NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re	BAP Nos. CC-06-1160-MoDT
	CC-06-1161-MoDT
JONATHAN ELIA BEKHOR,	CC-06-1162-MoDT
	CC-06-1269-MoDT
Debtor.	
	Bk. No. LA 03-30700-ER
VINCENT ROSATI and LORETTA ROSATI,	Adv. No. LA 03-02707-ER
Appellants,	
v.	**M E M O R A N D U M**[1]
JONATHAN ELIA BEKHOR,	
Appellee.	

Argued and Submitted on January 17, 2007
at Pasadena, California

Filed - March 19, 2007

Appeal from the United States Bankruptcy Court
for the Central District of California

Honorable Ernest M. Robles, Bankruptcy Judge, Presiding.

Before: MONTALI, DUNN, and TCHAIKOVSKY,[2] Bankruptcy Judges.

---

[1] This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

[2] Hon. Leslie J. Tchaikovsky, Bankruptcy Judge for the Northern District of California, sitting by designation.

Creditors Vincent and Loretta Rosati ("Creditors") appeal from the bankruptcy court's judgment discharging their individual claims against debtor Jonathan Elia Bekhor a/k/a Jonathan Elia Sassoon Bekhor ("Debtor") and the order discharging Debtor generally. Creditors argue that they should have been granted leave to amend their complaint to plead a claim for nondischargeability of securities-related debts under Section 523(a)(19).[3] Creditors also argue that the bankruptcy court did not properly consider Debtor's failure to keep books and records for purposes of denying Debtor's discharge under Section 727(a)(3).

We believe that the bankruptcy court applied an incorrect legal standard in denying Creditors leave to amend their complaint so we REVERSE the judgment discharging Creditors' claims and REMAND for further proceedings under Section 523(a)(19). We AFFIRM the discharge order under Section 727.

I. FACTS

Creditor Vincent Rosati was a plumber who became disabled in a job related explosion in 1992. He obtained a settlement and invested the funds with a broker, Alan Cohen ("Cohen"). Cohen later moved, with part of Creditors' account, to a firm called Island Securities, Inc. ("Island") which Debtor was purchasing.

Island engaged in day trading. There was conflicting

[3] Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, as enacted and promulgated prior to the effective date of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat. 23, because the case from which this appeal arises was filed before its effective date (generally October 17, 2005).

evidence about Debtor's role at Island, whether Creditors' signatures were forged on some Island documents, and whether Debtor ever spoke with Creditors. Creditors allege that Cohen, Debtor, and others defrauded them out of most of their principal by, among other things, making approximately 18,000 buy/sell trades for 5,121,000 securities over roughly seven to nine months, charging commissions of between $17.00 and $85.00 per trade, and trading on margin at a cost of $151,403.21 in margin interest.

A. The arbitration award

Creditors obtained an arbitration award against Debtor, Cohen, and Cohen's supervisor John Lee ("Lee"), jointly and severally, for compensatory damages of $113,316.00, punitive damages of $400,000.00, costs, pre- and post-judgment interest, and attorneys' fees. The award lists almost a dozen causes of action asserted by Creditors -- including violation of federal securities law, breach of contract, and failure to supervise -- but it makes no findings of fact and its only specific conclusion of law is that "Cohen, Lee, [Debtor], and [Island] violated Sections 517.211 and 517.301, Florida Statutes.[4]" The award was confirmed by a district court in Florida, except for attorneys' fees. The district court held that "an arbitration panel need not

---

[4] Both Florida statutes involve securities transactions. That is significant because Section 523(a)(19) (quoted in full in footnote 5 below) makes nondischargeable certain securities-related debts. Florida Statutes Section 517.211 provides for rescission or damages against (1) any purchaser or seller of a security in violation of Florida Statutes Section 517.301 (which is entitled "Fraudulent transactions; falsification or concealment of facts") and (2) jointly and severally, against "every director, officer, partner, or agent of or for the purchaser or seller, if [such person] has personally participated or aided in making the sale or purchase . . . ." Fla. Stat. § 517.211(2) (2003).

state any basis for its award," that Florida securities law (which apparently permits the scienter requirement to be satisfied by negligence as opposed to reckless disregard) was not necessarily the only basis for the award, and that punitive damages could have been awarded under either federal securities law or New York law. In 2001 the district court issued an amended judgment of slightly less than $550,000 against Debtor, Cohen, and Lee (the "Arbitration Judgment").

Creditors attempted to collect the Arbitration Judgment. They allege that Debtor lived a lavish lifestyle but hid his income and assets using entities that he secretly owns or controls. Debtor filed a Chapter 7 petition in 2002 (LA 02-35441-ER) which was dismissed for failure to file bankruptcy schedules or a statement of financial affairs. On August 6, 2003 (the "Petition Date"), Debtor filed the voluntary Chapter 7 petition commencing the present bankruptcy case (LA 03-30700-ER).

B. Creditors' complaint and motions to amend it

In November of 2003 Creditors filed their complaint commencing this adversary proceeding (Adv. No. LA 03-02707-ER). They later filed a motion to amend the complaint, which was granted, and they filed their first amended complaint (the "FAC") on March 25, 2005. Trial was set for September 26, 2005. On September 8, 2005, Creditors filed a motion for leave to amend the FAC under Rule 15(a) of the Federal Rules of Civil Procedure (incorporated by Fed. R. Bankr. P. 7015) ("Rule 15(a)") to add a

claim under Section 523(a)(19) (the "Second Motion to Amend").[5]

The bankruptcy court vacated the existing trial date and set a briefing schedule on the Second Motion to Amend. After hearing oral argument the bankruptcy court denied the motion and set a new trial date of January 23, 2006.

C. Evidence regarding Debtor's missing and incomplete financial records

1. Tax returns, wife's cancer

At trial Debtor testified that he stopped filing tax returns in 1997 or 1998. He did not explain why, but he placed most of the blame for his later failure to keep or preserve financial

---

[5] Section 523(a)(19) provides, in full:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt --
>
> * * *
>
> (19) that --
>
> (A) is for --
>
> (i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or
>
> (ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and
>
> (B) results from --
>
> (i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;
>
> (ii) any settlement agreement entered into by the debtor; or
>
> (iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

11 U.S.C. § 523(a)(19).

information on the fact that his wife was diagnosed with cancer "towards the end of 1999 to 2000" and that this cancer was "grade four" of a type that is "99.9 percent" terminal. Transcripts, Jan. 23, 2006, p. 57:21-22, Jan. 25, 2006, p. 113:9-20. According to Debtor, he and his family fell apart emotionally when this happened.

2. Lack of computer or paper records

Debtor explained that his computer crashed, wiping out his Quickbooks files, that he had prepared his original bankruptcy schedules and statement of financial affairs ("SFA") on an emergency basis, because of pending contempt proceedings, and that he had given his only copy of various financial documents, including bank records, to Creditors in response to discovery requests because it was too expensive to copy them. Debtor testified that when he later recovered copies of those financial records from Creditors he used them to prepare his amended bankruptcy schedules and SFA. Transcript, Jan. 24, 2006, pp. 9:4-5, 19:8-21. Debtor testified that he had produced "no W'2's or 1099's" from some entities because they did not provide him with those documents. Transcript, Jan. 23, 2006, p. 90:5-20.

3. Payment of Debtor's bills by other persons

Debtor's bank account had been garnished in the Spring of 2002 so he arranged for third parties who owed him consulting fees or salary to pay his landlord, credit card bills, auto insurance premiums, and some other debts directly. Transcript, Jan. 24,

2006, pp. 10:3-4, 43:21-25, 46:3-16, 61:10-21.[6] Creditors' attorney suggested that this was inconsistent with his deposition testimony. Id., p. 11:8-11. Debtor testified that he may have misunderstood the deposition question (id. at 12:10-11) and that when he was asked about his health at the end of the deposition he stated that he was on medications and was feeling dizzy. Transcript, Jan. 25, 2006, pp. 183:15-186:11.

4. Current employment

Debtor alleges that he is employed at an internet café for $75 per day plus payment of his medical and automobile insurance premiums. Debtor testified that he has been barred from the securities industry, apparently for failing to satisfy the Arbitration Judgment.

5. International and domestic connections

Debtor's mother was raised in Shanghai, his father had connections in Asia, and Debtor testified that this facilitated his business dealings in Hong Kong and elsewhere. Debtor explained that a number of the transactions in his name or through his bank account were actually on behalf of others and did not reflect his own assets or income or control of various foreign and domestic entities. See, e.g., Transcripts, Jan. 24, 2006, pp. 3:21-23, 53:10-56:7, 56:17-57:2, 67:1-9, Jan. 25, 2006, pp. 165:11-169:6.

[6] Debtor's testimony was not entirely consistent on this point. At one point he stated, "I don't believe [one entity] ever paid my bills" (Transcript, Jan. 24, 2006, p. 39:10) but shortly afterwards he testified that this same entity paid his health insurance and auto insurance premiums in 2004. Id. p. 43:21-25.

6. Loans to Debtor

Debtor allegedly did not recall how much money was loaned to him by an entity he owns called Stock Trading Simulator ("Simulator") and had no loan agreement with that entity, but called it a loan for tax purposes. Debtor produced a letter agreement documenting a $2 million loan to him from another entity, which he claims not to own. Debtor testified that at Creditors' request he had asked that entity verbally for an accounting but that "[t]he whole transaction was on a handshake" and "[t]hey were insulted that I was asking." Transcript, Jan. 23, 2006, pp. 90:21-91:3, 91:22-92:16.

7. Trade Fast and $750,000 transfer

Debtor acknowledged that when a third party agreed to purchase an entity called Trade Fast (a/k/a Tradefast), which Debtor claims not to own, part of the consideration was one million unrestricted shares to be issued to "such parties as [Debtor] shall identify." According to Debtor he was "acting on behalf of Trade Fast" and not for his own benefit. Transcript, Jan. 23, 2006, pp. 80:18-81:7. He testified that certain other options to be granted to him personally for facilitating this transaction were never issued. Id.

Debtor did not include in his disclosures of income for 2000 deposits of $750,000 and $250,000 into his bank account because those deposits were made "for safekeeping," or at least that this is "kind of an abbreviation of what happened." Transcript, Jan. 23, 2006, p. 65:15-21. Debtor later explained that the third party deposited $750,000 in his bank account (or the account of a company he owns), pending completion of the sale transaction, and

he did not regard these funds as his own and held them for only a few weeks. On cross examination he admitted that in fact he transferred only $710,000 back out of his account, the remaining $40,000 may have been his fee, and he did not know where the money was. Transcript, Jan. 25, 2006, pp. 195:18-196:5.

D. The bankruptcy court's post-trial rulings

After a four day trial the bankruptcy court issued a Memorandum of Decision in Debtor's favor on all claims. The bankruptcy court agreed with Creditors that Debtor's records were inadequate and that this made it impossible for Creditors to determine his financial condition or material business transactions, but it also ruled that Debtor had carried his burden to justify the inadequacy and nonexistence of records under Section 727(a)(3):

> . . . Debtor's failure to keep financial records was justified. Debtor testified that his wife was diagnosed with incurable cancer in 1999/2000, and that he basically fell apart. His daughter, Joanna, also testified that after her mother became ill, Debtor's focus was solely on his wife. In addition, his wife's illness took its toll on the rest of the family. During this time, Debtor's other daughter attempted suicide on more than one occasion and his youngest son dropped out of school. A person under like circumstances also would not ordinarily keep books or records.
>
> . . . Debtor has met his burden of proving that [his] failure to maintain books and records was justified. The Debtor's discharge will not be denied under § 727(a)(3).

On April 12, 2006, the bankruptcy court entered its judgment that all claims of Creditors against Debtor "are hereby discharged." On the same day the bankruptcy court entered duplicative orders granting Debtor a discharge under Section 727. Creditors filed timely notices of appeal from the judgment and the

orders, and also filed a notice of appeal from the bankruptcy court's order denying their Second Motion to Amend to add a claim under Section 523(a)(19) (BAP Nos. CC-06-1160 through CC-06-1162). In June the clerk of the BAP filed an order consolidating these appeals.

II. ISSUES

A. Did the bankruptcy court abuse its discretion under Rule 15(a) by denying Creditors' Second Motion to Amend to add a claim under Section 523(a)(19)?[7]

B. Did the bankruptcy court apply an incorrect legal standard to Debtor's justification of his failure to keep books and records under Section 727(a)(3) or did it clearly err in finding that Debtor's justification was adequate?[8]

---

[7] Both parties argue about the merits of Creditors' claim under Section 523(a)(19). Debtor argues that the Arbitration Judgment has no preclusive effect because Florida Statutes Section 517.211 has been found to require only a showing of negligence to impose liability, citing In re Goldbronn, 263 B.R. 347, 361 (Bankr. M.D. Fla. 2001). Debtor adds that there are unresolved issues of how to apply Section 523(a)(19) to joint and several liability and to punitive damages, and the claim "almost certainly" will implicate additional discovery. Creditors argue that there are no genuine factual issues, that neither fraud nor any intentional conduct is required under Section 523(a)(19), that all that is required is a debt based on a securities law violation and a judgment (citing In re Whitcomb, 303 B.R. 806, 810 (Bankr. N.D. Ill. 2004)), and that if punitive damages are included in the award then they are necessarily nondischargeable.

We express no opinion on these disputes and reject Creditors' request that we enter judgment (or direct the bankruptcy court to enter judgment) in their favor. The merits of Creditors' Section 523(a)(19) claim and Debtor's defenses are not before us.

[8] We dispose of several additional issues briefly. Debtor argues that Creditors waived legal issues by not including them in their statement of issues on appeal. We reject this argument because Creditors' opening brief clarified the issues on appeal, Debtor did not ask for more time to file his own brief, and Debtor has shown no prejudice. Debtor argues that Creditors' designation

(continued...)

III. JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. § 157(b)(2)(I) and (J). We have jurisdiction under 28 U.S.C. § 158(c).

IV. STANDARDS OF REVIEW

Denial of a motion for leave to amend a complaint is reviewed for abuse of discretion. Foman v. Davis, 371 U.S. 178 (1962). A bankruptcy court necessarily abuses its discretion if it bases its ruling on an erroneous view of the law or a clearly erroneous assessment of the evidence. We also find an abuse of discretion if we have a definite and firm conviction that the bankruptcy court committed a clear error of judgment in the conclusion it reached. In re Beatty, 162 B.R. 853, 855 (9th Cir. BAP 1994).

We review de novo Creditors' argument that the bankruptcy court applied an incorrect legal standard under Section 727(a)(3), and we review for clear error the bankruptcy court's determination that Debtor adequately justified his failure to keep or preserve financial information, which is a factual finding. In re Lawler, 141 B.R. 425, 428 (9th Cir. BAP 1992). A finding is clearly erroneous when, although there is evidence to support it, the reviewing court on the entire evidence is left with the definite

---

[8](...continued)
of record did not include transcripts. This argument has been mooted because a member of this panel granted Creditors' motions to supplement their designation and include the transcripts as part of the record on appeal. Creditors appealed from the bankruptcy court's order awarding costs (BAP No. CC-06-1269) but at oral argument before us the parties agreed that the award of costs would be treated as part of the judgment discharging Creditors' claims and that appeal would be abandoned. That appeal is hereby DISMISSED.

and firm conviction that a mistake has been committed. Id. at 429 (citation omitted).[9]

V. DISCUSSION

A. The bankruptcy court should have granted Creditors leave to amend their complaint to add a claim under Section 523(a)(19)

The bankruptcy court denied the Second Motion to Amend under Rule 15(a). Rule 15(a) provides in relevant part that leave of court is required in cases such as this one and that "leave shall be freely given when justice so requires." Fed. R. Civ. P. 15(a) (incorporated by Fed. R. Bankr. P. 7015).[10]

---

[9] Debtor cites authority that gross abuse of discretion is the standard under Section 727(a)(3), citing In re Cox, 904 F.2d 1399, 1401 (9th Cir. 1990) ("Cox I"), appeal after remand, 41 F.3d 1294 (9th Cir. 1994) ("Cox II"). This is no different from reviewing legal conclusions de novo and findings of fact for clear error. In re Roosevelt, 87 F.3d 311, 314 n. 2, amended, 98 F.3d 1169 (9th Cir. 1996), overruled on other grounds by, In re Bammer, 131 F.3d 788, 792 (9th Cir. 1997) (en banc).

There is also authority for applying a de novo standard of review to the ultimate determination whether inadequate recordkeeping is "justified" under Section 727(a)(3). Meridian Bank v. Alten, 958 F.2d 1226, 1329-30 and n. 2 (3d Cir. 1992). Creditors do not raise this issue and we believe that Meridian is distinguishable. The issue in Meridian was whether operating on a cash basis out of fear of creditors' liens was a justification for not keeping financial records. It was not, Meridian held. That was a legal issue or a mixed question of fact and law. In contrast, Debtor in this case claimed to be distraught and incapable of keeping adequate financial records because of his wife's cancer, his child's attempts at suicide, and other personal and family problems. Evaluating this justification, and how Debtor's emotional reaction compares to others in like circumstances, is heavily factual in nature. Therefore the bankruptcy court's finding of an adequate justification under Section 727(a)(3) is reviewed for clear error.

[10] We are not actually convinced that Creditors needed to amend the FAC. Its first paragraph states, "This is a proceeding . . . to determine the dischargeability of a securities fraud judgment . . . ." (Emphasis added.) Attached to the FAC and

(continued...)

1. Bankruptcy court's ruling

The bankruptcy court's written order states that the Second Motion to Amend is denied "on the grounds that (1) [Creditors] had inexcusably unduly delayed in seeking [to amend], and (2) [Debtor] would be prejudiced if the [motion] was granted." (Emphasis added.) At the hearing on the Second Motion to Amend the bankruptcy court stated:

> With respect to undue delay, this is not a situation where the facts underlying the proposed amended complaint or the law was at all hidden or that it only came up during discovery . . . This is . . . a situation where the lightbulb just went off virtually at the eleventh's hour * * *
>
> . . . In terms of prejudice to the Debtor, Debtor's law firm operating on a pro bono basis, has been going down the road that has been dictated by

---

[10](...continued)
later admitted in evidence are copies of the arbitration award and the Arbitration Judgment confirming that award. The FAC is replete with phrases like "securities fraud" and "fraudulent trading practices." The FAC does not cite Section 523(a)(19), but notice pleading requires only factual allegations and a prayer for relief, not citation of any statutes. See generally Fed. R. Bankr. P. 7008 (incorporating Fed. R. Civ. P. 8) and In re County of Orange, 203 B.R. 983, 993 (Bankr. C.D. Cal. 1996) ("If facts alleged by a plaintiff are sufficient to state a claim showing he is entitled to any relief, plaintiff need not set forth the legal theory on which he relies.") (citation omitted), aff'd in part, rev'd in part on other grounds, 245 B.R. 138 (C.D. Cal. 1997).

This is not to say that Creditors were entitled to keep their legal theories secret. Those legal theories would normally be disclosed in response to contention interrogatories or a motion for a more definite statement or through similar procedures. The excerpts of record contain stipulated pretrial orders by which Creditors agreed that no legal claims remained to be tried other than those listed, which do not include Section 523(a)(19). In effect, Creditors voluntarily narrowed the scope of the FAC.

Perhaps Creditors should have filed a motion to amend the stipulated pretrial orders so as to restore the FAC to its original scope. Instead they filed the Second Motion to Amend to add an explicit claim under Section 523(a)(19). We see no practical difference. No party has raised this issue and both parties and the bankruptcy court treated Rule 15(a) as the governing rule in the circumstances presented. So do we.

> the extant complaint, and now to completely switch gears, I think, would be unfair to it and to the Debtor as well. And I'm not entirely sure that the 523(a)(19) [claim] promises to be the silver bullet that [Creditors think] it will be. I think that there are significant issues of first impression having to do with punitive damages and whether those are liable to dischargeable [sic] or not.
>
> The effect of a joint and several liability judgment, I think, is yet to be explored within the context of that statute here in this Circuit and this District, certainly. There are almost no findings of fact that I've seen with respect to the underlying [Arbitration Judgment]. So I'm not sure, when you get right down to it, how much is going to be dischargeable by way of 523(a)(19).
>
> All that is a precursor to another element, I think, of prejudice, and that is that the -- if the Court were to grant the motion, that would not end in a trial. It would likely require further briefing by way of a summary judgment motion. . . . Somebody's probably going to make a counter motion, opposition.
>
> It's taking the litigation to a new direction that is going to be quite expensive and I equate that with prejudice to the firm and to its client. So, I think that that is an element that we need to really take into account when we talk about prejudice as well.
>
> * * *
>
> I want to make clear . . . that the Court is not determining this solely on the basis of undue delay, but that it has also articulated . . . the specific elements of prejudice . . . .

Transcript, Oct. 17, 2005, pp. 1:18-3:24, 9:18-23 (emphasis added).

We reject Creditors' arguments that the bankruptcy court did not adequately state its reasons or confused prejudice to Debtor with prejudice to his pro bono counsel.[11] Nevertheless we hold

---

[11] Contrary to Creditors' assertions, this record "clearly indicates reasons" for denying leave to amend and the bankruptcy court was not required to reduce all of its reasons to writing. DCD Prog's, Ltd. v. Leighton, 833 F.2d 183, 186 (9th Cir. 1987). We also reject Creditors' argument that prejudice to Debtor's pro bono counsel does not prejudice Debtor himself. The cases cited by Creditors do not hold otherwise. They merely follow the

(continued...)

below that Creditors' delay alone is insufficient to deny the Second Motion to Amend. There must also be prejudice, and Debtor has shown no cognizable prejudice.

2. Extremely liberal standards for leave to amend

The Supreme Court has held:

> Rule 15(a) declares that leave to amend "shall be freely given when justice so requires"; this mandate is to be heeded. . . . If the underlying facts or circumstances relied upon by a plaintiff may be a proper subject of relief, he ought to be afforded an opportunity to test his claim on the merits. In the absence of any apparent or declared reason -- such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc. -- the leave sought should, as the rules require, be "freely given."

Foman, 371 U.S. at 182 (citation omitted, emphasis added).

"[R]ule 15's policy of favoring amendments to pleadings should be applied with 'extreme liberality.'" DCD, 833 F.2d at 186 (citations omitted). The trial court has substantial discretion in determining when an amendment should be allowed, but denial of leave to amend is strictly reviewed. Plumeau v. Sch. Dist. No. 40 Co. of Yamhill, 130 F.3d 432, 439 (9th Cir. 1997).

---

[11](...continued)
typical convention of not distinguishing between a party and its counsel. See Howey v. U.S., 481 F.2d 1187, 1190 (9th Cir. 1973); DCD, 833 F.2d at 186. It would be arbitrary to decide whether to allow an amendment based on whether the opposing party is represented by paid counsel or pro bono counsel. Analogous authority supports our conclusion. See LeBrew v. Reich, 2006 WL 1662595 at *5 (E.D.N.Y.) (denying extension to file answer and counterclaim because of prejudice to pro bono counsel who had "already expended considerable time, resources and funds in litigating their claims"). Cf. Dennis v. Chang, 611 F.2d 1302, 1308 (9th Cir. 1980) (awarding costs to pro bono organization rather than prevailing party itself); Brandenburger v. Thompson, 494 F.2d 885, 889 (9th Cir. 1974) (same).

The party opposing the amendment bears the burden of demonstrating why leave to amend should not be granted. Butler v. Robar Enter., Inc., 208 F.R.D. 621, 623 (C.D. Cal. 2002).

Prejudice carries more weight than the other items mentioned in Foman. Eminence Capital, LLC v. Aspeon, Inc., 316 F.3d 1048, 1052 (9th Cir. 2003). The Ninth Circuit has called prejudice the touchstone of the inquiry. Id. Not any prejudice will do. In the Supreme Court's words, prejudice must be "undue." Foman, 371 U.S. at 182. Any amendment to a complaint is prejudicial in some sense, because any amendment worth making increases potential liability, but that is not typically a ground for denying leave to amend. C. Wright, A. Miller & M. Kane, 6 Fed. Practice & Proc. Civ. 2d ("Fed. Practice & Proc.") § 1487, text accompanying n. 13. The party opposing leave to amend bears the burden of establishing undue prejudice. DCD, 833 F.2d at 187.

3. Debtor established delay, but delay alone does not justify denial of the Second Motion to Amend

Debtor met his prima facie burden to show delay. Creditors' Second Motion to Amend was filed within three weeks of trial and almost two years after the adversary proceeding was commenced. The burden shifted to Creditors to offer a reasonable explanation for the delay. U.S. v. Pend Oreille Pub. Util. Dist. No. 1, 28 F.3d 1544, 1552 (9th Cir. 1994). Creditors' only explanation is oversight by all three of the law firms representing them, which is inadequate. See King v. Cooke, 26 F.3d 720, 723 (7th Cir. 1994) (rejecting "some sort of discovery rule" based on ignorance of the law).

Nevertheless, delay alone is not enough. The delay must be "undue," as stated in Foman, and we interpret "undue delay" to mean either extreme delay or delay combined with other facts such as material prejudice or bad faith. The Ninth Circuit has stated, "delay, by itself, is insufficient to justify denial of leave to amend." DCD, 833 F.2d at 186. Even some cases cited by Debtor recognize this general principle. See Roberts v. Arizona Bd. of Regents, 661 F.2d 796, 798 (9th Cir. 1981); King v. Cooke, 26 F.3d at 723. See also S. Bernstein, Annotation, Timeliness of Amendments to Pleadings Made by Leave of Court Under Fed. R. Civ. P. 15(a), 4 A.L.R. Fed. 123, text accompanying n. 9.

Debtor cites authority that "when extreme, delay itself may be considered prejudicial." King v. Cooke, 26 F.3d at 723. This makes sense. It is comparable to laches or a statute of limitations. Parties are eventually entitled to some repose even at the expense of meritorious claims, but only if the delay is extreme. See 6 Fed. Practice & Proc. § 1488, text accompanying n. 30 ("Some courts also have held that a long delay by the movant constitutes laches so that a refusal to permit an amendment is warranted."). See also Kaplan v. Rose, 49 F.3d 1363, 1370 (9th Cir. 1994) ("Expense, delay, and wear and tear on individuals . . . count toward prejudice.") (quoting trial court's comment with apparent approval).

The two year delay in this case is not "extreme." In King itself the defendants took three years to realize that they had admitted rather than denied all the key allegations against them due to a "word processing error," they admitted filing their answer "without carefully reading it," and because of the delay

evidence was lost and witnesses could not be located. King, 26 F.3d 720 (passim). Nevertheless, leave to amend was proper because the prejudice did not flow from "the tardy amendment" but from the inability of plaintiff, a prisoner, to obtain replacement counsel for several years. The Seventh Circuit held "we cannot, after finding that the admissions were inadvertent and that the amendment was not prejudicial, hearken back to the formalist days of common-law pleading and reject defendants' attempts to correct their mistake." Id. at 724. See also Howey, 481 F.2d at 1190 (abuse of discretion to deny motion to amend filed five years after original complaint was filed, on second day of trial, even though movant was "unable to establish any reason or excuse for its neglect in failing to bring a timely motion to amend"); Hurn v. Retirement Fund Trust, 648 F.2d 1252, 1254-55 (9th Cir. 1981) (abuse of discretion to deny leave to amend after two year delay); In re Gunn, 111 B.R. 291, 292 (9th Cir. BAP 1990) (same, and motion filed two-and-one-half months before trial).

Debtor cites cases that at first glance appear to deny leave to amend based on delay alone, or delay plus a prior opportunity to amend. On closer analysis these cases either involve longer delays than this case or other distinguishing facts like prejudice or knowing of the need to amend but delaying anyway. See, e.g., Mir v. Fosburg, 646 F.2d 342, 347 (9th Cir. 1980) (leave to add federal claim denied after plaintiff "continually represented" that he sought recovery only on state law grounds and waited for three years to seek amendment, after prior appeal to the Ninth Circuit); McGlinchy v. Shell Chem. Co., 845 F.2d 802, 809 (9th Cir. 1988) (stating that undue delay was sufficient to deny leave

to amend, but case also involved prejudice and "repeated failure to cure deficiencies by amendments previously allowed"); Swanson v. U.S. Forest Serv., 87 F.3d 339, 345 (9th Cir. 1996) (leave to amend properly denied, but despite invitation, movant inexplicably did not seek leave to amend until after court granted opponent's motion to dismiss and after due date for dispositive motions); Westlands Water Dist. v. Firebaugh Canal, 10 F.3d 667, 677 (9th Cir. 1993) (leave denied, but "appellants filed no motion to amend their complaint and gave no indication of a desire to do so until after the district court rendered its decision"); Texaco, Inc. v. Ponsoldt, 939 F.2d 794, 798-99 (9th Cir. 1991) (leave denied, but movant's complaint in related action had alleged most of same facts a year before proposed amendment); Jackson v. Bank of Hawaii, 902 F.2d 1385, 1388 (9th Cir. 1990) (leave denied, but movant "inexplicabl[y]" delayed even after it had learned the new facts at issue and had "fully analyze[d]" them, and amendment would have prejudiced opposing parties by requiring relitigation of separate action); Chodos v. West Publ'g Co., Inc., 292 F.3d 992, 1003 (9th Cir. 2001) (leave denied, but delay was not the only relevant circumstance, because trial court found prejudice and "the motion was a dilatory tactic"); Acri v. Int'l Ass'n of Machinists, 781 F.2d 1393, 1398 (9th Cir. 1986) (leave denied, but movant's attorney admitted that delay "was a tactical choice").

In Foman the Supreme Court held that the trial court had abused its discretion in denying leave to amend even though there is no explanation in the decision for the delay and the proposed amendment "would have done no more than state an alternative theory for recovery" on the facts previously alleged. Foman, 371

U.S. at 182. There is language in some cases that may appear contrary, but lower courts' decisions cannot override Supreme Court precedent and must be interpreted consistent with Foman. Compare Westlands Water Dist., 10 F.3d at 677 ("We have held that a district court does not abuse its discretion in denying leave to amend where the movant has presented no new facts but only new theories and has provided no satisfactory explanation for his failure to develop the new contentions originally") (citation omitted) with Mir, 646 F.2d at 347 ("when a party has a valid claim, he should recover on it regardless of his counsel's failure to perceive the true basis of the claim at the pleading stage, provided always that a late shift in the thrust of the case will not prejudice the other party in maintaining his defense upon the merits") (quoting 5 Fed. Practice & Proc. § 1219, text accompanying nn. 18-19) (emphasis added)). See also Johnsen v. Rogers, 551 F.Supp. 281, 284 (C.D. Cal. 1982) (delay not justified by counsel's failure to think of RICO claims previously, but leave to amend was denied partly for other reasons including "the severity of the remedies available under RICO"); Goss v. Revlon, Inc., 548 F.2d 405, 407 (2d Cir. 1976) (denial of third motion to amend complaint after a "barrage of post-trial motions, all of them meritless," would not be an abuse of discretion because movant advanced "no reason for his extended and undue delay, other than ignorance of the law" which "has been held an insufficient basis for leave to amend"), distinguished by Moore v. City of Paducah, 790 F.2d 557, 560 (6th Cir. 1986) (unjustified delay alone was not a basis to deny leave to amend, distinguishing Goss statements as dicta).

For all of these reasons, Creditors were entitled to amend their FAC unless their delay is coupled with prejudice.

4. Prejudice depends on whether the delay itself made Debtor's defense more difficult

As Creditors put it, the bankruptcy court "expressed concern at the hearing that [Debtor's] counsel had been preparing for trial and would have to oppose [Creditors'] summary judgment motion if the court granted leave to amend." Creditors argue that "this is the nature of litigation and is not prejudicial." Creditors cite decisions finding no prejudice even though an amendment would have required additional legal work. See In re Christian Life Center, 45 B.R. 905, 909 (9th Cir. BAP 1984); Hurn, 648 F.2d at 1254-55. Many of Creditors' other cases, cited above, are to the same effect.

Debtor cites cases that at first blush seem irreconcilable. They find prejudice, but the only stated basis is that the party opposing leave to amend has already engaged in legal work or would have to do more legal work in future in response to the proposed amendment. See McGlinchy, 845 F.2d at 809 (prejudice because new claims "would have required additional discovery on a wide range of new issues . . . additional research and rewriting of trial briefs"); Kaplan, 49 F.3d at 1370 (prejudice, as described in decision, consisted of past discovery); Roberts, 661 F.2d at 798. This proves too much. By definition any amendment worth making would require additional legal work by the opponent in the future, so leave to amend would never be granted if that were cognizable prejudice.

We believe that the unstated premise of these cases is that the delay itself caused prejudice, not the amendment per se. For example, a delay would be prejudicial if a party had to do more legal work because of the delay than if the amendment had been made sooner. Another example would be if a delay undermined a statute of limitations. See Kaplan, 49 F.3d at 1370 (proposed amendment would have added claim barred by statute of limitations in related case).

The alleged prejudice in this case is the time and money already spent by Debtor's pro bono legal counsel. Therefore the issue is whether Creditors' delay has caused Debtor's counsel to spend more time and money than they would have if the Section 523(a)(19) claim had been raised in the original complaint or FAC.

5. The bankruptcy court erred by finding undue prejudice

Debtor's counsel argued to the bankruptcy court that they would be prejudiced if the Second Motion to Amend were granted because they had already spent approximately 1000 hours and substantial expenses in defending the existing claims. This overstates the point. The Section 727 claims are entirely independent of any amendment to the Section 523 claims. Section 727 occupied much of the trial and, undoubtedly, much of the pre-trial preparation. Nevertheless, in theory we agree with Debtor that some amount of time and money already spent on the Section 523 claims might have been wasted if Section 523(a)(19) truly were a silver bullet that mooted those claims.[12]

---

[12] Ironically, Debtor's argument is supported by Creditor's own papers filed in the bankruptcy court. Creditors' Second Motion to Amend argues that liability under Section 523(a)(19) is (continued...)

Debtor did not establish that this was true. To the contrary, Debtor argued that the Section 523(a)(19) claim was not a silver bullet and implicated complex legal issues. Debtor claims that Section 523(a)(19) does not cover punitive damages (the bulk of Creditors' monetary claim against Debtor) and includes at most a portion of Debtor's joint and several liability. On this appeal Debtor adds that the Section 523(a)(19) claim would "almost certainly" implicate additional discovery.[13] And as noted in its ruling, supra, the bankruptcy court doubted that Section 523(a)(19) was Creditors' silver bullet and questioned how much of Creditors' claim would be nondischargeable.

In other words, the only indications in the excerpts of record are that the Section 523(a)(19) claim for relief is not a sure thing. So, regardless of whether that claim had been included in Creditors' complaint from the outset, the parties still would have had to litigate all the other claims. Therefore Debtor has not shown that any time or expense of defending against those claims was wasted. There was no showing of prejudice.

---

[12](...continued)
so obvious that "[a] trial of all the remaining and presently existing causes of action would be superfluous, unnecessary and a waste of time for the parties and the Court." (Emphasis added.) If Creditors were correct then perhaps, as Debtor argued to the bankruptcy court, all the discovery and trial preparation on other claims under Section 523 would have been "wasted."

[13] Debtor argues that he would have to take discovery on how the arbitration award was decided. Debtor does not explain the relevance, but perhaps in Debtor's view it makes a difference under Section 523(a)(19) whether the arbitration was based on Florida securities law or federal or New York law and whether Debtor's joint and several liability was based on negligence or some greater degree of intent. We do not speculate further. As noted above, the merits of the Section 523(a)(19) claim are not before us.

We recognize that, at the end of the day, the Section 523(a)(19) claim could turn out to be a silver bullet after all. We express no position on the merits of that claim. Our only point is that Debtor has not met his burden to show that Creditors' delay actually caused any prejudice, let alone undue prejudice.

6. Alternatively, it would be improper to deny leave to amend based on a presumption of undue prejudice without taking into account the ways to cure any such prejudice

Creditors argue that if there were any prejudice it could have been alleviated. They point out that the bankruptcy court could have let Debtor and his counsel choose whether to address the Section 523(a)(19) claim by summary judgment rather than going to trial on the other claims, or could have awarded costs including attorneys' fees to compensate Debtor and his counsel for any extra expenditure of time or money caused by Creditors' delay, or might have imposed other appropriate remedies. See General Signal Corp. v. MCI Tel. Corp., 66 F.3d 1500, 1514 (9th Cir. 1995) (costs may be imposed on amending party as condition for granting leave to amend); Dennis v. Dillard Dept. Stores, Inc., 207 F.3d 523, 526 (8th Cir. 2000) (denial of leave to amend was error when prejudice could be ameliorated by reopening discovery and deposing witnesses if necessary and district court had discretion to order moving party to pay costs incurred as a result of amendment).

Debtor argues that Creditors have waived any argument about ameliorating prejudice because they did not raise this issue before the bankruptcy court. See Conn. Gen. Life Ins. Co. v. New Images of Beverly Hills, 321 F.3d 878, 882 (9th Cir. 2003). That

puts the cart before the horse. Creditors were not required to respond to an argument that Debtor did not make. As discussed above, Debtor did not articulate any actual amount of time or money incurred because of Creditors' delay, so the burden was not on Creditors to speculate about prejudice and then rebut that speculation.

We also believe that any decision whether potential prejudice amounts to actual prejudice must include some consideration whether the hypothetical prejudice could be ameliorated. This approach is consistent with the Ninth Circuit's directive that "[R]ule 15's policy of favoring amendments to pleadings should be applied with 'extreme liberality.'" DCD, 833 F.2d at 186 (citations omitted).

For all of the above reasons, the bankruptcy court should have granted Creditors' Second Motion to Amend to add a claim under Section 523(a)(19). The judgment discharging all of Creditors' claims against Debtor must be reversed.

B. Creditors have not shown clear error in the bankruptcy court's finding that Debtor justified his failure to keep or preserve financial information under Section 727(a)(3)

Section 727(a)(3) provides, in full:

> (a) The court shall grant the debtor a discharge, unless --
>
> > (3) the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case[.]

11 U.S.C. § 727(a)(3).

The Ninth Circuit has stated:

> [T]he purpose of [Section 727] is to make the privilege of discharge dependent on a true presentation of the debtor's financial affairs. The initial burden of proof under § 727(a)(3) is on the plaintiff. In order to state a prima facie case under section 727(a)(3), a creditor objecting to discharge must show (1) that the debtor failed to maintain and preserve adequate records, and (2) that such failure makes it impossible to ascertain the debtor's financial condition and material business transactions. Once the objecting party shows that the debtor's records are absent or are inadequate, the burden of proof then shifts to the debtor to justify the inadequacy or nonexistence of the records.

Cox II, 41 F.3d at 1296 (citations and quotation marks omitted).

The Ninth Circuit further held that "[j]ustification for [a] bankrupt's failure to keep or preserve books or records will depend on . . . whether others in like circumstances would ordinarily keep them." Cox II, 41 F.3d at 1299 (citations omitted).[14] Creditors assert that sophisticated debtors are held to a higher standard, and that the bankruptcy court erred by not considering Debtor's education, intelligence, financial sophistication, business experience, and the complexity of his transactions and financial life. Creditors refer to these as critical "factors" and argue that the bankruptcy court committed an error of law by not considering such factors.

[14] Debtor argues that we and other courts have applied a more liberal standard, requiring only a "credible explanation" for a debtor's failure to keep or preserve financial information. We have reviewed the cases cited by Debtor and perceive no difference between the Ninth Circuit's standard and the requirement of a "credible explanation." The way for a debtor to offer a credible explanation is to show that others in like circumstances would not ordinarily keep the records at issue. See In re Lawler, 141 B.R. at 429.

We reject any formulaic list of factors. Creditors' own citations include authority that a debtor's justification for failing to keep books and records is evaluated based on the totality of the circumstances. Meridian Bank, 958 F.2d at 1231. There is nothing inconsistent between the totality of the circumstances approach and Creditors' other authority that "[m]ore sophisticated business persons are generally held to a high level of accountability in recordkeeping for purposes of § 727(a)(3)." In re Pulos, 168 B.R. 682, 692 (Bankr. D. Mn. 1994). See also Cox I, 904 F.2d at 1403 and n. 5 (remanding for consideration of "all circumstances of the case" (emphasis in original) including debtor's "intelligence and educational background," her "experience in business matters," and "the extent of her involvement in the [relevant] businesses"); Cox II, 41 F.3d at 1299 (considering debtor's sophistication); In re Hughes, 354 B.R. 801, 809-11 (Bankr. N.D. Tex. 2006) (sophisticated debtors held to higher standards); In re Scott, 172 F.3d 959, 969-70 (7th Cir. 1999) ("where debtors are sophisticated in business, and carry on a business involving significant assets, creditors have an expectation of greater and better record keeping"); In re Sigust, 255 B.R. 822, 827 (Bankr. W.D. La. 2000) ("More sophisticated business persons are held to a higher level of accountability"), aff'd, 281 F.3d 1280 (5th Cir. 2001).

We do not doubt that Debtor was a sophisticated business person. We also have no doubt that the bankruptcy court took this into consideration. The bankruptcy court was clearly aware of the evidence that Creditors now cite because, as Debtor argues, they spent considerable time at trial presenting such evidence. The

bankruptcy court's 33-page Memorandum of Decision carefully reviews much of that evidence.

The bankruptcy court was also aware of how little financial information Debtor kept or preserved. The Memorandum of Decision states:

> * [Debtor] has not filed federal and state income tax returns since 1998, and has no W-2 or 1099 forms for the tax years preceding 2003.
>
> * He has no accounting of monies loaned to him from Proxy.
>
> * There are no agreements evidencing the amounts loaned to him by [Simulator] during the years 1997 to 2001.
>
> * He has no record of any stock which he may have owned.
>
> * He stopped keeping financial records in 2001.
>
> * He has kept no records of his income and/or expenses.
>
> * He has kept no records of charitable gifts.

From our review of the bankruptcy court's decision and the trial transcripts we are persuaded that the bankruptcy court considered the totality of the circumstances including the facts highlighted by Creditors on this appeal. The next question is whether, having considered all of the circumstances, the bankruptcy court properly weighed them.

The bankruptcy court's Memorandum of Decision specifically discusses most of the facts cited by Creditors on this appeal. Those facts do establish Debtor's financial sophistication, and it is true that Debtor kept astonishingly few records, but knowing the importance of keeping records and being financially sophisticated is not the same thing as being mentally capable of keeping and preserving financial records when one is devastated because one's spouse has cancer, one's daughter is attempting to

commit suicide, and one's personal and family life are falling apart. We cannot say that the bankruptcy court clearly erred by not finding otherwise.

Creditors argue that Debtor failed to keep or preserve records long before his wife became ill. That is not convincing. The only specific example they mention is Debtor's tax returns, which he admits he did not file for one or two years beforehand. The bankruptcy court acknowledged this lack of tax returns in its Memorandum Decision.

Creditors' most persuasive argument may be that Debtor was not too devastated to continue remunerative consulting but claims to have been too devastated to keep or preserve records. The excerpts of record certainly could be interpreted as evidence that Debtor's lack of recordkeeping is only what others would "ordinarily" do if they were trying to hide income, which is not an excuse. See Meridian Bank, 958 F.2d at 1234 ("Fear of liens by creditors can never by itself constitute adequate justification for failing to candidly disclose the financial status of a debtor.").

On the other hand, that is not the only possible conclusion. Debtor and others testified that after his wife was diagnosed with cancer he truly was devastated. Creditors did not prove that Debtor actually owns or controls the various entities from Hong Kong, Cayman Islands, and elsewhere with which he has done business. If those entities did not provide W-2s or 1099s then perhaps they have their own reasons for doing so or are simply negligent, as opposed to being controlled by Debtor or helping him not to keep or preserve financial information. We did not have

the opportunity to observe the witnesses and we did not preside over a four day trial, as the bankruptcy court did.

We do not say that we would make the same decision as the bankruptcy court if we were sitting as the trial judge. That is not our role on this appeal. We are limited to reviewing the bankruptcy court's findings of fact for clear error. Anderson v. Bessemer City, 470 U.S. 564, 573; 105 S.Ct. 1504, 1511 (1985) (under Fed. R. Civ. P. 52(a), which parallels Fed. R. Bankr. P. 8013, appellate court oversteps its bounds if it reverses the finding of the trier of fact simply because it is convinced that it would have decided the case differently).

We cannot say that the bankruptcy court clearly erred in believing that, whatever else might be true of Debtor and the persons with whom he does business, his wife's cancer and other family problems truly did devastate him. Nor can we say that other persons in like circumstances would necessarily keep or preserve adequate financial records. Creditors have not established reversible error in the bankruptcy court's rejection of their claim under Section 727(a)(3).

VI. CONCLUSION

In this unfortunate case, day trading squandered a substantial portion of Creditors' retirement savings -- over $113,000 according to the arbitration award. Since then, protracted litigation has absorbed untold hours of attorneys' time and over $90,000 in costs incurred by Debtor's pro bono attorneys alone.

The opposing parties, their counsel, and the bankruptcy court had the Herculean task of sorting out vastly different versions of

the facts and complex legal issues. Our role on this appeal is far more limited.

We hold that the bankruptcy court applied an incorrect legal standard in denying Creditors leave to amend their complaint under Rule 15(a). Debtor did not establish that he or his pro bono counsel would have spent any less time or money if Creditors had included their claim under Section 523(a)(19) at the outset. Debtor did not show any cognizable prejudice. Alternatively, even if we were to presume some amount of prejudice, we cannot presume that such prejudice was undue or could not be cured. Because there was no showing of undue prejudice, it was error to deny Creditors' Second Motion to Amend.

We reject Creditors' argument that the bankruptcy court applied an incorrect legal standard under Section 727(a)(3). Nor can we say that it clearly erred in believing that, whatever else might be true of Debtor, his wife's cancer and other family crises caused him to act as others would have in not keeping or preserving adequate financial information.

Consistent with these holdings, the bankruptcy court's judgment discharging all of Creditors' claims against Debtor is REVERSED; the orders discharging Debtor generally from his other debts are AFFIRMED; and we REMAND for further proceedings under Section 523(a)(19).