No. 15-56800

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CHERI FU and THOMAS FU

Debtors, Defendants and Appellants,

v.

CITY NATIONAL BANK, N.A.

Creditor, Plaintiff and Appellee.

APPELLANTS' OPENING BRIEF

On Appeal From Order Of U.S. District Court, C.D. Cal., in Case No. 8:15-cv-00676-CJC, Affirming Partial Summary Judgments Entered By U.S. Bankruptcy Court, C.D. Cal., in Adv. No. 8:13-ap-01255-TA, arising in Case No. 8:09-bk-22699-TA (Jointly Administered with 8:09-bk-22695-TA)

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Defendants, Debtors, and Appellants Cheri Fu and the Estate of Thomas Fu, deceased ("Appellants") respectfully submit their Opening Brief on appeal from the District Court's Order in Case No. 8:15-cv-00676-CJC, which upheld on appeal the Bankruptcy Court's nondischargeable money Judgments entered on April 20, 2015 in favor of Plaintiff, Creditor, and Appellee City National Bank ("CNB" or "Appellee") in Adversary Case No. 8:13-ap-01255-TA (the "CNB Action") following the granting of CNB's Motion for Partial Summary Judgment ("MSJ") on CNB's Sixth and Fifth Claims for Relief ("Judgment No. 1"]), in the amount of $35,000,000, and CNB's Third and Fourth Claims for Relief ("Judgment No. 2"), in the amount of $5,812,183.75.

I. INTRODUCTION

This appeal challenges two nondischargeable money judgments totaling in excess of $40,000,000 which the Bankruptcy Court summarily entered against the Fus on their personal guarantee (Excerpts of Records ["EA"] Vol. 9, Tab 39, EA 002100-2108) of two loans that CNB made to the Fus and their company, Galleria U.S.A., Inc. ("GUSA"). At that time, GUSA was one of the largest importers and distributors of home accent and décor items in the United States. The $27 million CNB loan to GUSA, which resulted in the $35 million Judgment No. 1 (due to accumulated interest), was a fully secured revolving credit facility 100% collateralized by GUSA inventory and accounts receivable (A/R).

CNB based is partial summary judgment motion (the "MSJ") almost entirely on the Fus' criminal plea agreements in which they made narrowly-cabined admissions that they over-borrowed $4.7 million under a secured revolving line of credit managed by creditor Bank of America, N.A. ("BofA") between October 2008 and June 2009, and upon inadvertent admissions in the Fus' pro se Answer which they cobbled together without the benefit of counsel while they were incarcerated in separate federal correctional facilities. The Fus' pro se Answer did

not assert a single affirmative defense to CNB's conclusory claims.

Yet the Bankruptcy Court permitted CNB to railroad the Fus, who were still pro se and incarcerated when served with CNB's MSJ, into responding with inadequate notice and without permitting the Fus to conduct any discovery whatsoever with respect to proposed Judgments No. 1 and 2. Among other critical issues, the Fus sought, but were denied, discovery to establish the true amount and causes of CNB's alleged losses and its failure to mitigate those losses by locating and monetizing the GUSA security collateralizing the loans in a commercially reasonable manner. That was CNB's non-waivable duty as a secured creditor under the Uniform Commercial Code (Article 9).

The Bankruptcy Court's summary entry of nondischargeable money Judgments Nos. 1 and 2 was contrary to applicable legal standards and the interests of justice and due process. There was an inadequate basis in the record to support the Bankruptcy Court's findings of "undue delay," "substantial prejudice," and "bad faith" sufficient to overcome the strong presumption in favor of granting Rule 56(d), Rule 14, and Rule 15 motions. This is especially in true in cases, like this one, involving pro se, incarcerated defendants who responded to CNB's Complaint without the benefit of counsel.

The Bankruptcy Court and District Court erred by blaming the incarcerated, pro se civil defendants for not unilaterally initiating a Rule 26 conference with CNB so as to commence discovery themselves earlier. It was CNB -- not the incarcerated, pro se Fus -- which violated its obligation as the civil plaintiff under LBR 7026-1(a) to provide Rule 26 notice to the Fus with CNB's Summons and Complaint. CNB then also failed to initiate the early meeting or to make the initial disclosures required under Rule 26 at the outset of the litigation, even though the CNB Action (and CNB as plaintiff) were not exempt from Rule 26's requirements under Fed. R. Civ. P. 26(a)(1)(B)(iv) (exempting actions brought BY incarcerated,

pro se plaintiffs). Finally, CNB conveniently neglected to serve the Fus with the due-process-required Rule 56 Rand Notice under *Rand v. Rowland*, 154 F.3d 952 (9th Cir. 1998)) at or before the time its served its MSJ. These failures severely impeded the Fus' ability to mount a timely and effective opposition to CNB's conclusory claims.

The Bankruptcy Court and District Court erred by concluding that the surety waivers in the Fus' personal guaranty to CNB rendered futile and irrelevant discovery about the true amount and causes of CNB's alleged losses and its failure to mitigate its damages by marshalling and monetizing the security collateralizing the GUSA loan. Under Cal. Comm. Code § 9602, the Fus have non-waivable rights as GUSA guarantors to an accounting of the collateral and its liquidation, and to ensure the secured creditor, CNB, used commercially reasonable efforts to locate and monetize the collateral so as to minimize the Fus' guaranty liability. Denying discovery about the fulfillment or breach of these non-waivable rights and duties constituted error.

Precipitous $40 million nondischargeable money judgments entered on such a basis cannot be allowed to stand.

II. STATEMENT OF JURISDICTION

The Bankruptcy Court had jurisdiction under 28 U.S.C. § 157 and 1334. The District Court had jurisdiction under 28 U.S.C. § 158(a)(1). This Court has jurisdiction to review final orders of a district court acting in its bankruptcy appellate capacity under either 28 U.S.C. § 158(d)(1) or 28 U.S.C. § 1291. *See Lundell v. Anchor Constr. Specialists, Inc. (In re Lundell),* 223 F.3d 1035, 1038 (9th Cir. 2000). Appellants timely filed and served their Notices of Appeal. (AE Vol. I, Tabs 1, 3 & 5.)

III. STATEMENT OF ISSUES PRESENTED FOR REVIEW

A. Whether the Bankruptcy Court erred when it granted CNB's MSJ and

denied Appellants' Fed. R. Civ. Proc. 56(d) Motion to challenge the amount and causes of, and the failure to mitigate, Appellee's claimed losses.

B. Whether the Bankruptcy Court erred when it denied Appellants' Fed. R. Civ. Proc. 15 Motion to amend their *pro se* answer filed while incarcerated so as to correct erroneous *pro se* admissions and to assert viable defenses to CNB's claims.

C. Whether the Bankruptcy Court erred when it denied Appellants' Fed. R. Civ. Proc. Motion to implead Third Party Bank Defendants which caused and contributed in substantial part to CNB's claimed losses.

IV. STANDARD OF REVIEW

A bankruptcy court's decision to grant summary judgment is reviewed de novo. *See In re AFI Holding, Inc*., 525 F.3d 700, 702 (9th Cir. 2008). A bankruptcy court's decision not to permit discovery pursuant to Rule 56(d) is reviewed for an abuse of discretion. *Chance v. Pac-Tel Teletrac Inc*., 242 F.3d 1151, 1161 n.6 (9th Cir. 2001)(applying former Rule 56(f)). A bankruptcy court's decision to allow or forbid a party to amend its answer under Rule 15 is reviewed for an abuse of discretion. *C.F. ex rel. Farnan v. Capistrano Unified Sch. Dist*., 654 F.3d 975, 985 (9th Cir. 2011). A bankruptcy court's Rule 14 impleader decision also is reviewed for an abuse of discretion. *Brockman v. Merabank*, 40 F.3d 1013, 1016 (9th Cir. 1994). A bankruptcy court abuses its discretion if it applied the wrong legal standard or its findings were illogical, implausible or without adequate support in the record. *TrafficSchool.com, Inc. v. Edriver Inc*., 653 F.3d 820, 832 (9th Cir. 2011).

V. STATEMENT OF THE CASE

GUSA was a business that imported home decor items from China, which it resold in the United States. Cheri Fu was President of Galleria USA and a substantial equity holder of Galleria USA. Thomas Fu was Galleria USA's Chief

Financial Officer, Secretary and Treasurer.

Between May 2008 and June 2009, CNB extended credit and made which -- together with various personal guarantees provided by the Fus -- form the basis CNB's claims against the Fu; in particular (i) CNB's 15.38% of the BofA $130 million ABL Facility to Galleria USA, dated May 30, 2008, in the amount of $20 million; (ii) the CNB Individual Loan to the Fus, dated October 3, 2008, in the amount of $5 million, and the (iii) CNB Letters of Credit Issuance Facility with Galleria USA, dated May 1, 2009, in the amount of $27 million -- which CNB purports to seek not only on its own behalf, but also "for the benefit of the participant banks ." (*See* CNB Complaint ¶ 24 EA Vol. XIV, Tab 47, EA003350].)

On or about November 16, 2009, certain creditors of Debtors commenced these cases by filing an involuntary chapter 11 proceeding against Cheri Fu, Case No. 8:09-bk-22699-TA, and Thomas Fu, Case No. 8:09-bk-22695-TA. On March 16, 2010, the Bankruptcy Court entered an Order approving a stipulation for joint administration of the Involuntary Chapter 11 cases of *Thomas Fu*, 8:09-bk-22695-TA, and *Cheri Fu*, 8:09-bk-22699-TA. The case of *Cheri Fu*, 8:09-bk-22699-TA is the lead case. On October 5, 2011, the cases were converted to chapter 7.

On March 9, 2011, the Fus were charged pursuant to Indictment with nine (9) counts of bank fraud in *United States of America v. Cheri L Shyu, aka Cheri Fu, and Thomas Chia Fu*, Case No. 11-SACR11-59 (the "Fu Criminal Case").

In the Fu Criminal Case, the Fus each pled guilty to one (1) count of bank fraud in violation of 18 U.S.C. § 1344. On November 18, 2011, in the Fu Criminal Case, the Fus each signed Plea Agreements. The Plea Agreements were fully investigated by the U.S. Attorney's Office, and contain narrow, cabined admissions by Mrs. Fu that were limited in time (from October 2008 to April 2009), limited in scope (involving the submission of limited number of false borrowing base certificate reports with inflated computer data entries), and limited in amount ($4.7

million in bank losses attributed to Mrs. Fu's admitted misconduct. (EA Vol. XIII, Tab 36 at EA003124-3126.) There was no admission of fraud beyond $4.7 million which was used to pay BofA under its Hong Kong facility. The Fus did not pocket the money for themselves. They tried desperately, but mistakenly, to save their business.

On July 13, 2013, CNB filed its Complaint against the Fus in the CNB Action. In its Complaint, CNB asserted Six Claims for Relief, seeking the following recoveries: First and Second Claims for Relief for recovery of indedtedness from breach of the Fus' personal guarantees and fraud for CNB's 15.38% of the May 2088 $130 million ABL Facility; Third and Fourth Claims for Relief for breach of the CNB Revolving Note individual loan to the Fus and for fraud; the Fifth and Sixth Claims for Relief for recovery for breach of guarantees and for fraud with respect to the CNB Letter of Credit Facility; and for all Claims for Relief a nondischargeability determination under 11 U.S.C. § 523(a)(2)(A). EA Vol. XIV, Tab 47.)

From the commencement of the Action CNB on July 31, 2013, up through the time of hearing on CNB's Motion for Summary Judgment on December 4, 2014, no early meeting of counsel occurred under Rule 26(a), no discovery either occurred *or was permitted* under Rule 26(d), no initial disclosures were made under Rule 26(f), no pre-trial scheduling order was entered under Rule 16, no discovery cut-off, motion cut-off, or other pre-trial deadlines were established, no other motions had been filed, and no trial date was set. (EA Vol. V, Tab 33, at EA000979.)

CNB filed its MSJ (and supporting papers) on October 23, 2014. Service was never effectuated on Mr. Fu, as he had been released early to a half-way house at the time of service, and service was improperly effectuated on Ms. Fu, who did not receive the moving papers until 10 days before her response was due(App. Vol.

V, Tab 32, ¶¶ 6-9 at EA000833-834).

Counsel for the Fus appeared for the first time as their counsel in the CNB Action on Monday, November 10, 2014. (EA Vol. V, Tab 32, at EA0000833.)

On November 13, 2014, the Fus filed their Opposition to CNB's MSJ and their Rule 56(d) Motion for a continuance to conduct discovery, their Rule 14 motion to implead third party defendants Bank of America, N.A. ("BofA"), Wachovia Bank, N.A. ("Wachovia"), and Wells Fargo Bank, N.A. ("Wells Fargo, and collectively with BofA and Wachovia, the "Third Party Bank Defendants") as contractual and equitable indemnitors, and the Fus' Rule 15 Motion to amend their *pro se* Answer to correct erroneous admissions of legal conclusions and to assert 13 pertinent Affirmative Defenses, including CNB's failure to mitigate its damages by collecting and monetizing the collateral for the 100% secured GUSA loan. (EA Vol. IV, Tab 27, 30; Vol. V, Tabs 31-33.)

The hearing on CNB's MSJ and the Fus' Motions under Rule 56(d), Rule 14, and Rule 15 took place in the Bankruptcy Court on December 4, 2014.[1] (EA Vol. III, Tab 22 [Dec. 4, 2014 Hearing Transcript].) The Fus' counsel argued strenuously that CNB should not be permitted to foist upon the Fus 100% of GUSA's loan plus interest without challenge or discovery as if not one cent of collateral existed securing the loan, and as if not one penny of principal or interest had ever been paid. (EA Vol. III, Tab 22 at EA000410, 411, 412, 417, 426-427, 430.) On April 20, 2015, the Bankruptcy Court entered a nondischargeable money Judgment No. 1 in the amount of $35,000,000.00, plus pre- and post-judgment interest, and entered a nondischargeable money Judgment No. 2 in the amount of $5,812,183.75, plus pre- and post-judgment interest(EA Vol. III, Tabs 15 & 16.)

[1] Mr. Fu tragically died, presumably of heart failure, when released to a halfway house on or about December 23, 2014.

On April 28, 2015, the Fus timely filed and served their Notices of Appeal to the District Court. (EA Vol. III, Tabs 12 & 14.) By Order entered on November 4, 2015, the District Court affirmed the Bankruptcy Court's rulings. (EA Vol. I, Tab 2). Appellants timely filed their Notices of Appeal to this Court. (EA Vol. I, Tabs 1, 3 & 5.)

VI. SUMMARY OF ARGUMENT

The Bankruptcy Court abused its discretion under Rule 56(d), Rule 14, and Rule 15 by failing to apply the correct legal standards, and instead turning the very lenient standards of review on their head. The Bankruptcy Court made findings in support of its rulings that were illogical, implausible and without adequate support in the record. The Bankruptcy Court improperly discounted numerous service, procedural, and due process violations by CNB in order to "railroad" the Fus into filing rushed summary judgment oppositions without the benefit of any discovery whatsoever, even though CNB violated its Rule 26 and *Rand* notice obligations.

Comprehensive research of published decisions in every Circuit Court of Appeals and District Court nationwide has failed to uncover *any* case in which "prejudice," "bad faith," or "undue delay" has been established when the case is in its most incipient procedural stage, when no pre-trial or trial dates had been set, and no Rule 26(f) meeting or discovery had occurred. Nor did Appellee (or the Bankruptcy Court or District Court) cite any such case. It was error to blame the pro se, incarcerated Fus for the lack of commencement of discovery sooner, which was CNB's fault, pure and simple. It was error to conclude that the Fus' affirmative defenses, third party claims, and proposed discovery were futile or would be fruitless because of surety defense waivers in the Fus' CNB guaranty when by statute and public policy CNB was required to exercise commercially reasonable efforts to collect and monetize the collateral for the GUSA loans that the Fus guaranteed, so as to minimize the Fus' guarantor liability.

VII. ARGUMENT

A. THE BANKRUPTCY COURT ERRED BY DENYING APPELLANTS' RULE 56(D) MOTION AND BY GRANTING CNB'S PREMATURE SUMMARY JUDGMENT MOTION

Numerous Federal Rules of Civil Procedure embody the bedrock requirement that parties must have an adequate opportunity to gather evidence to defend themselves. Rule 56(b) sets the default deadline for filing a motion for summary judgment at "30 days after the close of all discovery."[2] Rule 56(d)(2) expressly contemplates deferring summary judgment in order to "allow time" for the non-movant "to take discovery." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986) (Rule 56 allows for summary judgment "after adequate time for discovery and upon motion") Similarly, upon converting a motion to dismiss to a motion for summary judgment under Rule 12(d), a district court must give the parties "a reasonable opportunity to present all the material that is pertinent to the motion" before ruling, including the opportunity to "pursue reasonable discovery." *Taylor v. FDIC*, 132 F.3d 753, 765 (D.C. Cir. 1997) (citation omitted).

Rule 56(d)'s purpose is to protect a nonmoving party from being "railroaded" into summary judgment by a "premature motion." *Celotex*, 477 U.S. at 326. "[T]he prevailing rule in all circuits" is that "[u]nder the Federal Rules of Civil Procedure, the parties must be afforded adequate time for general discovery before being required to respond to a motion for summary judgment." *Metro. Life Ins. Co. v. Bancorp Servs.*, LLC, 527 F.3d 1330, 1336-67, and n.3 (Fed. Cir. 2008) (collecting cases).

Rule 56(d) has been read as "requiring, rather than merely permitting,

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[2] Rule 56(d) provides:
"If a nonmovant shows by affidavit or declaration that, for specified reasons, it cannot present facts essential to justify its opposition, the court may:
(1) defer considering the motion or deny it;
(2) allow time to obtain affidavits or declarations or to take discovery; or
(3) issue any other appropriate order."

discovery 'where the nonmoving party has not had the opportunity to discovery information that is essential to its opposition.'" *Metabolife Inter., Inc. v. Wornick*, 264 F.3d 832, 846 (9th Cir. 2001). This is because a defendant must receive "a full opportunity to conduct discovery" to be able to successfully defeat a motion for summary judgment. *See Anderson v. Liberty Lobby, Inc*., 477 U.S. 242, 257 (1986).

When a party moves for summary judgment before the opposing party has had a "realistic opportunity to pursue discovery relating to its theory of the case, district courts should grant any [Rule 56(d)] motion fairly freely." *Burlington Northern Santa Fe R. Co. v. The Assiniboine*, 323 F.3d 767, 774 (9th Cir. 2003) ("*Burlington*"). This rule of leniency in granting Rule 56(d) motions is particularly applicable in cases involving *pro se* incarcerated defendants. *Jones v. Blanas*, 393 F.3d 918, 930 (9th Cir. Cal. 2004) ("[S]ummary judgment is disfavored where relevant evidence remains to be discovered, particularly in cases involving confined *pro se* plaintiffs"); *Klingele v. Eikenberry*, 849 F.2d 409, 412 (9th Cir. 1988) (same); *Lucas v. Silva*, 2011 U.S. Dist. LEXIS 23651, 7-8 (N.D. Cal. Feb. 22, 2011) ("Summary judgment is disfavored where relevant evidence remains to be discovered, particularly in cases involving confined *pro se* plaintiffs."). Summary judgment in the face of requests for discovery in cases involving *pro se* plaintiffs is appropriate only where such discovery would be entirely "fruitless." *Jones*, 393 F.3d at 930; *Klingele*, 849 F.2d at 412.

The point is that defendants – especially pro se, incarcerated defendants -- must have a "realistic opportunity to pursue discovery relating to its theory of the case[]" before summary judgment. *Burlington* , 323 F.3d at 774. Like *DCD Programs, Ltd. v. Leighton*, 833 F.2d 183 (9th Cir. 1987), this case, even today, is "still at the discovery stage with no trial date pending, nor has a pretrial conference been scheduled." The responsibility for failing to move this case forward to

discovery earlier does not lie with the Fus, who were incarcerated and unrepresented defendants, but with CNB, which had no such barriers to overcome in order to do so as plaintiffs represented by an international law firm. CNB should not be heard to complain of prejudice arising from its own willingness to allow its plaintiffs' case to languish without an early meeting of the parties under Rule 26(f), when it was required to commence that process under LBR 7026-1 but failed to do so.

In deciding that the Fus failed to discover the information they needed to resist the summary judgment motion just because "they did not avail themselves of the opportunity [to do discovery] earlier," the Bankruptcy Court simply ignored the question of whether the Fus ever had such a "realistic opportunity. (EA Vol. I, Tab 2 at EA000017). Under this Court's *Burlington* decision and its predecessor decision on the same issue -- *Texas Partners v. Conrock Co*., 685 F.2d 1116, 119 (9th Cir. 1982) (finding summary judgment prior to adequate discovery premature) -- the Bankruptcy Court abused its discretion in denying the Fus' Rule 56(d) continuance and discovery request.

1. CNB Failed To Serve The Requisite Rule 26 Notice On The Fus And This Action Was Not Exempt From The Early Meeting, Initial Disclosure, And Other Rule 26 Requirements

Burlington and *Texas Partners* require reversal of the Bankruptcy Court's MSJ Order and the Judgments resulting from it. The *Burlington* Court held that the district court's denial of defendants' Rule 56(f) motion was an abuse of discretion because the summary judgment motion was filed so early in the litigation that no discovery had yet taken place; thus, defendants did not have a reasonable opportunity to uncover facts before their opposition to the motion was due. The Bankruptcy Court based its ruling on its findings that Appellants supposedly unduly delayed in bad faith in making the Motion and in failing to

diligently pursue discovery, thereby prejudicing Appellee. (EA Vol. III, Tabs 12 & 14 [attaching Tentative Rulings adopted by the Bankruptcy Court as final].) But those findings are not adequately supported in the record.

It is not realistic to expect incarcerated inmates representing themselves to initial Rule 26 conferences, especially when the plaintiff fails to give the required Rule 26 notice to them. *Burlington Northern,* 323 F.3d at 774. In fact, it was only in early November, 2014, when Mr. Fu was released from prison to a halfway house and the Fus were represented by counsel in this case for the first time since CNB filed its complaint. They filed their Rule 56(d) motion immediately on November 13, 2014. It is hard to imagine how they could "realistically" have done so any sooner. When, as here, the issues are complicated or motives and intent are important, "putting [the non-moving party] to the test . . . without ample opportunity for discovery is particularly disfavored." *Timberlane Lumber Co. v. Bank of America*, 549 F.2d 597, 602 (9th Cir. 1976).

Here, just as in *Burlington Northern* and *Texas Partners* -- which both are squarely on point and should control the prematurity issue here -- CNB's MSJ was filed too early in the case, procedurally, because no discovery was permitted to occur and had taken place because no Rule 26(f) early meeting of counsel had taken place.

Rule 26(d) provides in pertinent part that "[a] party may not seek discovery from any source before the parties have conferred as required by Rule 26(f) . . .." *See* Fed. R. Civ. Proc. 26(d). Rule 26 is made applicable in bankruptcy adversary proceedings via Fed. Bankr. Rule 7026. Local Bankruptcy Rule ("LBR") 7026-1(a) provides that "Compliance with Fed. R. Bankr. Rule 7026 and this rule is required in all adversary proceedings." LBR 7026-1(a) (1) and (2) require that "The plaintiff must serve with the summons and complaint a notice that compliance with FRBP 7026 and this rule is required" and "The plaintiff must file

a proof of service of this notice together with the proof of service of the summons and complaint." Yet CNB violated these Rules by failing to serve upon the Fus the required Rule 26 notice and related proof of service.

Fed. R. Civ. P. 26(a)(1) requires that parties to civil actions make initial disclosures. Fed. R. Civ. Proc. 26(a)(1)(A). The rule, however, exempts proceedings brought under Fed. R. Civ. Proc. 26(a)(1)(B). One such proceeding is "an action brought without an attorney by a person in the custody of the United States, a state, or a state subdivision." Fed. R. Civ. Proc. 26(a)(1)(B)(iv). Thus, defendants in civil actions brought by pro se prisoners are not subject to the initial disclosure requirements. *Id*. Likewise, proceedings exempt from initial disclosures under Fed. R. Civ. Proc. 26(a)(1)(B) are not subject to the Rule 26(f) discovery conference rules. Fed. R. Civ. Proc. 26(f)(1). Therefore, there is no bar to pre-conference discovery under Rule 26(d) for cases falling under this exemption. But this exemption from the Rule 26 requirements is inapplicable here. The CNB action was brought against the Fus, and was not brought by the Fus. Comprehensive research has located no case applying the exemption under Fed. R. Civ. Proc. 26(a)(1)(B)(iv) where the action was brought against a pro se, incarcerated defendant. Apparently none exists; and with good reason.

On the other hand, numerous cases hold that when no Rule 26(f) early meeting has occurred and no discovery has taken place it is premature under Rule 56(d) to entertain a summary judgment motion. *See, e.g., McKinzy v. Norfolk S. R.R.*, 354 Fed. Appx. 371, 375 (10th Cir. Kan. 2009) ("It goes without saying that a plaintiff cannot be permitted to thwart his opponent's ability to launch a defense by filing a summary judgment motion before the Rule 26(f) conference[.]"); *Mazzetti v. Bellino*, 2014 U.S. Dist. LEXIS 116797, 8-9 (E.D. Cal. Aug. 21, 2014) (granting 56(d) motion and stating "[T]his case is in its infancy. There is no scheduling order, no discovery has occurred, no answers have been filed, no Rule 26

disclosures have been made, and no depositions of any party have occurred." [citing *Burlington*, 323 F.3d at 773-74]); *Atkins v. Foster*, 2012 U.S. Dist. LEXIS 156586, 4-7 (E.D. Tenn. Nov. 1, 2012) (granting Rule 56(d) motion, noting that "Here, the parties have not conducted the initial discovery required by Rule 26, Federal Rules of Civil Procedure, or any other discovery. At this juncture in the proceedings, the court finds defendant's motion for summary judgment to be premature, and that the plaintiffs should be given an opportunity to develop their case through discovery."); *Brock v. Marymount Med. Ctr., Inc*., 2007 U.S. Dist. LEXIS 4902, 22-23 (E.D. Ky. Jan. 23, 2007) (same, citing, *inter alia, Vance By and Through Hammons v. United States*, 90 F.3d 1145, 1149 (6th Cir. 1996) [reversing summary judgment because "no discovery was conducted before the motion for summary judgment was filed and decided"]) .

In an effort to justify its failure to comply with Rule 26 and LBR 7026-1(a), CNB repeatedly stated in its Unilateral Status Reports to the Bankruptcy Court that "CNB is not able to contract the Fus directly." [EA Vol. XIV, Tab 40-44] That is incorrect. CNB in fact was perfectly able to contact the Fus directly by telephone, email and regular mail, and even in person, by complying with applicable Bureau of Prisons guidelines (*see* required procedures at https://www.bop.gov/inmates/communications.jsp and https://www.bop.gov/inmates/visiting.jsp).

CBN never sought, and the Bankruptcy Court never entered, an order waiving the requirements of Rule 26 and LBR 7026-1, or otherwise permitting discovery notwithstanding Rule 26(d)'s no-discovery-rule prior to the early meeting of counsel. The Bankruptcy Court erred by entertaining CNB's summary judgment motion prematurely and by denying Rule 56(d) discovery due to the Fus' purported lack of diligence because CNB failed to serve the requisite Rule 26 notice on the Fus as required under LBR 7026-1(a) and failed to initiate the

requisite Rule 26(f) conference that would have permitted any discovery to occur.

2. CNB's Motion for Summary Judgment Was Improperly Served And Failed To Include The Rule 56 Notice Required Under *Rand v. Rowland*, 154 F.3d 952 (9th Cir. 1998)

CNB never properly served its summary judgment papers on the Fus. Mr. Fu already had been released to a halfway house when CNB attempted to serve its summary judgment motion papers on him at his former correctional facility in Texas. (EA Vol. V, Tab 32, ¶¶ 7-10 at EA000833-834.) Ms. Fu never received copies of the papers, and her Counsel only received them 10 days before her opposition papers were due to be filed. *Id*. Under LBR 7056-1(b)(1) the moving party is required to give forty-two (42) days advance notice of any hearing on a motion for summary judgment. Under the Local Bankruptcy Rules, the defendants' responses were due 21 days prior to hearing. *See* LBR 7056-1(c)(1). There are special requirements for mailing or otherwise serving legal documents on federally-incarcerated inmates. *See*, *e.g.*, http://www.bop.gov/locations/institutions/lat/. The mailing address rules must be strictly followed. That was not done here. This service failure was conceded by CNB's counsel.

Service on counsel in a separate lawsuit before he was retained in the CNB Action does not constitute proper service or remedy the service failure on the Fus. Accordingly, the Fus were given inadequate notice of CNB's MSJ and inadequate time to prepare a response. The MSJ should have been rejected on this procedural ground alone, which implicates due process and fairness issues given the Fus' incarceration and the amount of the money judgment sought (>$40 million). At the very least, a continuance should have been granted and the MSJ hearing taken off calendar so as to give the Fus' at least the minimum 42 days' notice required under LBR 7056-1(b)(1).

The Bankruptcy Court erred in excusing CNB's improper service because

the *pro se* incarcerated Appellants failed to update their prison addresses on the Court's docket. Given the practical realities of incarceration, this is unrealistic and cannot justify CNB's tardy and incomplete service of its MSJ papers or its prior failure to provide the Rule 26 notice required under LBR 7026-1(a)(1). Moreover, CNB repeatedly represented to the Bankruptcy Court in its "Unilateral Status Conference Statements" that it was unable to contact the Fus directly, which was untrue.

CNB and the Bankruptcy Court also failed provide the due-process-required "*Rand* Notice" to Appellants with the notice of the MSJ (or otherwise). *See Rand v. Rowland*, 154 F.3d 952 (9th Cir. 1998)(en banc) (*pro se* prisoners must be given notice by the court at the time of service of the MSJ of Rule 56's requirements). The failure to do so constitutes reversible error unless there no facts could possibly exist that would entitle the inmate to prevail. *See Woods v. Carey*, 684 F.3d 934, 935, 941 (9th Cir. 2012). This constitutes an independent ground for reversal. That the Fus were able to retain counsel at the eleventh hour before their MSJ response was due does not render the failure to provide the requisite *Rand* notice "harmless error." Fed. R. Civ. Proc. 61. If the *Rand* Notice had been timely given and service of the MSJ timely made, as required, the Fus would have been able to retain counsel earlier, mount a more effective response, and prepare Fu declarations, instead of only providing the Albert Rule 56(d) Declaration that he was able to prepare hurriedly "burning the midnight oil" at the eleventh hour.

3. Appellants' Requested Discovery Was Not Fruitless or Futile

Rule 56(d) should have barred CNB from forcing the Fus into summary judgment briefing without discovery essential to their defense. In support of their Rule 56(d)) Motion, Appellants submitted the Albert Rule 56(d) Declaration in which was set forth (1) the specific facts Appellants hoped to elicit from further

discovery; (2) that the facts sought existed; and (3) the sought-after facts were essential to oppose summary judgment. This showing satisfied the requirements of *Family Home & Fin. Ctr., Inc. v. Fed. Home Loan Mortgage Corp*., 525 F.3d 822, 827 (9th Cir. 2008) (the "*Family Home* factors"). The Albert Rule 56(d) Declaration outlined the existence, nature, and source of evidence that discovery would reveal regarding the contributing causes and actual amount of CNB's purported losses, taking into account the misconduct of the Third Party Participating Banks in breaching their credit obligations to the Fus and the Galleria Group of Companies, which precipitated their collapse, and the failure of the Banks, including CNB, to locate and fairly monetize the collateral and A/R securing the loans at issue. (EA Vol. V, Tab 32, ¶ 18 at EA000836-841).

Notably, the Bankruptcy Court did not base its ruling denying Appellants' Rule 56(d) Motion on any purported inadequacy in the above showing made in the Albert 56(d) Declaration. In its Tentative Ruling granting CNB's Summary Judgment Motion, which the Bankruptcy Court adopted as its final Order (EA Vol. III, Tab 17 & 18), and in the transcript of the December 4, 2014 hearing (EA Vol. III, Tab 22), the Bankruptcy Court did not mention any deficiency in the Albert Rule 56(d) Declaration's satisfaction of the *Family Home* factors.

Instead, the Bankruptcy Court focused almost entirely on the fact that the $5 million CNB Personal Loan to the Fus and the $27 million CNB Letter of Credit Facility both closed during the time period during which the Fus admitted in their Plea Agreements in the Fu Criminal Action they were falsifying borrowing base certifications in connection with the separate $130 million BofA ABL Facility, i.e., October 2008 through June 2009. (*EA* Vol. III, Tab 12 at EA000269-275.) The Bankruptcy Court, in its Tentative Ruling (which it adopted as final), never addressed the key issue of whether CNB properly and correctly was entitled to receive judgments for 100% of its principal and interest on it loans as if not one

cent of collateral ever existed, was found, or monetized, as if no interest or principal payments ever had been paid, and as if the Third Party Bank Defendants had nothing to do with the destruction of the Galleria Group of Companies and CNB's claimed losses.

While counsel and the Bankruptcy Court discussed the need to conduct discovery regarding the calculation of the amount of CNB's claimed loss of 100% of principal and interest, and the mystery of the lost collateral, in the end the Bankruptcy Court simply adopted its Tentative Ruling while nonetheless conceding that CNB had a duty to mitigate its damages. (EA Vol. III, Tab 22.)

This ruling in that respect overlaps with the Bankruptcy Court's ruling denying Appellants' Rule 15 Motion for leave to amend their Answer, since one of the key Affirmative Defenses Appellants wished to, but were denied the right to assert was "Failure to Mitigate Damages." (EA Vol. V, Tab 32, at EA000780) [Eleventh Affirmative Defense].) But the amount of CNB's claimed damages, and the amount of the money Judgments issued in that regard, were not just subject to a proposed mitigation affirmative defense by Appellants, since CNB was required to support the existence and amount of its purported losses. The conclusory statements in that regard in their supporting Declarations were completely silent about the fact the $27 million CNB Letter of Credit facility, for example, was supposed to be fully secured and collateralized, and what, if anything happened to the collateral securing 100% of the loan. (EA Vol. XIV, Tabs 37 & 38.)

CNB argued that facts showing that their losses would have been less but for their own actions or those of other banks are irrelevant to the summary judgments entered against the Fus. The Bankruptcy Court and District Court agreed. But that finding is illogical. Discovery on the true extent, amount, and causes of CNB's losses would establish that the Fus' conduct did not cause CNB to lose the whole amount due it on the loans. A showing that any part of CNB's loss was caused by

third parties, or CNB itself, rather than the Fus, would diminish the Fus liability for that loss.

CNB argued, and the Bankruptcy Court and District Court agreed, that CNB had the legal right to pursue the debt against the Fus without first exhausting any security or support for the indebtedness. (EA Vol. I, Tab 2, pg. 20, ll.1-10 at EA000028) But that finding is contrary to applicable law and not supported by the record. Although the Fus' guaranties were unconditional, this meant only that CNB could move against the guarantors without first proceeding against Galleria USA, Inc. (the primary obligor) or the collateral. But that does not obviate the statutory requirement that a secured creditor such as CNB "must use reasonable care in the custody and preservation of collateral in his possession." Cal. Comm. Code , § 9207, subd.

Cal. Comm. Code § 9601, *et seq*., governs defaults in the context of secured transactions, and § 9610 specifically deals with the disposition of collateral after default. *See* Cal. Comm. Code § 9610. "After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its possession …." Cal. Comm. Code § 9610(a); *see also Cerritos Valley Bank v. Stirling*, 81 Cal. App. 4th 1108, 1113 (2000). "Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings …." Cal. Comm. Code § 9610(b). A disposition of collateral is made in a commercially reasonable manner if the disposition satisfies any of the following conditions: "(1) It is made in the usual manner in a recognized market, (2) It is made at the price current in any recognized market at the time of disposition, [or] (3) It is made otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition." Cal. Comm. Code § 9627(b). The Fus, as "obligors" (i.e.,

guarantors) of GUSA's secured loans, were entitled to receive notice of the location and liquidation of CNB's collateral and to ensure that the collateral was located and sold in a commercially reasonable manner. Discovery in that regard could and would, Appellants believe, lead to disputed material facts justifying a trial. "Whether a disposition is commercially reasonable is generally a question of fact and depends on all of the circumstances existing at the time of the sale." *Bank of the Sierra v. Kallis*, 2006 U.S. Dist. LEXIS 88234, 24-33 (E.D. Cal. Dec. 6, 2006) (denying the bank creditor's motion for summary judgment on commercial reasonableness of sale of collateral in action against guarantor).

CNB, the Bankruptcy Court, and the District Court also erred on the efficacy of the Fus' surety defense waivers in their guaranty. Cal. Comm. Code § 9602 provides in pertinent part that "the debtor or obligor may not waive or vary the rules stated in the following listed sections," including the duty to collect and liquidate collateral in a commercially reasonable manner (*id.*, § 9607), the duty to apply noncash proceeds of collection or disposition in a commercially reasonable manner (*id.*, §§ 9608 and 9615), the duty to give an explanation of the calculation of a surplus or deficiency (*id.*, § 9616), the right to limitations on the effectiveness of certain waivers (*id.*, § 9624), and the right to hold a secured party liable for failure to comply with these obligations and limitations (*id.*, §§ 9625 and 9626).

Moreover, in all suretyship and guaranty relations, the creditor owes the surety a non-waivable duty of continuous good faith and fair dealing. *Sumitomo Bank of California v. Iwasaki*, 70 Cal.2d 81, 85 (1968). "Like the principal obligor, the guarantor has an interest in preventing collusive or commercially unreasonable sales of collateral, so as to minimize its liability on the obligation secured. " *Canadian Commercial Bank v. Ascher Findley Co.*, 229 Cal. App. 3d 1139, 1153 (1991)

CNB, as a secured creditor, also had a non-waivable duty "to reasonable care

in the custody and preservation of collateral in the secured party's possession." (Cal. Comm. Code § 9207). Under Section 9207(c)(2), "a secured party having possession of collateral or control of collateral . . . [s]hall apply money or funds received from the collateral to reduce the secured obligation." (Emphasis added.) That is what should have happened here. CNB's failure to do so constitutes a non-waivable and unjustifiable impairment of the collateral supporting the GUSA loan that the Fus guaranteed. The Fus were entitled to, but denied, discovery on these critical issues.

The Bankruptcy Court erred by accepting at face value the full 100% loss of principal and interest on the loans, and foisting those entire losses on the Fus as non-dischargeable liabilities, without permitting them to challenge the amount (and causes) of those purported losses. The Albert Rule 56(d) Declaration pointed out there was about $80 million in "landed cost" inventory when the same lenders (including CNB) ousted the Fus from the company in July 2009 that easily could have been, and should have been, sold for $100 million or more. In addition, GUSA's and GalleriaHK's remaining A/R should have been at least $30 million in October 2009. (EA Vol. V, Tab 32, ¶ 18 at EA000836-841). CNB and the other bank creditors never provided an accounting of what happened to all of the inventory (landed and in transit) and A/R. Rule 56(d) discovery should have been permitted in that regard. *See Zell v. Intercapital Income Securities, Inc*., 675 F.2d 1041 (9th Cir. 1982) (holding that granting summary judgment without permitting reasonable discovery was premature when the challenged information was not so unimportant as to be immaterial as a matter of law).

No exigency existed which required an expedited MSJ hearing and briefing schedule before the Rule 26 meeting of counsel and initial disclosures occurred under Fed. R. Bankr. Proc. 7026 and LBR 7026-1 et seq., before discovery was even permitted to commence, and before any scheduling order had been entered

under Fed. R. Bankr. Proc. 7016 and LBR 7016-1 et seq. *See Freeman v. ABC Legal Svc.*, 827 F. Supp.2d 1065, 1078 (N.D. Cal. 2011) (granting a Rule 56(d) motion where, as here, "no discovery ha[d] been conducted . . . , initial disclosures ha[d] not been exchanged, and a Rule 26([d]) discovery planning conference ha[d] not occurred.").

Discovery on the status and liquidation of the collateral for CNB's loans should have been permitted. The Bankruptcy Court and District Court erred in concluding that the Fus waived their right to ensure that the collateral for the loans they guaranteed was secured and monetized in a commercially reasonable manner to minimize their guaranteed obligations. *See Solfanelli v. Corestates Bank N.A.*, 203 F.3d 197, 202 (3d Cir. 2000) ("An Agreement provision attempting to expunge a commercial reasonableness requirement is per se 'manifestly unreasonable.'"). Accordingly, the Bankruptcy Court should have denied CNB's summary judgment without prejudice under Fed. R. Civ. P. 56(d) and *Burlington Northern*, 323 F.3d at 773-74. Once a scheduling order were entered under Rule 16, and adequate discovery and initial disclosures had occurred under Rule 26 and 56(d), CNB would have been able to a new summary judgment motion at that time, if warranted. *See Mazzetti v. Bellino*, 2014 U.S. Dist. LEXIS 116797 (E.D. Cal. Aug. 21, 2014).

B. THE BANKRUPTCY COURT ERRED WHEN IT DENIED APPELLANTS' RULE 15 MOTION FOR LEAVE TO AMEND THEIR *PRO SE* ANSWER

Leave to amend "is to be applied with extreme liberality." *Morongo Band of Mission Indians v. Rose*, 893 F.2d 1074, 1079 (9th Cir. 1990); *Foman v. David*, 371 U.S. 178, 182 (1962) (leave to amend should be "freely given") (upholding district court's order permitting amended answer to add affirmative defense). In considering a party's request for leave to amend, the Bankruptcy Court should consider whether the amendment would prejudice the opposing party, would cause

undue delay, is sought in bad faith, or would be futile. *Loehr v. Ventura County Community College Dist*., 743 F.2d 1310, 1319 (9th Cir. 1984) (citing the *Foman* factors). A correct analysis of the *Foman* factors in light of the record below shows that Appellants' Rule 15 Motion should have been granted.

1. The Bankruptcy Court's "Substantial Prejudice" Finding Was Not Supported By The Record

"Prejudice to the opposing party is the most important factor in deciding a motion for leave to amend under Rule 15." *Jackson v. Bank of Hawaii*, 902 F.2d 1385, 1387 (9th Cir. 1990)(internal citation omitted); *Howey v. United States*, 481 F.2d 1187, 1190 (9th Cir. 1973). "The party opposing amendment bears the burden of showing prejudice." *DCD Programs, Ltd. v. Leighton*, 833 F.2d 183, 188 (9th Cir. 1987) (noting that no prejudice from delay occurs when a is "still at the discovery stage with no trial date pending, nor has a pretrial conference been scheduled"). "Undue prejudice" means "substantial prejudice or substantial negative effect . . . ." *Hip Hop Beverage Corp. v. RIC Representacoes*, 220 F.R.D. 614, 622 (C.D. Cal. 2003).

An almost universal theme in the cases discussing "substantial prejudice" and "undue delay" for purposes of Rule 15 is that the need to reopen or engage in substantial new discovery near to the trial date are sufficient grounds to deny leave to amend. "A need to reopen discovery and therefore delay the proceedings supports a district court's finding of prejudice from a delayed motion to amend the complaint." *Lockheed Martin Corp. v. Network Solutions, Inc*., 194 F.3d 980, 986 (9th Cir. 1999) (internal citation omitted); *DCD Programs*, 833 F.2d at 188 (no prejudice from delay occurs when action is "still at the discovery stage with no trial date pending, nor has a pretrial conference been scheduled"); *IXYS Corp. v. Advanced Power Tech., Inc*., 2004 U.S. Dist. LEXIS 804 at *3 (N.D. Cal. Jan 22, 2004) ("[T]he need for a party to conduct supplemental discovery or to consider a

new line of legal argument are classic sources of prejudice that have regularly proven sufficient to defeat a motion for leave to amend.") Permitting a party to amend a pleading to add new claims would unduly prejudice the other party where the new claims "would have required [the opposing party] to have undertaken, at a late hour, an entirely new course of defense." *Morongo Band of Mission Indians*, 893 F.2d at 1079; *Jackson*, 902 F.2d at 1387-88.

Here, Appellee failed to carry its burden of demonstrating that "substantial prejudice" would be caused by the First Amended Answer, and the record did not support the Bankruptcy Court's finding in that regard, because the case was in its infancy procedurally, CNB was the culpable party in not providing the Rule 26 notice or initiating a Rule 26(f) conference, and discovery therefore had not even commenced under Rule 26(d).

The Bankruptcy Court also found that permitting the Fus to correct by amendment admissions that the Fus supposedly "freely made" in their pro se Answer would prejudice CNB by causing it to incur additional time and expense in defending the action. (EA Vol. III, Tab 20, EA000365-367). That finding also is illogical and not supported by the record.

For example, in support of its MSJ, CNB emphasized that that the Fus supposedly knowingly and voluntarily admitted in their pro se Answer to CNB's Complaint that had CNB known the truth, as admitted in the Fus' Plea Agreement, CNB would not have made any of the three loans that are the subject of the Complaint. (EA Vol. XIV, Tab 39, fn. 8 at EA003287; fn. 10 at EA003289; fn. 16 at EA003304.) to the record.

Mrs. Fu prepared the *pro se* Answer, without the benefit of counsel or legal assistance, while she and her husband were incarcerated in separate federal minimum security correctional facilities. (EA Vol. XIV, Tab 45) The Answer purports to admit Paragraph 53 in CNB's Complaint, which states as follows:

"Had CNB known, prior to making the CNB Loans, the facts as admitted by Cheri Fu and Thomas Fu in their guilty pleas, CNB would not have made any of the CNB Loans to Cheri Fu, Thomas Fu, GUSA, or any entity affiliated with them."

That purported admission was in error; an inadvertent mistake. That a lay, pro se, incarcerated defendant can be said to "freely make" admissions of complex legal and factual issues of which they have no knowledge or experience is farfetched.

That the admission was an innocent mistake inadvertently made which should be disregarded is shown by the fact that the Fus denied in the same Answer two other paragraphs in CNB's Complaint which were substantively identical to Paragraph 53 – Paragraphs 45 and 58. Paragraph 45, which the Fus denied, states as follows:

"CNB would not have made any of the CNB Loans, and would not have done business with Cheri Fu, Thomas Fu, GUSA, or any of the Galleria entities, had CNB known the truth about Defendants and the Galleria entities, as alleged herein."

(EA Vol. XIV, Tab 45 (Fu pro se Answer denying Paragraph 45) at EA003340; Tab. 48 at EA003355 (CNB Complaint ¶ 45).)

Paragraph 58, which the Fus also denied, states as follows:

"In carrying out their fraudulent scheme, the Debtors misrepresented and failed to disclose to CNB the true facts about their fraudulent business practices regarding the importation and sale of home decor items. Such misrepresented and omitted facts were material in that, had CNB known the true facts, it would not have entered into, extended credit, advanced funds or loaned money under any of the CNB Loans (including the BofA ABL Facility, the CNB Individual

Loan, and the CNB Facility)."

(EA Vol. XIV, Tab 45 (Fu pro se Answer denying Paragraph 58) at EA003340; Tab. 48 at EA003364 (CNB Complaint ¶ 58).)

While the Fus mistakenly admitted Paragraph 53 of CNB's Complaint, they at the same time denied the substantively identical factual allegations set forth in Paragraph 45 and Paragraph 58 of CNB's Complaint. That shows their true intent not to admit the central allegations on which CNB is basing its MSJ. The Bankruptcy Court's finding that the Fus' "freely made" an admission of allegations that they also twice denied must be set aside as illogical and lacking support in the record.

"A defendant will not be prejudiced when a court merely permits a plaintiff to proceed to adjudicate the action on the merits, when the plaintiff is proceeding on the same claims based on the same facts and discovery has not yet been completed." *Vanleeuwen v. Keyuan Petrochemicals, Inc.*, 2013 U.S. Dist. LEXIS 121976, 7-8 (C.D. Cal. Aug. 26, 2013). That discovery will be required regarding the Fus' affirmative defenses and the cause and amount of CNB's purported losses does not justify denial of leave to amend particularly when, as here, no discovery to date has occurred at all on those issues[3] and no pre-trial dates have even been set whatsoever. Requiring CNB to demonstrate what happened to all of the Galleria Accounts Receivable and inventory that collateralized the loans at issue so as to justify CNB's effort to impose a 100% loss on its loan on the Fus -- as if not a single penny's worth of collateral ever existed -- does not constitute "prejudice:" it is mandated by common sense and the interests of justice and due process.

[3] The Bankruptcy Court subsequently permitted very limited discovery on CNB's First and Second Claims for relief, which were the subject of a later, renewed MSJ which also was granted.

2. The Bankruptcy Court's "Undue Delay" Finding Was Not Supported By The Record

The Bankruptcy Court's finding of "undue delay" in seeking to amend the Fus' pro se Answer is illogical and not supported by the record. Appellants' proposed First Amended Answer not untimely given their *pro se* status, their prior lack of funds to hire an attorney, their incarceration, and the very preliminary stage of these proceedings. *See DCD Programs, Ltd.*, 833 F.2d at 187-88 (granting leave to amend where "case is still at the discovery stage with no trial date pending, nor has a pretrial conference been scheduled"); *Hip Hop Beverage Corp*, 220 F.R.D. at 620-621. The "undue delay" factor turns on "whether the moving party knew or should have known the facts and theories raised by the amendment in the original pleading." *AmerisourceBergen Corp. v. Dialysist West, Inc*., 465 F.3d 946, 954 (9th Cir. Ariz. 2006) (internal citations omitted); *Jackson*, 902 F.2d at 1388 (internal citations omitted).

It is error to deny leave to amend on grounds of undue delay when, as in this case, "there is a lack of prejudice to the opposing party and the amended complaint is obviously not frivolous, or made as a dilatory maneuver in bad faith." *United States v. Pend Oreille Pub. Util. Dist. No. 1*, 926 F.2d 1502, 1511 (9th Cir. 1991) (quoting *Howey v. United States*, 481 F.2d 1187, 1190-91 (9th Cir. 1973)). *See also Jiminez v. Sambrano*, 2009 U.S. Dist. LEXIS 28554, at *7-8 (S.D. Cal. Apr. 6, 2009) (finding that a plaintiff acted diligently in seeking leave to amend where the proposed new claim for damages was likely omitted from the original pleading due to plaintiff's former pro se status and lack of legal expertise).

The "undue delay" finding is illogical because the proper timeframe for assessing the timeliness of a proposed amendment is measured by the stage at which pre-trial and trial proceedings have progressed, not merely by how much time has passed since the filing of the original complaint. "[D]elay alone no matter

how lengthy is an insufficient ground for denial of leave to amend." *United States v. Webb*, 655 F.2d 977, 980 (9th Cir. 1981). "Undue delay" requires more than a large delay in time, but also prejudice or bad faith involved in the delay. *Webb*, 655 F.2d at 980. Indeed, *Webb* cites with approval precedent where amended pleadings sought to be filed five years after the original pleadings were not unduly delayed because they were made without prejudice or bad faith. *Id*. (citing, inter alia, *Howey v. United States*, 481 F.2d 1187, 1191 (9th Cir. 1973).

3. The Bankruptcy Court's "Bad Faith" Finding Was Not Supported By The Record

The Bankruptcy Court indicated that the timing of Appellants' Rule 15 Motion – 13 months after the CNB Action had commenced and in response to CNB's MSJ – was suggestive of "bad faith." (EA Vol. III, Tab 12 at EA000281.) But the Bankruptcy Court failed to apply the correct standard for determining bad faith. To overcome the extremely liberal standard of allowing amendment based on a party's alleged bad faith, the non-moving party must show extreme "sharp practice" tactics, not merely an attempt by the moving party to adjudicate the case fully and fairly on its merits. *Sorofsky v. Burroughs Corp*., 826 F.2d 794, 805 (9th Cir. 1987) (bad faith existed where the reason to add a defendant was to destroy diversity); *SAES Getters S.p.A. v. Aeronex, Inc*., 219 F. Supp. 2d 1081, 1095 (S.D. Cal. 2002) ("To oppose a motion for leave to amend on grounds of bad faith, a party must show 'sharp practice' tactics such as, for example, seeking to add a defendant merely to destroy diversity jurisdiction."). No such "sharp" practices or tactics were present here, and none were cited or established in the record.

4. Appellants' Proposed Amendments Were Not Futile

The burden for denying leave to amend on the basis of futility is a heavy one: to establish that there is "no set of facts" under which the amendments would give rise to "a valid and sufficient claim or defense." *Miller v. Rykoff-Sexton, Inc*.,

845 F.2d 209, 214 (9th Cir. 1988). CNB failed to meet that burden and the record does not support a Bankruptcy Court finding of futility.

(a) Failure To Mitigate Damages

The Fus' Rule 56(d) motion for discovery was based in large part on the Albert Rule 56(d) Declaration detailing the extent to which CNB's losses were in fact the result, not of any wrongdoing by the Fus, but instead the conduct of CNB itself and the other banks with which it was associated in funding the Galleria Group and their failure to properly locate and monetize the collateral for the loans in a commercially reasonable manner. (EA Vol. V, Tab 32, ¶ 18 at EA000836-841). Neither CNB nor the Bankruptcy Court refuted that Rule 56(d) showing. This Court should reverse the denial of leave to amend the Answer in order to allow the Fus to prove that CNB should not be able to charge them with the whole of its losses as a non-dischargeable debt given their non-waivable responsibilities as secured creditors under Article 9 of the Uniform Commercial Code.

(b) Lack of Standing

In its Complaint against the Fus, which forms the basis for Judgments Nos. 1 and 2 entered against the Fus, CNB alleges that it brings this Action "as lender, for its own benefit and for the benefit of the participant banks." (EA Vol XIV, Tab 47, at EA003350). But CNB lacks standing to sue the Fus under the CNB Facility with respect to the vast majority of the loan which was paid by non-party "participant banks" because the applicable Participation Agreement provides that "CNB is neither an agent nor a trustee of any Participant" is neither an agent nor a trustee of any Participant." (EA Vol. IX, Tab 36 at EA002114).

Although the Participation Agreement was entered into after the CNB's Letter of Credit Facility, the fact remains that, after CNB sold interests in the CNB Letter of Credit Facility to the other Participant Banks, CNB's remaining participation share in the CNB Facility was only 15.38%, *i.e.*, $5 million. CNB, in

its Complaint, does not allege that it is the assignee of the participant banks or otherwise set forth a valid basis to establish its standing to assert breach of contract or Section 523 discharge claims on their behalf with respect to the Participant Banks' 84.62% participating interests in the Facility. So CNB's allegations about its ability to assert claims "for the benefit of" participating banks in the CNB Facility (EA Vol. XIV, Tab 47, at EA003350) must be rejected. CNB already had received $20 million from the other Participant Banks and it therefore lacked standing to seek $20 million of the damages awarded in its favor. The $35 million nondischargeable summary judgment against the Fus should be vacated on that basis.

(c) CNB's Claims Are Subject To Binding Arbitration

CNB's claims were and are arbitrable. Section 10.2.1 of CNB Facility - entitled "Mandatory Arbitration," contains an extremely broad arbitration provision that encompasses and controls CNB's claims against Appellants in the CNB Adversary Proceeding. (EA Vol. IX, Tab 36, at EA002093.) Similarly, Section 16.14.1 of the Participation Agreement, entitled "Mandatory Arbitration," contains a similarly broad arbitration provision. (EA Vol. IX, Tab 36, at EA002122.) Arbitration provisions are required to be enforced in bankruptcy court. "The Federal Arbitration Act ("FAA"), see 9 U.S.C. §§ 1 et seq., requires a federal court to enforce arbitration agreements and to stay litigation that contravenes them." *Burns v. New York Life Ins. Co*., 202 F.3d 616, 620 (2d Cir. 2000). The FAA "affords no latitude for discretion," and "arbitration is indicated unless it can be said `with positive assurance' that an arbitration clause is not susceptible to an interpretation that covers the asserted dispute." *Id*. at 620. Bankruptcy judges do not have discretion to refuse to compel or to stay arbitration of non-core matters. *See MCI Telecomm. Corp. v. Gurga (In re Gurga)*, 176 B.R. 196 (9th Cir. BAP 1994) (bankruptcy court lacks discretion to stay arbitration of a non-core dispute).

Even as to core proceedings, "the bankruptcy court will not have discretion to override an arbitration agreement unless it finds that the proceedings are based on provisions of the Bankruptcy Code that 'inherently conflict' with the Arbitration Act or that arbitration of the claim would 'necessarily jeopardize' the objectives of the Bankruptcy Code." *Id*. *See also Mor-Ben Ins. Mkts. Corp. v. Trident Gen. Ins. Co., Ltd. (In re Mor-Ben Ins. Mkts. Corp.)*, 73 B.R. 644, 649, (9th Cir. BAP 1987) (affirming a bankruptcy court's orders staying bankruptcy proceedings in favor of arbitration). The Fus should have been permitted to pursue arbitration.

The Fus' status as guarantors (referenced throughout both Agreements) creates the kind of "close relationship" with CNB as signatory to the arbitration provisions in the other agreements such that CNB is equitably estopped from resisting "the nonsignatory's [the Fus] insistence" on arbitration. *Comer v. Micor, Inc*., 436 F.3d 1098, 1101 (9th Cir. 2006), quoting *E.I. DuPont de Nemours & Co. v. Rhone Poulenc Fiber & Resin Intermediates*, 269 F.3d 187, 199 (3d Cir. 2001). This Affirmative Defense is not futile and should have required arbitration of CNB's state law contract claims.

(d) Appellants' Other Affirmative Defenses

In their Rule 15 opening and reply briefs (EA Vol. V, Tab. 31, Vol. III, Tab 24), Appellants showed that their other, related Affirmative Defenses also were not futile because it was more than merely possible that a "set of facts can be proved under the amendment to the pleadings that would constitute a valid and sufficient claim or defense." *See Miller v. Rykoff-Sexton, Inc.,* 845 F.2d 209, 214 (9th Cir. 1988). It was error for the Bankruptcy Court to preclude Appellants from asserting any defenses to CNB's conclusory claims by denying the Fus leave to amend their pro se Answer.

C. THE BANKRUPTCY COURT ERRED WHEN IT DENIED APPELLANTS' RULE 14 MOTION FOR LEAVE TO FILE A THIRD PARTY INDEMNITY COMPLAINT

Rule 14 "is construed liberally in favor of allowing impleader." *FDIC v. Loube*, 134 F.R.D. 270, 272 (N.D. Cal. 1991). A court "should allow impleader on any colorable claim of derivative liability that will not unduly delay or otherwise prejudice the ongoing proceedings." *Lehman v. Revolution Portfolio LLC*, 166 F.3d 389, 393 (1st Cir. 1999). A third party complaint is proper "if under some construction of facts which might be adduced at trial, recovery might be possible." *Banks v. Emeryville*, 109 F.R.D. 535, 540 (N.D. Cal. 1985).

Courts are supposed to construe secondary liability broadly, allowing joint tortfeasors to be added to the case "on any colorable claim." *See, e.g., United States v. One 1977 Mercedes Benz*, 708 F.2d 444, 452 (9th Cir. 1983). In the proposed Third Party Complaint, the Fus seek to hold BofA, Wachovia, and Wells Fargo secondarily liable under the doctrine of equitable indemnity in proportion to their comparative fault in causing the collapse of the Galleria group of companies and thereafter failing to mitigate their damages (including but not limited to failing to collect and monetize GUSA collateral in a commercially reasonable manner), all of which were a substantial factor contributing to CNB's losses. As such, the third-party action against these banks is dependent upon the outcome of the underlying CNB Action, making impleader under Rule 14 proper.

In its ruling denying Appellants' Rule 14 impleader Motion, the Bankruptcy Court stated that the proposed Third Party Complaint was brought "quite late" and would "unduly complicate the issues in this trial." But the problem here is that there was no trial permitted at all. The Motion was not brought "quite late" because no discovery had occurred or was permitted to occur because no Rule 26(f) meeting had taken place and no other pre-trial or trial dates had been sent. Trial delay is "unlikely" where discovery remains in its early stages. *Press*

Rentals, Inc. v. Genesis Fluid Solutions, Ltd., 2011 U.S. Dist. LEXIS 132405, at *3-4 (N.D. Cal. Nov. 16, 2011); *see also Haehn v. Jetblue Airways Corp*., 2012 U.S. Dist. LEXIS 93817, at *3 (C.D. Cal. July 6, 2012) (a case may still be in its early stages with only "five months remaining for discovery."). Because a trial date has not yet been set, any suggested delay in trial is mere speculation. The "undue delay" and "unduly complicate" findings are illogical and not supported by the record.

The Bankruptcy Court's statement that "The third party complaint discusses issues from over two years before the issues with CNB arose, and thus would require substantially more discovery, witnesses at trial, and general time needed in preparation" (EA Vol. III, Tab. 20, at EA000284-285) also is incorrect insofar as the Fus' Third Party Complaint primarily focuses on the representations and omissions of BofA leading up to the May 2008 $130 million BofA ABL facility that is the very subject of CNB's First and Second Claims for Relief. Where the issues in the plaintiff's complaint and the third-party pleadings are sufficiently intertwined that the focus of the trial will remain on the cause of the plaintiff's injuries, and the third-party defendant will likely participate in discovery regardless of whether impleader is permitted, denial of leave to file a third-party complaint under Rule 14 is inappropriate. *See Haehn v. JetBlue Airways Corp*., *supra*; *Universal Green Solutions, LLC v. VII Pac Shores Investors, LLC*, 2013 WL 5272917, at *2 (N.D. Cal. Sept. 18, 2013) (stating that plaintiff will not suffer prejudice because third-party defendant "will likely participate in further discovery regardless of whether impleader is permitted."); *F.D.I.C. v. Varrasso*, No. CIV. 2:11-2628 WBS, 2012 WL 5199147, at *2-3 (E.D. Cal. Oct. 19, 2012) (holding that the third-party complaint "will not complicate issues at trial, but rather will promote judicial efficiency, as it will eliminate the need for [defendants] to bring a separate action against the proposed third-party defendants. . ..").

The Best Ascent action in Orange County Superior Court (EA Vol. IV, Tab 30, at EA000658-692) is substantively and practically very different from the Fus' proposed indemnity claims asserted in the Third Party Complaint. It is no substitute for indemnity relief. The Fus are not even parties to that action. Best Ascent, as assignee, brings affirmative claims for relief seeking monetary damages from the banks. The results of that action could not reduce the Fus' liability to CNB in this lawsuit; but the impact of the Third Party Complaint could do so.

That is because the Fus' Rule 14 indemnity claims, while based on many of the same facts as the Best Ascent action, seek to impose secondary and derivative liability on the Third Party Banks vis-à-vis CNB, based on the their proportionate share of responsibility vis-à-vis CNB. If Best Ascent were to lose its case against BofA, Wells Fargo, and Wachovia in the state court Best Ascent action, that result would have no collateral estoppel or res judicata effect on the Fus' indemnity claims in the CNB Action because the Fus are not parties to the Best Ascent action and the claims are distinct and different (direct vs. derivative). Conversely, resolution the third party indemnity claims in the CNB Action would be binding as a matter of collateral estoppel or res judicata on the Fus and the Banks. That would promote judicial efficiency. It was error to deny Appellants' Rule 14 Motion, which should be "'freely granted to promote . . . efficiency." *FMC Corp. v. Vendo Co*., 196 F. Supp. 2d 1023, 1038 (E.D. Cal. 2002) (quotation omitted).

VIII. CONCLUSION

For the foregoing reasons, the Court should vacate the Judgments entered by the Bankruptcy Court and remand the matter with instruction that the Bankruptcy Court enter new and different orders denying CNB's MSJ without prejudice, permitting Appellants to conduct reasonable discovery regarding the causes and amounts of CNB's alleged losses under Rule 56(d), and granting Appellants' Motions under Rule 14 and Rule 15.

DATED: April 12, 2016 MARK ANCHOR ALBERT & ASSOCIATES

By: s/Mark Anchor Albert
Mark Anchor Albert
Attorneys for Debtors, Defendants, and Appellants Cheri Fu and the Estate of Thomas Fu, deceased

STATEMENT OF RELATED CASES

Pursuant to Ninth Circuit Rule 28-2.6, Appellants state that to the best of their knowledge there are no other cases pending in this Court that (a) arise out of the same or consolidated cases in the district court or agency; (b) are cases previously heard in this Court which concern the case being briefed; (c) raise the same or closely related issues; or (d) involve the same transaction or event.

DATED: April 12, 2016 MARK ANCHOR ALBERT & ASSOCIATES

By: s/Mark Anchor Albert
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CERTIFICATE OF COMPLIANCE PURSUANT TO FED. R. APP. P. 32(a)(7)(C) AND CIRCUIT RULE 32-1 FOR CASE NO. 15-56800

I certify, pursuant to Fed. R. App. P. 32(a)(7)(C) and Circuit Rule 32-1, that this brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 11,075 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

DATED: April 12, 2016 MARK ANCHOR ALBERT & ASSOCIATES

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