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Our File Number

July 12, 1994

Lloyd N. Cutler, Esq.
Counsel to the President
The White House Counsel's Office
1600 Pennsylvania Avenue
Washington, D.C. 20500

Re: Judge Stephen G. Breyer

Dear Mr. Cutler:

In connection with the pending hearings on Judge Stephen G. Breyer for the Supreme Court, I submit the attached statement requested by you on a problem of disqualification of judges.

Yours very truly,

John P. Frank

JPF/lld
Enclosure

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July 12, 1994

JUDGE STEPHEN G. BREYER DISQUALIFICATION MATTER

I. Identification – John P. Frank.

Mr. Frank is a partner at the law firm of Lewis and Roca, Phoenix, Arizona, who has been heavily involved in disqualification matters over the decades. He is the author of the seminal article on that subject in the 1947 Yale Law Journal. He was subpoenaed by the Senate Judiciary Committee to testify as an expert on disqualification in connection with the nomination of Judge Haynsworth to the Supreme Court in 1969. In the aftermath of that episode, the Congress took to rewrite the Disqualification Act, creating the present statute, 28 U.S.C. § 455. Simultaneously, a commission under the chairmanship of Chief Justice Roger Traynor of California for the American Bar Association was rewriting its canon of judicial ethics. Mr. Frank became, informally, Senate representative in negotiations with the ABA Traynor Commission to achieve both a canon and a new statute which would be nearly the same as possible. Senator Bayh and Mr. Frank appeared before the Traynor Commission. Mr. Frank worked out a mutually satisfactory canon/bill with Professor Wayne Thode of Utah, reporter for the Traynor Commission. The canon was then adopted by the Traynor Commission and essentially put into bill form by Senators Bayh and Hollings. Major witnesses for the bill on the Senate side were Senators Bayh and Hollings, and Mr. Frank. On the House side, Judge Traynor and Mr. Frank jointly lobbied the measure through. Mr. Frank is intimately acquainted with the legislative history and well acquainted with subsequent developments.

The foregoing outline is my final conclusion on this subject. I am aided not merely by numerous attorneys in my own office, but also by Gary Fontana, a leading California insurance law specialist of the firm of Thelan, Marrin, Johnson & Bridges of San Francisco.

II. Issue.

In his capacity as an investor, Judge Stephen G. Breyer has been a "Name" on various Lloyds syndicates up to a maximum of 15 at any one time over an 11-year period from 1978 through 1988. This means, essentially, that he is one of a number of investors who have put their credit behind the syndicates to guarantee that claims arising under certain insurance policies directly written or

reinsured by the syndicates are paid. If the premiums on the policies and the related investment income outrun the losses, expenses and reinsurance,there is payment to the Names. If there is a shortfall, the Names must make up the difference. For an extensive description of the Lloyds system, see Guide to the London Insurance Market, BNA 1988, and particularly chapter 3 on underwriting syndicates and agencies. As the full text shows, this is a highly regulated enterprise, a matter of consequence in relation to views of Chief Justice Traynor expressed below.

The syndicates commonly reinsure North American companies against a vast number of hazards. Among these probably are certain hazards arising in connection with pollution which may relate to the "superfund," a financing mechanism of the United States for pollution clean-up. A question has been raised as to whether, in any of the various cases in which Judge Breyer has sat involving pollution, he may have been disqualified. The identical question could arise in connection with any number of other cases in which Judge Breyer has sat because the syndicates have infinitely more coverage than pollution. The selectivity of the current interest is probably due to nothing but the colorful nature of pollution or the failure of some inquiring reporter to see the problem whole.

A very significant factor is that the Lloyds syndicates are not merely insurers or re-insurers. They are also investment companies and much of their revenue comes from investments in securities.

III. Answer.

Should Judge Breyer have disqualified in any pollution cases in which he participated because of his Name status?

Answer: No.

IV. Disqualification Standards As Applied To This Situation.

A. Party Disqualification.

Under the statute, if a judge has an interest in a party, no matter how small, he must disqualify. Knowledge is immaterial; a judge is expressly required to have such knowledge so that he can meet this responsibility. Since the statute, judges have had to narrow their portfolios; "I didn't know" is not even relevant.

We may put this strict criteria of disqualification aside because neither Lloyds nor any of the syndicates is a party to any of these cases. This is of vital

importance because this is the one strict liability disqualification criterion in this situation.

B. The Common Fund Exception.

Congress in § 455 did not mean to preclude judges from investing; this was fully recognized both in § 455 and the canons; H.R. Rep. No. 1453, 93d Cong., 1st Sess. at 7 (Oct. 9, 1974). Judges have a range of income expectations and an investment is quite appropriate. Investment is restricted only where it would lead to needless perils of disqualification.

In that spirit, § 455(d)(4)(i) recognizes that judges may invest in funds which are themselves investment funds and while the judge cannot sit in any case which involves the fund, he is exempted from a duty of disqualification in matters involving securities of the fund unless he participates in the management of the fund, Sen. Hrg. 1973 at 97, which Judge Breyer did not do. "Investments in such funds should be available to a judge," *id.* This section was intended to create "a way for judges to hold securities without needing to make fine calculations of the effect of a given suit on their wealth," *New York Develop. Corp. v. Hart*, 796 F.2d 978, 980 (7th Cir. 1986). As Chief Justice Traynor said of this exception, it is "because of the impossibility of keeping track of the portfolio of such a fund," Sen. Hrg. 1973, House of Rep. Subcomm. Jud. Com. on S. 1064, May 24, 1974 (hereafter H.R. Hrg. 1974), p. 16.

The relevant section is as follows:

> (i) Ownership in a mutual or common investment fund that holds securities is not a "financial interest" in such securities unless the judge participates in the management of the fund;

1. A large Lloyds syndicate is a "common investment fund." There is a definition in Reg. § 230.132 of "common trust fund," which is a particular type of bank security specifically exempted from the Securities Act of 1933 pursuant to Section 3(a)(2). The only useful portion of that definition is "maintained exclusively for the collective investment and reinvestment of monies contributed thereto by one or more [bank] members. . ." A "common enterprise" is one of the four elements of an "investment contract" as set forth in the *Howey* case:

> [A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person

> [1] invests his money, [2] in a common enterprise, and [3] is led to expect profits, [4] solely from the efforts of a promoter or third party . . .

SEC v. W. J. Howey Co., 328 U.S. 293, 298 (1946). The common enterprise requirement is usually satisfied by a number of investors who have a similar stake in the profitability of the venture.

2. While the precise form of common fund involved here was not contemplated in the statute, functionally a Lloyds investment is the same as any other common fund investment. It is an investment in a common fund in which the judge has no practical way of knowing on what he may make a return.

V. The Non-Party Exception Criteria.

Under § 455(d)(4), "financial interest" covers "ownership of a legal or equitable interest, however small" and then moves on to an additional thing, "or a relationship as director, advisor, or other active participant in the affairs of a party." This, too, is under the "however small" criterion, Sen. Hrg. 1973 at 115. This disqualifies the judge if he is a creditor, debtor, or supplier of a party if he will be affected by the result; but this only applies to a party, *id.* 115. A different standard is applied under § 455(d)(4)(iii) to any "proprietary interest" similar to mutual insurance or mutual savings. Here the disqualifying interest must be "substantial"; the "however small" standard is inapplicable. There is more latitude here than in the other relationships and these can be usefully described as the "non-party" involvement of the judge. I have elaborated on this topic in Commentary, 1972 Utah Law Review § 77, which has reflected the views of Professor Thode of the Utah Law School, reporter on the canon, and which is referenced in the legislative history of § 455, Sen. Hrg. 1973 at 113.

This covers the relationship of the judge not in terms of his direct financial interest in a party (as to which his disqualification is absolute and unawareness is not relevant)[1] but rather covers non-party interest. For classic illustration, if the home of a judge is in an irrigation district and if he is passing on the validity of the charter of the irrigation district itself, the answer to that

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[1] *See, In re Cement Antitrust Litigation (MDL No. 296)*, 688 F.2d 1297, 1313 (9th Cir. 1982) (judge was disqualified when his wife had a minor investment in a party, "After five years of litigation, a multi-million dollar lawsuit of major national importance, with over 200,000 class plaintiffs, grinds to a halt over Mrs. Muecke's $29.70.").

question may affect the value of this home. As owner, he is not at all a party to the case and he has no financial interest in the irrigation company, but he is affected. The distinction in these non-party cases is that here the interest, instead of being measured by the "however small" criteria must be "substantial" and also in converse to the direct financial interest, must be knowing. Statement of Prof. E. Wayne Thode, Hearing, Subcomm. Sen. Jud. Com. on S. 1064, July 14 and May 17, 1973 (hereafter Sen. Hrg. 1973), pp. 95, 97, 103, and the illustration given is shareholder a domestic bank where decision concerning another bank will have "substantial in effect on the value of all banks." For a comprehensive discussion of the "direct and substantial" approach to nonparty interests, *see Sollenberger v. Mt. States Tel. & Tel. Co.*, 706 F. Supp. 780-81 (D.N.M. 1989).

If "a judge owns stock of a company in the same industry as one of the parties to the case," he is not "substantially affected" by the outcome and is not disqualified, as the Fifth Circuit held in *In re Placid Oil Co.*, 802 F.2d 783 (5th Cir. 1986), *reh'g den.*, 805 F.2d 1030 (5th Cir. 1986). The judge in *Placid Oil* owned stock in a bank and was not disqualified from hearing a case that could affect the banking industry.

In *Chitimacha Tribe of Louisiana v. Harry L. Laws Co.*, 690 F.2d 1157, 1166 (5th Cir. 1982), *cert. den.*, 464 U.S. 814 (1983), and *Ogala Sioux Tribe v. Homestake Min. Co.*, 722 F.2d 1407, 1414 (8th Cir. 1983), *cert. den.*, 466 U.S. 907 (1982) both judges' interests in land adjoining the land in litigation was held not to be a disqualifying interest. The parties seeking disqualification in both cases argued that all land within the territory would be directly affected by the outcome of the litigation, which was a title dispute. That argument was rejected in both cases because the disposition of the litigation would not affect the judges' title in any way.

A rare case involving insurance in a disqualification controversy is *Weingart v. Allen & O'Hara, Inc.*, 654 F.2d 1096, 1107 (5th Cir. 1981). The judge in *Weingart* owned three life insurance policies, "representing mutual ownership" in a corporation which wholly owned the defendant corporations. Based in part on Advisory Committee Opinion No. 62, that a judge insured by a mutual insurance company is not disqualified to hear cases involving that company unless he was also a stockholder, the court held "the judge's mere ownership of three life insurance policies, representing mutual ownership, in the parent corporation of a party to the suit does not demonstrate that the outcome of the proceeding could have substantially affected the value of the ownership interest." *Id.* at 1107.

In *Department of Energy v. Brimmer*, 673 F.2d 1287 (Temp. Emerg. Ct. of Appe. 1982) the court held a judge hearing a case involving an Entitlement Program, who had stock ownership in other Entitlement Programs, was not disqualified. In reaching this conclusion the court used a two step analysis; 1) did the judge have a financial interest in the subject matter in controversy, and, if not, 2) did the judge have some other interest that could be substantially affected by the outcome of the litigation.

The court held the judge did not have a financial interest in the subject matter of the litigation, with a brief analysis:

> The use of the term "subject matter" suggests that this provision of the statute will be most significant in *in rem* proceedings. *See* E. Wayne Thode, Reporters Notes to A.B.A. Code of Judicial Conduct, 66 (1973). We hold that the judge does not have a direct economic or financial interest in the outcome of the case, and thus could hear it without contravening the constitutional due process.

Here is where Judge Breyer drops completely out of the disqualification circle. In the financial relationship of any of his cases to the totality of his dividend potential, his Name is utterly trivial and, in any case, he not only does not know that a litigant is insured with the syndicates but, realistically, has no practical way of finding out. As the legislative history clearly shows, it is intended in these situations, generally speaking, that for a judge not to be kept currently informed is an affirmative virtue, or else the persons controlling the investments, as in a common fund situation, would have the power to disqualify a judge by making an investment and forcing the knowledge on the judge. This was deliberately considered in the legislative history as a hazard and was guarded against. An opinion, closely analogous, shared by several district judges, is whether Alaskan district judges must disqualify in cases claiming "amounts for the Alaska Permanent Fund, from which dividends can flow to, among others, district judges. Held, no disqualification; the amounts are too remote and speculative, *Exxon Corp. v. Heinze*, 792 F. Supp. 77 (D. Ala. 1992). For perhaps the leading case that a judge should not disqualify for a contingent interest where he is not a party but, speculatively, might get a small dividend some day, *see In re Va. Elec. Power Co.*, 539 F.2d 357 (4th Cir. 1976).

VI. Appearance Of Impropriety.

This leaves the generalized provision of § 455(a) that a judge shall disqualify where "his impartiality might reasonably be questioned." This is commonly caught up in the phrase which has a long history, pre-§ 455 ABA and

U.S. Supreme Court opinions. The amorphous quality of the phase makes it hard to deal with decisively. However, the phrase has gained technical meaning in both the legislative history and the cases; categorically it does not mean that pointing a finger and expressing dismay is enough. Moreover, when, as developed above, certain types of investment are expressly allowed under the statute, it will be difficult to make them "improper."

The 1974 Act eliminated the "duty to sit," permitting the judge to disqualify where his impartiality may reasonably be questioned. Both Justice Traynor and Mr. Frank advised the Senate committee that this disqualification was to be determined by "what the traditions and practice have been," Sen. Hrg. 1973 at 15. These do not authorize disqualification for "remote, contingent, or speculative interest," or "indirect and attenuated interest"; *In re Drexel Burnham Lambert Inc.*, 861 F.2d 1307, *reh'g den.* 869 F.2d 116, *cert. den.* 490 U.S. 1102 (1988); *TV Communications Network, Inc. v. ESPN, Inc.*, 767 F. Supp. 1077 (D. Colo. 1991).

It is here that the common fund exception has great bearing by analogy. Such an investment involves the same factors which motivated the common fund exception. That is to say, the statutes mean to preserve the right of judges to invest and clearly except from the rigorous disqualification standards investments in common funds where the judge has no effective way of knowing precisely what interests may be within the scope of the investments. Functionally an investment in Lloyds is the same as an investment in any common fund with general holdings. In these circumstances, there cannot be an "appearance of impropriety" in an investment which is just the same, functionally, as those expressly protected.

VII. The Disqualification Claim, If Accepted, Would Produce Unreasonable and Unintended Results.

As noted in the preliminary observations to this memorandum, the concern here is grossly excessive. The syndicates have a broad reach. The returns to the Names could be affected by numerous other matters beside pollution claims. For a comprehensive discussion of the proposition that there is no ground for disqualification because a case may affect general rules of law, *see New York City Develop. Corp. v. Hart*, 796 F.2d 976, 979 (7th Cir. 1986) ("Almost every judge will have some remote interest of this sort.")

Almost any case relating to the business community could relate to Lloyds in some remote way, and any number of cases can relate to other reaches of the business community. Even the criminal cases, in at least some instances, can have significant business fallout, as for example, the RICO cases. To say that

Judge Breyer should have recused himself from all pollution cases would logically be to say that judges should not invest in a business generally.

I reiterate that neither the canon nor § 455 meant to preclude investment by judges. The focus on the pollution cases is excessively sharp because, if there were disqualification here, there would necessarily be disqualification as to too many other aspects of investment. This would defeat the purpose of the canons and the statute.

VIII. Conclusion.

Judge Breyer properly did not disqualify in the pollution cases which came before him.

John P. Frank

JPF:cc