CALIFORNIA JUDGES ASSOCIATION
Judicial Ethics Committee
Opinion No. 59

DISQUALIFICATION AND DISCLOSURE REQUIREMENTS WHERE A JUDGE OWNS STOCK IN THE PARENT OR SUBSIDIARY CORPORATION OF A PARTY

I. Introduction

Thanks to the increasing tempo of corporate mergers and reorganizations, the Ethics Committee has been presented with several requests for advice with respect to whether a judge is disqualified from hearing a case in which a party is a parent, subsidiary, or otherwise connected with a business entity in which the judge has a financial interest that exceeds one thousand five hundred dollars ($1,500).

II. Applicable Authority

Canon 3E(1)(2): "In all trial court proceedings, a judge shall disclose on the record information that is reasonably relevant to the question of disqualification under Code of Civil Procedure section 170.1, even if the judge believes there is no actual basis for disqualification."

California Code of Civil Procedure §170.1(a):

"A judge shall be disqualified if any one or more of the following is true:

. . . .

(3)(A) The judge has a financial interest in the subject matter in a proceeding or in a party to the proceeding.

(B) A judge shall be deemed to have a financial interest within the meaning of this paragraph if:

(i) A spouse or minor child living in the household has a financial interest.

(ii) The judge or the spouse of the judge is a fiduciary who has a financial interest.

(C) A judge has a duty to make reasonable efforts to inform himself or herself about his or her personal and fiduciary interests and those of his or her spouse and the personal financial interests of children living in the household.

. . . .

(6)(A)(iii): A person aware of the facts might reasonably entertain a doubt that the judge would be able to be impartial."

Code of Civil Procedure §170.5(b): "'Financial interest' means ownership of more than a 1 percent legal or equitable interest in a party, or a legal or equitable interest in a party of a fair market value in excess of one thousand five hundred dollars ($1,500), or a relationship as director, advisor or other active participant in the affairs of a party. . . ."

Code of Civil Procedure Section 170.1(a)(8):

"(A) The judge has a current arrangement concerning prospective employment or other compensated service as a dispute resolution neutral or is participating in, or, within the last two years has participated in, discussions regarding prospective employment or service as a dispute resolution neutral, or has been engaged in such employment or service, and any of the following applies:

(i) The arrangement is, or the prior employment or discussion was, with a party to the proceeding.

. . . .

(B) For the purposes of this paragraph, all of the following apply:

(ii) 'Party' includes the parent, subsidiary, or other legal affiliate of any entity that is a party and is involved in the transaction, contract, or facts that gave rise to the issues subject to the proceeding."

California Government Code §82034:

"'Investment' means any financial interest in or security issued by a business entity, including, but not limited to, common stock, preferred stock, rights, warrants, options, debt instruments, and any partnership or other ownership interest owned directly, indirectly, or beneficially by the public official, or other filer, or his or her immediate family, if the business entity *or any parent, subsidiary, or otherwise related business entity* has an interest in real property in the jurisdiction, or does business or plans to do business in the jurisdiction, or has done business within the jurisdiction at any time during the two years prior to the time any statement or other action is required under this title. . . . The term 'parent, subsidiary or otherwise related business entity' shall be specifically defined by regulations of the commission." (Emphasis added.)

Central Pacific Railway Company v. Superior Court (1931) 211 Cal. 706
People v. Franco (1993) 19 Cal.App.4th 175

David M. Rothman, *California Judicial Conduct Handbook* (3d Edition 2007) §§7.30, 7.31, 7.70, 7.72, 7.73

Frederick R. Bennett, *Disqualification of Judges* (Los Angeles Superior Court 2007) §4C

III. Question

Is a judge disqualified from hearing a case in which a party to the action owns, controls, or is owned or controlled, in whole or in part, by an entity in which a judge has a financial interest that exceeds one thousand five hundred dollars ($1,500)? For example, a judge owns more than $1,500 worth of stock in Corporation A. Corporation A wholly owns Corporation B. Or, alternatively, Corporation B wholly owns Corporation A. A case in which Corporation B is a party is assigned to the judge. Corporation A is not a party, nor could Corporation A be made a party. Is the judge disqualified? If not, is disclosure required?

IV. Answer

The judge is not disqualified under Code of Civil Procedure Section 170.1(a)(3)(A), but may be disqualified under CCP 170.1(a)(6)(A)(iii). Disclosure is required.

V. Discussion

1. Code of Civil Procedure Section 170.1(a)(3)(A)

Code of Civil Procedure Section 170.1(a)(3)(A) refers to a *party* to the proceeding, not to an entity that is related to a party, no matter how close that relationship may be. In *Central Pacific Railway Company v. Superior Court* (1931) 211 Cal. 706, the Supreme Court confronted a case in which: 1) a bank was a party to the action; 2) the bank was wholly owned by Transamerica Corporation; 3) Transamerica was not a party in the case; and 4) the judge owned stock in Transamerica. The Supreme Court held that even though Transamerica owned a party, the judge was not disqualified because Transamerica itself was not a party in the case: "To be a stockholder in some corporation which is not and could not be made a party to the action cannot by any stretch of reasoning be held to amount to a disqualification, and we are cited to no authority which so holds. On the contrary, the cases not only within our own but other jurisdictions have expressly held that in such cases no disqualification exists. [Citations omitted.]" *Id.*at 720.

When *Central Pacific* was decided, the disqualification statute was less explicit than it is now, because the old provision did not include the words "interest in a party." At that time Civil Procedure Code

section 170 barred judges from hearing any action or proceeding "2. In which he is interested as the holder or owner of any capital stock of a corporation...." It follows that if a judge was not disqualified under the old wording, *Central Pacific's* conclusion that the interest must be in a *party*, not a parent or subsidiary of a party, is strengthened by the more explicit language in the present section 170.1(a)(3)(A).

Moreover, the legislature knows how to define terms if it chooses to do so. *See, e.g.*, *People v. Franco* (1993) 19 Cal.App.4th 175, 184 n.17 ("[Government Code] Section 13960 shows the Legislature knows how to define and include indirect victims if it chooses to do so.") Code of Civil Procedure Section 170.1(a)(3)(A) does not define the term "party." This stands in contrast to Code of Civil Procedure Section 170.1(a)(8)(B)(ii), which pertains to involvement with private dispute resolution providers before retirement. That section expressly defines a party to include a "parent, subsidiary, or other legal affiliate of any entity that is a party and is involved in the transaction, contract, or facts that gave rise to the issues subject to the proceeding." Another example comes from Government Code section 82034, which is part of the Political Reform Act of 1974. In defining the term "investment" for the purpose of a judge's annual financial disclosure obligation, the statute provides "[I]f the business entity or any parent, subsidiary, or otherwise related business entity has an interest in . . ." and "[t]he term 'parent, subsidiary or otherwise related business entity' shall be specifically defined by regulations of the commission . . ." If the legislature wanted the word "party" in section 170.1(a)(3)(A) to include parents, subsidiaries, and the like, it would have so indicated.

If the entity in which the judge has an ownership interest could lawfully be made a party to the action, disqualification may be necessary. *See Central Pacific Railway Co.,* 211 Cal. at 720. Since a judge usually will not know the answer to this question when the case is first assigned, it would be prudent not only to disclose the judge's ownership interest in the related entity, but to ask counsel by way of a minute order or at the first case management conference whether anyone plans to make the entity in which the judge owns an interest a party or whether facts exist pursuant to which the entity could be made a party.

2. Civil Procedure Code Section 170.1(a)(6)(A)(iii)

Before a judge proceeds with the case, the judge must consider whether disqualification would be warranted under Code of Civil Procedure section 170.1(a)(6)(A)(iii). That section requires disqualification when "[a] person aware of the facts might reasonably entertain a doubt that the judge would be able to be impartial."

The criteria that would make a person entertain such a doubt include the potential impact of the litigation on the entity, the size of the judge's investment in the entity, and the proportion of the judge's portfolio represented by the ownership interest in the entity. The judge must ask, first, whether the litigation before the judge presents the threat of a potential large financial impact on the entity in which the judge owns a financial interest. Answering this question requires an analysis of the range of exposure in the case compared to the entity's assets. A potential judgment of one million dollars against a subsidiary of Exxon Corporation could not reasonably be said to have a large financial impact on that entity or, it follows, on the judge's investment in Exxon. An exposure of fifty thousand dollars against a family-owned store that is related to another small business in which the judge has an investment could be devastating to the judge's interest. The Committee believes that if an adverse result in the litigation would not materially impact the party that is related to the entity the judge owns, no disqualification is necessary.

The second question the judge must ask is: how large is the judge's financial interest in the entity? Even if the answer to the first question is yes, i.e., the litigation before the judge presents the threat of a potentially large financial impact on the entity in which the judge has a financial interest, a judge still may determine that disqualification is not required if his or her financial interest in the related entity is small. For example, if the judge owns slightly over $1,500 worth of an entity, receives a small dividend from the investment, and an adverse result in the pending suit might cause the temporary loss of that dividend, a person aware of those facts would not reasonably entertain a doubt about the judge's ability to be impartial.

The third question the judge must ask is: regardless of the size of the judge's financial interest in the nonparty, how important is the financial interest to the judge? A person would entertain a doubt concerning the judge's ability to be impartial if, regardless of its size, a judge's financial interest in the entity represents a significant portion of the judge's asset base. In the example given in response to the second question, if the temporary loss of a dividend had a significant impact on the judge's life style, then the judge would have to recuse because a person aware of the circumstances would be justified in doubting his/her ability to be impartial. This would be the case even if the judge's financial interest were not objectively substantial, because regardless of the amount, a significant portion of the judge's assets would be invested in the entity.

3. Disclosure

In any event, Canon 3E(2) requires a judge to disclose the ownership interest in this type of situation. Such an interest constitutes information that is reasonably relevant to the question of disqualification under Code of Civil Procedure section 170.1.

VI. Conclusion

A judge is not automatically disqualified from hearing a case in which a party to the action owns or controls, or is owned or controlled, by an entity in which a judge has a financial interest exceeding one thousand five hundred dollars. Nevertheless, disqualification may be required when a person aware of the facts might reasonably entertain a doubt that the judge would be able to be impartial. Such a doubt may be created depending upon the size of the judge's financial interest in the entity and the importance to the judge of his or her financial interest. In any event, a judge must disclose his or her ownership interest. Jurists who find themselves in this situation are encouraged to contact the Ethics Committee for advice based on the individual circumstances at hand.