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Come to a Full Stop

Halt the running of prejudgment interest under tolling agreements.

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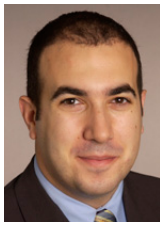
When parties enter into tolling agreements, the conventional wisdom is that the potential litigation has come to a complete standstill. It is presumed that this agreement results in prejudice to neither side, as the plaintiff gains the benefit of not having to file its claim prematurely or risk losing it, and the defendant puts off an imminent claim against it, which avoids litigation and the costs associated with it in the near term. However, what most defendants fail to consider is that under New York law, while the claim against a defendant may be tolled, in the ordinary course prejudgment interest on that claim continues to run unabated. Left to accrue for extended periods, prejudgment interest, often statutorily set at substantially above-market interest rates, can have a dramatic impact on the value of a case and alter the dynamic of resolving the dispute.

This does not have to be the case. As discussed below, under New York law, parties should structure their tolling agreements to include a clause tolling the accrual of prejudgment interest for the period that the agreement is in effect so as to create a true standstill.

Relationship Between Prejudgment Interest and Tolling Agreements. Tolling agreements are executed agreements pursuant to which a plaintiff refrains from imminently filing the cause of action against a defendant in exchange for the defendant agreeing to toll the statute of limitations on that claim so that it will not be time-barred. Claims can be tolled for multiple years, with delays of over five years not being unusual.[1]

Prejudgment interest is awarded as a matter of right to a plaintiff that brings a successful claim for the period between the date of the plaintiff's injury and the date judgment is entered.[2] The policy behind this award is to make the plaintiff whole: "Prejudgment interest is not a penalty, but simply a cost of having the use of another person's money for a specified period; such interest is intended to indemnify successful plaintiffs for the nonpayment of what was due to them, and is not meant to punish defendants."[3] To ensure that the plaintiff is fully compensated, New York has set an extremely high statutory prejudgment interest rate of nine percent interest per annum.[4,5]



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Tolling of Prejudgment Interest Should Be Enforceable. Consistent with the rationale of ensuring plaintiffs are fully compensated, New York courts have generally held that absent an explicit agreement otherwise, prejudgment interest continues to accrue even during periods of litigation delays.[6] Despite this law, however, tolling agreements commonly do not explicitly address how the parties wish to treat prejudgment interest during the tolling period,[7] with many parties likely assuming that all aspects of the potential claim are on hiatus. This erroneous assumption can be quite costly; a five year delay at nine percent interest per annum can almost double the potential damages a defendant faces. In complex commercial litigation, tolling agreements initiated by plaintiffs can prolong litigation by years, resulting in defendants facing prejudgment interest that may total hundreds of millions of dollars, just for agreeing to a standstill.

While not extensive, New York case law seems to provide that this result can be avoided if the parties explicitly agree to toll prejudgment interest while their tolling agreement is in effect.[8] In *Automatic Findings v. Certain Underwriters at Lloyds of London*,[9] the plaintiff expressly agreed in writing to waive interest on the condition that defendants agreed to extensions of time allowing the plaintiff to commence the action. The court, considering the plaintiff's claim for prejudgment interest for the period during which the plaintiff was granted an extension, held that "[o]nce the parties have entered into an agreement to toll interest, this court will not disturb the terms of the agreement absent a showing that the contested terms are invalid."[10]

Similarly, other New York cases addressing prejudgment interest and the right to contract also suggest that courts would enforce a mutually agreed-upon tolling of prejudgment interest. Courts have at times concluded that prejudgment interest does not run during periods of litigation delay caused by plaintiffs.[11] If delay caused by plaintiffs can prevent the accrual of prejudgment interest, agreement by a plaintiff to the same should be treated no differently. Additionally, courts have recognized that prejudgment interest will not be applied where the parties contractually agree to the contrary.[12] Further, parties are

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entitled to contract to a specific prejudgment interest rate,[13] including altering the statutory rate.[14] If the freedom of contract permits parties to agree as to rates of interest, it should equally permit parties to agree to temporary furloughs in the accrual of interest.

Moreover, allowing parties to contract to toll prejudgment interest while their tolling agreement is pending is consistent with most parties' expectations under a tolling agreement and is in no way contrary to the policy underlying prejudgment interest. While prejudgment interest is intended to make plaintiffs whole, it should not provide them potentially substantial interest payments for a period in which they have sought a delay of the proceedings of their own claims.[15] Otherwise, the potentially substantial costs caused by the delay will fall squarely, and only, on the defendant. This will disincentivize defendants from agreeing to requests for tolling agreements that plaintiffs might need. More importantly, because tolling agreements often lead to settlements, benefiting both the court and the parties, this framework may reduce the likelihood that differences between parties will be resolved outside of the court.

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Parties Should Consider the Impact of Prejudgment Interest on Their Tolling Agreement. The interplay between prejudgment interest and tolling agreements can have a material effect on a litigation. Consciousness of whether or not prejudgment interest is accruing should inform both parties' decisions as to whether to enter into a tolling agreement and at what point to terminate that agreement.

For many defendants, agreeing to a tolling agreement is done without significant consideration of the downside risk, as it is presumed that it is to their advantage not to have a claim pending against them. But the immediate benefit of avoiding the imminent filing of a potential claim can quickly be outweighed by the costs associated with the accrual of prejudgment interest during the tolling of that claim. While the likelihood of damages, the duration of the proposed delay, and a defendant's own litigation readiness will all impact its consideration of whether to insist upon a tolling of prejudgment interest as a term of any tolling agreement, there is little reason not to seek to negotiate for a tolling of prejudgment interest, particularly where the defendant is aware that the plaintiff is not in a position to bring suit at that time. Similarly, for a plaintiff that is dealing with a defendant that is refusing to enter into a much-needed tolling agreement out of concern for the potential accrual of prejudgment interest, it is important to consider that not only should the parties be able to contractually agree to toll prejudgment interest, they should also be able to negotiate for a lower rate.

Conclusion. New York courts should follow a clear line of case law that appears to provide that parties are permitted to agree to toll prejudgment interest while their tolling agreement is in effect. Moreover, courts are incentivized to recognize the legitimacy of such agreements as doing so will encourage defendants to accommodate plaintiffs' requests for tolling, which may alleviate the need for filing potentially unnecessary lawsuits in our overburdened courts. Given this, defendants (and plaintiffs seeking to ameliorate a defendant's concerns) should avail themselves of this freedom to bargain for a tolling of prejudgment interest, particularly where plaintiffs have reached out to them for tolling agreements. Absent doing so, the potential damages at stake may grow significantly, while the defendants assume their cases are dormant. Only through a tolling agreement with a contractual clause that also tolls prejudgment interest will parties achieve a true standstill of their litigation.

1. *WYS Design P'ship Architects v. Bd. of Managers of 258 Lafayette St. Condo.*, 958 N.Y.S.2d 311, 2010 WL 3769212 (Sup. Ct. Sept. 16, 2010) (TABLE) (tolling agreement entered in 2003 and Arbitration Demand served in 2009); *Don Johnson Prods. v. Rysher Entm't*, 209 Cal.App.4th 919, 147 Cal.Rptr.3d 590, 598 (2012) (tolling agreement entered in 2002 and complaint served in 2009).

2. See, e.g., *Iaizzo v. Gerard*, 620 N.Y.S.2d 266 (2d Dept. 1994) (holding that prejudgment interest applies as a matter of right for breach of contract).

3. 22 Am. Jur. 2d, Damages §462 (2013); *State Farm Mut. Auto. Ins. v. Enrique*, 16 A.3d 938, 2011 WL 1004604, at *2 (Del. March 22, 2011) (TABLE) ("prejudgment interest" is an "expense associated with the defense costs and strategy in the case"); *Mfgs.' & Traders Trust v. Reliance Ins.*, 8 N.Y.3d 583, 589 (2007).

4. See N.Y. C.P.L.R. §5004 (McKinney 2013).

5. A high rate of statutory prejudgment interest is not unusual. See, e.g., Del. Code Ann. tit. 6, §2301 (2012) (five percent over the Federal Reserve discount rate); Cal. Const., Art. XV §1 (highest rate that can be set is 10 percent; absent applicable statute, the rate is seven percent).

6. See *Love v. State*, 78 N.Y.2d 540, 545 (1991) (prejudgment interest should be calculated from the date liability is adjudicated to have arisen regardless of whose fault it is that judgment and fixing of damages is delayed); see also *Van Nostrand v. Froehlich*, 844 N.Y.S.2d 293, 296 (2d Dept. 2007) ("Interest accrues independent of whether either party causes a delay in reaching the damages trial"); *Sawtelle v. Southside Hosp.*, 760 N.Y.S.2d 206, 208 (2d Dept. 2003) (granting additional prejudgment interest because "the cause of the delay between verdict and judgment is not the controlling factor").

7. See, e.g., 5 Env. L. Forms Guide §54:7 (2013); 3 Shareholder Litig. §27:45 (2012).

8. Parties should take care that any provision limiting or tolling prejudgment interest is clearly worded. Simply pointing to the fact that the parties entered into a tolling agreement to create a standstill in the litigation will almost assuredly be insufficient to toll prejudgment interest. In *Amerisource v. Rx USA Int'l*, No. 02-CV-2514 (JMA), 2010 WL 2160017 (E.D.N.Y. May 26, 2010), the court considered whether an ambiguous contract provided that prejudgment interest accrue at a rate of 1.5 percent per month, or as a one-time flat fee. The court concluded that the parties intended the rate to be monthly, because interpreting the rate as a one-time fee would "render the parties' interest agreement essentially meaningless and would lead to an unreasonable result." The court noted that in the absence of clear language to the contrary, in an "arm's length deal between sophisticated parties, the Court is unpersuaded that [plaintiff] intended such a substantial departure from its statutory rights or that [defendant] expected that it would be granted such a favorable rate without having to make a comparable concession of its own." Id. at *5. Therefore, any contract provision reducing or eliminating prejudgment interest should clearly communicate that intent.

9. Civ. No. 92-6191 (DLD), 1994 WL 273367, at *3 (S.D.N.Y. June 20, 1994).

10. Id.; cf. *Cohan v. Movtady*, 751 F. Supp. 2d 436, 443-44 (E.D.N.Y. 2010) (noting that while New York law is silent, law from other states allows for "agreement[s] to waive prejudgment interest").

11. See *Kinek v. Gulf & Western*, 1993 U.S. Dist. LEXIS 8478, at *7 (S.D.N.Y. 1993) (holding that defendants' consent to plaintiffs' requests for extensions served to toll prejudgment interest rate because "defendants should not be prejudiced because of the disagreement between the plaintiffs…, nor should the plaintiffs be rewarded for their inability to meet the court-imposed deadline"); *Jones v. Spentonbush-Red Star*, 155 F.3d 587, 593 (2d Cir. 1998) (affirming denial of prejudgment interest in admiralty action due to plaintiff's unjustified delay in bringing the action). But see *Automatic Findings*, 1994 WL 273367, at *2-3 (refusing to toll prejudgment interest for periods in which plaintiff caused delay but which were not covered by the specific agreement to toll interest).

12. See, e.g., *H.K.S. Hunt Club v. Town of Claverack*, 634 N.Y.S.2d 816, 816 (3d Dept. 1995) (refusing to award prejudgment interest where "the parties' unmistakable intention conveyed by its language is that they were settling all of plaintiff's claims for an amount that did not include interest").

13. See, e.g., *NML Capital v. Argentina*, 17 N.Y.3d 250, 258 (2011) ("When a claim is predicated on a breach of contract, the applicable rate of prejudgment interest varies depending on the nature and terms of the contract. Most agreements associated with indebtedness provide a 'contract rate' of interest…. If the parties failed to include a provision in the contract addressing the interest rate that governs after principal is due or in the event of a breach, New York's statutory rate will be applied as the default rate."); *Nat'l Audubon Soc'y v. Sonopia*, No. 09 Civ. 975 (PGG) (FM), 2010 WL 3911261, at *3 (S.D.N.Y. Sept. 1, 2010) (applying contractual rate, even though "this rate is substantially lower than the nine percent prejudgment interest rate to which [Plaintiff] would otherwise be entitled").

14. *Madonna v. Madonna*, 697 N.Y.S.2d 119, 120 (2d Dept. 1999) ("[T]he rate of 9% per annum is not mandatory, and, as a matter of discretion in the interest of justice, we lower the rate to 4½% per annum." (internal citations omitted)); see also *Nat'l Audubon Soc'y*, 2010 WL 3911261, at *3.

15. Plaintiffs will still be entitled to prejudgment interest for the period preceding the tolling agreement and for when the case is actively being litigated.

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