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Applying Simple Prejudgment Interest Not So Simple

BY KEVIN SCHLOSSER

In today's investment environment, most would agree that a 9% return on one's investment would be quite a favorable rate of return. Despite the precipitous drop of interest rates over the years, since 1981 New York has maintained a 9% rate for the award of pre- and post-judgment interest. For the past few years, bills have been introduced by the New York State legislature to address the gap between the statutory rate set by the CPLR and the prevailing rates of return, but none of the bills has been enacted thus far.

On January 31, 2005, another bill was introduced in the New York Senate to amend relevant provisions of the CPLR and the Estates, Powers and Trusts Law to change the rate of interest from the flat rate of 9% to a flexible one based upon a floating rate fixed by the tax commissioner for tax payments. The sponsors of the bill assert that the current rate of 9% on accrued claims is "inequitable because of the gap which exists between such rate and current interest rates." They maintain that "[a] more equitable scheme is to tie the rate payable on such claims to a flexible interest rate" as is applied to certain tax payments.

Unless and until the 9% rate set by the CPLR is changed, however, issues surrounding the award of prejudgment in-

terest will continue to be very important and meaningful for litigators and their clients. Under the statutory scheme set forth in the CPLR, there are three basic time periods for which interest can be awarded: (1) interest on the underlying cause of action from the date the action arose until the verdict or decision; (2) interest on the verdict or decision until judgment is rendered; and (3) interest on the judgment until the judgment is paid.

Under the first category, prejudgment interest is limited to sums "awarded because of a breach of performance of a contract, or because of an act or omission depriving or otherwise interfering with title to, or possession or enjoyment of, property." That means that personal injury actions are specifically excluded from those qualifying for pre-verdict interest. Moreover, because pre-verdict interest is intended to compensate a party for the loss of use of the money it was entitled to receive, pre-verdict interest is not added to an award of punitive damages, regardless of the underlying cause of action.

In calculating the time period upon which to award pre-verdict interest, interest "shall be computed from the earliest ascertainable date the cause of action existed," and where damages "were incurred at various times, interest shall be computed upon each item from the date it was incurred or upon all of the damages from a single reasonable intermediate date."

Within this statutory framework, issues arise as to the precise date upon which interest shall be applied as well as the interplay between state and federal rules in applying prejudgment interest. In three recent decisions, U.S. District Judge Arthur D. Spatt, sitting in Central Islip, was presented with and resolved several interesting issues involving prejudgment interest.

In *New England Insurance Co. v. Healthcare Underwriters Mutual Insurance Co.*, 333 F.Supp.2d 87 (E.D.N.Y. 2004), the underlying cause of action was based upon defendant's bad faith refusal to settle a medical malpractice case against the insured of both the defendant and plaintiff. Judge Spatt noted that in "what may be a novel ruling, the Court must determine the date from which prejudgment interest is computed pursuant to [CPLR 5001] in an insurance 'bad faith' action when the underlying medical malpractice action was settled and no judgment was entered." 333 F.Supp.2d at 88. While noting that prejudgment interest is to be computed from "the earliest ascertainable date the cause of action existed," and that in bad faith actions prejudgment interest should begin from the date of the underlying judgment because it is not until that date that liability in excess of the policy limits is imposed on the insured, Judge Spatt recognized that the question was complicated because the underlying case was settled before it was actually reduced to judgment. *Id.* at 89.

The plaintiff argued that because no judgment was entered due to the settle-

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ment of the underlying state court case, it should receive prejudgment interest from the date of the verdict in the underlying medical malpractice action, which exposed the plaintiff to liability due to the defendant's bad faith conduct. *Id.* In rejecting the plaintiff's argument, Judge Spatt found that "where no judgment was entered because of a settlement, 'liability' was imposed on the date the settlement obligated the plaintiff to pay in excess of the insurance coverage." *Id.* at 90. Judge Spatt found that awarding prejudgment interest in this fashion was supported by the "long-standing recognition that the purpose of awarding interest is to make an aggrieved party whole" and "to compensate a plaintiff for the loss of use of money." *Id.* Thus, Judge Spatt concluded that by awarding plaintiff interest from the date the verdict was rendered but before the actual settlement payment was made would be contrary to the underlying policy of awarding prejudgment interest.

In *Collins v. Suffolk County Police Department*, 349 F.Supp.2d 559 (E.D.N.Y. 2004), Judge Spatt was presented with the question whether to award prejudgment interest under state or federal law in an employment discrimination case. Plaintiff, a black, female Suffolk County police officer, alleged racial and gender discrimination, retaliation for making complaints of discrimination, and a hostile work environment, alleging that defendants violated Title VII of the New York Human Rights Law and 42 U.S.C. § 1983. The jury awarded plaintiff damages for back pay, in addition to other relief. The plaintiff sought prejudgment interest on the back pay award at the interest rate of 9% as set forth in CPLR 5004, arguing that this award was made under both New York State and federal law.

While finding that damages awarded to plaintiff represent compensation for lost wages and, therefore, "it is ordinarily an abuse of discretion not to include prejudgment interest" on such an award, Judge Spatt declined to apply the interest rate provided under New York law. *Id.*

at 565. The court noted that "in cases where the judgment is based on violations of both state and federal law, it is common practice in the Second Circuit to apply the federal interest rate pursuant to 28 U.S.C. § 1961(a)." *Id.* Thus, Judge Spatt granted prejudgment interest on the back pay award, but only pursuant to the current federal rate under 28 U.S.C. § 1961(a).

Finally, in *Koylum, Inc. v. Peksen Realty Corp.*, 2005 WL 407790 (Feb. 19, 2005 E.D.N.Y.), Judge Spatt was again asked to determine whether state or federal law should apply to the award of prejudgment interest. This time, the court ruled that New York law controlled, rather than federal law.

In *Koylum*, the tenant of a gas station brought a federal action against the landlord alleging violations of the Petroleum Marketing Practices Act (PMPA). The landlord asserted a counterclaim for breach of contract, alleging damages under the lease. Judge Spatt rejected the plaintiff's cause of action under the PMPA and found in favor of the landlord under its counterclaim seeking liquidated damages under the lease. Although the court's jurisdiction was initially invoked based upon plaintiff's cause of action under the PMPA, Judge Spatt noted that "the applicability of state law depends on the nature of the issue before the court and not on the basis of the court's jurisdiction." *Id.* at *2. Thus, the court found that state law "is applicable to questions of prejudgment interest on claims arising out of state law even in an action predicated upon violations of the federal laws." *Id.* Because the successful counterclaim for breach of contract was based upon state law, heard under the court's pending jurisdiction, Judge Spatt ruled that the award of prejudgment interest would be governed by state law and, specifically, CPLR 5001(a).

Judge Spatt was then required to determine the date from which the prejudgment interest would run. Noting that CPLR 5001(b) generally requires

interest to be computed from "the earliest ascertainable date the cause of action existed," Judge Spatt nevertheless noted that "when damages were incurred at various times, courts have wide discretion in choosing a reasonable date." *Id.* at *3. The damages were indeed incurred at various times -- at monthly intervals when the rent was due under the lease. Although pursuant to CPLR 5001(b), the court could have applied interest on each monthly amount as and when it was due, it exercised its discretion to choose a "median date between the beginning of the holdover period . . . and the date that the Tenants vacated the premises," finding that it was "a reasonable intermediate date from which to calculate the prejudgment interest for damages from the state law claim." *Id.*

So long as the interest rate set by the CPLR remains significantly higher than prevailing interest rates, the award of prejudgment interest will remain a ripe area of litigation. Prudent litigators will undoubtedly continue to look for ways to mitigate against the higher rate afforded by the CPLR, as shown in the recent cases discussed above.

Endnotes

1. CPLR 5004. The interest rate was increased from 6% to 9% in a 1981 amendment. L. 1981, c. 258, § 1.
2. 2005 New York Senate Bill No. 1532, New York 220 Eighth Annual Legislative Session.
3. CPLR 5001.
4. CPLR 5002.
5. CPLR 5003.
6. CPLR 5001(a).
7. *Kassis v. Teachers' Ins. & Annuity Ass'n*, 13 A.D.3d 165, 786 N.Y.S.2d 473 (1st Dep't 2004).
8. *Stassou v. Casini & Huang Construction, Inc.*, 14 A.D.3d 695, 789 N.Y.S.2d 225 (2d Dep't 2005).
9. CPLR 5001(b).
10. 28 U.S.C. § 1961(a) provides in relevant part: "Such interest shall be calculated from the date of the entry of the judgment, at a rate equal to the weekly average 1-year constant maturity Treasury yield, as published by the Board of Governors of the Federal Reserve System, for the calendar week preceding. [sic] the date of the judgment."