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' REPLY BRIEF

On Appeal From Order Of U.S. District Court, C.D. Cal., So. Div., in Case No. 8:15-cv-00676-CJC, Affirming Partial Summary Judgments Entered By Hon. Theodor Albert, U.S. Bankruptcy Court, C.D. Cal., So. Div., 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)

MARK ANCHOR ALBERT & ASSOCIATES
Mark Anchor Albert, State Bar No. 137027
albert@LAlitigators.com
Jason W. Rothman, State Bar No. 304961
rothman@LAlitigators
633 West 5th Street, Suite 2600
Los Angeles, California 90071
Telephone: (213) 223-2151
Facsimile: (213) 223-2154

Attorneys for Debtors, Defendants, and Appellants
CHERI FU and the Estate of THOMAS FU, deceased

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I. SUMMARY OF ARGUMENT

In Appellee's Brief ("AB"), CNB says that the Fus improperly seek "another chance to engage in discovery, another chance to assert new defenses, and another chance to sue other banks" (AB at 4), all of which CNB claims "is entirely beside the point as well as entirely misguided" because "the CNB Action is over from a trial court perspective, and new claims will simply open up a futile second action." (AB at 45.) But the Fus seek appellate relief precisely because they were unjustly denied a first chance to engage in discovery, to amend their *pro se* answer to assert meritorious defenses, and to assert third party claims against creditors sharing liability for CNB's alleged losses. Similarly, the Fus are not seeking to assert "new defenses" (AB at 36) in a "second action," as they were denied leave to assert *any* defenses in this lawsuit.

CNB blames the *pro se* incarcerated Fus for not commencing discovery earlier. But it was CNB, not the Fus, which failed to fulfill its Fed. R. Civ. Proc., Rule 26[1] notice obligation as the creditor/plaintiff under LBR-7026-a(1), even though CNB's lawsuit was not exempt from Rule 26 notice, early meeting, and initial disclosure requirements under Rule 26(a)(1)(B)(iv). CNB failed to seek relief from its Rule 26 requirements by court order or stipulation. Discovery therefore was not permitted under Rule 26(d). CNB then neglected to attempt other means to contact the Fus in prison (by email, telephone, or in person), and its unilateral status reports did not purport to request an early meeting with the Fus or to provide any initial disclosures. CNB thereafter failed to serve the due-process-required *Rand* notice on the Fus before CNB improperly served the Fus with its motion for summary judgment. All of these procedural and substantive failures

[1] Unless otherwise noted, all future references to "Rules" refer to the Federal Rules of Civil Procedure.

deprived the *pro se* incarcerated Fus of a fair opportunity to mount a defense to CNB's claim that the Fus were liable for 100% of GUSA's CNB loans, as if not one cent of collateral ever existed for the 100% secured loans.

To deflect attention from its material errors which undermined the Fus' ability to mount a meaningful defense to its claims, CNB refers time and again to the Fus' "criminal convictions" (AB at 2) as "felons" (*id.* at 35) for "stealing tens of millions of dollars" (*id.* at 1). CNB's suggests that, as "admitted" criminals, the Fus deserved whatever treatment they got from the Bankruptcy Court, however punitive. However, conviction of crime cannot diminish a party's right to due process in civil proceedings.

To depict the Fus as unsympathetic evildoers, CNB misstates the scope and extent of the Fus' admitted misconduct in order to justify the deprivation of due process and procedural fairness for the Fus in the proceedings below. Contrary to CNB's statements, the Fus did not admit to stealing "tens of millions of dollars." (AB at 1.) The Fus' Plea Agreements were narrowly cabined and involved over-borrowing on a secured line of credit with Bank of America in the total amount of $4.7 million. (ER Vol. V at EA000927, ll.5-10.)[2] That money was used to pay off another line of credit with Bank of America. After spending millions in attorneys' fees and costs, the U.S. Trustee and Chapter 11 Trustee failed to adduce any evidence that the Fus personally pocketed even one stolen dollar; and no fraudulent conveyance actions were ever filed against them or anyone else.

In the Fus' criminal case, CNB and the other bank creditors – led by Bank of America (BofA) – argued that the Fus' Plea Agreements amounted to an admission that they were singularly to blame for the creditor banks' entire $229 million in

[2] Plea agreements must "honestly reflect the totality and seriousness of the defendant's conduct." (*See* http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/27mcrm.htm.)

alleged losses – instead of the $4.7 million loss which the Fus actually admitted to in the Plea Agreement. District Judge Cormac Carney (who presided over the Fus' criminal case) was not swayed:

> YOU [THE BANK CREDITORS] HAVE INDICATED HUNDREDS OF MILLIONS IN LOSS. THE EVIDENCE THAT I CAN RELY ON, THAT'S BEFORE ME, IS ONLY WHAT IS SPECIFIC AND CLEAR IN THE PLEA AGREEMENT, AND THE ONLY LOSS THAT IS IN THE PLEA AGREEMENT IS THE $4.7 MILLION. I CAN'T GO ON AND RELY ON YOUR WORD BECAUSE WHAT YOU ARE SAYING TO ME IS NOT EVIDENCE. AND I DON'T HAVE THE EVIDENCE BEFORE ME TO SUGGEST THAT THE LOSS IS $129, $229 MILLION.

(ER Vol. V at EA000923, ll. 5-11.)

Judge Carney was similarly unimpressed with the CNB's related argument that the Fus engaged in long-term financial fraud and that the Galleria companies were some kind of elaborate Ponzi scheme since at least 2001:

> THIS WAS NOT A FRAUD FROM THE ONSET, IN MANY CASES, THE FRAUD CASES I SEE IS YOU HAVE VERY VULNERABLE VICTIMS THAT ARE SENIOR CITIZENS, PEOPLE WHO HAVE INVESTED THEIR LIFE SAVINGS AND IT'S A FRAUD AT THE INCEPTION. IT'S A PONZI SCHEME. YOU ARE JUST RIPPING THESE PEOPLE OFF.
> FROM WHAT I COULD GATHER, THIS WAS A VERY SUCCESSFUL BUSINESS FOR YEARS. IT CAME ON DIFFICULT FINANCIAL TIMES AND UNFORTUNATELY, AND TRAGICALLY, MS. FU GAVE IN TO THE ECONOMIC PRESSURE AND LIED.

(ER Vol. V at EA000956, ll.10-19.)

The Fus are much more sympathetic human beings deserving of leniency, in contrast to the evil portraiture painted by CNB, depicting them as "felons," "perjurers," and "thieves." As Judge Carney found:

> MS. FU IS A GOOD PERSON. SHE DID A BAD THING, BUT SHE IS A GOOD PERSON, AND SHE JUST HAD A MOMENT OF FAILURE, UNFORTUNATELY, OVER A SEVERAL-MONTH PERIOD AND, UNFORTUNATELY, A MULTI-MILLION DOLLAR FAILURE.

(ER Vol. V at EA000958, ll.2-6.)

In addition to its distortions of the factual record, CNB also misstates applicable law. As shown in Appellants' Opening Brief (and in the Fus' briefs in the proceedings below), Ninth Circuit precedents require that incarcerated defendants be given special consideration to compensate for the difficulties they will necessarily encounter litigating behind bars.

CNB asks this Court, in effect, to countenance the upending of the extremely liberal standards of review under Rule 14 (third party practice), Rule 15 (amended answers) and Rule 56(d) (continuances to permit adequate summary judgment discovery) based on the Fus' admitted criminal conduct. In CNB's alternative procedural universe, inadvertent admissions by a *pro se* incarcerated defendant are "freely made" and particularly damning, rather than liberally excused; "prejudice" results from having to respond to legitimate and good faith defenses rather than from railroading incarcerated defendants into responding on shortened notice to an improperly-served $40 million motion for summary judgment without any discovery; and purported judicial economy trumps fundamental fairness, due process, and the policy favoring dispute resolution on the merits.

CNB claims that the Fus "were afforded every opportunity to engage in

discovery and respond to CNB's arguments, but failed to do so" (AB at 7) and "received more process and more opportunity for discovery than they were due." (AB at 9 [initial caps removed].) In support of these contentions, CNB argues, without citation to authority, that its mailing of unilateral status reports to the *pro se*, incarcerated Fus -- which stated that CNB supposedly was unable to contact the Fus under Fed. R. Civ. Proc. 26 and that is intended to move for summary judgment without conducting any discovery based on the Fus' Plea Agreements and criminal convictions [ER Vol. XIV, Tab 40-44] -- somehow absolved CNB of its own Rule 26 notice, meeting, and initial disclosure requirements. CNB's provision of unilateral status reports somehow was sufficient, it claims, to shift the burden onto the Fus to seek relief from Rule 26's requirements so as to commence the discovery process themselves without an early meeting or initial disclosures.

But that also is not the law.

Instead, Appellee is asking this Court to create new law absolving a plaintiff creditor from compliance with Rule 26 and LBR 7026-1(a) without a stipulation or court order when the plaintiff creditor makes unilateral status reports that it is having difficulty meeting with the *pro se* debtor defendant for Rule 26 purposes and intends to make a discovery-free motion for summary judgment against the debtor defendant. That would establish a terrible precedent.

When, as here, a creditor plaintiff sues incarcerated debtor defendants (especially *pro se* non-lawyer inmates), this Court should insist upon strict compliance with (i) the rules requiring that the creditor plaintiff provide the requisite Rule 26 notices to the debtor defendants with the summons on plaintiff's complaint under LBR 7026-1(a), (ii) the rules requiring service of the *Rand* notice before any summary judgment motion is filed and served, and (iii) the rules requiring an early meeting of counsel and initial disclosures before discovery is permitted or a stipulation or court order relieving the parties from their Rule 26

obligations. (*Cf.* Rule 26(a)(1)(A) & (B) (exempting from Rule 26's requirements actions brought by *pro se* incarcerated plaintiffs).)

CNB has failed to cite any published decision, in any district court or Circuit Court of Appeal nationwide in which a contested summary judgment motion was granted when the case was in its most incipient procedural stage, before any Rule 26 meeting or disclosures occurred, before any Rule 16 scheduling order was entered or any pre-trial or trial dates set, and before any discovery took place or was even permitted to occur. Evidently, no such precedent exists; and this Court should decline to create such an unwise precedent under the facts of this case.

Secured creditors should not be permitted to railroad *pro se* incarcerated debtor defendants into responding to discovery-less, improperly-served summary judgment motions based on defense waivers in the debtors' personal guarantees. Secured creditor are not absolved of their duty to mitigate their damages and guarantors are not stripped of their right to discovery on the location and liquidation of the security for their guaranteed obligations simply because the creditors place the primary borrowers into involuntary bankruptcy. *See Ctr. Capital Corp. v. Eagle Jet Aviation, Inc.*, 2010 U.S. Dist. LEXIS 38683 (D. Nev. Apr. 20, 2010) (denying summary judgment for secured creditor on guarantor's liability for secured creditor's failure to establish it mitigated its damages as to collateral).

II. ARGUMENT

A. Reversal Is Warranted Under *Burlington Northern Santa Fe. R. Co. v. The Assiniboine*, 323 F.3d 767 (9th Cir. 2003) Because The Fus Never Had A "Realistic Opportunity" To Conduct Discovery

CNB argues that the Fus had ample opportunity to conduct discovery before it filed is summary judgment motion (AB at 11-12), and that the discovery requested would have made no difference. CNB also argues that the Fus were not entitled to discovery on the issue of the true extent and causes of CNB's losses in

order to respond effectively to CNB's summary judgment motion, because CNB was allowed to sue the Fus on their guarantees without proceeding first against the collateral securing the loans the Fus guaranteed. (AB at 5-6.) Citing to the District Court, CNB also argues that "the lack of discovery was 'not because [the Fus] did not have the opportunity. It is largely because they did not avail themselves of the opportunity earlier.'" (AB at 12 [citing ER Vol. I, Tab 2, at EA000017]). CNB is wrong all counts.

These arguments improperly discount the fact that the Fus were at critical times incarcerated and without representation in this case. CNB finds justification for that approach in cases which hold that the unrepresented and incarcerated are subject to the same rules as other litigants. *King v. Atiyeh*, 814 F.2d 565, 567 (9th Cir. 1987); *Ghazali v. Moran*, 46 F.3d 52, 54 (9th Cir. 1995); *Sanchez v. Rodriguez*, 298 F.R.D. 460, 470 (C.D. Cal. 2014). (AB at 15.) Yet these cases simply hold that *pro se* litigants can no more willfully violate the rules than others.

Rather, the issue here is how *pro se* incarcerated defendants should be treated when seeking relief under Rule 56(d) in order to obtain discovery before summary judgment hearing. The answer, as shown by the authority cited in the Opening Brief, is that they deserve greater lenience than others. *Jones v. Blanas*, 393 F.3d 918, 930 (9th Cir. Cal. 2004); *Klingele v. Eikenberry*, 849 F.2d 409, 412 (9th Cir. 1988); *Lucas v. Silva*, 2011 U.S. Dist. LEXIS 23651, 7-8 (N.D. Cal. Feb. 22, 2011).

The point is that litigants should have a "realistic opportunity to pursue discovery relating to its theory of the case..." before summary judgment. *Burlington Northern Santa Fe R. Co. v. The Assiniboine*, 323 F.3d 767, 774 (9th Cir. 2003). And, it is not realistic to expect people like the Fus to initiate Rule 26 meetings on their own so as to commence discovery while incarcerated and representing themselves, especially when the creditor plaintiff fails to serve them

with the Rule 26 notice required under LBR-7026-1(a). 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.

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. The Bankruptcy Court abused its discretion in doing so under *Burlington*.

CNB's unilateral status reports did not purport to initiate Rule 26 meetings with the Fus, did not request such a meeting, and instead said CNB was unable to contact the Fus when CNB simply failed to avail itself of the various different ways in which it could do so. It was error to blame the Fus for supposedly failing to avail themselves of the right to conduct discovery when the failure to commence the discovery process falls squarely at the feet of CNB, which violated its Rule 26 obligations. CNB never sought a court order waiving its Rule 26 notice, meeting, and disclosure requirements, nor did it request or obtain a stipulation in that regard from the Fus, or from its former counsel, or from its current counsel.

B. CNB's Service Of Its Summary Judgment Motion Was Defective, Leaving The Fus Inadequate Time To Mount A Defense

The Fus showed in the Opening Brief that service of CNB's summary judgment motion was defective, leaving them with only a few days in which to prepare opposition to it, rather than the 42 days provided by the rules. In response, CNB blames the delay on the Fus, and insists that they nevertheless had enough time to proceed because CNB served its motion on their counsel in the related U.S. Trustee action, even though he was not counsel of record in the CNB

action. (AB at 8.)

The Bankruptcy Court and District Court found that the delay was the Fus' own fault, because they should have updated their current federal prison addresses with the Bankruptcy Court. This stance callously disregards the difficulties the Fus faced in prison, as most painfully illustrated by Mr. Fu's death of heart failure shortly after being released to a half-way house. It also improperly applies a strict standard rather than the lenient one required by law. *See Cal. Writer's Club v. Sonders*, 2011 U.S. Dist. LEXIS 113699 (N.D. Cal. Oct. 3, 2011) ("Courts have routinely held that *pro se* parties should be afforded special leniency with respect to procedural matters"); *Hughes v. Rowe*, 449 U.S. 5, 9 (1980) (discussing less stringent pleading standard applicable to pro se litigants); *Draper v. Coombs*, 792 F.2d 915, 924 (9th Cir. 1986) (affording pro se litigant leniency with regard to compliance with local rules and civil rules of procedure pertaining to discovery matters); *Moore v. Agency for Intern. Dev.*, 994 F.2d 874, 876 (D.C. Cir. 1993) (discussing leniency to be afforded to pro se litigants in procedural matters such as service of process). The rule of leniency applies with special force when, as here, the *pro se* litigants are incarcerated. *Jones v. Blanas*, 393 F.3d at 930; *Klingele v. Eikenberry*, 849 F.2d at 412.

CNB further contends that the Fus were properly served through counsel. They do so on the basis that the Fus present counsel here was served while he was representing them in the U.S. Trustee adversary proceeding, and after he had "generally appeared" at a status conference in this matter in early September, 2014 (AB at 25). Service on counsel was equivalent to service on the Fus, CNB contends, because the September appearance raised a presumption that he was representing the Fus at the time he was served (*Id*. at 25).

But is not what happened and that was not the Bankruptcy Court's conclusion. Counsel did not "generally appear" as counsel for the Fus at the CNB

status conference; he informed the Bankruptcy Court that he had not yet been retained in that action. Counsel stated in his declaration that he was not officially retained in this action until early November, 2014 (*see* ER Vol. V, Tab 32, at EA000832, ¶6). And the Bankruptcy Court confirmed that statement. In particular, the Bankruptcy Court did not adopt CNB's view that counsel represented the Fus at the time of service, making it service on the Fus as a matter of law. Rather, it opined that "the Fus essentially did have effective notice since their soon to be counsel was also served." (ER Vol. I, Tab 2 at EA000044)

The Bankruptcy Court's finding that service was on "soon to be counsel" was a refutation of any presumption that such service could be identical to service on the Fus as a matter of law. In fact, it establishes that service on counsel was, as a matter of law, not proper.

Beyond the fact that timely proper service was not accomplished in accordance with law, there is the question of whether, as a matter of due process and fairness, the notice the Fus did in fact receive once they had retained counsel in this matter was adequate to allow preparation of an effective response. CNB contends that it was, pointing out that, despite the shortness of time, the Fus' counsel produced a substantial body of pleadings in response to its motion. The fact that counsel did the best they could, however, cannot justify depriving them of the far more extensive time which, according to the rules, they had a right. That is all the more clear given the difficulties counsel had in meeting and communicating with the Fus.[3] (ER Vol. 5, Tab 32 at EA0000834, ¶ 11)

[3] These logistical difficulties do not excuse CNB from its Rule 26 notice, early meeting, and disclosure requirements. If CNB wanted to be relieved from its Rule 26 obligations, it was required to seek a court order or stipulation to do so.

C. The Discovery The Fus Sought And Was Denied Was Not Futile And Would Have Made A Difference

The Fus' Rule 56(d) motion and supporting Declaration of Mark Anchor Albert (the "Albert Rule 56(d) Decl.") more than adequately detailed the need for discovery on the true extent and causes of CNB's losses, the failure of CNB to reasonably mitigate its losses, the status of the collateral for the GUSA loans that the Fus guaranteed and any unreasonable impairment of that collateral, and to establish that the Fus' conduct did not cause CNB to lose the whole amount due it on the loans. CNB's arguments to the contrary are mistaken.

CNB contends that facts showing that their losses would have been less but for their own actions or those of other banks, were irrelevant to the summary judgments because CNB was entitled to sue on the Fus' guarantees without first foreclosing on the collateral. (AB at 9, 16 .) But that is beside the point. 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. None of the Fus' waivers in their guarantees obviated CNB's obligations to exercise commercial reasonableness when pursuing its guarantees and the collateral securing the primary guaranteed obligations, or obviated CNB's obligation to avoid any unreasonable impairment of that collateral, or obviated CNB's hornbook obligation to mitigate its damages.

CNB responds to the Fus' specific showing of the need for discovery regarding the collateral which should have gone to repay the loans by referring to the large report by the GUSA trustee which reported the results of the investigation he conducted in an effort to collect GUSA's assets and his motion for bankruptcy court approval for the disposition of GUSA inventory, and the Order thereon. (AB at 10-11.)

However, this bulking mass of material provides no basis for CNB's underlying assumption that the Trustee's report could not be supplemented or challenged by new evidence obtained through discovery, or that additional collateral either was not located or was undervalued prior to the appointment of the Trustee, when the Chief Reorganization Officer, John Pelton, was in control of GUSA in consultation with CNB and the other bank creditors (ER Vol. VI, Tab 35, at EA001218) and later when the banks' receiver, Jeffrey Granger, was appointed. (ER Vol. VI, Tab 35, at EA001219.)

Generally, an action or omission by the creditor in breach of an obligation to the guarantor, which injures the guarantor's rights, discharges the guarantor. *See S.&S. Builders, Inc. v. Di Mondi*, 126 A.2d 826, 830 (Del. 1956) (a guarantor may be released from his obligations when the guarantor's position changes to a disadvantage as a result of the creditor's mistaken advice about the debt he guaranteed). Guarantors have the same rights vis-à-vis lenders as principal debtors when it comes to disposition of collateral.

CNB's supposed exemption from its responsibility as a secured creditor to exercise commercially reasonable efforts to secure and monetize the collateral for the loans the Fus guaranteed misses the mark. The essential point here is that CNB and the Courts below concluded -- mistakenly and reversibly -- that the defense waivers in the Fus' guarantees rendered irrelevant any discovery about the status of the collateral, CNB's efforts, if any, to mitigate its losses with respect to the collateral, and the responsibility of other creditors for CNB's losses. The anti-waiver provisions of Cal. Comm. Code § 9602 apply to all secured creditors, whether they have actual possession of the collateral or not. "A plaintiff claiming damages must do everything reasonably possible to mitigate his loss, and cannot recover for harm that was reasonably foreseeable and avoidable." *Roberts v. Lomanto*, 112 Cal. App. 4th 1553, 1569 (2003).

Nor was this mitigation issue raised for the first time on appeal. Proposed discovery on the Fus' proposed Affirmative Defense alleging that CNB failed to adequately mitigate its losses all turned on the issue of the location, value, and monetization of the GUSA collateral securing the loans the Fus guaranteed. (ER Vol. V, Tab 33 at EA000991, ll.6-8, ER Vol. V, Tab 32 at EA000840, ll.4-11, ER Vol. III, Tab 23 at EA000484, ll.9-15.)

It is also is not true that it is irrelevant whether CNB acted in a commercially reasonable manner with respect to the collateral securing the GUSA loans because "the Bankruptcy Trustee did all the work under the auspices of the Bankruptcy Court." (AB at 21 [italics omitted].). While CNB states that it "neither maintained nor liquidated the inventory" (AB at 6), it cites no support for that statement and the Fus should have been able to test that contention in discovery. What happened to all of the collateral before the Trustee was appointed when GUSA was taken out of the Fus control and put into CRO Pelton's control and then Receiver Granger's control, in coordination with CNB and the bank creditors? The Fus were entitled to discovery on those critical issues. Summary judgment functions by working through conflicting evidence to come to undisputed facts, not by precluding the non-moving party from gathering evidence on the assumption that the moving party's evidence is unassailable. But that is what the Bankruptcy Court and District Court did here.

It also is incorrect "that the Fus were not contesting the amount that they were loaned or any wrongdoing on the part of CNB." (AB at 17.) The Fus repeatedly contested the amount of CNB's alleged losses and asserted that CNB failed to exercise commercially reasonable efforts to mitigate its losses with GUSA collateral. (*See, e.g.*, ER Vol. V, Tab 33 at EA000991, ll.6-8, ER Vol. V, Tab 32 at EA000840, ll.4-11, ER Vol. III, Tab 23 at EA000484, ll.9-15.)

Finally, CNB disingenuously claims that "on another loan not at issue here,

the Fus admit they received the discovery they wanted . . .," suggesting that the Fus already were allowed the discovery they previously were denied. (AB at 7 & 16 n.3.) That is demonstrably untrue. The Fus were only granted very limited discovery for a limited time and were forbidden any discovery on the key issue of the existence, amount, and liquidation of GUSA collateral, whether CNB exercised commercially reasonable efforts to mitigate its claimed losses, and whether CNB truly suffered 100% losses as if no payments were ever made and as if no collateral ever existed. (ER Vol. I, Tab 3 at EA000048-49 and ER Vol. III, Tab 22 at EA000461-463.)

D. The Bankruptcy Court's Rule 15 Ruling Was Not Supported By The Record And Failed To Apply The Correct Legal Standards

1. The Fus' Amended Answer Was Not Unduly Tardy, Would Not Unduly Delay The Case, And Would Not Unduly Prejudice CNB

Denying leave to amend on the basis of undue delay is error "[w]here 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)). CNB cites *Morongo Band of Mission Indians v. Rose*, 893 F.2d 1074, 1079 (9th Cir. 1998) ("*Morongo*") (AB at 30-31) for the proposition that an amendment that would "chang[e] their entire theory and story of the case" requiring "CNB to spend time and money addressing numerous new theories" constitutes severe prejudice warranting denial of the Fus' Rule 15 motion.

The cases cited by CNB which denied motions to amend brought on the eve of summary judgment (AB at 28-29, citing 6 Wright & Miller, Federal Practice and Procedure Civ. § 1488 n.20 (3d ed. 2010) and Schwarzer et al., Cal. Prac. Guide: Fed. Civ. Pro. Before Trial (The Rutter Group 2015)), are inapposite. *Morongo*

and similar cases (*see, e.g., Acri v. Int'l Ass'n of Machinists & Aerospace Workers*, 781 F.2d 1393, 1398-99 (9th Cir. 1986) (prejudice where amendment would necessitate further discovery)) all involved cases, unlike this one, in which discovery was advanced after pre-trial dates had been established.

Of course undue prejudice has been found where "[t]he parties have engaged in voluminous and protracted discovery" (Texaco, Inc. v. Ponsoldt, 939 F.2d 794, 799 (9th Cir. 1991); see also Schwarzer et al., Cal. Prac. Guide: Fed. Civ. Pro. Before Trial, supra, ¶ 14:340 ("[M]ost courts will deny the opposing party's motion to amend its pleadings to add new or different theories of liability after discovery has been completed and a summary judgment motion filed") (italics in original; underlining added). But that was not the case here.

The lack of any discovery, due to CNB's violations of Rule 26, completely undermines CNB's tardiness, undue delay, and prejudice arguments. *See Beecham v. City of W. Sacramento*, 2008 U.S. Dist. LEXIS 121176 (E.D. Cal. Aug. 22, 2008) (granting leave to amend under Rule 15 where defendants' delay in requesting leave to amend did not "include the passing of any major litigation dates, such as the closing of discovery or the dispositive motion deadline"); *DCD Programs, Ltd. v. Leighton*, 833 F.2d 183, 188 (9th Cir. 1987) (no prejudice from delay when the case was "still at the discovery stage with no trial date pending, nor has a pretrial conference been scheduled").

Likewise, a "change in theory" does not constitute undue prejudice when, as here, no discovery has occurred and the focus is on the cause and amount of the creditor's losses and its failure to mitigate those losses. Requiring CNB to demonstrate what happened to all of the GUSA 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. "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).

2. The Record Also Fails To Support A Bad Faith Finding

A motion for leave to amend cannot be denied for bad faith unless the motion is shown to involve "'sharp practice' tactics," as, for example, where a party seeks to add a defendant solely for the purpose of destroying diversity. *SAES Getters S.p.A. v. Aeronex, Inc.*, 219 F. Supp. 2d. 1081, 1095 (S.D. Cal. 2002). No such "sharp practices" were or could be shown here. As already seen, the timing of the motion was not the product of some nefarious scheme, but of the Fus unfortunate circumstances. They filed the motion as soon as they could after retaining counsel to represent them in this case. While CNB uses "bad faith" as an epithet (e.g., AB at 27 & 35 n.5), it provides no analysis to show that the applicable standard of bad faith was adequately met here.

3. CNB Has Failed To Show That None Of The Fus' Proposed Amendments Is Meritorious.

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.

The Bankruptcy Court commented that the Fus had "chosen" to add the defenses "at this late hour," when in fact, as shown repeatedly they had little choice in the matter under the circumstances (*see* App. Vol. IV, Tab 47 at A003094). Nowhere, however, did the Bankruptcy Court explain why it found all of the

defenses futile. Several defenses certainly are not futile.

(a) Mitigation Of Damages

Specifically, the merit of a key affirmative defense, CNB's failure to mitigate damages (*see* App. Vol. IV, Tab 19, at A002526 [Eleventh Affirmative Defense]) turns on the existence, value, and monetization of the collateral for the GUSA loans that the Fus guaranteed before the Chapter 11 trustee took over the case, not just afterwards. As shown above, the Fus' Rule 56(d) motion for discovery was in large part based on the counsel's 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 (*see* App. Vol. IV, Tab 18, ¶ 18, at A002375-80). He also showed that there was over $100 million in collateral that should have offset and mitigated CNB's alleged losses. Moreover, contrary to the rulings below, CNB's duty to mitigate its losses was non-waivable under Cal. Comm. Code § 9602.

Neither CNB nor the Bankruptcy Court have refuted that 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.

(b) Arbitrability Of Claims

The Fus showed in the Opening Brief that there are broad arbitration provisions in both the CNB Facility Agreement and the Participation Agreement, and further that bankruptcy courts must enforce such provisions in a case such as this. *See MCI Telecomm. Corp. v. Gurga (In re Gurga),* 176 B.R. 196 (9th Cir. BAP 1994); *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).

CNB responds that (1) the Fus are not signatories to the two agreements

which include arbitration clauses, (2) the Bankruptcy Court had discretion not to compel arbitration here, because this case involves core claims, and (3) the Fus have waived the right to arbitrate by waiting until now to raise the issue (*see* AOB at 26-27). But none of those contentions have merit.

The Fus' status as guarantors creates the kind of "close relationship" with CNB as signatory to the arbitration provisions in the other agreements 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) ("*Comer*"). Seeking to avoid *Comer's* applicable here, CNB cites *Rajagopalan v. NoteWorld, LLC*, 718 F.3d 844, 847 (9th Cir. 2013) ("*Rajagopalan*") as stating that "We have never previously allowed a non-signatory defendant to invoke equitable estoppel against a signatory plaintiff, and we decline to expand the doctrine here." (AB at 38)

But that case is wholly distinguishable.

Here, unlike in *Rajagopalan*, the Fus' defenses and claims relate directly to the Participation Agreement and related documents that contain the arbitration provisions, CNB seeks to recover from the Fus moneys paid under those Agreements (on behalf of the "Participating Banks"), the Fus are mentioned throughout the Agreements (as the "guarantors"), and the Fus are, therefore, third party beneficiaries under those Agreements.

CNB's breach of contract claim (under the Fus' guarantees) is a non-core, state law claim that an arbitrator properly could and should have adjudicated.

Finally, the Fus waived their right to arbitration only if they "knew of their right to arbitrate" and "acted inconsistently with it...." *Chappel v. Laboratory Corporation of America*, 232 F.3d 719, 724 (9th Cir. 2000). Given that the Fus were acting *pro se* and were incarcerated at the time at which they filed their answer, and since then until very recently, it is entirely implausible to assume that

they knew they had a right to arbitrate and chose to act "inconsistently with it...." The same is true of all of their defenses. The idea that they knowingly waived them by filing an answer *pro se* while in confinement cannot pass muster.

(c) Lack of Standing

In its Complaint against the Fus, which forms the basis for the partial summary judgments 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." (*See* ER Vol. 14, Tab 47, at EA003350). But CNB lacks standing to bring its Claim for Relief under the CNB Facility seeking $38,443,543.76 with respect to the vast majority of that sum which was incurred by non-party "participant banks" which are not plaintiffs in this action.. 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. CNB was repaid by the Participating Banks all of its GUSA loan except for its remaining 5% ($5 million) interest. That reduces CNB's right to repayment; and CNB lacks standing to recover the funds it already was repaid by the other Participating Banks.

(d) CNB Failed To Undermine The Fus' Other Proposed Affirmative Defenses

As to the Fus' other proposed Affirmative Defenses,[4] CNB similarly failed

[4] *I.e.*, 1. Failure to State A Claim, 2. Lack of Subject Matter Jurisdiction, 3. Failure

to establish that "no set of facts" existed under which the amendments would give rise to "a valid and sufficient claim or defense." *Miller v. Rykoff-Sexton, Inc.*, *supra*, 845 F.2d 209 at 214. Seeking to avoid the consequences of that failure, CNB claims that those defenses are not adequately fleshed out in Appellants' Opening Brief. (AB at 35-36.) It is not necessary to recite de novo all of the arguments made by the Fus in their Rule 15 opening brief and reply brief submitted to the Bankruptcy Court below. (ER Vol. III, Tab 24 and 25) Appellants' Opening Brief satisfied the requirements of Fed. R. App. Proc. 28 by articulating its arguments sufficiently in (1) "a statement of the issues presented for review"; (2) "a summary of the argument"; and (3) "the argument" section itself. In addition, Appellants' Excerpts of Record is carefully and systematically indexed and tabbed, and if fully searchable electronically. Accordingly, Appellants' submissions do not require this Court to "hunt[] for truffles buried in briefs." *Greenwood v. Federal Aviation Administration*, 28 F.3d 971, 977 (9th Cir, 1994).

E. The Bankruptcy Court Abused Its Discretion Under Fed. Rule Civ. Proc. 14 By Denying The Fus Leave To File A Third Party Indemnity Complaint

CNB's arguments are insufficient to surmount the "liberal" standard of Rule 14 for permitting third party indemnity actions. *FDIC v. Loube*, 134 F.R.D. 270, 272 (N.D. Cal. 1991). There is a "colorable claim of derivative liability" here, *Lehman v. Revolution Portfolio LLC*, 166 F.3d 389, 393 (1st Cir. 1999), and far from causing undue delay and prejudice, it will serve the interest of justice and efficiency. *FMC Corp. v. Vendo Co.*, 196 F. Supp. 2d 1023, 1038 (E.D. Cal. 2002).

CNB responds that the conduct of the other banks in the years before the Fus

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To Meet Pleading Standards, 5. In Pari Delicto, 6. Unclean Hands, 7. Intervening or Superseding Acts of Third Parties, 8. Plaintiff's Acts or Omissions, 9. Failure to Exercise Reasonable Care, and 11. Comparative Fault/Contributory Negligence.

incurred the debts at issue here have nothing to do with the present case, and there is, therefore, no basis for the Fus' interpleader motion (AB at 16, 41-42).

On the contrary, however, the issues of the third-party complaint are intimately intertwined with those already pending in this case.

First, the only claim against the third-party defendants is one of indemnity from CNB's claims in the present case, and the courts have consistently held that interpleader is appropriate in such a case. *Haehn v. JetBlue Airways Corp*., No. CV 11-07781 DDP JCGX, 2012 WL 2700387, at *1 (C.D. Cal. July 6, 2012); *Universal Green Solutions, LLC v. VII Pac Shores Investors, LLC*, No. C-12-05613- RMW, 2013 WL 5272917, at *2 (N.D. Cal. Sept. 18, 2013).

Second, CNB argues that the Best Ascent action is the same as the Fus' proposed third party complaint and that the Fus stand to obtain the same relief in that action as they would in the third party action because Best Ascent is controlled by the Fus. (AB at 41-43.) While the factual allegations overlap considerably, the actions are distinct. There is no support for CNB's naked and foundationless assertion that Best Ascent is owned or controlled by the Fus. The Fus are not parties to the Best Ascent action. The Fus would not have standing to substitute in as additional plaintiffs in that action because they assigned all of their rights under the loan agreements to Best Ascent. They could not assert indemnity claims as plaintiffs in that action.

CNB argues it would be more efficient for the Fus to add their third-party action against the banks into the Orange County Superior Court Best Ascent action by substituting in as additional plaintiffs (AB at 44-45). That is so, CNB argues, because this action "is over from a trial court perspective." (AB at 45.)

The problem is, however, that there was never first trial. Taken together, the Bankruptcy Court's denial the Fus' motions under Rule 56(d), to amend the answer, and to implead the other banks, deprived the Fus of the right to have any trial at all

on their defenses.

Finally, CNB protests that the Rule 14 motion, like the others, was tardy. (AB at 42.) That claim deserves the same response as the others. Given their circumstances, the Fus brought it as early as could realistically be expected.

III. CONCLUSION

The Bankruptcy Court's precipitous $40 million nondischargeable money judgments should be set aside in the interests of fairness, justice, and due process.

DATED: May 26, 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

CERTIFICATE OF COMPLIANCE PURSUANT TO

FED. R. APP. P. 32(a)(5) and (a)(7) AND CIRCUIT RULE 32-1

FOR CASE NO. 15-56800

I certify, pursuant to Fed. R. App. P. 32(a)(5) and (a)(7)(B)(ii) 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 6978 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

DATED: May 26, 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

9th Circuit Case Number(s) 15-56800

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