

Prejudgment Interest

Introduction

A defendant may be required to pay prejudgment interest at the rate from 7% or 10% on a plaintiff's recovery of those damages that are "certain, or capable of being made certain by calculation."¹ The right to recover prejudgment interest is a creature of statute enacted for the purpose of making an injured party whole. The "certainty" requirement may be met if the debtor knows the amount or principal owed or the debtor could compute interest on the principal amount of damages. Recovery of prejudgment interest is mandatory from the first day there exists both a breach and a liquidated claim. Simple interest is calculated at the rate of 10% on sums due under contracts entered into after January 1, 1986, or at 7% on earlier contracts and on tort claims. Interest may be awarded by a judge or a jury.

Practice Pointer: Applicability to Liability Insurance

Insurance companies understand that time is money. An insurance company that earns a return on investment of 10% annually that delays payment of one dollar for five years while a dispute winds its way through the courts, and pays the dollar in year five will pay the functional equivalent of only 59 cents. Conversely if the insurer pays on day one and the recipient earns a return on investment at 10% annually, then at the end of five years the recipient will have \$1.61.

There are two ways that policyholders and plaintiffs can make dilatory insurers pay for the passage of time. One is to establish that prejudgment interest is due. Another is for a policyholder or plaintiff to incur interest charges on sums due. For example, if a plaintiff recovers a judgment in California, it earns 10% while it remains unpaid.

But sums that a liability insurer owes for costs of defense do not automatically accrue interest charges. Insurers often successfully argue that amount of defense costs are not "certain, or capable of being made certain by calculation" so long as the insurer challenges that the defense costs were reasonable or necessary. The required "certainty" may be supplied in several ways. Independent counsel may charge interest on sums that are unpaid after 30 days so that interest becomes part of the recoverable damages. Also, the policyholder can borrow the money needed to pay for costs of defense in order to pass along to the recalcitrant insurer interest due on unpaid sums. So long as the policyholder challenges the reasonableness of defense costs and does **not pay** them, the amount defense costs may not be certain. But policyholders who pay defense costs may argue that the insurer, as a mere indemnitor, is not permitted to challenge the reasonableness or necessity of the legal work done to conduct the defense.

Liability insurers may be required to pay interest at the rate of 10% on past due costs of defense and on covered judgments or settlements that are "certain, or capable of being made certain by calculation."² The likelihood of recovering prejudgment interest from the insurer may be maximized in several ways. First, independent counsel's retainer agreement may require the policyholder to pay interest on overdue sums. Second, cost of defense invoices may be promptly submitted to the insurer (even if the insurer has denied all liability) so as to eliminate a defense that the insurer did not know how much to pay. Third, the policyholder may pay the defense invoices, whereupon the policyholder starts to earn 10% interest on the sums paid. Fourth, a defaulting insurer may be required to pay defense costs that the policyholder has not paid, but has

¹ Civ. Code § 3287(a).

² *Ibid.*

“incurred in good faith, and in the exercise of a reasonable discretion.”³ However, if Civil Code § 2860 applies⁴ the amount that the insurer owes may not become “certain” until adjudicated by mandatory arbitration.

Statutory Right

Civil Code § 3287(a) provides: “A person who is entitled to recover damages certain, or capable of being made certain by calculation, and the right to recover which is vested in the person upon a particular day, is entitled also to recover interest thereon from that day, except when the debtor is prevented by law, or by the act of the creditor from paying the debt.”

Purpose

“[O]ne purpose of section 3287[(a)], and of prejudgment interest in general, is to provide just compensation to the injured party for loss of use of the award during the prejudgment period - in other words, to make the plaintiff whole as of the date of the injury.”⁵ Prejudgment interest is intended to make an injured party whole “for the accrual of wealth which could have been produced during the period of loss.”⁶ A similar purpose is served by prejudgment interest awarded by a jury pursuant to Civil Code § 3288.⁷

Certainty of Amount

Civil Code § 3287(a) permits recovery of prejudgment interest on sums that are “certain, or capable of being made certain by calculation.” California courts have recognized a variety of ways that prejudgment interest becomes due when the requisite certainty is established. “[T]he certainty requirement of section 3287, subdivision (a) has been reduced to two tests: (1) whether the debtor knows the amount owed or (2) whether the debtor would be able to compute the damages.”⁸ Also, “[d]amages are deemed certain when, though the parties dispute liability, they

³ “An indemnity against . . . liability . . . embraces the costs of defense . . . incurred in good faith, and in the exercise of a reasonable discretion.” (Civ. Code § 2778(3).)

⁴ *Civil Code § 2860 - Limited Application.*

⁵ *Lakin v. Watkins Associated Industries* (1993) 6 Cal.4th 644, 663; *Howard v. American National Fire Ins. Co.* (2010) 187 Cal.App.4th 498, 535 (*Howard*).

⁶ *Wisper Corp. N.V. v. California Commerce Bank* (1996) 49 Cal.App.4th 948, 958.

⁷ “Prejudgment interest [on a punitive damage recovery] is awarded to compensate a party for loss of use of his or her property and is in the nature of damages. ‘The inclusion of interest in the verdict is not the granting of damages in excess of the loss incurred. When, by virtue of the fraud or breach of fiduciary duty of the defendant, a plaintiff has been deprived of the use of his money or property and is obliged to resort to litigation to recover it, the inclusion of interest in the award is necessary in order to make the plaintiff whole.’ It is always the trier of fact that determines the issue of damages and this is true with regard to prejudgment interest.” (*Michelson v. Hamada* (1994) 29 Cal.App.4th 1566, 1586 (*Michelson*); *Nordahl v. Department of Real Estate* (1975) 48 Cal. App.3d 657, 665 (ellipses omitted).)

⁸ *Polster, Inc. v. Swing* (1985) 164 Cal. App.3d 427, 434-35 (*Polster*).

essentially do not dispute the computation of damages, if any.”⁹

“The test for determining certainty under section 3287(a) is whether the defendant knew the amount of damages owed to the claimant or could have computed that amount from reasonably available information. Uncertainty as to liability is irrelevant. A dispute concerning liability does not preclude prejudgment interest in a civil action. The certainty required by section 3287(a) is not lost when the existence of liability turns on disputed facts but only when the amount of damages turns on disputed facts. Moreover, only the claimant’s damages themselves must be certain. Damages are not made uncertain by the existence of unliquidated counterclaims or offsets interposed by the defendant.”¹⁰

“Where the fact of damages is certain, the amount of damages need not be calculated with absolute certainty. The law requires only that some reasonable basis of computation of damages be used, and the damages may be computed even if the result reached is an approximation.”¹¹ However, § 3287(a) “does not authorize pre-judgment interest as a matter of law where the amount of damages depends upon a judicial determination based upon conflicting evidence.”¹²

Mandatory Award

“Under section 3287(a), ‘the court has no discretion, but must award prejudgment interest upon request, from the first day there exists both a breach and a liquidated claim.’”¹³ “[The creditor] was entitled as a matter of law to interest from the date it paid the obligation which [the debtor] was, under its contract, obligated to pay.”¹⁴

10% or 7% Rate of Interest?

Civil Code § 3289(b) provides in part: “If a contract entered into after January 1, 1986, does not stipulate a legal rate of interest, the obligation shall bear interest at a rate of 10 percent per annum after a breach.” For earlier contracts and tort claims, the interest rate is 7%.¹⁵ “Whether the proper interest rate was applied is a question of law. [T]he constitutional rate of 7 percent applies to tort damages.”¹⁶

Simple or Compound Interest?

The Civil Code § 3287(a) does not authorize an award of compound interest. However, a jury may exercise its discretion to award compound interest pursuant Civil Code § 3288 in cases of

⁹ *Employers Mut. Cas. Co. v. Philadelphia Indem. Ins. Co.* (2008) 169 Cal.App.4th 340, 354 (*Employers Mut.*).

¹⁰ *Howard, supra*, 187 Cal.App.4th at 535-36 (citations and quotation marks omitted).

¹¹ *GHK Associates v. Mayer Group, Inc.* (1990) 224 Cal. App.3d 856, 873-874; *Michelson, supra*, 29 Cal.App.4th at 1585.

¹² *Polster, supra*, 164 Cal. App.3d at 434.

¹³ *Howard, supra*, 187 Cal.App.4th at 535; *North Oakland Med. Clinic v. Rogers* (1998) 65 Cal.App.4th 824, 828 (*North Oakland Med.*).

¹⁴ *Oil Base, Inc. v. Transport Indem. Co.* (1957) 148 Cal.App.2d 490, 491 (*Oil Base*).

¹⁵ Ca Const. Art. 15, §1; see *Michelson, supra*, 29 Cal.App.4th at 1586.

¹⁶ *Michelson, supra*, 29 Cal.App.4th at 1585 (citations and ellipses omitted).

oppression, fraud, or malice where the defendant “stood in a fiduciary relationship with [the plaintiff] and the jury found that [the defendant] breached his fiduciary duty. These cases confirm that an award of compound interest is appropriate in this type of case.”¹⁷

Contractual Obligation to Pay Another’s Attorneys Fees and Costs

A contractual obligation to pay attorneys fees and costs of another party to the contract constitutes an indemnity obligation. That is, A is obligated to indemnify B for loss that B has incurred or paid to C. A may become liable to pay prejudgment either because B has paid C or C is charging interest to B for unpaid sums “Upon an indemnity . . . against . . . costs, . . . the person indemnified is not entitled to recover without payment thereof.”¹⁸ If an attorney (C) is entitled to charge interest on unpaid sums from a client (B) or if the client must pay interest to the lawyer because the amount of fees and costs meets the certainty requirement, then a debtor (A) who is required to pay attorneys fees and costs of a creditor (B) may also be required to pay prejudgment interest.

Waiver of Interest

Civil Code § 3290 provides: “Accepting payment of the whole principal, as such, waives all claim to interest.”

The Duty to Defend

When an insurer fails to faithfully fulfill its duty to defend, the amount due from the insurer for costs of defense may be “certain” because the insurer must pay “all” defense costs. “[The insurer] was under a duty to defend [the policyholder] in the [liability] action and is liable for all costs and attorneys’ fees expended by [the policyholder] for this purpose.”¹⁹ “[The insurer’s] obligation to reimburse [the insured] attached the moment [the insured] made the payment which [the insurer] was obligated under its policy to make, and, the amount being certain, interest commenced to run from that date.”²⁰ Breach of the duty to defend renders the insurer liable for all damage proximately caused damages suffered by the insured “plus appropriate interest.”²¹

Duty to Indemnify

When an insurer wrongfully fails to defend and the policyholder settles with the plaintiff, the defaulting insurer owes interest on the amount of the settlement paid by the policyholder from the date of payment. “[The insurer’s] liability was created by its contract and, under its contract, it was obligated to pay the [settlement amount] that was paid by [the policyholder]. The fact that it misconceived and put an erroneous construction upon this contract in no way affected its liability to pay the [settlement amount] at the time the [liability] claim was settled, and its obligation to reimburse [the policyholder] attached the moment [the policyholder] made the payment which [the insurer] was obligated under its policy to make, and, the amount being

¹⁷ *Id.* at 1586.

¹⁸ Civ. Code § 2778(2).

¹⁹ *Hogan v. Midland National Ins. Co.* (1970) 3 Cal.3d 553, 558 (emphasis added).

²⁰ *Oil Base, supra*, 148 Cal.App.2d at 492.

²¹ See, *Amato v. Mercury Casualty Co.* (1997) 53 Cal.App.4th 825, 840.

certain, interest commenced to run from that date.”²²

When judgment is entered against the policyholder that the insurer wrongfully fails to pay, postjudgment interest accrues automatically on the judgment at the rate of 10%. The insurer may be held liable for the entire amount of the judgment, including the amount of post judgment interest. “[T]he general rule [is] that [i]t was not necessary for the judgment to contain a direction for payment of interest; the obligation follows automatically.”²³ However, there is a narrow statutory exception. “In the absence of an express provision in the judgment to the contrary, the [judgment creditor]’s belated attempt to assess postjudgment interest on the entire amount of the judgment from the date of its entry runs afoul of the policy enunciated in Code of Civil Procedure section 685.020.”²⁴

²² *Oil Base, supra*, 148 Cal.App.2d at 492.

²³ *County of Alameda v. Weatherford* (1995) 36 Cal.App.4th 666, 670.

²⁴ *Id.* at 670-71.