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Stopping the Clock on Prejudgment Interest in Contract Disputes

By **Douglas J. Pepe**

Litigation takes time. Contract disputes are no exception. In the post-crisis era of near zero interest rates, New York's 9 percent prejudgment interest rate can actually prove to be a plaintiff's best investment strategy. The New York 9 percent rate runs in contract cases from the "earliest ascertainable date the cause of action existed" to the verdict or decision (CPLR 5001, 5004), then continues to accrue at the above-market rate through judgment (CPLR 5003). In the current low-rate environment, this means one thing: Time is on plaintiffs' side.

Are there options available to defendants to stop the clock on statutory prejudgment interest in contract disputes?

In New York state court, the clear answer is "yes." Under CPLR 3219, a "deposit" and "tender" by the defendant cuts off interest if the plaintiff ultimately recovers less. The mechanics are straightforward. At any time up to 10 days before trial, the defendant may deposit "an amount deemed by him to be sufficient to satisfy the claim asserted against him" and serve a written tender on the plaintiff.

The plaintiff then has 10 days to accept the tender by withdrawing the deposited money, or the defendant gets it back. If the plaintiff fails to obtain a "more favorable judgment" in the case, the plaintiff must pay the defendant's costs, and prejudgment interest is cut off as of the date of the tender. In state court, CPLR 3219 can be a powerful tool in the hands of defendants because it puts time back on their side.

In federal court, the answer is a bit more complicated. Contract disputes in federal court are usually diversity cases, governed by the Erie doctrine. That old saw teaches that while federal procedural rules govern in diversity cases, state substantive law applies. See, e.g., *Gasperini v. Center For Humanities*, 518 U.S. 415, 426-27 (1996) (citing *Erie R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938)). But which one is CPLR 3219? Despite the fact that the statute is more than 50 years old, no clear answer is in the books.

The relatively few federal cases discussing CPLR 3219 have not considered or addressed *Erie*. Over the years, several courts sitting in diversity have entertained arguments seeking to apply CPLR 3219 to cut off prejudgment interest, only to rule that the party invoking CPLR 3219 failed to satisfy the strict requirements of the statute. See, e.g., *Bison Capital Corp. v. ATP Oil & Gas*, 884 F.Supp.2d 57, 59 (SDNY 2012) (offer of payment insufficient to stop interest running; actual deposit with court required); *Aristocrat Leisure v. Deutsche Bank Trust*, 618 F.Supp.2d 280, 310 (SDNY 2009) (same); *Boyce v. Soundview Tech.*, No. 03 Civ. 2159 (HB), 2005 WL 627780, at *3 (SDNY March 17, 2005) (same); *Malson Ltd. v. Liberty Mut. Fire Ins.*, No. 84 Civ. 1717 (CMM), 1986 WL 2963, at *1 (SDNY March 3, 1986) (tender with conditions insufficient).

The one published decision actually applying CPLR 3219 to stop the running of statutory interest in federal court is *Quintel v. Citibank*, 606 F.Supp. 898 (SDNY 1985). *Quintel* refused to award prejudgment interest after an unaccepted offer of judgment in a legal malpractice case, referencing CPLR 3219 and "equitable principles of estoppel." Id. at 914. The opinion suggests that the defendant never followed the "deposit" and "tender" requirements of CPLR 3219, casting doubt on *Quintel's* reference to the statute in light of authority mandating strict compliance. Most importantly for present purposes, *Quintel* did not consider *Erie*.

The question therefore remains: Does CPLR 3219 apply in federal diversity actions?

Federal and State

First, courts must resolve whether *Erie* is even relevant to the question. In diversity cases, when a federal rule of civil procedure is directly on point and conflicts with a state rule, the federal rule governs unless it is invalid. This issue is decided under the Rules Enabling Act, not *Erie* (or the Rules of Decision Act on which *Erie* is based). See *Shady Grove Orthopedic Assocs. v. Allstate*, 559 U.S. 393, 398 (2010) ("We do not wade into Erie's murky waters unless the federal rule is inapplicable or invalid" under the Rules Enabling Act.).

> Whether CPLR 3219 applies in federal court in diversity cases under 'Erie' is a question that has not been resolved.

One federal rule of civil procedure is at least potentially on point: the federal offer of judgment rule, Fed. R. Civ. P. 68. Under Rule 68(a), a defendant can serve "an offer to allow judgment on specified terms, with the costs then accrued." A plaintiff who refuses an offer and fails to obtain a "more favorable" judgment "must pay the costs incurred after the offer was made" under Rule 68(d).

An "offer of judgment," however, is very different from the "deposit" and "tender"

DOUGLAS J. PEPE *is a partner with Joseph Hage Aaronson.*

required by CPLR 3219. A Rule 68 offer can contain "specified terms"; a CPLR 3219 deposit and tender must be unconditional. A Rule 68 offer yields an enforceable "judgment" against the defendant; a withdrawn CPLR 3219 deposit results only in a "judgment dismissing the [plaintiff's] *pleading*" (emphasis added). In the Rule 68 context, the plaintiff must take steps to enforce that judgment; in the CPLR 3219 context the plaintiff recovers the deposited funds immediately.

With perhaps the limited and debatable exception of *Quintel*, courts applying CPLR 3219 have refused to apply it to unaccepted "offers." Tellingly, New York has a separate "offer to compromise" statute, CPLR 3221. It is in all material respects the same as Rule 68, and Rule 68 was in fact modeled after CPLR 3221's predecessor, Civil Practice Act §177. See Fed. R. Civ. P. 68 advisory committee's note. So, while Rule 68 can be said to cover the same ground as CPLR 3221, the same cannot necessarily be said for CPLR 3219. They are different statutes, each with a different scope, text, purpose and effect.

While some federal courts—particularly the U.S. Court of Appeals for the First and Ninth Circuits—historically tend toward a broad preemptive view of the federal rules, even those courts may find the notion that CPLR 3219 conflicts with Rule 68 to be a bridge too far. There is certainly no direct textual conflict of the kind that animated a majority of justices in *Shady Grove* to find preemption. See 559 U.S. at 397-406 (finding a direct conflict between the Rule 23 mandate that "a class action may be maintained" if specified conditions are met and CPLR 901(b) provision that class action "may not be maintained" to recover statutory penalty).

Nor can it be said that Rule 68 leaves "no room for the operation" of CPLR 3219 (id. at 421 (Stevens, J., concurring)), given that the rules govern the consequences of different actions—an "offer of judgment" in the case of Rule 68 versus a "deposit" and "tender" under CPLR 3219. Cf. *Gasperini v. Center for Humanities*, 518 U.S. at 427 n.7 (1996) ("Federal courts have interpreted the Federal Rules… with sensitivity to important state interests and regulatory policies," including in cases finding "state provision for offers of settlement by plaintiffs [to be] compatible with Federal Rule 68, which is limited to offers by defendants.").

In short, there is no federal law or rule governing the consequences of an unaccepted "deposit" and "tender," and courts may well conclude that Rule 68 can comfortably "operate alongside the state rule" (see *Shady Grove*, 559 U.S. at 421), just as the New York analog to Rule 68 has operated alongside CPLR 3219 throughout their joint existence.

Substantive or Procedural

Second, on the assumption that Rule 68 is not preemptive, courts would need to address and resolve the fundamental Erie question: whether CPLR 3219 is substantive or procedural. No court has answered the question. One non-New York court has held that CPLR 3219 is procedural, but that ruling was in a very different context. In *MPEG v. Dell Global,* No. 7016-VCP, 2013 WL 812489, at *6 (Del. Ch. March 6, 2013), the Delaware Court of Chancery found that CPLR 3219 is "a procedural rule *for conflict-of-law purposes*" (emphasis added). The analyses are not congruent, and there is no "equivalence between what is substantive under the Erie doctrine and what is substantive for purposes of conflict of laws." *Sun Oil v. Wortman*, 486 U.S. 717, 726 (1988); *Liberty Synergistics v. Microflo*, 718 F.3d 138, 152 (2d Cir. 2013). Because *MPEG* did not address the relevant question, it also cannot answer it.

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To be sure, courts long ago settled on the rule that prejudgment interest statutes themselves are substantive for Erie purposes. But CPLR 3219 is not part of the New York prejudgment interest statute (that is found in CPLR Article 50, not Article 30). CPLR 3219 certainly does concern the running and computation of prejudgment interest, but that is not the same thing as being a prejudgment interest statute. Cases answering the prejudgment interest question—holding that it is substantive for Erie purposes in federal court—therefore do not definitively resolve the issue with respect to CPLR 3219.

General prejudgment interest cases do, however, provide some mooring for the CPLR 3219 Erie analysis. In contract actions governed by New York law, prejudgment interest is a component of damages. *J. D'Addario v. Embassy Indus.,* 20 N.Y.3d 113, 117-18, 980 N.E.2d 940, 942-43, 957 N.Y.S.2d 275, 277-78 (2012) (statutory interest designed to "compensate the wronged party for the loss of use of the money" and is necessary in order "to make [the] aggrieved party whole").

Courts treat prejudgment interest as substantive for Erie purposes precisely because it "is a substantive aspect of formulation of [the plaintiff's] remedy." *Valle v. Joint Plumbing Indus. Bd.*, 623 F.2d 196, 205 n.19 (2d Cir. 1980). This analysis applies not just to the availability of prejudgment interest and the rate to be awarded, but also to the date of accrual. See, e.g., *United Bank Ltd. v. Cosmic Int'l*, 542 F.2d 868, 877 (2d Cir. 1976) ("Since this is a diversity action, New York CPLR 5001 controls the date from which interest is to be computed.").

It does not take a great leap of logic to extend that analysis to the date that prejudgment interest ends. For example, state statutes of limitation, like prejudgment interest statutes, are substantive for Erie purposes. Courts have had no difficulty concluding that issues surrounding the running and ending of limitations are equally substantive. See, e.g., *Walker v. Armco Steel*, 446 U.S. 740, 744-53 (1980) (state law, not federal law, governs whether the limitations period ends or is tolled by commencement of an action notwithstanding Fed. R. Civ. P. 3). "Just as the Erie principle precludes a federal court from giving a state-created claim 'longer life…than [the claim] would have had in the state court'…so *Erie* precludes a recovery in federal court significantly larger than the recovery that would have been tolerated in state court." *Gasperini*, 518 U.S. at 430-31.

Purposes and Function

CPLR 3219 serves several salient purposes. Like the federal and state offer of judgment rules (Rule 68 and CPLR 3221), CPLR 3219 facilitates and encourages settlements. CPLR 3219, however, serves an additional and more substantive function. It can be said that when a defendant deposits and tenders more than the plaintiff is contractually entitled to, the plaintiff suffers no damage from the loss of use of that money. The funds were actually made available and were plaintiff's for the taking. Unlike offer of judgment rules, CPLR 3219 speaks to the absence of damage, and bars recovery as a consequence.

Whether CPLR 3219 applies in federal court in diversity cases under *Erie* is a question that has not been resolved. Absent 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.