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BY RONALD D. ROTUNDA*

Introduction

Bankruptcy judges, like tax law judges, are “Article I judges,” not Article III judges. Congress, which creates these judge-like positions pursuant to its Article I legislative powers, cannot constitutionally give them all the judicial powers of Article III judges. Were the rule otherwise, Congress could transfer all the judicial power of the United States to Article I courts and we would no longer have the safeguard and independence that Article III guarantees with its requirement of lifetime tenure and salary protection.1 The independence of the Article III judiciary is an “inseparable element of the constitutional system of checks and balances.”

I am indebted to William C. Heuer for his comments and suggestions. Any errors, sad to say, are all my fault.

1 For example, bankruptcy judges have a term of 14 years, not life. Also, the Constitution does not prevent a diminution in their salaries.


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1 For example, bankruptcy judges have a term of 14 years, not life. Also, the Constitution does not prevent a diminution in their salaries.
Consequently, Article I judges cannot constitutionally preside in those cases (e.g., jury cases that involve assertion of private rights) that must be heard in Article III courts unless all the relevant parties expressly waive their rights. A recurring constitutional question relates to the scope of review from decisions of bankruptcy courts and other Article I courts. The U.S. Supreme Court will divide into Stern v. Marshall: the scope of review that the Article III court can exercise over Article I courts, and the power of those courts to issue final orders.

The Prior Litigation—in the Texas Probate Court, the California Bankruptcy Court, the Federal District Court, the Ninth Circuit, and the U.S. Supreme Court

This lengthy litigation arose out of the marriage of Anna Nicole Smith (also known as Vickie Lynn Marshall), a former Playboy Playmate, to J. Howard Marshall, a billionaire. They met in 1991. Marshall asked Smith to marry him several times and, eventually, she said yes. She then divorced her husband, Billy Wayne Smith, in 1993 and, in 1994, married Marshall. She was 26 years old. They married secretly. They lived together. Thirteen months later, Marshall died. Many of the facts are still in controversy, with different courts reaching different results and conclusions.3

As the Court said in, Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 42 n.4 (1989):

"we do not declare that the Seventh Amendment provides a right to a jury trial on all legal rather than equitable claims. If a claim that is legal in nature asserts a 'public right,' as we define that term . . . then the Seventh Amendment does not entitle the parties to a jury trial if Congress assigned its adjudication to an administrative agency or specialized court of equity . . . . The Seventh Amendment protects a litigant's right to a jury trial only if a cause of action is legal in nature and it involves a matter of 'private right.'"

See also, 2 WILLIAM HOUSTON BROWN, THE LAW OF DEBTORS AND CREDITORS § 11:24 (updated Nov. 2010).

The district court can authorize the bankruptcy court to hear jury cases but only with "express consent of all the parties," 28 U.S.C.A. § 157 (e).


The Brief in Opposition to the Petition for Cirtiorari, 2010 WL 3337662 *4-5 (Aug. 20, 2010), outlines some of the disputes:

"Although Stern states at the outset that J. Howard 'attempted to provide for Vickie through an inter vivo trust,' and that Pierce 'suppressed or destroyed the trust instrument,' Pet. 2, these statements require qualification. It is true that the District and Bankruptcy Courts made 'findings' adverse to Pierce on these points. As the Court of Appeals observed, however, 'the district court made its factual findings without the benefit of the percipient witnesses that Pierce . . . sought to have testify as part of his defense.' Pet. App. 63 n.33. Likewise, the Bankruptcy Court made its findings on the basis of 'deemed facts and without allowing Pierce to put on his case. Marshall v. Marshall, 392 F.3d 1118, 1126-27 (9th Cir. 2004). Moreover, when the Court of Appeals inquired directly (and insistently) of Stern's counsel whether there was any actual evidence in the record to back up the Bankruptcy and District Courts' adverse findings on these matters, Stern's counsel was unable to cite to any. Tr. 35-37 Oct. 9, 2003. Thus, although Stern's statements are based on the Bankruptcy and District Court's 'findings,' they remain highly disputed."


The subsequent law suits have lasted years longer than the marriage, and are the fodder of entertainment commentators. Indeed, an opera titled, "Anna Nicole," based on her life, recently premiered in London. The Royal Opera House called it the "celebrity story of our times that includes extreme language, drug abuse and sexual content." Larry Birkhead, the father of Smith's only surviving child Dammielynn, criticized the opera as "trashy," and said the estate was considering legal options.

The petitioner in Stern v. Marshall is Howard K. Stern, who is the Executor of the estate of Vickie Lynn Marshall, popularly known as Anna Nicole Smith, her stage name. The respondent is Elaine T. Marshall, who is the Executrix of the Estate of E. Pierce Marshall, a son of oil tycoon J. Howard Marshall. The two estates are disputing to what extent, if any, Anna Nicole Smith is entitled to any proceeds from J. Howard Marshall's estate.

J. Howard Marshall gave Smith millions of dollars in gifts during his lifetime "in consideration of her marriage to me," but he did not provide for her in his estate plan. After months before his death, Smith sued in Texas Probate Court in an effort to invalidate Marshall's estate plan. After Marshall's death, she contested the probate estate and filed a tortious interference claim against Pierce, but voluntarily dismissed both claims once the Bankruptcy Court entered its judgment. The probate court, after a jury trial, eventually held that Smith was not entitled to anything from Marshall's estate.

While this probate action was pending, a former housekeeper of Smith, Maria Cerrato, filed another case. She sued Smith for sexual assault and harassment, leading yet another court to enter a default judgment against Smith for $884,607.98. That default led to Smith's bankruptcy filing in California.

In Smith's bankruptcy case, Pierce Marshall (Howard's son) claimed that a defamation claim he had against Smith should not be dischargeable in bankruptcy, and he also filed a proof of claim asserting the defamation claim. In response, Smith counterclaimed, alleging that Pierce had tortiously interfered with his father's oral promises to Smith. The bankruptcy court
agreed with Smith and awarded her $474 million (later reduced to $88 million). The California federal district court eventually agreed, but it did that only after the Texas probate court ruled that Smith was entitled to nothing from J. Howard Marshall's estate.

This is where the distinction between the “final” and “non-final” order power that can be given to Article I bankruptcy courts becomes important. The district court, while it agreed with the bankruptcy court, found that the bankruptcy court could not enter a final order on the counterclaim; rather, the district court considered the bankruptcy court's findings and conclusions to be proposed findings of fact and conclusions of law. After conducting de novo review, the district court then entered judgment. If the district court's view was correct, then the Texas probate court's judgment came first. If, however, the bankruptcy court’s view were correct—i.e., if the bankruptcy court’s order was a final order, reviewable only by appeal (rather than by de novo review by the district court)—then the bankruptcy court’s order preceded the order of the Texas probate court.

After the district court entered its judgment, the case went to the Ninth Circuit. In 2006, it rejected all of Anna Nicole Smith’s claims, concluding that a state probate court (not a ruling from a bankruptcy court) should settle estate matters. Because application of the “probate exemption” from federal jurisdiction was dispositive, the Ninth Circuit never reached the question of whether the bankruptcy court could enter a final order on the counterclaim. The case then went to the U.S. Supreme Court, which ruled in 2006, that the “probate exemption” rule (that is, state courts, not federal courts, normally deal with probate issues), did not apply to Anna Nicole Smith's claim that E. Pierce Marshall had tortiously interfered with his father's oral promises to Smith—is a “core” matter for which a bankruptcy court can enter a final order. Rather, it is about the power of Article III courts to enter final orders and the scope of review from cases within their jurisdiction. The scope of review that an Article III court exercises over the decisions and findings of Article I courts reflects the constitutional and statutory limitations on the judicial power that these Article I judges can exercise.

Hence, one can summarize more pithily the major question before the Court: whether the counterclaim at issue—Smith’s claim in the bankruptcy court that Pierce had tortiously interfered with his father’s oral promises to Smith—is a “core” matter for which a bankruptcy court can enter a final order? Or, is this a “non-core” matter for which the bankruptcy court can only enter proposed findings of fact and conclusions of law that the Article III district court can review de novo? In either case, the bankruptcy court still hears the matter.

The Main Issues Before the Supreme Court

The U.S. Supreme Court granted certiorari on three questions:17


2. Whether Congress may, under Articles I and III, constitutionally authorize core jurisdiction over debtors’ compulsory counterclaims to proofs of claim.

3. Whether the Ninth Circuit misapplied Marathon20 and Katchen21 and contravened this Court’s post-Marathon precedent, creating a circuit split in the process, by holding that Congress cannot constitutionally authorize non-Article III bankruptcy judges to enter final judgment on all compulsory counterclaims to proofs of claim.

Although the parties sometimes refer to jurisdiction,22 Stern v. Marshall is not really about the jurisdiction of Article I bankruptcy judges to hear cases. Rather, it is about the power of Article I courts to enter final orders and the scope of review from cases within their jurisdiction. The scope of review that an Article III court exercises over the decisions and findings of Article I courts reflects the constitutional and statutory limitations on the judicial power that these Article I judges can exercise.


15 The Respondent’s brief also refers to “jurisdiction.” E.g., “The Bankruptcy Court Lacked Jurisdiction To Hear Or Deter- mine Pierce’s Defamation Action Under Section 157(b)(5) and Thus Lacked Jurisdiction To Hear Vickie’s ‘Counterclaim.’” Brief for Respondent, Stern v. Marshall, 2010 WL 5125440, *65 (Dec. 13, 2010) (emphasis added). On the other hand, it states shortly before that (2010 WL 5125440, *61): “Adherence to the commands of Article III and the governing statutory text does not mean that bankruptcy courts are barred from ‘hearing’ all counterclaims. On the contrary, it simply limits the bankruptcy courts’ ability to finally decide a narrow category of pre-existing claims that arise under state law.”


18 28 U.S.C.A. § 157(b)(2)(C): “Core proceedings include, but are not limited to—counterclaims by the estate against persons filing claims against the estate.”

19 28 U.S.C.A. § 157(b)(2)(B): “Core proceedings include, but are not limited to—allowance or disallowance of claims against the estate or ex- emptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11.”

ter and the district court (or bankruptcy appellate panel) reviews the order, but the scope of review changes.

Limits on the Powers of Article I Courts

Because of the constitutional limits on the powers of Article I judges, the 1984 Bankruptcy Act divided the bankruptcy court’s jurisdiction into “core” matters and “non-core” matters. For core matters, Article I bankruptcy judges have full power to enter final orders, which Article III courts review on appeal. For “non-core” matters (matters merely “related to” a bankruptcy case), the bankruptcy court can only propose findings of fact and conclusions of law. On appeal to the federal district court, the Article III judge has de novo review.

The Ninth Circuit, in its decision in 2010, In re Marathon, held that under Northern Pipeline Construction Co. v. Marathon Pipe Line Co., core matters constitutionally exist under § 157(b)(2)(C) only for compulsory counterclaims entirely encompassed within the allowance or disallowance of the creditor’s claim against the estate and that raise no issue beyond that claim. Even though Smith’s compulsory counterclaim against Marshall constituted an affirmative defense to the proof of claim, the counterclaim was non-core because the debtor had to prove additional elements to prevail.

The Ninth Circuit judges agreed with the amici curie professors that “a counterclaim under § 157(b)(2)(C) is properly a ‘core’ proceeding ‘arising in a case under’ the [Bankruptcy] Code only if the counterclaim is so closely related to the proof of claim that the resolution of the counterclaim is necessary to resolve the allowance or disallowance of the claim itself.” Professors’ Amicus Br. at 11.

Because Smith’s compulsory counterclaim was not a core proceeding under § 157(b)(2)(C), the bankruptcy court’s judgment was not “final.” The Ninth Circuit then concluded that it should give preclusive effect to the Texas probate court’s findings that the testator did not intend to give his widow a gift from the assets that passed through his will or that were held in his living trust.

The U.S. Supreme Court will decide if the Ninth Circuit’s interpretation of Marathon is correct. That case itself offers no easy answer because there was no Opinion of the Court in Marathon.

Northern Pipeline filed for bankruptcy and sued Marathon in the bankruptcy court for a state-law breach-of-contract claim. The state-law claim did not “arise under” the Bankruptcy Code or “arise in” the bankruptcy case, but was “related to” the bankruptcy case because any recovery that Marathon received on this claim would increase its assets. The Bankruptcy Code at the time provided that the bankruptcy court had plenary jurisdiction over proceedings “related to” the bankruptcy estate.

A majority of the justices in Marathon concluded Article III did not allow non-Article III bankruptcy courts to exercise plenary jurisdiction (and thus enter final judgments and orders) over state-law contract claims merely because those claims were “related to” the bankruptcy case. That statutory scheme violated Article III because it removed “the essential attributes of the judicial power from the Article III district court and vested those attributes in a non-Article III adjunct.”

Justice Rehnquist, joined by Justice O’Connor, concurred in the judgment and embraced a narrower view of the permissible scope of power that Congress can give to Article I judges. Justices Rehnquist and O’Connor agreed that a non-Article III court could not constitutionally decide this breach of contract claim against Marathon, “against its will,” and that no prior cases sanctioned this power. Rehnquist did not embrace a “public rights” exception to Article III.

Behind that, the reach of Marathon is unclear. In fact, during the oral argument in Stern v. Marshall, Justice Breyer exasperatedly remarked, “Marathon, you know, you had four, four and—and who knows what it stands for.”

Congress responded to Marathon by limiting the power of bankruptcy courts to enter final judgments and orders in “public rights” matters that the Marathon plurality suggested may be constitutionally adjudicated in a non-Article III court. It did so by distinguishing between “core” bankruptcy proceedings that arise under the Bankruptcy Code or arise in a case under the Bankruptcy Code, and “non-core” bankruptcy proceedings that are “otherwise related to” a case under the bankruptcy laws. For “non-core” matters, the bankruptcy court can only enter proposed findings subject to de novo review.

There a few cases on the Supreme Court level elaborating on Marathon, but not on the precise issues here. That is, after all, why the Court took the Stern v. Marshall case.

One such case is Katchen v. Landy. The creditor filed a claim and the trustee responded by asserting a preferential transfer. The law at the time provided that the bankruptcy court could not give a creditor an allowed claim, unless the creditor first paid back to the bankruptcy estate the amount of any preferential payment it had received. The Court held (7 to 2) that the bankruptcy court had summary jurisdiction to order the creditor to surrender voidable preferences asserted and proved by the trustee in response to a claim that the creditor (who had received the preferences) had filed. The bankruptcy court could not allow (or disallow) the claim against the estate until it decided the preference issue. Hence, the question whether the creditor had received a voidable preference was “part and parcel of the allowance process” for the underlying claim, and so the bankruptcy court could adjudicate it and enter judgment on both the claim against the estate and the preference claim by the estate.

The Katchen Court observed that the bankruptcy court was merely adjudicating interests claimed in the

25 600 F.3d 1037 (9th Cir. 2010).
27 600 F.3d 1037, 1058.
28 458 U.S. 50, 56.
29 458 U.S. 50, 54, 71-72 (plurality).
30 458 U.S. 50, 54.
res, “and thus falls within the principle” that “bankruptcy courts have summary jurisdiction to adjudicate controversies relating to property within their possession.”\(^\text{37}\) Katchen does not solve the question before the Court in Stern v. Marshall because Smith’s estate is using the bankruptcy court to augment the estate, not to resolve claims on the res that is already in the possession of the bankruptcy court.

Another relevant case in this area is Commodity Futures Trading Commission v. Schor.\(^\text{38}\) Schor asserted a reparation complaint against his broker arising out of his broker’s alleged violations of the Commodity Exchange Act (CEA) in handling Schor’s financial futures accounts. Schor’s claim was a creature of federal law and, pursuant to federal statute, the Commodity Futures Trading Commission (CFTC), an Article I court, heard it. Schor’s broker counterclaimed, relying on a provision of state law.

Schor had an account with the broker, and this account contained a debit balance because Schor’s net futures trading losses and expenses, such as commissions, exceeded the funds deposited in his account. Schor claimed that this debit balance was because of his broker’s numerous violations of the CEA. Before the broker knew of Schor’s administrative proceeding, it filed suit in federal district court for an order requiring his broker’s numerous violations of the CEA. Before the broker knew of Schor’s administrative proceeding, it filed suit in federal district court for an order requiring Schor to pay his debit balance. Later, the broker voluntarily dismissed that suit and counterclaimed in the CFTC proceeding. “Schor said he should not have to pay the debit charges, and the broker said that Schor should have to pay the debit charges.”\(^\text{39}\) The parties based their claims on the account and the success of one claim required the failure of the other one. In order for the CFTC to resolve Schor’s complaint under federal law, it had to resolve the validity of the broker’s denial of Schor’s complaint.

Smith’s estate argues that the facts of Schor support its position. Smith’s “success on her counterclaim would have defeated Pierce’s defamation claim, and Pierce’s success on his defamation claim would have defeated her counterclaim.”\(^\text{40}\) However, the facts of Schor do not mean that a bankruptcy court can decide, as if it were an Article III court, the claim that Anna Nicole Smith brought against Pierce Marshall for tortious interference with a gift. Judge Kleinfeld, concurring in the Ninth Circuit opinion, summarized a few facts that highlight the differences compared to the facts of Schor:

(1) because Pierce Marshall sought no damages from the bankruptcy estate, just a judgment that his Texas defamation judgment would not be discharged by the California bankruptcy, his claim could not affect the size of the estate available to Vickie Marshall’s creditors; (2) Vickie’s [Smith’s] counterclaim for money could not affect whether Pierce’s defamation claim was dischargeable; (3) Vickie’s [Smith’s] counterclaim was not related to the bankruptcy because she had already been discharged and her creditors would get none of the money she sought from Pierce in her counterclaim; (4) Pierce’s defamation claim in Texas was a common law claim for personal injury, which cannot be core. Vickie’s [Smith’s] counterclaim (itself a non-core tort claim) amounted to evasion of Pierce’s constitutional right to jury trial in Texas. That evasion cannot stand shielded by bankruptcy court jurisdiction, especially when her bankruptcy was over and her debts discharged.\(^\text{41}\)

Yet another major decision in this area is Granfinanciera, S.A. v. Nordberg.\(^\text{52}\) That case considered whether a person who had not submitted a claim against a bankruptcy estate had a right to a jury trial when the bankruptcy trustee sued it to recover an alleged fraudulent transfer from the debtor.\(^\text{43}\) Granfinanciera held that the defendant in that action was entitled to a jury trial, even though Congress had designated fraudulent transfer actions as “core proceedings.”\(^\text{44}\) The Court concluded that a fraudulent transfer action was a matter of “private right” because it was a common-law action that more closely resembled a contract suit that a debtor would bring to augment the estate as opposed to creditors’ claims to distributions from the estate:

If a statutory right is not closely intertwined with a federal regulatory program Congress has power to enact, and if that right neither belongs to nor exists against the Federal Government, then it must be adjudicated by an Article III court. If the right is legal in nature, then it carries with it the Seventh Amendment’s guarantee of a jury trial.\(^\text{45}\)

Ultimately, the Smith estate argues that Congress intended 28 U.S.C.A. § 157(b)(2)(C) to authorize “bankruptcy courts to determine all compulsory counterclaims,”\(^\text{46}\) that Article III courts (the district court or bankruptcy appellate panel) can then review on appeal (rather than by de novo review), and that this delegation of judicial power is constitutional. “Compulsory counterclaims, in particular, ‘arise in’ the bankruptcy case: The debtor must file them and they are factually and legally interconnected with the creditor’s claim.”\(^\text{47}\)

The rules of civil procedure make some claims compulsory for purposes of judicial economy.\(^\text{48}\) This rationale for compulsory counterclaims has nothing to do with the concern expressed in Marathon and other cases that non-Article III judges should not preside over all Article III cases. In other words, the distinctions between core and non-core proceedings satisfy different concerns than the distinctions animating the differences between compulsory and non-compulsory counterclaims.

**Conclusion**

If the Supreme Court accepts the Smith view that an Article I court can issue final orders for all compulsory counterclaims in bankruptcy matters, its decision can have wide applications. Consider the situation dis-

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\(^{37}\) 382 U.S. 323, 330.

\(^{38}\) 478 U.S. 833 (1986).


\(^{41}\) 600 F.3d 1037, 1065 (Kleinfeld, concurring).


\(^{43}\) 492 U.S. 33, 36 (1989).


\(^{45}\) 492 U.S. 33, 54-55 (footnote omitted).


\(^{48}\) Albright v. Gates, 362 F.2d 928, 929 (9th Cir.1966).
cussed in one amicus brief. An individual (Alpha) has a contract with a large corporation (Beta) to sell it widgets. Alpha sold Widget A for many years, and then started producing Widget B. For years, Beta only ordered Widget A, but recently decided to order only Widget B. Alpha ships $50 of Widget B to Beta, which soon thereafter files for bankruptcy. Alpha fills out the bankruptcy claim form mailed to him, seeking to collect for Widget B, which he had sold to Beta. The bankruptcy court will resolve, as a "core matter," Alpha's claim for the amounts owed for Widget B. Because it is a core matter, bankruptcy court can enter a final order. Any appeal to the Article III district court and the district court's power to review that final order is limited.

Now, let us vary this hypothetical. Alpha still submits it $50 claim to the bankruptcy court for Widget B. However, this time Beta counterclaims and asserts that Widget A (which Alpha earlier sold to Beta) was defective, that Alpha fraudulently induced Beta to buy Widget A, and that buying those widgets caused Beta (the debtor) to suffer tremendous financial losses, loss of prestige, and loss of good will. Alpha and Beta have a contract that deals with Widgets. Note that Alpha filed a bankruptcy claim for Widget B while Beta counterclaims that Widget A is defective. Beta also argues that because both matters arise out of the same contract, Beta's counterclaim is compulsory.

There, the bankruptcy court can hear the counterclaim because the statutory jurisdiction is broad. However, it is quite a different question whether this Article I court can issue final orders. Or, is the dispute involving Widget A a "non-core" matter for which the bankruptcy court can only enter proposed findings of fact and conclusions of law for which the Article III court can review de novo? In either case, the bankruptcy court still hears the matter and the district court (or bankruptcy appellate panel) reviews the order, but the scope of review changes significantly.

If the Court allows Article I courts to issue final orders in matters that would otherwise be heard in an Article III court, simply because the rules of procedure designate a counterclaim as compulsory, that will greatly broaden the powers of Article I judges. Only Article III courts offer the special protections to litigants (such as a jury trial and a presiding judge with full tenure and salary protection) that are the hallmark of federal jurisprudence. At the very least, this decision should illuminate the reach of Marathon and the distinction between core and non-core matters.
