Incurring Debt: You must not purchase additional property or incur additional debt in excess of $10,000.00 without prior approval of the court.

Paragraph 11 is merely rephrasing The Local Rules. It is a notice of the existence of The Local Rules and not an independent court order that is separate and apart from The Local Rules. The remainder of the ORDER AND NOTICE TO DEBTOR is a hodge podge of rephrasing Code provisions and E.D.N.C. chapter 13 miscellany. The document should not be afforded the weight of a court order that arose from a case or controversy between parties.

A bankruptcy judge has a limited statutory role in chapter 13 cases. The primary functions are to adjudicate disputes between parties about plan confirmation, plan modification, dismissal and issues related to the automatic stay. One of the main goals of the change from the Act of 1898 to the Code of 1978 was to remove the bankruptcy judge from the administration of cases so that the bankruptcy judge could impartially focus on adjudicating disputes between parties in interest. A bankruptcy court has no statutory role with regard to the financial or lifestyle decisions a chapter 13 debtor makes. The bankruptcy court has no role in promoting the completion of plans. The bankruptcy court has no role in limiting a chapter 13 debtor's spending so as to maximize the chance for plan modifications brought by trustees or holders of unsecured claims. Chapter 13 is voluntary, and no debtor is even forced to make the plan payments or remain in a case. Even with the core function of adjudicating contested plan confirmation, the bankruptcy court is

required to confirm plans unless it can identify a specific reason not to. See §1325(a) and *LVNV v. Harling*, 852 F.2d 367, 372 (4th Cir. 2017). The Purdys' case and plan were filed in good faith as determined by the plan confirmation. There is no good faith inquiry as to post-confirmation actions of a chapter 13 debtor. Subjective motivations are irrelevant to performance under a binding plan. A decision to relocate and buy a family home does not violate the purposes, provisions, or spirit of chapter 13. It is not the role of a bankruptcy judge to determine what is in the best interest of a debtor. It is not the role of a bankruptcy judge to make sure that a debtor is living within their means or to regulate what spending habits are necessary and reasonable. The Purdys' decision was wholly unrelated to the chapter 13 case. Chapter 13 is a legal process whereby pre-petition debt is restructured. A bankruptcy judge cannot control whether a debtor can finance the purchase of a residence. The E.D.N.C. Bankruptcy Court has usurped power it was not given by Congress. In a prior holding, Judge Warren explained "Perhaps in establishing E.D.N.C. LBR 4002-1(g)(5), the Local Rules Committee for this district wisely envisioned, and the judges agreed, that any attempt to incur significant debt by a Chapter 13 debtor performing under a plan is in direct conflict with the interests of his creditors." *In re Faircloth*, 16-02900-5-DMW (Bankr. E.D.N.C. 2017). However, a bankruptcy court cannot "…alter the balance struck by the statute…" and "…deviate from the procedure specified by the Code even when they believe that creditors would be

better off." *Czyzewski v. Jevic Holding*, 580 U.S. 451, 471 (2017). So even though the E.D.N.C. Bankruptcy Court may believe that The Local Rules are good for creditors and an enhancement over the Code, it lacks the authority to control the Purdys' finances and housing decisions. The "Code, like all statutes, balances multiple, often competing interest." *Bartenwarfer v. Buckley*, 143 S.Ct. 665, 676 (2023). The Congress did not see fit to allow bankruptcy judges to supervise the incurrence of debt or purchases by chapter 13 debtors. Perhaps this was to maximize economic activity and tax revenues. Perhaps this was to keep the bankruptcy judge from devoting valuable time to trivial matters unrelated to adjudicating disputes between parties about matters arising under the Code. Perhaps it was a recognition that chapter 13 debtors are rational and self-interested. Perhaps it was a recognition that lenders can determine lending limits for a chapter 13 debtor better than a bankruptcy judge can. Perhaps this was a way to not discourage chapter 13 filings as compared to chapter 7 filings. Perhaps it was to not impair the economic rehabilitation process of chapter 13 debtors. Perhaps it was a combination of many factors. The result is the same—a bankruptcy judge has no power to determine the housing decisions of chapter 13 debtors. As such, the dismissal order should be reversed.

Plan provision 7.2 was not violated. The bankruptcy estate terminated upon confirmation of the plan pursuant to plan provision 7.1, §1322(b)(9) and §1327.

Also, chapter 13 debtors have the rights and privileges of a trustee under §1303 but are not subject to the obligations of a trustee. Assuming for the sake of argument that chapter 13 debtors were subjected to the obligations of a trustee regarding usage of estate property outside the ordinary course of business, The Local Rules are impermissibly duplicative of that requirement. However, even if the Purdys' wages and income were estate property, the use of such estate property would have been in the ordinary course of business and not subject to any notice requirements under §363(b). Trustees are permitted to use estate property in the ordinary course of business without any notice required. Under §1306(b), the chapter 13 debtor remains in possession of all estate property except as provided in a plan. The vast majority of chapter 13 debtors have a monthly rental or mortgage expense, and there is no need to obtain permission from the bankruptcy court to pay this expense each and every month. Even assuming for the sake of argument that such a notice was necessary that would be governed by Federal Bankruptcy Rules 6004, 2002 and 9014 which implement the use of estate property outside the ordinary course of business. The Purdys paid monthly rent from October 2019-January 2022 and never once filed a notice with the bankruptcy court seeking approval beforehand. There is no material difference between using wages and other income to make a payment to a landlord as opposed to a mortgage servicer.

The Bankruptcy Court erred in finding that no evidence of harm was needed to dismiss the case. Bankruptcy Rule 9005 incorporates Federal Rule of Civil Procedure 61, which provides that:

> Unless justice requires otherwise, no error in admitting or excluding evidence—or any other error by the court or a party—is ground for granting a new trial, for setting aside a verdict, or for vacating, modifying, or otherwise disturbing a judgment or order. At every stage of the proceeding, the court must disregard all errors or defects that do not affect any party's substantial rights.

As such, although the Purdys violated The Local Rules, no substantial rights were affected. The Bankruptcy Court cites "…the Debtors' lack of deference to the orders of this court harms the entire bankruptcy system and all the other 'honest but unfortunate debtor' debtors who adhere to the requirements under state and federal laws and the orders of the judiciary." At the hearing, Judge Warren explained that "I feel like every citizen of this great nation has been harmed by the action taken in this case. It is a challenge to the justice system that we fight so hard to keep and we fight so hard to maintain. It's irrelevant that they are performing under the plan." The Bankruptcy Court found that the Purdys pointing out the lack of damages reflected "…unmatched callousness and narcissism this court has not witnessed in recent history." Rule 61 specifies that a "party's substantial rights" must have been affected. Hyperbolic and sweeping statements about ethereal issues and motives are insufficient under Rule 61. Besides, the Bankruptcy Court's own invalid local rules of bankruptcy procedure that are unconstitutionally nonuniform and abridge

substantive rights are of far greater systemic concerns (e.g. separation of powers and unconstitutional nonuniformity) than a married couple who want to purchase a family residence and does not wish to breach a contract. Indeed, the Bankruptcy Court's holding in this case exposes the substantive nature of The Local Rules. The Purdys were not required to obtain court permission prior to financing the home purchase under the Code.

CONCLUSION

The Bankruptcy Court abused its discretion by dismissing this case with a bar to refile. The Bankruptcy Court's role is to adjudicate disputes that arise under the Code. In this case, the Purdys merely decided to finance the purchase of a family home which is permitted and encouraged by law. No party to the case opposed the Purdys' housing decision. There was no evidence of damage to any party to the case resulting from the Purdys' housing decision. E.D.N.C. LBR 4002-1(g)(5) and (g)(6) are unconstitutionally nonuniform, abridge substantive rights and are not procedural. As to the abridgment issue and non-procedural issues, The Local Rules violate the separation of powers. As such, The Local Rules are invalid. No court order was violated. The Bankruptcy Court abused its discretion in dismissing the case and its decision should be reversed.

Respectfully submitted, this the 31st day of May, 2023.

/s/ Travis Sasser
Travis Sasser
SASSER LAW FIRM
2000 Regency Parkway, Suite 230
Cary, NC 27518
Tel: (919) 319-7400
Fax: (919) 657-7400
travis@sasserbankruptcy.com
NC State Bar No. 26707
Attorney for Debtors-Appellants

CERTIFICATE OF COMPLIANCE

I hereby certify that this Appellate Brief complies with Federal Rule of Bankruptcy Procedure 8015(a)(7)(B)(i), and that this Appellate Brief contains a total of 8,560 words.

/s/ Travis Sasser
Travis Sasser
SASSER LAW FIRM
2000 Regency Parkway, Suite 230
Cary, NC 27518
Tel: (919) 319-7400
Fax: (919) 657-7400
travis@sasserbankruptcy.com
NC State Bar No. 26707
Attorney for Debtors-Appellants

STATEMENT REQUESTING ORAL ARGUMENT

The Purdys believe that oral argument is appropriate in this appeal. They believe that oral argument would aid the Court in its decisional process. Hence, they request that the Court set the case for oral argument. *See* Fed. R. Bankr. P. 8019(a).

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing BRIEF OF APPELLANTS was served on the parties listed below through the CM/ECF system.

Michael Burnett, Chapter 13 Trustee
Served electronically via CM/ECF

Brian Charles Behr
Served electronically via CM/ECF

This the 31th day of May, 2023.

/s/ Travis Sasser
Travis Sasser
SASSER LAW FIRM
2000 Regency Parkway, Suite 230
Cary, NC 27518
Tel: (919) 319-7400
Fax: (919) 657-7400
travis@sasserbankruptcy.com
NC State Bar No. 26707
Attorney for Debtors-Appellants

ADDENDUM INDEX

LOCAL BANKRUPTCY RULES

United States Bankruptcy Court
for the Eastern District of
North Carolina

December 1, 1983

PART IV

THE DEBTOR: DUTIES AND BENEFITS

Rule 4001.1

RELIEF FROM AUTOMATIC STAY; USE OF CASH COLLATERAL

The automatic stay as provided in 11 U.S.C. §362(a) is modified in bankruptcy cases as follows:

(1) In chapters 7 and 13 cases, the Internal Revenue Service is authorized:

(a) to make income tax refunds, in the ordinary course of business, directly to chapter 7 and 13 debtors unless otherwise ordered by the Court or otherwise instructed by the chapter 7 trustee or the standing chapter 13 trustee;

(b) to offset against any refund due a debtor any taxes due the United States government;

(c) to assess any tax liability satisfied by offsetting any refunds, when such liability has not been assessed previously;

(d) to assess tax liabilities shown on voluntarily filed returns and other agreed-to liabilities.

(2) In chapter 13 cases, affected secured creditors may:

(a) contact the debtor about the status of insurance coverage on property used as collateral;

(b) if paid outside the plan, contact the debtor about any payment in default.

(3) In chapter 13 cases, if the collision insurance coverage on a vehicle less than seven (7) years old on which there is a lien lapses and the debtor fails to obtain coverage and furnish evidence to the lienholder within ten (10) days thereafter, the automatic stay as to that lienholder shall be lifted.

(4) In chapter 7 cases, the abandonment of property pursuant to 11 U.S.C. §554 shall have the effect of lifting the automatic stay with respect to the property abandoned as to the estate and as to the debtor.

Rule 4002.1

DUTIES OF CHAPTER 13 DEBTOR

The debtor filing a petition requesting relief under chapter 13 of the Code shall comply with the following:

(1) The debtor shall begin making the payments called for in the proposed plan on the first day of the first month following the month in which the chapter 13 case is filed. Said payments shall be made directly to the standing chapter 13 trustee.

(2) If secured claims are to be paid outside of the plan, the debtor must continue to make the regular scheduled payments to the secured creditor prior to confirmation.

(3) The debtor shall maintain collision insurance on any vehicle less than seven (7) years old on which there is a lien. Failure to keep such insurance in force shall result in the lifting of the automatic stay as provided in Local Bankruptcy Rule No. 4001.1(3), EDNC.

(4) The debtor shall not dispose of any property by sale or otherwise without prior approval of the trustee and an order of the Court.

(5) The debtor shall not purchase additional property or incur additional indebtedness for an amount in excess of FIVE HUNDRED DOLLARS ($500) without prior approval of the trustee and an order of the Court.

(6) When a case is dismissed prior to confirmation, the Court may require the debtor to provide adequate protection to one or more secured creditors by directing the chapter 13 trustee to make adequate protection payments from funds received under paragraph (1) of this rule.

THE U.S. TRUSTEE SYSTEM

TUESDAY, MARCH 25, 1986

U.S. SENATE,
SUBCOMMITTEE ON COURTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:35 a.m., in room SD-628, Dirksen Senate Office Building, Hon. John P. East (chairman of the subcommittee) presiding.

Present: Senators Thurmond, DeConcini, and Heflin.

Staff present: David E. Anderson, chief counsel and staff director; James E. Hinish, Jr., general counsel; William G. Short, professional staff assistant; Ann M. Loudermilk, chief clerk; and Melanie L. Oliver, special assistant.

OPENING STATEMENT OF HON. JOHN P. EAST, A U.S. SENATOR FROM THE STATE OF NORTH CAROLINA

Senator EAST. I wish to welcome you this morning, and to call to order this hearing of the Subcommittee on Courts, to consider S. 1961, the U.S. Trustee Act of 1985.

We have a list of distinguished witnesses here this morning. We look forward to hearing from them. I would like to caution, however, that we will greatly appreciate, and will have to insist upon, brevity so that we can make our appointed rounds and allow everyone an opportunity to be heard within some reasonable timeframe.

I am anticipating that other members of the subcommittee will be here during the course of the morning to participate in the hearing.

In keeping with my desire that we remain relatively brief, I would like to place my full statement in the record, and just make a few very brief observations on S. 1961.

[The prepared statement of Senator East and a copy of S. 1961 follow:]

PREPARED STATEMENT OF SENATOR JOHN P. EAST

I would like to call to order this hearing of the Subcommittee on Courts to consider S. 1961, the United States Trustee Act of 1985. Before proceeding to the witnesses, I would like to make a few preliminary remarks.

S. 1961 was introduced on December 17, 1985, by request by Senators Thurmond and DeConcini, both members of this Subcommittee, as well as by several other distinguished members of the Senate. It was referred to the Courts Subcommittee on January 13. The purpose of the bill is to effect a nationwide expansion of the United States Trustees pilot program.

The U.S. Trustees pilot program was created in the Bankruptcy Reform Act of 1978. That Act significantly increased the judicial functions of the bankruptcy judge. As a reform parallel to that, the 1978 Act also separated those adjudicatory

STATEMENT

of

THOMAS M. MOORE
BANKRUPTCY JUDGE
EASTERN DISTRICT OF NORTH CAROLINA

THE UNITED STATES TRUSTEE PILOT PROGRAM

VS.

THE NON-PILOT PROGRAM

Thank you very much for permitting me to express my views on S. 1961 and the United States Trustee System.

Many of the underlying problems resulting in the enactment of the United States Trustee Pilot Program in 1978 have been eliminated or the magnitude of the problems substantially diminished since the enactment of the Bankruptcy Reform Act of 1978. Congress has recognized the increasing workload in bankruptcy courts and has met this challenge by providing a much improved system from that which previously existed. The bankruptcy judges are now authorized a clerk's office with full staffing. This has significantly improved the judge's ability to supervise the administration of bankruptcy cases. Increased staffing and resources provided by Congress have enabled the clerks of bankruptcy courts to administer bankruptcy cases much more efficiently and effectively. In addition, Congress has authorized each judge a law clerk and this has enhanced the judge's ability to supervise the case administration process. The Bankruptcy Reform Act of 1978 has provided us with the best bankruptcy system in the history of this country. It provides an adequate organizational structure to deal with the problems of day-to-day case administration. Adequate staffing and funding of the existing system will provide far better results than the United States Trustee System.

supervisor and the supervised. Under the United States Trustee System, we will have one United States trustee for North Carolina and South Carolina. He will be responsible for supervising the trustees panel in four districts, a total of forty trustees. Can these trustees be better supervised by one United States trustee or by four clerks of court? The answer is obvious. The trustees will have more direct supervision from the clerks and the clerks will be more accessible to the trustees than will the United States trustee. Also keep in mind that the court in each district has its own local rules. These rules vary from district to district. This is true with any court system. Differences in judges, geographic area, trustees, practitioners, and types of cases all necessitate minor differences in procedures. The United States trustee must know the differences in the four sets of local rules, but this problem does not confront the clerk.

It is also argued that the United States Trustee System will result in more uniformity. Uniformity may be a desirable goal, but it does not always produce a more efficient or effective system. For example, the United States trustee expects to have uniform audits for Chapter 13 trustees by getting a major or national accounting firm to audit the Chapter 13 trustees. Well, last year we solicited bids in our district for Chapter 13 audits, and the result was that a bid from a local certified public accounting firm was about $10,000.00 less than the bid from the national firm used by the United States trustee.

Many panel trustees oppose the United States Trustee System, but are reluctant to speak in opposition thereto. They do not know what impact it may have on them if the United States Trustee System is enacted nationwide. I understand and appreciate their position. If the system is enacted, I submit that the United States trustees will make considerably more changes than they have to date. Once the program becomes

App. Pt. 4(c) Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93rd Cong., 1st Sess. (1973)

Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d. Cong., 1st Sess., Pts. I and II (1973)

The Commission on the Bankruptcy Laws of the United States was established by Public Law 91-354, effective July 24, 1970. Because of organizational delays, the Commission did not begin its work until June, 1971. During the following two years, it conducted eight days of public hearings and fourty-four days of executive sessions.

At the conclusion of its work, and on the date on which its existence was to terminate under the statute creating it, July 30, 1973, the Commission filed its report in two parts with the president, the Chief Justice and the Congress. Part I explains the Commission's history, its charge, its membership, its consultants, and its recommendations for revision of the bankruptcy laws of the United States. Throughout Part I, references are made to a draft of a new bankruptcy law, optimistically entitled "The Bankruptcy Act of 1973."

Part II of the Commission's report consists of this proposed statute and explanatory notes. The notes follow each proposed section, and explain the history and meaning of the section, and its relation to existing law.

This draft statute was the focus of all subsequent activity surrounding the revision of the bankruptcy laws, until the introduction by Congressman Don Edwards on January 4, 1977, of H.R. 6, the immediate precurser of the bill that ultimately became law. Between the submission of the Commission's Report to Congress and the introduction of H.R. 6, all discussion and debate, both in Congressional hearings and in legal periodicals, centered around the draft statute prepared and submitted by the Bankruptcy Commission.

93d Congress, 1st Session——House Document No. 93-137, Part I
COMMUNICATION

FROM THE

EXECUTIVE DIRECTOR, COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES

TRANSMITTING A

REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES JULY 1973

and impose conditions on the administration for the protection of creditors pursuant to section 4-305.

Section 6-104. Filing of Claims; Allowance of Postpetition Claims.

***(a) Filing of Prepetition Clai*ms.**A proof of claim filed by a creditor or a codebtor pursuant to section 4-401(a) or (b), respectively, against a debtor under this chapter shall set forth facts showing that such claim is free from any charge forbidden by applicable law. A proof of claim filed by the debtor or the administrator pursuant to section 4-401(c) shall set forth facts, if any, indicating that the claim includes charges forbidden by applicable law.

***(b) Filing of Postpetition Cla*ims.**The administrator may fix a time for filing of proofs of claim against a debtor under this chapter for the following:

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(1) claims arising from the rejection of executory contracts and unexpired leases of the debtor pursuant to section 4-602 or pursuant to the provisions of the plan;

(2) claims for taxes that become payable to the United States, any state, or any subdivision thereof after the filing of the petition and while the case is pending; and

(3) claims against the debtor arising after the date of the petition for property or services needed by him to assure proper performance under the plan.

***(c) Allowance of Postpetition* Claims.**A postpetition claim filed pursuant to subdivision (b) of this section shall be allowed subject to the following limitations:

(1) such a claim shall not be allowed to the extent in amount that under any other applicable law the debtor can defend against the enforcement of the claim, the claim is unaccrued at the time of allowance and excepted from discharge under section 4-506(a)(6), or the claim is one described in clause (1), (2), (3), (4), (6), (7), or (8) of section 4-403(b); and

(2) a claim filed pursuant to clause (3) of subdivision (b) of this section shall not be allowed if prior approval by the administrator of the debtor's incurring the obligation was feasible and was not obtained.

NOTE

1. *Subdivision (a)* is derived from § 656(b) of the present Act and Proposed Rules 13-301, 13-303, and 13-304 and is designed to elicit information that will give the debtor the benefit of various consumer protection laws. This subdivision supplements § 4-401, which applies to cases under this chapter.

2. *Subdivision (b).* Clause (1) is derived from § 355(2) of the present Act and recognizes that some claims based on the rejection of executory contracts and unexpired leases will not arise until after the time fixed in the first notice for filing a claim.

3. *Clause (2)* is a revision of the first clause of § 680 of the present Act and Proposed Rule 13-305(2) but extends the authority for allowance of postpetition taxes to any that become payable while the case is pending. The tax claims covered by the second clause of § 680 of the present Act and by Proposed Rule 13-305(1) are prepetition claims now covered by §§ 4-401 and 4-405(b).

4. *Clause (3)* is based on § 606(1) of the present Act and Proposed Rule 13-305(3). Together with clause (2) of subdivision (c), it outlines a procedure now followed in some districts to enable the debtor to obtain on credit property or services needed to assure performance under the plan when he cannot so obtain them unless the claims therefor are brought under the plan.

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Normally, such credit is to be obtained only with the prior approval of the administrator, but it is recognized in clause (2) of subdivision (c) that this will not in all instances be feasible, particularly for emergency medical services.

5. *Subdivision (c).* The allowability of claims is generally governed by § 4-402, but an additional provision for postpetition claims is necessary because § 4-403(b) provides that claims shall generally be determined as of the date the petition is filed.

Part 2. Proceedings Relating to Plan and Performance Thereunder

Section 6-201. Provisions of Plan.

A plan under this chapter may provide for a composition or an extension of indebtedness, or for a composition of some and an extension of other indebtedness, and

(1) shall include provisions dealing with unsecured claims generally, or by classes, on any terms, and may alter or modify the rights of the holders of such claims;

(2) may include provisions dealing with claims secured by personal property severally, on any terms, and may provide for the curing of defaults within a reasonable time and otherwise alter or modify the rights of the holders of such claims;

(3) may provide for payments on unsecured claims to be made concurrently with payments on claims secured by personal property;

(4) may include provisions for the curing of defaults within a reasonable time and the maintenance of payments while the case is pending on claims secured by a lien on the debtor's residence and on unsecured claims or claims secured by personal property on which the last payment is due after completion by the debtor of all payments under the plan;

(5) may include provisions for the assumption or rejection of executory contracts and unexpired leases, if not previously rejected by the administrator pursuant to section 4-602;

SO ORDERED.

SIGNED this 27 day of January, 2017.

David M. Warren
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NORTH CAROLINA
RALEIGH DIVISION

IN RE: **CASE NO. 16-02900-5-DMW**

RYAN ALEXANDER FAIRCLOTH

CHAPTER 13

DEBTOR

ORDER DENYING MOTION TO INCUR DEBT

This matter comes before the court upon the Motion to Incur Debt filed by Ryan Alexander Faircloth ("Debtor") on December 13, 2016 and the Response filed by Chapter 13 trustee John F. Logan, Esq. ("Trustee") on December 27, 2016. The court conducted a hearing on January 11, 2017 in Raleigh, North Carolina. Cort Walker, Esq. appeared for the Debtor, and Michael B. Burnett, Esq. appeared for the Trustee. Based upon the evidence presented and arguments of counsel, the court makes the following findings of fact and conclusions of law:

1. This matter is a core proceeding pursuant to 28 U.S.C. § 157, and the court has jurisdiction pursuant to 28 U.S.C. §§ 151, 157, and 1334. The court has the authority to hear this matter pursuant to the General Order of Reference entered August 3, 1984 by the United States District Court for the Eastern District of North Carolina.

2. The Debtor filed a voluntary petition for relief under Chapter 13 of the United States Bankruptcy Code ("Code")[1] on June 1, 2016, and the court appointed the Trustee to administer the case pursuant to § 1302. The Debtor sought bankruptcy relief to allow for structured repayment through a Chapter 13 plan of sales and payroll tax liability resulting from his prior restaurant business. The Debtor is now self-employed as a general contractor.

3. The Debtor's Chapter 13 plan ("Plan"), confirmation of which is pending, requires the Debtor to make monthly payments to the Trustee in the amount of $1,000.00 for six months and $1,969.00 for 54 months. The Plan provides for 100% payment of allowed priority claims totaling $80,244.85 and 75% payment of allowed unsecured claims totaling $980.58. In addition, the Plan provides for the re-amortized payment of a claim secured by the Debtor's motor vehicle.

4. The Debtor's wife owns a 401(k) account ("401(k)")[2] which is managed through her employer by Fidelity Investments and an Individual Retirement Account ("IRA") which is managed by the investment company of Edward Jones. The current value of the 401(k) is approximately $55,000.00, and the current value of the IRA is approximately $50,000.00.

5. The Debtor plans to take an active role in managing his wife's retirement accounts, including transferring the IRA from Edward Jones to a self-directed account, and to the extent possible, directing Fidelity Investments' management of the 401(k). In an effort to better educate himself in stock trading skills and strategies, the Debtor desires to take a one-week stock trading class with Online Trading Academy. In the Motion to Incur Debt, the Debtor seeks authorization to finance his tuition with Online Trading Academy in the approximate of $10,000.00, to be paid over a period of 24 months with monthly payments not to exceed $490.00.

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[1] References to the Code, 11 U.S.C. § 101 *et seq.*, shall be by section number only.

[2] Although the Debtor refers to this account as a 401(k) account, it is unclear to the court whether the account qualifies under 26 U.S.C. § 401(k).

6. The Trustee is opposed to the Debtor incurring a significant post-petition obligation that could impede his ability to fund the Plan; however, if the Debtor is allowed to incur the debt, then the Trustee recommends that the Debtor be required to provide for immediate payment in full of the allowed unsecured claims. The Debtor indicates that within approximately two months he would be able to pay the Trustee an amount sufficient to fully satisfy these unsecured claims.

7. The Code and Federal Rules of Bankruptcy Procedure do not expressly prevent a Chapter 13 debtor from incurring post-petition debt; however, the local rules of this district dictate that a Chapter 13 debtor "shall not purchase additional property or incur additional debt of $7,500.00 or more without prior approval of the court." E.D.N.C. LBR 4002-1(g)(5). While recognizing this mandate, the Debtor urges the court to find guidance in the United States Bankruptcy Court for the District of Minnesota's recent determination that "[t]here is nothing in the Bankruptcy Code that requires court authorization for a debtor in chapter 13 who is not 'engaged in business'[3] to incur post-petition debt or to obtain credit." *In re Fields*, 551 B.R. 424, 428 (Bankr. D. Minn. 2016).[4] The Debtor suggests that the Motion to Incur Debt should be evaluated under a "business judgment rule" analysis, and the Debtor's desire to gain knowledge that will hopefully enable him to manage his wife's retirement accounts with greater return and fewer outside fees and commissions is a sound and reasonable motivation for incurring debt.

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[3] The Debtor contends, and the court agrees, that the Debtor is not "engaged in business" within the meaning § 1304.

[4] The *Fields* court noted that although the Code does not require authorization for a Chapter 13 debtor to incur post-petition debt, the appropriateness of incurring such a debt could nonetheless come under the court's scrutiny, because § 1302(a)(2) allows the holder of a post-petition claim for a consumer debt that is for property or services necessary for the debtor's performance under the plan to file a proof of claim, and § 1322(b)(6) allows a Chapter 13 plan to provide for payment of such a post-petition claim. *Fields*, 551 B.R. at 427. Either the debtor, the creditor, or trustee could seek to include that claim in the plan through the modification provisions of § 1329 which mandates compliance with the confirmation requirements of § 1325(a). *Id.* at 427 n. 4. This possibility does not exist in the current case, because the debt the Debtor proposes to incur would not qualify as a consumer debt that is for property or services necessary for the Debtor's performance under his Plan.

8. The business judgment rule is a doctrine of corporate law that "serves to prevent courts from unreasonably reviewing or interfering with decisions made by duly elected and authorized representatives of a corporation." *F.D.I.C. v. Willetts*, 882 F. Supp. 2d 859, 864 (E.D.N.C. 2012) (citing *Robinson on North Carolina Corporations*, § 14.06). Under the business judgment rule,

> [a]bsent proof of bad faith, *conflict of interest*, or disloyalty, the business decisions of officers and directors will not be second-guessed if they are "the product of a rational process," and the officers and directors have "availed themselves of all material and reasonably available information" and honestly believed they were acting in the best interest of the corporation."

Id. (quoting *State v. Custard*, 2010 N.C.B.C. 6, 2010 WL 1035809 *21 (N.C. Super March 19, 2010) (quoting *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 124 (D. Ch. 2009)) (emphasis added).

9. The Debtor's business judgment rule analogy, albeit clever, is misplaced for several reasons. The Debtor is not an officer or director making a decision on behalf of a corporate entity but is rather an individual acting on his own behalf. The court commends the Debtor for wanting to accumulate wealth for his family's future; however, investing money towards this endeavor is ostensibly in conflict with the Debtor's commitment to pay his pre-petition creditors through the Plan. Perhaps in establishing E.D.N.C. LBR 4002-1(g)(5), the Local Rules Committee for this district wisely envisioned, and the judges agreed, that any attempt to incur significant debt by a Chapter 13 debtor performing under a plan is in direct conflict with the interests of his creditors. For this reason, the court must consider the effect of the financial burden for the stock trading class upon the Debtor's ability to perform under the Plan.

10. The Debtor is convinced, maybe through the efforts of aggressive marketing, that the information gleaned from this education will result in the financial security for which most

Americans dream. The Debtor had difficulty in discerning between an Individual Retirement Account and a 401(k) plan. This lack of basic understanding of these very different retirement plan vehicles leads the court to conclude that the Debtor is a gullible novice who will probably drain his spouse's retirement nest egg with a few day trades. Of course, the 401(k) and the IRA are not property of the Debtor's bankruptcy estate, and the court has no jurisdiction over those funds. The court's interest is that the Debtor be able to complete his Plan, received a discharge, and move forward with a "fresh start." Allowing the Debtor to incur the debt for the stock trading course will frustrate progress toward those ultimate goals.

11. The court cannot insulate the Debtor from every financial misstep, but it certainly can prevent this one. The court suggests that the Debtor focus his efforts primarily on his current profession and maximizing his disposable income. The Debtor can also monitor and manage the 401(k) and the IRA, but in doing so, the court will not allow the Debtor to incur a debt that will require him to divert $490.00 per month of post-petition income from the Plan; now therefore,

IT IS ORDERED, ADJUDGED, AND DECREED that the Motion to Incur Debt be, and hereby is, denied.

END OF DOCUMENT