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VIA FACSIMILE and OVERNIGHT MAIL

December 7, 2005

Honorable Edward M. Kennedy
United States Senate
520 Dirksen Senate Office Building
Washington DC 20010
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Dear Senator Kennedy:

The President has nominated Judge Samuel A. Alito, Jr., currently a judge on the United States Court of Appeals for the Third Circuit, to be an Associate Justice of the United States Supreme Court. Your office has asked for my views regarding Judge Alito's participation on the Circuit Court in a case entitled Monga v. Ottenberg (Docket No. 01-1827). The defendants in that case included Vanguard Group, Inc., and two other Vanguard entities. I understand that the claims against the Vanguard entities sought compensatory and punitive damages. Judge Alito was part of a three judge panel which, in affirming the decision of a lower court, among other holdings rejected the claims against the Vanguard entities "as a matter of law."

The case was submitted to Judge Alito's panel on April 12, 2002 and decided on July 30, 2002. At the time the case was before him, Judge Alito held shares in 12 Vanguard mutual funds, with a value between $360,010 and $830,000 according to the judge's financial disclosure report for the 2002 year. When that report became public, the unsuccessful plaintiff (appellant) moved to vacate the opinion on the ground that Judge Alito had a statutory conflict of interest that prohibited him from sitting on the appeal. In a December 10, 2003, letter to Chief Judge Scirica of the Third Circuit, Judge Alito wrote that "I do not believe that I am required to disqualify myself based on my ownership of the mutual fund shares." But he added that it was his "personal practice to recuse in any case in which any possible question might arise." He then "voluntarily" recused himself. The decision on the appeal was vacated and the appeal was assigned to a new panel, which also affirmed in favor of the Vanguard entities.

Several other events provide additional context.

In connection with Judge Alito's 1990 hearings for confirmation to the Third Circuit, the Senate Judiciary Committee questionnaire asked him to "[i]dentify the categories of litigation and financial arrangements that are likely to present potential conflicts-of-interest during your initial service in the position to which you have been nominated." Judge Alito's response included the statement that he "would disqualify myself from any cases involving the Vanguard companies...." I understand that the Vanguard companies appear on the standing recusal list that Judge Alito thereafter provided to the Circuit Court clerk's office and that, as a result, the clerk's office did not send Judge Alito cases in which the name "Vanguard" appeared as a party (although apparently on

two occasions the particular "Vanguard" was unaffiliated with the Vanguard Group). I understand that Vanguard has continued to appear on Judge Alito's standing recusal list because the clerk's office has refrained from sending him cases in which Vanguard is a party as late as this year.

Judge Alito and the White House have offered various explanations for Judge Alito's failure to recuse himself in *Monga*, including that a "computer screening program" at the Court had failed to identify the conflict (Washington Post, November 1, 2005, at page A11); that the statute did not in any event require recusal on these facts; that the representation Judge Alito made to the Committee in 1990 only addressed his "initial" service on the Court and the appeal was heard in 2002, twelve years after his service began; that Judge Alito had been "unduly restrictive" on his 1990 questionnaire; and that the failure to notice that "Vanguard's status in the matter might call for my recusal" was an "oversight." The last four explanations (and quotations) appear in an undated letter from Judge Alito to Senator Specter, faxed on November 10.2005.

I assume that Judge Alito knew that Vanguard entities were parties to the appeal before him (the name "Vanguard" appears in the caption three times and numerous times through out the Court's opinion); and that Judge Alito knew that he owned substantial shares of Vanguard funds. Indeed, his financial disclosure report for 2002 shows that he continued to invest in Vanguard funds throughout the year although it is not possible to tell whether these investments were automatic reinvestments of dividends or new money.

In addressing the legal and ethical issues raised in the inquiry from your office, I am not offering a view on whether Judge Alito should be confirmed to sit on the Supreme Court or on what weight, if any, the Senate should give to these issues. I am also not addressing any obligation that arise solely from the promises Judge Alito made to the Committee during his confirmation hearings for the Third Circuit. My opinion is limited to the question whether Judge Alito was statutorily disqualified from sitting in the *Monga v. Ottenberg* appeal.

An answer to that question requires an understanding of the relationship between the Vanguard Group, Inc., one of the parties before Judge Alito, and its fundholders. Vanguard promotes itself by declaring that its fundholders are "owners" of Vanguard, not merely shareholders in the funds in which they invest. While the company's website describes the relationship in various brief ways, a sample prospectus describes the relationship in greater detail:

> The Vanguard Group is truly a mutual mutual fund company. It is owned jointly by the funds it oversees and thus indirectly by the shareholders in those funds. Most other mutual funds are operated by for-profit management companies that may be owned by one person, by a group of individuals, or by investors who own the management company's stock. The management fees charged by these companies include a profit component over and above the companies' cost of providing services. By contrast, Vanguard provides services to its member funds on an "at cost" basis, with no profit component, which helps to keep the funds' expenses low.

An even more detailed description appears in the disclosure statement that court rules required the Vanguard entities to file in connection with the appeal. The purpose of this statement is to inform judges of corporate relationships so that judges can comply with statutory rules for disqualification. The Vanguard disclosure statement identifies the Vanguard Group, Inc., as "a wholly-owned subsidiary of the mutual funds that comprise The Vanguard Group of Investment Companies." The disclosure statement then says that "the various Vanguard Funds (identified on the attached list) are all owned by individuals and institutions that own share of those funds." The

attached list includes funds owned by Judge Alito. Finally, the statement discloses that "[a]ll expenses of Vanguard are paid for by the funds that own it and all revenues are returned to those funds. To the extent that Vanguard or any of its subsidiaries, including Vanguard Fiduciary Trust Company [also a party to the appeal], would be the subject of any judgment, that payment would be spread across the member funds given the expense-sharing structure."

So to recapitulate: the Vanguard Group, Inc., is a wholly owned subsidiary of the mutual funds that comprise it; those funds are owned by their respective investors, including Judge Alito. As stated, the plaintiff in the appeal was seeking compensatory and punitive damages against the Vanguard Group, Inc. It follows that any damages it would be required to pay by virtue of an adverse judgment or settlement would in turn be borne by "the funds that own it."

I now turn to the question whether Judge Alito as a Vanguard fundholder was disqualified from hearing a case in which the Vanguard Group, Inc., was a party.

The issues raised by the question are addressed both in the Code of Conduct for U.S. Judges and 28 U.S.C. §455. The statute, like the Code of Conduct, derives from the American Bar Association's Model Code of Judicial Conduct (1990). Because the statute and the Code of Conduct for U.S. Judges contain substantially the same language in so far as the issues here are concerned, I will mainly address the statute.

In 28 U.S.C. §455(b)(4) and (d)(4), Congress decided that a "financial interest" (legal or equitable) in a party is a basis for recusal, "however small" that interest may be (even one share of stock, say). This is a categorical rule, a bright line. The statute makes the disqualification non-waivable. §455(e).

There are good reasons to have the categorical or bright line language here, rather than a flexible standard that would, for example, disqualify a judge only if his or her interest in a litigant could be "substantially affected." A bright line avoids satellite hearings to determine the size of a judge's holdings, which the judge may find invasive of his or her privacy. And a bright line assures that the same rule of recusal will apply to all judges regardless of their personal wealth. Last, for all federal courts below the Supreme Court, recusal of a judge means only that the matter will be assigned to another judge on the judge's court. Consequently, any disruption is minimal.

Congress created four exceptions to the categorical rule of disqualification. Two concern us. In §455(d)(4)(i), Congress decided that "[o]wnership in a mutual or common investment fund that holds securities is not a 'financial interest' in such securities unless the judge participates" in the fund's management. So if a judge owns 100 shares of Fund X and Fund X has 10,000 share in Company Y, the judge can sit in a case where Y is a party. The reason for this is that the judge, as an investor, has no power to buy or sell stock that the fund holds if the judge does not participate in managing the fund.

The other relevant exception is for a "proprietary interest of a policyholder in a mutual insurance company, of a depositor in a mutual savings association, *or a similar proprietary interest*...." (Emphasis added.) In that situation, a "financial interest" exists only if "the outcome of the proceeding could substantially affect the value of the interest." §455(d)(4)(iii). Here we have a fluid standard, not a bright line.

The question in the case of Judge Alito's Vanguard holdings is this: Are his holdings governed by the bright line rule of §455(b)(4) and (d)(4) or are his holdings within the fluid standard

of §455(d)(4)(iii)? If the latter, then Judge Alito could sit in the Vanguard case at issue because his interest in his investments could not have been "substantially affect[ed]" by the decision in the case. If, however, the bright line rule governs, then he could not sit.

I understand that Judge Alito and others take the position that even if Vanguard fundholders have a financial interest in Vanguard itself because of how the company is structured, nonetheless the judge's interest in Vanguard is "a similar proprietary interest" within the meaning of paragraph §455(d)(4)(iii) and therefore the bright line test (that is, the "however small" test) does not apply. If §455(d)(4)(iii) does govern, then Judge Alito was entitled to sit in the case under the statute and the Code of Conduct for U.S. Judges because the decision could not have affected the value of the judge's Vanguard shares "substantially." But I believe this position is wrong.

First, as background, it is important to realize that Congress identified in the first exception above - §455(d)(4)(i) - the extent to which it was prepared to exempt "mutual or common investment fund" interests from the "however small" test. I believe it misreads the statute then categorically to expand §455(d)(4)(iii)'s reference to "similar proprietary interest" to a type of investment (i.e., mutual funds) that Congress had already (and narrowly) addressed in §455(d)(4)(i). It is relevant to my analysis that Congress, in using the "however small" language, chose a very strict rule of recusal for the valid reasons noted above. It then took care to define the exceptions to this strict rule quite narrowly.

I next look to Advisory Opinion 57 of the Advisory Committee on Judicial Activities of the Judicial Conference, issued in 1978 and revised in 1998. This is the Committee that advises federal judges on the equivalent language in the Code of Conduct for U.S. Judges. The Committee is now called the Committee on Codes of Conduct. The Committee was asked whether a judge who owns stock in a parent company must recuse himself if a "controlled subsidiary" of the parent (but not the parent) is a party before the judge.

The Committee quoted legislative history from the reporter for the ABA Code of Judicial Conduct, which was the source for the Code of Conduct for U.S. Judges. The language it quoted recognizes the exception that eventually became (in somewhat different text) the exception preserved in §455(d)(4)(iii) for mutual savings banks and insurance companies, the exception on which Judge Alito also relies.

And just as §455(d)(4)(iii) uses the term "similar proprietary interest," the legislative history language used the term "and other similar" interests.

Notwithstanding the looser test for mutual insurance companies, mutual savings banks, "and other similar" interests, however, the Committee concluded that "the owner of stock in a parent corporation has a direct legal or equitable interest in a controlled subsidiary, and where a judge knows that a party before him is controlled by a corporation in which the judge owns stock, he should disqualify in the proceeding."

In other words, the Committee refused to expand the exception for mutual insurance companies and mutual savings banks and "similar" interests to the facts before it – ownership of stock in a parent whose controlled subsidiary was before the judge. As a result, a judge who owned even one share of stock in the parent could not knowingly sit in a case in which a controlled subsidiary (which may not even be wholly owned by the parent) was a party.

This refusal to expand the exception for mutual insurance companies and mutual savings banks – through use of the catchall for "other similar" interests – supports the view that §455(d)(4)(iii)'s reference to "similar proprietary interest" cannot properly be used to bring Judge Alito's mutual fund interest within the looser exception in §455(d)(iii), especially as Congress had specifically and narrowly addressed the "mutual or common investment fund" exception to the bright line rule in §455(d)(4)(i). Instead, Judge Alito's ownership of Vanguard funds made him an investor in a "parent" entity whose "subsidiary," the Vanguard Group, Inc., was a litigant before him, precisely the situation that Opinion 57 concluded required disqualificaiton.

Direct support for this reading of the statute appears in "Checklists for Financial and Other Conflicts of Interest," which the Administrative Office of the United States Courts issued for the guidance of federal judges in 1999. Footnote 3 of the Checklist (which construes parallel language from the Code of Conduct for U.S. Judges) describes the relationship between the Vanguard Group, Inc., and the funds that comprise it and concludes that disqualification is required when that relationship exists:

> Shares in mutual funds do not constitute a financial interest in the companies whose stock is held by the mutual fund, unless the judge participates in management of the fund. However, shares in some mutual funds may convey an ownership interest in the mutual fund management company (in which case that company should be included on the conflicts list).

Perhaps, notwithstanding the revealed relationship between the Vanguard Group, Inc., and its fundholders, and the statutory recusal language and other authorities, Judge Alito concluded that the governing standard was 28 U.S.C. §455(d)(4)(iii) – that is, that his right to sit was controlled by the less demanding standard that the statute applies to depositors in mutual savings banks and policyholders in mutual insurance companies. If so, Judge Alito should nevertheless have alerted the parties to his Vanguard investments so that, if advised, any could seek his recusal. Any such recusal motion may have persuaded Judge Alito that the statute did require his recusal; or may have led to his recusal even if he was not persuaded (as eventually he did recuse himself following issuance of the opinion); or if recusal were denied, would have enabled the moving party to make its record and preserve its claim for further review. See the Commentary to Canon 3E, ABA Code of Judicial Conduct:

> A judge should disclose on the record information that the judge believes the parties of their lawyers might consider relevant to the question of disqualification, even if the judge believes there is no real basis for disqualification.

See also Liljeberg v. Health Services Acquisition Corp., 486 U.S. 847, 867 (1988)(criticizing district judge for "his silence" that "deprived respondent of a basis for making a timely motion for a new trial and also deprived it of an issue on direct appeal").

I hope this letter adequately addresses your request.

Sincerely yours,

Stephen Gillers

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