

# A Primer on Prejudgment Interest

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# A Primer on Prejudgment Interest

## I. Introduction

There are a number of factors practitioners can consider when assessing recoverable damages in a case. When evaluating and assessing damages that are meant to compensate a party for an alleged wrong, a damages evaluation and analysis should include consideration of prejudgment interest. Whether a compromise through settlement or final judgment is anticipated, prejudgment interest is part of the valuation of a matter. Interest is generally recoverable on a final judgment in civil actions. State statutes dictate the recovery of pre-judgment and postjudgment interest on final judgments. Even where damages are unliquidated, prejudgment interest is recoverable.

Prejudgment interest typically is compensation for the loss of use of money to which a prevailing party is entitled. In short, the purpose of prejudgment interest is to make a party whole, not to penalize the defendant. See *Robinson v. Fetterman*, 387 F. Supp. 2d 483 (E.D. Pa. 2005); and *International Flight Ctr. v. City of Murfreesboro*, 45 S.W.3d 565, 574 (Tenn. Ct. App. 2000).

Usually, prejudgment interest begins to run on the date the injury or the incident occurred. However, the calculation of prejudgment interest can be troublesome in some instances. There are a number of case-specific nuances that should also be considered. This article will discuss the factors a practitioner should consider in evaluating prejudgment interest as part of a client's case.

## II. Discussion

### A. State and Federal Law

The accrual date for a prejudgment interest calculation typically depends on individual state statutes. Thus, practitioners should examine state statutes to determine the calculation of prejudgment interest. Some state statutes also limit the recoverability of prejudgment interest. For instance, some states do not allow an award of prejudgment interest on punitive or exemplary damages. See *Seward Constr. Co. v. Bradley*, 817 P.2d 971 (Colo. 1991). Other states do not allow recovery of prejudgment interest on future damages. See Alaska Stat. §9.30.070 and Tex. Fin. Code Ann. §304.1045. The rate of prejudgment interest is also dictated by statute unless the parties have reached an agreement for a stated prejudgment interest rate.

Many federal courts apply state statutory law regarding prejudgment interest because there is no well-defined federal law governing prejudgment interest. See, e.g., *In re Exxon Valdez*, 484 F.3d 1098 (9th Cir. 2007) (federal courts sitting in diversity should apply state law regarding prejudgment interest unless federal law pre-empts it). Particularly, federal statutes do not define the rate of prejudgment interest. However, federal courts have indicated that they will use the prime rate as the benchmark for prejudgment interest unless there is a statutorily defined rate or the district court engages in "refined rate-setting" directed at determining a more accurate market rate for interest. See *Radcliffe v. International Painters*, 372 B.R. 401 (Bankr. N.D. In. 2007).

### B. Discretion of the Courts

In most jurisdictions, the prejudgment interest calculation and accrual date are within the sound discretion of the trial judge. Moreover, the determination of whether to award simple or compound interest may fall within the discretion of the trial court. *Hughes Aircraft Co. v. United States*, 86 F.3d 1566 (Fed. Cir. 1996).

Therefore, a practitioner should be prepared to present her best argument of how the court should calculate prejudgment interest.

### **C. Rate of Prejudgment Interest**

There are various methods used to calculate compound annual rate or simple annual rate of prejudgment interest. The common-law rule is that prejudgment interest should not be compounded. See *Restatement (Second) of Contracts* §354, cmt. a (1981); Michael S. Knoll, *A Primer on Prejudgment Interest*, 75 Tex. L. Rev. 293 n.76 (1996). However, there are a number of state jurisdictions that statutorily permit the compounding of prejudgment interest awards. In addition, the applicable interest rate may reflect prevailing interest rates by being indexed to the treasury bill rate on the filing date of a claim.

### **D. Tort Reform**

Many jurisdictions have been affected by tort reform. The recovery of prejudgment interest in the context of tort reform should also be considered. Early tort reformers sought prejudgment interest legislation to penalize defendants for drawing out settlement negotiations or trials. On the other hand, defense counsel argued in response that prejudgment interest often leads to overcompensation and thus hampers settlements. From the defense perspective, moving a case forward is imperative to protect clients from being penalized by delay caused by claimants or the natural progression of litigation. Due to the evolution of tort reform, the application of prejudgment interest continues to be defined by courts and legislatures.

### **E. Type of Case**

Practitioners should also examine the type of case and damages alleged to make a determination of how prejudgment interest will be treated. For insurance purposes, prejudgment interest is an element of compensatory damages and is subject to the insurance policy limits applicable to covered damages. Grund and Miller, *Colorado Personal Injury Practice—Torts and Insurance, Damages*, 37.48 (2000). Courts have also held that prejudgment interest up to the amount of the carrier's liability limit is part of the compensatory damages for which a UIM carrier is liable. *Austin v. Midgett*, 583 S.E.2d 405, 419 (N.C. Ct. App. 2003).

### **F. Contract or Agreement Fixing Date**

In determining when prejudgment interest begins to run in contract disputes, one should look at the contract or agreement, if applicable. Prejudgment interest based on breach of contract may run from the time fixed in the contract or agreement. *Hillside Enters., Inc. v. Continental Carlisle, Inc.*, 147 F.3d 732 (8th Cir. 1998). If it is not fixed by contract, one should look to state or federal law to determine the date from which prejudgment interest begins to run. For instance, in the case of *Puerto Rico Electric Power Authority v. Action Refund*, 483 F. Supp. 2d 153 (D.P.R. 2007), the court held that under Puerto Rico law, interest shall be allowed only where it is expressly stipulated. As the contract at issue in the action made no reference to interest, the claimant in *Puerto Rico* was not entitled to prejudgment interest on its breach of contract action.

### **G. Wrongful Withholding**

Many of the issues regarding prejudgment interest revolve around determining a date certain when interest begins to run. In tort actions, prejudgment interest typically begins to run from the date of the injury or incident giving rise to a lawsuit. In nonpersonal injury actions, a claimant may recover prejudgment interest if money or property has been wrongfully withheld and if the claimant can determine the rate of interest based on the gain or benefit realized by the party wrongfully delaying or denying payment. Many states have found

that where money is wrongfully withheld, prejudgment interest begins to run from the date of the wrongful withholding. *Joffer v. Warne*, 509 P.2d 601 (Colo. App. 1973). The purpose of prejudgment interest in this situation is to compensate a claimant for the use or detention of money to which the claimant is entitled.

Determining a date certain for a wrongful withholding of money or property is one of the most disputed issues in the calculation of prejudgment interest. In a simple situation, one whose property is converted generally is entitled to interest from the time of the conversion. *Colorado Bank & Trust Co. v. Western Slope Investments, Inc.*, 539 P.2d 501 (Colo. App. 1975). However, determining the date of the wrongful withholding can be more complicated depending on the type of damages alleged. For example, when there is a loss in value to property, a claimant may seek replacement-cost damages rather than diminution in value. See *Goodyear Tire & Rubber Co. v. Holmes*, 193 P.3d 821 (Colo. 2008). The date from which prejudgment interest begins to run will be different depending on which type of damages the claimant seeks. Repair or replacement-cost damages provide the claimant with the reasonable costs of repairing the damage or the cost of replacement. See 1 *Dobbs Law of Remedies* §5.2, at 714 (2d ed. 1993). On the other hand, diminution-in-value damages are measured by the difference in the value of the property before and after the injury to the property occurs. *Dobbs* §3.2, at 288.

While there is limited statutory or case authority involving claims seeking compensation for replacement cost, it is an evolving area of the law. In cases involving damage to property, replacement costs are measured at a later date than are diminution-in-value damages. Instead of looking at the damaged property itself, replacement-cost damages measure the expense of obtaining repair or replacement. *Dobbs* §3.3, at 305. Such damages depend on whether the claimant requests replacement costs prospectively or retroactively. If prospective, the account between the parties closes out as of the date of the verdict, while in the case of retroactive damages a claimant may be made whole as of the date when the costs were incurred. *Id.* 827.

Because diminution-of-value damages and replacement-cost damages assess a claimant's loss differently and tie the determination to a different point in time, the wrongful withholding of claimant's money or property occurs at different times. *Holmes* at 827. Where the claimant seeks diminution-in-value damages, prejudgment interest accrues from the date injury occurred. *Id.* at 827. Generally, in diminution in value cases, the date when a claimant is wronged is the same date as when a claimant's property or money was wrongfully withheld. In replacement cost cases, a claimant is not entitled to prejudgment interest at the time the property was injured because the claimant retains the use of his money. Prejudgment interest accrues at a later date when the claimant spends money to repair or replace the damaged or injured property. *Id.* at 828.

Whether in tort or contract, the period of interest runs until judgment is entered.

## H. Date the Cause of Action Accrued

In some jurisdictions, prejudgment interest may be calculated from the date the cause of action accrued. *Rodriguez v. Consolidation Coal Co.*, 524 S.E.2d 672 (W. Va. 1999). However, identifying when the cause of action "accrued" may require careful attention in certain situations. For example, in *Bank v. Thermo Elemental, Inc.*, 888 N.E.2d 897 (Mass. 2008), the court held that when expenses incurred as a result of a contract breach are not paid by a plaintiff until after the breach has occurred, the interest was calculated not from the date of the breach, or even the date the action was commenced, but from the date on which the plaintiff made payments for the expenses. The court stated that applying the plain language of the statute, which allowed interest to accrue "from the date of the commencement of the action," would allow the plaintiff a windfall and instead calculated prejudgment interest from the date post-breach expenses were incurred.

## I. Liquidated *versus* Unliquidated Claims

Some states may award interest only from the date a claim is liquidated. *Milgo Elec. Corp. v. United Bus. Comms., Inc.*, 623 F.2d 645 (10th Cir. 1980) (applying Kansas law). A claim becomes liquidated when the amount of damages is easily ascertainable or fixed. Some states have held that prejudgment interest may be awarded if a claim was liquidated or readily ascertainable by reference to objective standards. *Ventrua v. Titan Sports, Inc.*, 65 F.3d 725 (8th Cir. 1995) (applying Minnesota law). See also *Vaughn Dev., Inc. v. Westvaco Dev. Corp.*, 642 S.E.2d 757 (S.C. Ct. App. 2007). Further, prejudgment interest may be determined by whether the injury and consequential damages are complete and can be ascertained as of a particular time and in accordance with fixed rules of evidence and known standards of value. *Harlan Sprague Dawley, Inc. v. S.E. Lab Group, Inc.*, 644 N.E.2d 615, 617-19 (Ind. App. 1994).

Some courts have found that the liquidation of damages is determined by the specific contract language. In *Theobald v. Nosser*, 784 So. 2d 142 (Miss. 2001), the court found in a breach-of-contract action, where there was a dispute about how much was owed by each party and there was no specific liquidated damages clause in the contract, the damages were viewed as unliquidated. The court also pointed out that it was important for the claimants to plead in their complaint the date from which prejudgment interest is allegedly due. *Id.*

Such rulings underscore the basic tenet that the purpose of a prejudgment interest award is to make an aggrieved party whole rather than to serve as punishment to a party that has allegedly wrongfully withheld money or property.

Moreover, when there is a claim for the reasonable value of services, some states have determined that prejudgment interest could accrue only after the amount of the claim was established by the court. *Unitec Corp. v. Beatty Safway Scaffold Co. of Or.*, 358 F.2d 470 (9th Cir. 1966) (applying Oregon law).

Other states have determined that whether a claim is liquidated does not control when prejudgment interest begins to run. *Lovejoy v. Westfield Nat. Ins. Co.*, 688 N.E.2d 563 (Ohio App. 7. Dist. 1996). Even in such circumstances, whether a claim is liquidated is still an important factor to be considered in determining when payment is due and payable. *Id.* at 476.

Further, interest may not accrue on the unpaid balance of a liquidated claim from the date the cause of action arose until the date when no reasonable controversy exists as to either plaintiff's right to recover or as to the amount of such recovery. *Lincoln Benefit Life Co. v. Edwards*, 243 F.3d 457 (8th Cir. 2001) (applying Nebraska law).

## J. Tax Implications

Even from the defense perspective, one must consider the tax implications of a prejudgment interest award. In some cases, defendants have argued that the court should adjust a prejudgment interest award to take into account the deferral of taxes. See *Hughes Aircraft Co. v. United States*, 86 F.3d 1566 (Fed. Cir. 1996). While the court in *Hughes* did not make an adjustment, it may be worth an effort by the defendant to raise this argument in order to resist a large prejudgment interest award.

## III. Practice Pointers

Prejudgment interest is intended to put a claimant in the same position it would have been in had it not been injured by another party. Prejudgment interest is an award of the time value of money perceived to have been wrongfully withheld by a defendant in a civil action. While the intent of a prejudgment interest award is to compensate a plaintiff for the wrongful withholding of money or property, an interest award can be a windfall. There may be circumstances outside a defendant's control that delay a plaintiff's recovery of claimed

damages. The calculation of prejudgment interest can be problematic because its calculation is typically dependent upon the application and interpretation of state statutes. Practitioners should pay careful attention to the treatment of prejudgment interest in their specific jurisdictions. Tort reform in many jurisdictions has affected the evaluation of prejudgment interest. Practitioners must also consider what type of case and damages their clients are alleging in evaluating when interest begins to accrue. Whether a claim is liquidated or unliquidated is also an important factor for consideration. Practitioners can use early evaluation and assessment to assist defendants in avoiding financial hardship due to litigation delays.

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