FOCUS - 16 of 22 DOCUMENTS

The Wall Street Journal

August 3, 1988 Wednesday

LENGTH: 1493 words

HEADLINE: Rescuing Contracts From High Weirdness

BYLINE: By L. Gordon Crovitz

BODY:

The counterrevolution is gaining a beachhead where judicial activism began -- in California. The voters replaced the Rose Bird court, and now a member of the federal appeals court in Pasadena is on a one-judge campaign to restore both common law and judicial restraint.

A ruling in a contract dispute issued in May by conservative Judge Alex Kozinski, appointed by President Reagan in 1985 at the record young age of 34, at first seems mystifying in that it reverses a lower-court decision that seemed like an eminently sensible reaction to the litigation explosion. Last year, District Court Judge James Ideman tossed out as baseless a suit by some sophisticated plaintiffs trying to wiggle out of contract obligations. Judge Ideman even assessed a penalty against them for bringing a frivolous case. Judge Kozinski reversed the decision on the ground that after 20 years of judicial activism no contract claim is so ridiculous that it can't win in California.

This riddle is a law-and-morality tale with something for everyone: Litigation-happy lawyers; 1960s judges citing moonbeam legal evidence including "the Swedish peasant custom of curing sick cattle"; and a judge, Mr. Kozinski, who escaped the arbitrary laws of Bucharest when he emigrated in 1962, now hoping to restore the ancient Anglo-American concept of sanctity of contract.

The roots of Trident Center v. Connecticut General Life Insurance are in the decision by two of Los Angeles's big law firms, along with two other investing partners, to build their own office towers. The law firms Manatt, Phelps, Rothenberg & Phillips and Mitchell, Silberberg & Knupp decided on a pioneering area for office buildings in West Los

Angeles, just off the San Diego Freeway. They borrowed $56.5 million in 1983 to build Trident Center. An office glut soon developed, and carrying the mortgage took a big bite out of the law partners' draw.

At the same time, interest rates fell below the loan's fixed rate. The lawyers went to court, arguing that despite what the contract said about 12 1/4% interest over 15 years, they could prepay the loan subject to a 10% prepayment penalty. They would then refinance at a lower rate.

But the contract was clear that there could be no prepayment for the first 12 years. The promissory note said that Trident "shall not have the right to prepay the principal amount hereof in whole or in part before January 1996." The plaintiffs wanted to offer evidence from the contract negotiations that despite the language, the parties intended that a prepayment was possible at their option. Judge Ideman refused, citing the "parol evidence rule" that extrinsic evidence can't be used to interpret, vary or add to the terms of an unambiguous written agreement.

Judge Ideman went further, and invoked the federal rule against frivolous cases to assess $56,000 in penalties on the plaintiffs for bringing the case. "Plaintiff's contention that it misunderstood the terms in the note and deed of trust is not credible especially since the plaintiff has two reputable law firms as its general partners," he wrote. "No reasonable person, much less firms of able attorneys, could possibly misunderstand this crystal-clear language. . . . Therefore, this action was brought in bad faith."

In his reversal, Judge Kozinski agrees that the language is "devoid of ambiguity." He also agrees that "Trident is attempting to obtain judicial sterilization of its intended default." And he agrees it would be wrong to "truncate the lender's remedies and deprive Connecticut General of its bargained-for protection." Yet he nevertheless ruled the plaintiffs can introduce evidence outside the contract to contradict the written agreement.

There is method in Judge Kozinski's apparent madness. He insists that judicial restraint means that federal judges must be bound by the precedents of state courts when interpreting state law, no matter how awful, until the precedents are changed.

And the precedent here is a real doozy: the 1968 California Supreme Court decision, Pacific Gas & Electric v. G.W. Thomas Drayage & Rigging. In that case, there was a clear indemnification provision in a contract, but the court said the words didn't settle the matter. The plaintiffs could present other evidence, which the judges could use to allocate the parties' risks regardless of the contract.

The opinion by then-Chief Justice Roger Traynor rejected the common-law notion that parties must be free to negotiate among themselves. This old view that individuals can use words -- that is, contracts -- to allocate risks and rewards, he wrote, "is a remnant of a primitive faith in the inherent potency and inherent meaning of words." He concluded that "Words, however, do not have absolute and constant referents."

Judge Traynor went on to cite semantic and anthropologic evidence for his proposition that only primitives ascribe binding meaning to words. This supporting reference appears in what may be the single weirdest footnote in the history of U.S. courts:

"E.g., 'The elaborate system of taboo and verbal prohibitions in primitive groups; the ancient Egyptian myth of Khern, the apotheosis of the words, and of Thoth, the Scribe of Truth, the Giver of Words and Script, the Master of Incantations; the avoidance of the name of God in Brahmanism, Judaism and Islam; totemistic and protective names in medieval Turkish and Finno-Ugrian languages; the misplaced verbal scruples of the Precieuses; the Swedish peasant custom of curing sick cattle smitten by witchcraft, by making them swallow a page torn out of the psalter and put in dough . . .' from Ullman, The Principles of Semantics."

Whatever the Finno-Ugrians had to say, Judge Kozinski emphasizes in his opinion that freewheeling judicial reinterpretations of contracts have made California a dangerous place to do business. Judge Kozinski says " Pacific Gas casts a long shadow of uncertainty over all transactions negotiated and executed under the law of California. As (Trident

Center) illustrates, even when the transaction is very sizable, even if it involves only sophisticated parties, even if it was negotiated with the aid of counsel, even if it results in contract language that is devoid of ambiguity, costly and protracted litigation cannot be avoided if one party has a strong enough motive for challenging the contract."

In dismissing the frivolous-case fine, Judge Kozinski concludes that "at fault, it seems to us, are not the parties and their lawyers, but the legal system that encourages this kind of lawsuit." He also notes that the activist judges' view of contracts creates problems for other areas of law. "If we are unwilling to say that the parties, dealing face to face, can come up with language that binds them, how can we send anyone to jail for violating statutes consisting of mere words. . . ?"

For that matter, how can Judge Kozinski be sure he knows what the mere words of Pacific Gas mean? Such reductio ad absurdum reasoning, undermining the rule of law, is what the deconstructionist theory of the Critical Legal Studies movement is all about.

It didn't take long before litigants caught on. After reading the Kozinski opinion, lawyers for Metromedia Inc., which relies on an equally clear contract in a case concerning the ownership of videotapes, urged the California Supreme Court to heed this warning. Metromedia's attorney, Theodore Olson, recently urged the justices, "If anything is to remain of the integrity of written contracts in California, it is necessary for this court to intervene."

This is not the first time a legal system has ignored contract law. The Pennzoil v. Texaco case put investors world-wide on notice that anything could happen in a Texas courtroom. Nor is this the first time Judge Kozinski has spoken out for a return to traditional contract law.

In February, he decided a case from Guam where the plaintiff wanted to get out of a release he had signed with an automobile insurance company in exchange for a settlement. "Despite recent cynicism, sanctity of contract remains an important civilizing concept," he wrote. "It embodies some very important ideas about the nature of human existence and about personal rights and responsibilities: that people have the right, within the scope of what is lawful, to fix their legal relationship by private agreement; that the future is inherently unknowable and that individuals have different visions of what it may bring . . . and that enforcement of these agreements will not be held hostage to delay, uncertainty, the cost of litigation or the generosity of juries."

The freedom to write contracts and the duty to abide by their terms are features of American life so basic that it's hard to believe they could be litigated. Yet this is where the law has now led. Judge Kozinski did his best to embarrass the judicial activists into retreat. We will now see if they have any shame.

Mr. Crovitz is assistant editor of the Journal's editorial page.

NOTES:
PUBLISHER: Dow Jones & Company

LOAD-DATE: December 5, 2004