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Expert Analysis

Consideration of Pre-Judgment Interest In Evaluating the Risk of Litigation

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When counseling a client on litigation involving a breach of contract or property claim, attorneys will presumably evaluate many factors and then attempt to quantify the expected recovery or exposure. Often overlooked in the analysis is the impact (or lack thereof) of pre-judgment interest, whether statutory or contractual. As demonstrated in a recent Appellate Division, First Department decision, such interest could significantly add to the amount at stake, especially in a complex commercial matter that may take many years to resolve. With statutory interest rates varying greatly among jurisdictions, choice of forum also becomes significant. This article gives a broad overview of the application of pre-judgment interest in New York and federal courts and discusses some procedural ways in which to limit or cut off the accrual of interest.

New York Law

Under New York law, the application of pre-judgment interest is set forth in CPLR §5001(a), which provides that such interest "*shall be recovered*" by a prevailing plaintiff in a breach of contract action or in an action involving "an act or omission depriving or otherwise interfering with title to, or possession or enjoyment of, property." This latter provision has been interpreted to allow for pre-judgment interest in cases involving malpractice, conversion, breach of fiduciary duty, and other claims. The legislature's use of the term "shall" in the statute has been found by the courts to make pre-judgment interest mandatory, not discretionary. See *Spodek v. Park Prop. Dev. Assoc.*, 96 N.Y.2d 577, 581 (2001). Pre-judgment interest is not recoverable in tort actions resulting in personal injury, nor for punitive damage claims. For equitable actions such as unjust enrichment that involve monetary recovery, the assessment of pre-judgment interest is subject to the court's discretion.

CPLR §5004 sets forth 9 percent as the statutory rate of pre- and post-judgment interest in New York, calculated on a simple basis. This is a significant amount in this era of historically low interest rates. Because the statutory rate for pre-judgment interest is much lower in federal court, as discussed below, a plaintiff who may have the choice to bring the claim in either state or federal court may choose to litigate in state court in order to take advantage of a significant pre-judgment interest component of any potential award.

While the New York Court of Appeals has said that the purpose of awarding interest is to "make an aggrieved party whole" (*Spodek*, 96 N.Y.2d at 581 (citing *Van Rensselaer v. Jewett*, 2 N.Y. 135, 140 (1849)), the 9 percent interest rate may be perceived by some to be more than compensatory, perhaps even punitive. Statutory pre-judgment interest can accumulate to the point that it exceeds the amount of the award itself. For example, in *Corsiatto v. Maddalone*, 2013 WL 1281020 (N.Y. Sup., Suffolk Cty. March 13, 2013), pre-judgment interest at the statutory rate more than doubled a $200,000

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malpractice award. However, there are no cases in New York that have reduced the amount of statutory interest on the ground that it is punitive, and constitutional challenges to New York's statutory scheme have been rejected. See *Citibank, N.A. v. Barclays Bank, PLC*, 28 F. Supp. 3d 174, 182 (S.D.N.Y. 2013).

Federal Law

In federal court, the pre-judgment interest rate is determined by whether the case is brought under diversity jurisdiction invoking state laws or as a federal question. In diversity cases, pre-judgment interest is determined by state law under the *Erie* doctrine (see *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938)) since interest is considered part of the substantive claim. *Quincy Mut. Fire Ins. Co. v. New York Cent. Mut. Fire Ins. Co.*, 89 F. Supp. 3d 291, 313 (N.D.N.Y. 2014).[1] However, in a case involving a federal question, pre-judgment interest is determined by federal statute and/or applicable case law. Under 28 U.S.C. §1961, pre-judgment interest (as well as post-judgment) is allowed on *any* civil monetary judgment. Thus, pre-judgment interest under *federal* law is not limited to breach of contract and property claims, like under New York law. The interest rate under this federal statute is a rate "equal to the weekly average one-year constant maturity Treasury yield" for the week preceding the judgment. Since the end of 2008, that rate has fluctuated between 1.10 percent and 0.10 percent and stands, as of May 1, 2017, at 1.09 percent.

Federal courts have allowed recovery of pre-judgment interest under a variety of other federal laws even where such laws are silent on the subject of interest. *Wickham Contracting Co. v. Local Union No. 3*, 955 F.2d 831, 837 (2d Cir. 1992). At the same time, federal courts have disallowed pre-judgment interest when finding it clearly controverted congressional intent, based on the language or interpretation of the statute governing the claim at issue. Id. at 834-35.

Contractual Over Statutory

A clear contractual provision will supersede the statutory pre-judgment interest rate. Both the state and federal courts in New York consistently hold that the contract rate, rather than the statutory rate, governs the rate of interest. *NML Capital v. Republic of Argentina*, 17 N.Y.3d 250, 928 N.Y.S.2d 666 (2011); *Trans-Pro Logistic v. Coby Elec.*, 2012 WL 526764, at *14 (E.D.N.Y. Feb. 16, 2012). Such a provision can (1) set an interest rate much higher or lower than the applicable statutory rate, (2) set forth a particular means of calculating a rate based on variables chosen by the parties, or (3) waive interest altogether. Such agreed-upon language will provide clarity and may offer incentives for a prompt settlement, rather than prolonged litigation potentially facing an ever-growing sum of interest being added to any award.

If the parties set forth in clear, unambiguous language the terms under which pre-judgment interest will accrue for a party found to be owed funds, the courts will respect and enforce such terms. Whether in state or federal court in New York, the language of the contract will control, and it will be enforced according to its terms, consistent with standard principles of contract interpretation. *J. D'Addario & Co. v. Embassy Indus.*, 20 N.Y.3d 113, 119 (2012) (enforcing what the parties set forth in a real estate contract as the "sole remedy," denying any other recovery of interest); *NML Capital*, 17 N.Y.3d at 256; *Good Hill Master Fund L.P. v. Deutsche Bank AG*, 146 A.D.3d 632 (1st Dep't 2017).

This is true even if the interest rate specified in the contract is substantially higher than the statutory rate. In *Good Hill*, pre-judgment interest at a 21 percent contractual default rate in a swap agreement turned a $22.1 million breach of contract claim accruing in 2009 into a $93.9 million judgment awarded in 2016. The court stated "[w]hile the resulting judgment is large relative to the original award, 'this is no reason to depart from the legal principle that contracts must be enforced according to the language adopted by the parties,'" citing *NML Capital*. Contractual provisions can also be used to extend the accrual of interest past the entry of judgment, to collect post-judgment interest at a specified rate until the amount due has been fully paid. And contractual terms providing for the compounding of interest will also be enforced. McKinney's General Obligations Law §5-527.

Other examples where New York state and federal courts have readily applied interest rates far higher than the statutory rates, based on contractual provisions, include In *Marine Mgmt. v. Seco Mgmt.*, 176 A.D.2d 252, 574 N.Y.S.2d 207 (2d Dep't 1991), where the state court found that the mortgage required pre-judgment interest to accrue at a rate of *25 percent*, with post-judgment interest thereafter at the statutory rate, and *Finance One Public Co. v. Lehman Bros. Special Financing*, No. 00-Civ.-6739, 2003 WL 21638214, at *2 (S.D.N.Y. July 11, 2003), modified, 2003 WL 22056983 (S.D.N.Y. Sept. 4, 2003), rev'd on other grounds, 414 F.3d 325 (2d Cir. 2005). Interpreting the same ISDA swap agreement at issue in *Good Hill*, the court in *Finance One* set pre-judgment interest at *17.04 percent* and post-judgment interest at *18.04 percent* based on a calculation of the non-breaching party's "costs of funds." See also *In re Best Payphones*, 2003

WL 1089525, *5 (Bankr. S.D.N.Y. March 10, 2003) (18 percent pre-judgment interest on unpaid invoices as set forth in a purchase agreement); *Ret. Accounts v. Pacst Realty*, 49 A.D.3d 846, 846 (2d Dep't 2008) (24 percent pre-judgment interest required in the event of default on a mortgage note and agreement).

On the other hand, a clear contractual provision can be used to preclude or waive any pre-judgment interest, statutory or otherwise, in order to prevent the issue from arising at all, or to set forth different remedies instead. In *Ithilien Realty v. 176 Ludlow*, 139 A.D.3d 582 (1st Dep't 2016) and *J. D'Addario*, 957 N.Y.S.2d at 279, the down payments made pursuant to the respective real estate contracts were placed in interest-bearing accounts, which interest, under the terms of the contracts, would provide the exclusive compensation for the party deprived of such funds. In both cases, the courts found this to be the exclusive remedy agreed upon by the parties, and denied any statutory interest.

Smart contract drafting can provide certainty and clarity with regard to this issue.

Accordingly, transactional counsel should take advantage of any opportunity to include a contractual provision clearly establishing the terms of pre- or post-judgment interest, eliminating the uncertainty and risk of a future judicial determination. However, litigators faced with a contract already formed must be attuned to the consequences of contractual or statutory pre-judgment interest.

Tools for Tolling Accrual

When a litigant faces potentially protracted litigation with the risk that significant interest may accrue, there are means by which to stop the accrual of interest before it grows to a substantial sum. The following are some of the options that are available in such cases:

• A defendant can simply pay the plaintiff the amount allegedly owed. This stops the running of interest, as the plaintiff is no longer deprived of the use of the funds.[2] If the ultimate judgment is in the defendant's favor, it can recover the funds. (Of course, there is the risk the funds may be dissipated or otherwise unreachable.)

• If willing to concede liability for the claim at issue, but not necessarily the amount of damages, a defendant can make either (1) a tender pursuant to CPLR Rule 3219 or (2) an offer of judgment, pursuant to CPLR Rule 3221 or Federal Rules of Civil Procedure (FRCP) Rule 68.

- For a tender, the defendant deposits with the clerk of the court an amount "deemed … to be sufficient to satisfy the claim" and then serve the plaintiff a written tender of payment with a copy to the clerk.
- For an offer of judgment, the defendant serves on the plaintiff a written offer to allow judgment against the defendant on specified terms, "with costs then accrued."
- For either a tender or an offer of judgment, the plaintiff has 10 days to accept it (14 days under FRCP 68) and, if the plaintiff does so, the claim is considered fully satisfied and the case resolved. If the plaintiff does not accept it in ten days, (1) any tender will be repaid to the defendant upon request and (2) if plaintiff ultimately obtains a judgment in an amount the same or less than what had been offered or tendered, or otherwise fails to obtain a "more favorable judgment," the plaintiff cannot recover interest or costs since the date the offer was made *and* must pay the defendant's costs incurred in defending the claim since that time.[3]

• If willing to concede the amount of damages that will be owed if found liable, a defendant can make a *conditional* offer of judgment pursuant to CPLR Rule 3220. This is similar to an offer under CPLR Rule 3221, except that the judgment offered under Rule 3220 can only be entered "if the party against whom the claim is asserted fails in his defense."

In short, counsel should be aware at the outset of any litigation of the potential impact of pre-judgement interest on the case. Interest can accumulate to an amount larger than the award itself as a result of lengthy litigation. Smart contract drafting can provide certainty and clarity with regard to this issue. If it is too late for that, there are a number of actions for attorneys and litigants to potentially take to stop or limit the accrual of interest.

1. Post-judgment interest, even in a diversity case, will be governed by the federal statute, 28 U.S.C. 1961. *Cappiello v. ICD Publications*, 720 F.3d 109, 112 (2d Cir. 2013).

2. *Newbro v. Freed*, 409 F. Supp. 2d 386, 402 (S.D.N.Y. 2006), aff'd, No. 06-1722-CV, 2007 WL 642941 (2d Cir. Feb. 27, 2007).

3. If in federal court, it is not clear if CPLR Rule 3219 can be applied or if it would be preempted by FRCP Rule 68 like CPLR Rule 3221. However, "[a] bsent controlling authority rejecting the use of CPLR 3219 in federal court on Erie grounds, defendants in contract cases would do well to consider the use of this statutory device." Pepe, Douglas, "Stopping the Clock on Prejudgment Interest in Contract Disputes," N.Y.L.J., April 21, 2014.