UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

NOT FOR PUBLICATION

In re:	Chapter 11
PAYROLL EXPRESS CORP., et al.,	Case No. 92-43150 (ALG)
Debtors.	(Jointly Administered)
JOHN S. PEREIRA, ESQ., AS CHAPTER 11 TRUSTEE OF THE ESTATES OF PAYROLL EXPRESS CORPORATION AND PAYROLL EXPRESS CORPORATION OF NEW YORK,	Adv. Proc. No. 98-8405
Plaintiff,	
-against-	
MARSHALL & STERLING, INC.,	
Defendant.	

MEMORANDUM OF OPINION

A P P E R A N C E S:

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ALLAN L. GROPPER
UNITED STATES BANKRUPTCY JUDGE

Before the Court is the motion of the Chapter 11 Trustee (the "Trustee") of Payroll Express Corporation and Payroll Express Corporation of New York (collectively, the "Debtors") for an award of up to $46,779,544.37 in prejudgment interest against Marshall & Sterling, Inc. (the "Defendant"). For the reasons set forth below, the Trustee's request is denied.

BACKGROUND

This motion concerns an adversary proceeding – referred to this Court upon the retirement of Judge Blackshear – wherein the Trustee alleged that the Defendant negligently and in breach of contract failed to procure insurance policies for the Debtors. The Trustee sought the return of all premiums and fees paid to the Defendant as well as $37 million in damages and prejudgment interest. (Judge Blackshear's Mem. of Dec. dated Mar. 30, 2005 ("Mem. of Dec.") at 1.) On March 30, 2005, Judge Blackshear awarded the Trustee approximately $21 million in damages in addition to the return of "all premiums, fees and commissions paid to it in connection with the Lloyd's policies from 1989 to 1992." (Mem. of Dec. at 52.) Judge Blackshear dismissed the Trustee's remaining "causes of action." *Id*. The comprehensive Opinion's only mention of prejudgment interest comes in the opening paragraph, where the Court noted that the Trustee was seeking a $37 million judgment together with prejudgment interest.

DISCUSSION

The Trustee argues that Judge Blackshear intentionally left the issue of prejudgment interest open, that prejudgment interest is mandatory on his tort claims by virtue of New Jersey law and that the equities favor an award of interest on his contract

claims. The Defendant argues that Judge Blackshear's Opinion decided the issue of an award of interest in its favor and that, in any event, prejudgment interest is neither mandated by New Jersey law nor appropriate in this case.

I. Judge Blackshear's Opinion Does Not Decide the Issue

The parties first disagree as to the binding effect of Judge Blackshear's Opinion. Defendant argues that under the controlling case law it is not necessary for a court to deny an award of prejudgment interest expressly; rather a court's silence on the issue constitutes a decision against the award. Defendant cites *Paddington Partners v. Bouchard*, 34 F.3d 1132 (2d Cir. 1994), and *In Re Frigitemp Corp.*, 781 F.2d 324 (2d Cir. 1986), for the proposition that prejudgment interest "may be overlooked or denied . . . the failure of the decision-maker to award prejudgment interest is an accurate reflection of the court's decision." *Paddington Partners*, 34 F.3d at 1140. However, both *Paddington Partners* and *Frigitemp* concerned attempts by successful plaintiffs to amend a previously entered judgment by means of Rule 60 of the Federal Rules of Civil Procedure, and here there is no suggestion that a motion under Rule 60 is needed to alter Judge Blackshear's Opinion. *Id.*

In the case at bar, no judgment has been entered. There is no question that it is appropriate to seek interest in connection with the entry of judgment. See *Paddington Partners*, 34 F.3d at 1143; *In Re Frigitemp Corp.*, 781 F.2d at 328. Although Judge Blackshear's Opinion is silent as to pre-judgment interest, the Trustee has properly raised the issue in post-trial but pre-judgment papers, and the Court must make a determination as to the propriety of such an award. See *Paddington Partners*, 34 F.3d at 1140; *In Re Frigitemp Corp.*, 781 F.2d at 324.

II. New Jersey Law Applies to the Question of Prejudgment Interest.

Federal courts must apply the choice of law rules of the forum state. See *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941). Even though the parties have assumed that New Jersey law governs pre-judgment interest in this case, because of the important differences between Federal and State rules on prejudgment interest, and indeed the differences between the States' rules, the Court will turn first to the question of which law applies.[1]

The applicability of State law remedies to a claim in Federal court depends on the nature of the issue, not the basis of the court's jurisdiction. *Mallis v. Bankers Trust Co.*, 717 F.2d 683, 692 n.13 (2d Cir. 1983). It follows, then, that State law is applicable to questions of prejudgment interest on claims arising out of or based on State law, even where the action was brought in Federal court pursuant to the court's exclusive jurisdiction. See *Strobl v. New York Mercantile Exchange*, 590 F. Supp. 875, 881-82 (S.D.N.Y. 1984) (determining prejudgment interest on Federal claims under Federal law and prejudgment interest on State common law claims under State law). In the case at bar, the Trustee's claims arise entirely under State law, although they were brought in Federal court based on bankruptcy-related jurisdiction. As such, the Court must look to State law in deciding the remedies.

Bankruptcy courts confronting State law claims apply the choice of law rules of the forum state. See *In re Gaston v. Snow*, 243 F.3d 599, 602 (2d Cir. 2001). Under New York choice of law principles, the allowance of prejudgment interest is controlled by the

[1] Where, as here, the parties do not raise an issue of choice of law, a court may decline to examine the issue *sua sponte*. See *Keles v. Yale Univ.*, 889 F. Supp. 729, 732 (S.D.N.Y. 1995). However, a court can raise the issue of the correct rule of law, even where the parties are in agreement. Cf. *Bethea v. Levi Strauss & Co.*, 916 F.2d 453, 456 n.6 (8th Cir. 1990).

law of the State whose law governs the main claim. See *Entron, Inc. v. Affiliated FM Ins. Co.*, 749 F.2d 127, 131 (2d Cir. 1984); *Patch v. Stanley Works (Stanley Chem. Co. Div.)*, 448 F.2d 483, 494 n.18 (2d Cir. 1971) (noting a "consistent line" of cases holding that under New York choice of law principles, "the allowance of prejudgment interest is controlled by the rule of the jurisdiction whose law determines liability").

In the case at bar, Judge Blackshear decided that New Jersey law applied to the Trustee's claims. (Mem. of Dec. at 18-28.) The parties have not argued that this Court should, or even whether this Court could, re-examine this issue, previously decided in this case. Cf. *Manhattan Eye Ear & Throat Hosp. v. N.L.R.B.*, 942 F.2d 151, 156 (2d Cir. 1991); *accord Liona Corp. v. PCH Assoc. (In re PCH Assoc.)*, 949 F.2d 585, 592 (2d Cir. 1991). Thus, the Court must look to State law in determining the propriety of an award of prejudgment interest, and the applicable law is New Jersey's.

III. The Trustee Is Not Entitled to Prejudgment Interest under New Jersey Law

With regard to the grant of prejudgment interest in a tort action, New Jersey Civil Practice Rule 4:42-11(b) states, in pertinent part:

> Except where provided by Statute with respect to public entity or employee, and except as otherwise provided by law, the court shall, in tort actions . . . include in the judgment simple interest calculated as hereafter provided, from the date of the institution of the action or from a date 6 months after the date the cause of action arises, whichever is later, provided that in exceptional cases the court may suspend the running of such prejudgment interest.

N.J. Ct. R. 4:42-11(b). There is, then, a presumption under New Jersey law that prejudgment interest will be awarded in tort actions unless the matter is an "exceptional case". See, e.g., *Busik v. Levine*, 307 A.2d 571, *appeal dismissed*, 414 U.S. 1106 (1973); *N. Bergen Rex Trans., Inc. v. Trailer Leasing Co.*, 730 A.2d 843, 851 (N.J. 1999); *Heim*

v. Wolpaw, 638 A.2d 1373, 1376 (N.J. Super. Ct. App. Div. 1994). A court's decision to suspend prejudgment interest in tort cases is guided by "equitable principles with the concept of making the victim whole of paramount significance." See *Bailey v. Pocaro & Pocaro*, 701 A.2d 916, 920 (N.J. Super. Ct. App. Div. 1997).

Although New Jersey Rule 4:42-11(b) allows a court to suspend payment of prejudgment interest in "exceptional cases," it does not define or give examples of "exceptional cases." N.J. Ct. R. 4.42-11(b) (1999). In determining whether prejudgment interest should be suspended, courts look to the "equitable purpose of prejudgment interest[,] to compensate a party for lost earnings on a sum of money it was entitled to, but which has been retained by another." *N. Bergen Rex Transp., Inc.*, 730 A.2d at 851; *Busik*, 307 A.2d at 571; see also, Pressler, *Current N.J. Court Rules*, Comment on R. 4:42-11 (2003) ("[P]rejudgment interest is not a penalty but rather its allowance simply recognizes that until the judgment is entered and paid, the defendant has had the use of money rightfully the plaintiff's.") Under the New Jersey rule, the "judicial suspension of interest extends only to those cases where an award of interest would neither advance the aim of early settlement nor constitute fair compensation to plaintiff for money withheld and used or presumptively used by defendant." *Dall'Ava v. H.W. Porter Co.*, 488 A.2d 1036, 1037 (N.J. Super. Ct. App. Div. 1985) (internal citations omitted).

The New Jersey rules are silent as to the grant of prejudgment interest in contract actions, but courts have held, generally, that prejudgment interest is available in contract actions "in accordance with equitable principles." *George H. Swatek, Inc. v. N. Star Graphics, Inc.*, 587 A. 2d 629, 632 (N.J. Super. Ct. App. Div. 1991).

The parties to this case hotly dispute whether the action sounds more in contract or in tort, but this is an issue that need not be decided. Under New Jersey law, a court need not determine whether an action sounds primarily in either contract or in tort to determine prejudgment interest, as the same equitable factors for which a court would suspend prejudgment interest in a tort action would also weigh against awarding prejudgment interest in a contract action. See *Rova Farms Resort, Inc. v. Investors Ins. Co. of America*, 323 A. 2d 495, 512 (N.J. 1994) (holding that a court need not resolve whether action sounds more in contract or tort because compensation is not "dependent on what label we placed upon an action but rather on the nature of the injury . . . and the remedies requested . . . ."); cf. *N. Bergen Rex Transp., Inc.*, 730 A.2d at 851. Moreover, the New Jersey courts have held that the strict application of the tort recovery rule for prejudgment interest, R. 4:42-11(b), may not appropriate in malpractice actions. A professional malpractice case is not treated as a typical tort action in New Jersey. See *Bailey*, 701 A.2d at 919-20; *Osborne v. O' Reilly*, 631 A.2d 577 (N.J. Super. Ct. Law Div. 1993). In *Bailey*, the New Jersey court, in a legal malpractice case, held that "a legal malpractice claim is hybrid itself, consisting a blend of contract and tort elements", and therefore, "the award of prejudgment interest in a legal malpractice action should not be limited to the tort recovery rule, but should be guided by equitable principles with the concept of making the victim whole of paramount significance." 701 A.2d at 920.

In carrying out the equitable goals of New Jersey law, the Court begins with the fact that Judge Blackshear awarded the Trustee damages of $21 million "representing the amount due Payroll Express under the Lloyd's policies." This presumably compensated the estate for its inability to recover on the policies that the Defendant failed to procure.

He also ordered the Defendant to repay "all premiums, fees and commissions" paid on those policies. (Mem. of Dec. at 52.) This constituted additional damages of a restitutionary nature, measured by the "defendant's unjust gain rather than [by the plaintiff's] loss." *Great West Life & Annuity Insurance Co. v. Knudson*, 534 U.S. 204, 229 (2002) (Ginsburg, J., dissenting). But it should be noted that the Defendant did not have the use of all of the premiums, fees and commissions that Payroll Express paid; the Defendant was a broker, and it presumably paid the premiums over to the insurers. (See Def.'s Mem. of Law in Op. to Trustee's Motion for an Order Fixing Prejudgment Interest at 15.) There is no implication that the Defendant gained any direct pecuniary benefit from "withholding" most of these funds.

In any event, the additional restitutionary damages awarded to the Trustee by Judge Blackshear should be more than adequate to compensate the Trustee for any delay in his receipt of the insurance policy proceeds. Judge Blackshear awarded damages in a very precise amount, and there is no reason to believe that his large damage award was not intended to fully compensate the Trustee and the estate and that any further payment would be punitive and inappropriate. Cf. *J & R Ice Cream Corp. v. California Smoothie Licensing Corp.*, 31 F.3d 1259, 1267 (3d Cir. 1994). Certainly, tripling the award as a result of an interest payment would violate the policies underlying New Jersey's prejudgment interest rule. The New Jersey courts do not award prejudgment interest when such an award would punish the defendant, Pressler, *Current N.J. Court Rules*, Comment on R. 4:42-11(b), or where the recipient would receive more than necessary to compensate him for the loss. See *Osborne*, 631 A.2d at 581; see also *Chattin*, 524 A.2d

at 854 (holding that prejudgment interest was inapplicable because the plaintiff was fully compensated by underlying damages).

This Court is also hesitant to award prejudgment interest where there have been delays in the entry of judgment not resulting from the conduct of the parties. The New Jersey courts have refused to grant prejudgment interest in tort actions in such circumstances. *Dall'Ava,* 488 A.2d 1036; *Osborne*, 631 A.2d at 580; *Elec. Mobility Corp.*, 87 F. Supp. 2d at 402-03; *N. Bergen Rex Transp., Inc.*, 730 A.2d at 851. As one New Jersey court said, an award of prejudgment interest in such circumstances would not constitute fair reimbursement to the plaintiff and would penalize the defendant unjustly. *Dall'Ava,* 488 A.2d at 1037-38 (holding no prejudgment interest where case suspended for bankruptcy filing); see also, *Mandile v. Clark Material Handling Co.*, 303 F. Supp. 2d 531, 537-38 (D.N.J. 2004).

CONCLUSION

For the reasons set forth above, the Trustee's motion for prejudgment interest is denied. The Court understands that the parties have agreed on a form of judgment, except for the interest component, and they are requested to submit this form of judgment, omitting any award of pre-judgment interest.

Dated: New York, New York
July 28, 2005

/s/ Allan L. Gropper
UNITED STATES BANKRUPTCY JUDGE