Dear Trial Court: Please Key The Post-Judgment Interest Rate To An Index, Not Making It The Best Investment In Town

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This article first appeared in the June 2011 edition of the Louisville Bar Association’s Bar Briefs.

In *Emberton v. GMRI*, 299 S.W.3d 565 (2009), our highest court gives trial courts seemingly unfettered direction, as a practical matter, in deciding what interest rate to impose on a final judgment awarding unliquidated damages. KRS 360.040 refers to 12% interest, but provides that a judgment “may bear less interest” if a trial court “is satisfied” that lower interest is appropriate “after a hearing on the question.” Some or many civil practitioners may not realize that under KRS 360.040, a losing party can move the trial court to amend a judgment, hold a hearing, and present evidence to prove that lower interest makes sense. Logically, the most rationale rate is one tied to an index fluctuating with up and down economic conditions. An index should address the Court’s concerns in *GMRI*.

**KRS 360.040.** KRS 360.040 directs a trial court to reduce the rate when damages are unliquidated and the trial court is “satisfied that the rate of interest should be less than 12%.”

Provided, that when a claim for unliquidated damages is reduced to judgment, such judgment may bear less interest than twelve percent (12%) if the court rendering such judgment, after a hearing on that question, is satisfied that the rate of interest should be less than twelve percent (12%).

If a judgment “may bear less interest,” as the statute allows, trial courts may tie the rate to an index that reflects fairly the fluctuating market.
When the General Assembly raised the statutory cap to 12% in 1982 – but allowed trial courts to lower the rate – interest rates were in a time period of historic highs. In fact, the 1-year constant maturity Treasury rate (which is the index the federal courts use to measure their post-judgment interest rate) was 12.2% in 1982 and the prime rate reached 17% that year. Today, the Treasury rate is less than 1% and the prime rate is less than 4%. If a court keys the interest rate to an index, it should have a reasonable relationship to changes in economic conditions, just as 12% approximated the Treasury rate when it became part of the statute in 1982.

**Emberton v. GMRI.** Proper exercise of a trial court’s discretion cannot be overstated because the judge enjoys wide latitude. In *GMRI*, the losing defendant mounted a shot gun constitutional assault on KRS 360.040. After analyzing each contention, the Court rejects GMRI’s challenge in all respects and affirms application of the 12% rate, despite evidence that a zero rate, or “more equitable sum,” was at least arguably reasonable.

GMRI contended that KRS 360.040 was “void for vagueness” and, therefore, ran afoul of Kentucky Constitution §115, mandating equal protection, as well as the separation of powers doctrine. Rejecting this position, the Court looks initially to *Elk Horn Coal Corporation v. Cheyenne Res. Inc.*, 163 S.W.3d 408 (Ky. 2005), which deemed the appeal penalty statute, KRS 26A.300, unconstitutional. But the Court found that, unlike KRS 26A.300, KRS 360.040 was not a “penalty.” *Id.* at 582. Rather, the Court explains, KRS 360.040 serves both to compensate a winning plaintiff “for delay in receiving a money judgment” and to “discourage frivolous appeals.” *Id.* (internal citations omitted).
GMRI’s equal protection argument likewise failed because the Court views KRS 360.040 as treating “all similarly situated appellants” the same – namely, all those appealing from money judgments. See id. Under the Court’s “ingrained conclusion,” money judgment appellees and non-monetary judgment appellees are “not similarly situated.” Id. at 582, n. 19. It reasons that winning a monetary award deserves “in kind compensation in the form of annual interest payments,” but the same cannot be said of “a non-money judgment, such as specific performance or an injunction.” Id.

The Court also reasons that, even if these appellees are similarly situated, the difference in treatment has a rational basis, which lies in the general purpose of awarding post-judgment interest: “to compensate” the appellee for the loss of use of his money judgment during the appellate process. See id. at 583. Given this purpose, the Court “cannot say that the statute so discourages meritorious appeals as to infringe Section 115 of the Kentucky Constitution and its guarantee of an appeal as a matter of right.” Id. The statute does not “discourage” meritorious appeals, the Court explains, because it “authorizes the trial court to hear argument and, in its discretion, lower the post-judgment interest rate from twelve percent in the case of unliquidated damages” Id. at 584. In deciding whether to lower interest, the trial court “is to be guided by the peculiar equities of the case before it,” and its decision “is not above reproach and may be reviewed for an abuse of discretion.” Id.

While the Court recognizes that the trial court’s power is “not above reproach,” it finds no abuse of discretion in refusing to lower interest rates “in the face of evidence showing lower market rates.” Id. at 585. The Court defers to the Legislature: “[T]he fact that the twelve percent rate in today’s economic climate may be well above the
marketplace norm is a matter properly to be considered by the General Assembly because that body has the power and discretion to lower the *de facto* legal interest rate contained in KRS 360.040.” *Id.* (quoting Morgan v. Scott, 291 S.W.3d 622, 644 (Ky. 2009)). The Court reiterates its belief that gripes about interest rates “are better addressed to our legislature and the political process rather than the courts,” noting that recent attempts (in 2009) to amend the statute have failed. *See id.* at 585, n. 25.

The Court therefore affirms the trial court’s refusal in *GMRI* to lower the interest rate. It reasons that “great economic variation,” including significant inflation, can occur over the fifteen-year period of time available for enforcing a money judgment under KRS 413.090(1). “[W]hile twelve percent may be on the high end of today’s market, a current market rate today may also, in time, prove so low as to inadequately compensate the money-judgment appellant awaiting payment.” *Id.* at 585. In addition, the Court suggests that an appellee has less reason to promptly pay the judgment, “which in turn prolongs the appellant’s risk of loss by exposing him to greater possibilities of the appellee’s . . . insolvency.” *Id.* The Court concludes with its belief that “the statute’s *de facto* rate reflects the realities of constantly changing financial conditions over the life of a money judgment and the inability of a trial judge – indeed anyone – to predict the future.” *Id.*

But *GMRI* does not specifically consider whether tying the rate to an index, which in turn is keyed to the economy or current market conditions, would address the hardship on losing defendants – with appellate rights – that 12% causes, and simultaneously fairly compensate the plaintiff who prevails on appeal. Arguably, an interest rate reflects “constantly changing financial conditions,” not when it becomes set
in stone at 12%, but when the rate is related to something that “reflects the realities” of the market. That could well be an index.

**An Index-Based Approach.** Nothing in KRS 360.040 prevents the trial court from tying the interest rate to an index. KRS 360.040 simply says the “judgment may bear less interest than 12%.” It does not provide that “less interest” must be a specific rate. If a trial court keys the interest rate to an index that fluctuates with market conditions, the result is fair to all parties.

The victorious plaintiff will not be under-compensated and the defendant exercising the right to a meritorious appeal will not be unjustly penalized. The “penal” nature of 12% today may not be unconstitutional to the Court in *GMRI*, but it is surely unfair at the least. Similarly, while the General Assembly refused to amend KRS 360.040, its inaction may rest on the simple fact that KRS 360.040, as written, gives trial courts the power to impose interest at less than 12%. Lowering the rate to an index that moves with the economy presents the sensible procedure in most civil cases.

An index is not inconsistent with the Court’s concepts in *GMRI*. If an appellee or a surety becomes insolvent over the fifteen-year period for executing on a judgment, as the Court in GMRI fears, the successful plaintiff will stand “under-compensated” whether the interest rate is 12% or tied to an index. And, a defendant confronting a monetary judgment seems unlikely to incur the cost of an appeal unless the amount of the judgment is significant. Any interest on a significant judgment should discourage a defendant from pursuing a useless appeal and simultaneously encourage the defendant to “promptly pay the judgment.”
GMRI articulates concern over the somewhat lengthy 15-year statutory period for executing on a judgment, but the vast majority of judgments are surely satisfied in much less time. And, the reality of interest rates over the last fifteen years suggest that 12% is unrealistic.

Other jurisdictions impose an index rate to reflect movements in the economy. Federal courts key post-judgment interest to the Treasury bill rates: Under 28 U.S.C. § 1961, the interest rate on federal court judgments is determined by the weekly average 1-year constant maturity Treasury yield, a periodically changing rate that realistically reflects current expected money market returns. In the past few years, the Treasury rate has steadily dropped from 5.06% in January of 2007. The current rate (as of May 2, 2011) is .25%. See http://www.federalreserve.gov/releases/h15/current/. The highest weekly average 1-year constant maturity Treasury yield rate in 2000 was a mere 6.40%, scarcely more than half the maximum statutory rate under KRS 360.040. In fact, since 1990 the Treasury rate has never been higher than 7.89%, and in the past decade, the highest Treasury rate has been 5.22% (in July of 2006). See http://www.harpfinancial.com/InterestRateHistory/1YearConstantMaturityTreasury.htm.

Other states also apply a fluctuating interest rate tied to an index. Georgia’s post-judgment interest rate, for instance, is based upon the prime rate: “All judgments in this state shall bear interest upon the principal amount recovered at a rate equal to the prime rate as published by the Board of Governors of the Federal Reserve System, as published in statistical release H. 15 or any publication that may supersede it, on the day the judgment is entered plus 3 percent.” Ga. St. §7-4-12. Similarly, Idaho ties its post-judgment interest rate to the weekly average yield on U.S. treasury securities: “The
legal rate of interest on money due on the judgment of any competent court or tribunal shall be the rate of five percent (5%) plus the base rate in effect at the time of entry of the judgment. The base rate shall be determined on July 1 of each year by the Idaho state treasurer and shall be the weekly average yield on United States treasury securities as adjusted to a constant maturity of one (1) year and rounded up to the nearest one-eighth percent (1/8%).” Id. St. § 28-22-104.

Nebraska also bases its post-judgment interest rate upon a Federal index: “For decrees and judgments rendered on and after July 20, 2002, interest . . . shall be fixed at a rate equal to two percentage points above the bond investment yield, as published by the Secretary of the Treasury of the United States. . . .” Neb. St. 45-103. Interestingly, Nevada requires a post-trial hearing to determine the appropriate interest rate and directs the trial judge to enter a rate “which must not be less than the prime rate of interest plus 2 percent.” Nev. St. 37.175.

**KRS 360.040 Should Allow Use Of An Index.** While the statutes or rules in these jurisdictions expressly mention an index-based rate and therefore contain language different from that in our statute, the fact remains that KRS 360.040 expressly allows a judgment “to bear less interest” without dictating anything specific about a particular lower rate. And, if trial courts have the broad discretion that GMRI appears to accord, they should have the power to adopt an index-based rate as the “less interest.”

The history of KRS 360.040 is consistent with an index-based approach to post-judgment interest. Decades ago, the statute contained no provision that allowed a trial court to reduce the interest rate. Courts recognized, nevertheless, that it was unfair to impose an interest rate that was out of line with the economy. In *Kaufman v. Kaufman’s*
Administration, 166 S.W.2d 860, 867 (Ky. 1942), the trial court reduced the post-judgment interest rate because it was “inequitable that court obligations should carry a rate of interest altogether out of proportion to the earning of money generally.” Because the statute at that time did not allow the trial court to reduce the interest rate, the Court of Appeals reversed. But in doing so, it observed: the lesser rate “seems fair and just under existing conditions, economically speaking….” GMRI does not discuss Kaufman.

At its next session after the Kaufman judgment, in Kentucky Acts, 1976, Ch. 59 §2, the General Assembly amended KRS 360.040 to allow trial courts to set interest rates less than the statutory maximum. In Decker v. Glasscock Trucking Service, Inc., 403 S.W.2d 275 (Ky. 1966), the Court specifically observed: “KRS 360.040 reposes discretion in the trial judge in the matter of fixing an interest rate at less than 6% in instances of reduction of unliquidated claims to liquidated judgments.” Because the trial court in Decker failed to hold a hearing, the Court reversed “with directions” to enter a new interest rate after a hearing.

In the late 1970s and early 1980s, interest rates soared: the prime rate reached 21.5% by late 1980. Prime lending and mortgage rates well into the teens became common during that economic period. The General Assembly therefore amended KRS 360.040 in 1982 to provide the current 12% rate. In 1981, the 1-year constant maturity Treasury rate was 14% and in 1982 it was 12.2% – the two highest rates ever on record (based on the available information which covers the past 50 years). See http://www.harpfinancial.com/InterestRateHistory/1YearConstantMaturityTreasury.htm.

1979, 1980 and 1984 appear to be the only other years where the Treasury rate was in the double-digits. It was during this unique time period that the General
Assembly set the 12% maximum interest rate. At that time, Kentucky’s statutory rate, therefore, was in directly line with the Treasury rate (which the federal courts use in determining post-judgment interest rates). On the other hand, today Kentucky’s statutory rate is 48 times the Treasury rate. In 1982, the prime rate had reached 17% so the 12% rate adopted by the General Assembly was actually less than the prime rate. By contrast, today the prime rate is 3.25%, markedly less than the 12% statutory rate.

Surely realizing that trial judges could not blindly and indefinitely cling to any fixed rate when the General Assembly amended KRS 360.040, it retained an exception to its 12% maximum rate for unliquidated damages to accommodate the likelihood that interest rates would spiral down, just as they have done in recent years. As the Court observed in Perkins v. Daugherty, 722 S.W.2d 907 (Ky. App. 1987), “KRS 360.040 is Kentucky’s interest on judgment statute. It provides that in cases based on claims for unliquidated damages … once the claim is reduced to judgment it ‘may bear less’ than the ordinary judgment rate of 12% per annum.” In Owensboro Mercy Health System v. Payne, 24 S.W.3d 675 (Ky. App. 2000), the Court of Appeals affirmed the trial court’s reduction of the interest rate from 12% to 9% based on an expert’s affidavit that recommended a 6% reduction.

The unrealistic nature of 12% in the current economic climate is obvious by example. Consider what happens when the total judgment is $1 million. An exercise in simple mathematics reveals that even one year’s interest on $1 million at a 12% rate is unduly costly, amounting to $120,000 annually. One level of appellate review easily consumes more than one year, and if the trial court applies 12%, each passing day at
the appellate level would cost a defendant approximately $328.77. As it stands now, a judgment appears to be the best investment in town. Under an index approach (whether the rate be keyed to the Treasury bill rate, the prime rate, or some other tangible index that is based on current market conditions), the result would be more fair and realistic. The holder of the judgment would be compensated for the delay in receiving payment and the defendant would not be unjustly punished for seeking an appeal. Trial courts should exercise their discretion in lowering the default post-judgment interest rate and an index-based approach provides guidance to them in setting a fair rate for all involved.

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