The following constitutes the ruling of the court and has the force and effect therein described.

Signed July 29, 2015

United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

In re:	§	
	§	
LATITUDE SOLUTIONS, INC.,	§	CASE NO. 12-46295-RFN-11
	§	
Debtor.	§	
	§	
	§	
CAREY EBERT, AS TRUSTEE FOR LATITUDE SOLUTIONS, INC.,	§	
	§	
Plaintiff,	§	
	§	
v.	§	ADVERSARY NO. 14-4107
	§	
HOWARD APPEL, EARNEST A. BARTLETT, III, MATTHEW J. COHEN, RMS ADVISORS, INC., CAPITAL GROWTH REALTY, INC., CAPITAL GROWTH INVESTMENT TRUST, DIT EQUITY HOLDINGS, KWL	§	

EXPLORATION AND DEVELOPMENT, INC., VIRGINIA DADLEY, BELLCREST ADVISORS, LLC, DEBORAH COHEN, HAWK MANAGEMENT GROUP, INC., FEQ REALTY, LLC, HARVEY KLEBANOFF a/k/a HARVEY KAYE, HELEN KLEBANOFF, MOGGLE, LLC, ISLAND CAPITAL MANAGEMENT, LLC, TSS INVESTMENTS, INC., VERNON RAY HARLOW, JEFFREY WOHLER, MICHAEL GUSTIN, WILTOMO REDEMPTION FOUNDATION, SLD CAPITAL CORP., DeROSA FAMILY TRUST, WILLIAM BELZBERG REVOCABLE LIVING TRUST, MICHAEL GARNICK, and JOHN PAUL DeJORIA,	§
Defendants.	§

REPORT AND RECOMMENDATION REGARDING
WITHDRAWAL OF THE REFERENCE

TO THE HONORABLE UNITED STATES DISTRICT COURT:

I, Russell F. Nelms, United States Bankruptcy Judge, make this report and recommendation regarding a motion to withdraw the reference in this adversary proceeding filed by defendants John Paul DeJoria, Michael Gustin, and Jeffrey Wohler. For the reasons stated below, I recommend immediate withdrawal of the reference.

Background

Latitude Solutions, Inc. owns water remediation technology and equipment intended to treat large quantities of waste water for reuse or environmentally safe discharge. It filed a voluntary petition for relief under chapter 7 on November 9, 2012. On the motion of a shareholder

who believed the company was more valuable if reorganized, I converted the case to chapter 11 on April 5, 2013 and appointed Carey Ebert as its trustee.

On November 9, 2014, the trustee filed this adversary proceeding against twenty-seven defendants. The trustee alleges generally that the defendants (a) engaged in or benefited from a fraudulent pump-and-dump scheme to inflate the price of the debtor's stock so they could sell their shares at great personal gain, (b) breached their fiduciary duties to the debtor and its shareholders and creditors, (c) misused and squandered the debtor's assets, and/or (d) received fraudulent transfers of the debtor's assets.

In her complaint, the trustee seeks to recover assets or obtain damages under the following causes of action: (1) fraudulent transfer under sections 544 and 550 of the Bankruptcy Code using the fraudulent transfer laws of Florida or Nevada; (2) fraudulent transfer under sections 548 and 550 of the Bankruptcy Code; (3) breach of fiduciary duty; (4) aiding and abetting breach of fiduciary duty; (5) fraud; (6) conspiracy to commit fraud; (7) aiding and abetting fraud; and (8) punitive damages and attorneys' fees under Florida or Nevada law.

Analysis

The District Court may withdraw, in whole or in part, any proceeding referred to the bankruptcy court. 28 U.S.C. § 157(d). Withdrawal of the reference is mandatory when the resolution of the proceeding requires application of "both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce." *Id.* Although the trustee alleges certain violations of federal securities laws, she has pleaded no claims for relief under those laws. Instead, she has pleaded two causes of action under title 11 and various state law claims. So, withdrawal of the reference is not mandated under section 157(d).

The District Court also may withdraw the reference for "cause shown." *Id*. In this circuit, courts consider the following factors in deciding whether to withdraw the reference: (i) whether the matter involves core, non-core, or mixed issues; (ii) whether there has been a jury demand; (iii) the effect of withdrawal on judicial efficiency; (iv) reduction in forum shopping; (v) uniformity in bankruptcy administration; (vi) fostering economical use of the parties' resources; and (vii) expediting the bankruptcy process. *See Holland Am. Ins. Co. v. Succession of Roy*, 777 F.2d 992, 998-99 (5th Cir. 1985).

A. Core Matters Do Not Predominate

Core proceedings are those that invoke substantive rights provided by the Bankruptcy Code or that, by their nature, can only arise in a bankruptcy case. *Wood v. Wood (In re Wood)*, 825 F.2d 90, 97 (5th Cir. 1987). Most of the trustee's claims are based on state law, do not involve any rights created by title 11, and could and do arise outside of the bankruptcy context. Although, the cause of action under section 544 of the Bankruptcy Code is classified as a core proceeding under 28 U.S.C. §157(b)(2), Florida or Nevada law will determine the substance of that dispute. The cause of action under section 548 does arise under the Bankruptcy Code, but it is so intertwined with the non-core claims that it would make no sense to adjudicate that claim separately.

This adversary proceeding cannot be characterized as merely an adjudication of the defendants' claims against the estate. Only four of the defendants have filed proofs of claim in the bankruptcy case. John Paul DeJoria filed a claim based on a promissory note and loans. Capital Growth Investment Trust and FEQ Realty, LLC filed claims based on convertible promissory notes. Matthew Cohen filed a payroll claim. Because the trustee's claims against these defendants do not require resolution of their claims against the estate, not only are her claims not core, but this court has no constitutional authority to enter a final judgment over such claims without the

consent of all parties. *Stern v. Marshall*, 131 S. Ct. 2594, 2608, 2617 (2011); *Wellness Int'l Network, Ltd. v. Sharif*, 135 S. Ct. 1932, 1942 (2015). The trustee does not consent to such relief in the bankruptcy court. Moreover, three of the defendants have expressly withheld their consent as well. Because non-core matters predominate and all parties do not consent to the entry of final relief in this court, the ultimate adjudication of this proceeding must occur in the District Court.

B. Parties Have Demanded Trial by Jury

It is also noteworthy that the trustee and the three defendants who filed the motion to withdraw the reference have demanded a jury trial. The claims involved in this suit—breach of fiduciary duty, fraud, and fraudulent transfer—facially appear to be claims as to which the right to a jury trial applies. The trustee's demand for a jury, coupled with her lack of consent to final adjudication in the bankruptcy court, only bolsters the conclusion that the reference must be withdrawn. So, the only real question is the timing of the withdrawal of the reference.

C. Economy and Efficiency Concerns Dictate Immediate Withdrawal

Some of the parties insist that the reference be withdrawn immediately. Others are willing to allow me to preside over the proceeding until trial. I believe that the efficient and economical administration of justice will be best served if the reference is withdrawn immediately.

First, several dispositive motions have been filed and the parties have indicated that more will be filed. Because the issues involved in those motions are predominantly non-core, I can only submit proposed findings of fact and conclusions of law on such motions. The procedure is as follows: (1) a dispositive motion is filed and responded to; (2) I review the motion and conduct a hearing; (3) I submit proposed findings of fact and conclusions of law, which are entered in the bankruptcy adversary docket; (4) my proposed findings and conclusions are transmitted by the bankruptcy clerk to the District Court clerk; (5) the parties are given time to respond to my

proposed findings and conclusions; (6) the District Court rules on the dispositive motion; and (7) if the District Court does not grant the dispositive motion, the matter is referred back to me for pre-trial purposes. This procedure is inefficient and expensive even when it involves just a few parties. But, where, as here, the proceeding involves a plaintiff and twenty-seven defendants, it is even more burdensome, expensive, and time-consuming.

Parties often ask me to place discovery on hold while dispositive issues are being decided. I routinely grant such requests in order to avoid unnecessary expense in case the motion is granted. However, placing the case on hold while I decide a dispositive motion necessarily builds delay into the case if the motion is not granted. That delay is only prolonged if the District Court must decide the motion under the protocol outlined above.

While it is obvious that motions to dismiss and motions for summary judgment may have dispositive effect, it is also true, but less obvious, that certain discovery disputes can lead to requests for dispositive relief as well. For example, under Rule 7037(b)(2) of the Federal Rules of Bankruptcy Procedure, a party who fails to comply with an order compelling discovery is subject to sanctions that include: (1) having the matters embraced in the order taken as established as the prevailing party claims; (2) prohibiting the disobedient party from supporting or opposing designated claims or defenses, or from introducing designated matters in evidence; (3) striking pleadings in whole or in part; (4) dismissing the proceeding in whole or in part; or (5) rendering a default judgment against the disobedient defendant. The potentially dispositive nature of these sanctions raises the logical question of whether a bankruptcy court can award them or merely recommend that the District Court do so. Because there is no settled answer to this question, the safer course of action is to withdraw the reference of such motions and, in doing so, exacerbate the inefficiencies of the bifurcated procedure.

The same problem can arise with admissions under Federal Rule of Civil Procedure 36(b)(as incorporated into bankruptcy practice by Federal Rule of Bankruptcy Procedure 7036). A matter admitted under Rule 36 is conclusively established unless the court, on motion, permits the admission to be withdrawn or amended. *Williams v. Wells Fargo Bank, N.A.*, 2014 U.S. App. LEXIS 5137, *24-26 (5th Cir. 2014). Once again, *Stern* raises the question of whether the bankruptcy court can refuse to relieve a party from an admission that is outcome determinative if that party (or for that matter, the other party) has not consented to the entry of a final order in the bankruptcy court.

There are other disputes that can arise during discovery which, though not necessarily outcome determinative, can impact the rights of parties, if not dramatically affect the presentation of evidence. For example, once a bankruptcy court has ordered the disclosure of confidential or privileged information, it is difficult for the District Court to "un-ring the bell," even if that information is never admitted into evidence. Accordingly, the bankruptcy court, erring on the side of caution, might prefer to refer such a dispute back to the District Court for disposition.

All of these scenarios are possible in the smallest two-party dispute. But, where the proceeding involves twenty-seven defendants who are alleged to have engaged in fraud, pump-and-dump schemes, and breach of fiduciary duty, it is all the more likely that such motions will be filed and recourse to the District Court requested. So, a proceeding that has the potential to be procedurally complex and prolonged to begin with might become even more so if the reference is not withdrawn for pre-trial purposes.

D. Other *Holland* Factors Are Neutral or Favor Withdrawing the Reference

There does not appear to be any forum shopping in this proceeding, so that factor has no bearing on my recommendation. Because withdrawal of the reference will not impact the

administration of the bankruptcy case itself, that factor is either neutral or one that favors withdrawal of the reference.

Recommendation

For the reasons stated herein, I recommend that the District Court withdraw the reference of this proceeding immediately, and that it do so with respect to both trial and pre-trial matters.

###END OF REPORT AND RECOMMENDATION###