What is Arkansas' Pre-Judgment Interest Rate? A Vexing Question with No Clear Answer.

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Since the time of publication, a statute has been revised which impacts the content of this post. See *Ark. Code Ann. § 16-65-114.*

If you become engaged in litigation in Arkansas, the answer to this question can be worth hundreds of thousands of dollars in potential recovery or exposure.[1] As such, pre-judgment interest is an important consideration. This blog post focuses on a timely issue in the law: the appropriate pre-judgment interest rate to be applied in the state of Arkansas.

As the most recent court to dive deep into pre-judgment interest rates in Arkansas,[2] Federal District Judge D. P. Marshall, Jr. reviewed the relevant statutes, traced back the case law of the past century, and with scholarly precision came up with an educated prediction.[3] In so doing, he concluded that pre-judgment interest in Arkansas was a "vexing question with no clear answer."[4]

The Issue

Presumably, pre-judgment interest exists to make a plaintiff whole when they have been wrongfully deprived of the use of their money. However, Arkansas case law instructs that pre-judgment interest should be awarded at the "rate of interest which is currently in use by those lending money."[5] Given that rationale, one might think that the pre-judgment interest rate would fluctuate to reflect changing economic realities. However in practice, the rate routinely applied by courts has remained relatively constant for more than a century. University of Arkansas law professor Howard Brill teaches that "courts have typically awarded 6% pre-judgment interest, not only in contract disputes, but in almost all cases."[6] Judge Marshall reached the same conclusion in applying 6% as the rate established by precedent. The underlying rationale that the appropriate rate is the one currently in use by those lending money is further undermined by the fact that in most cases courts have not taken testimony as to prevailing interest rates, choosing instead to rely on precedent.[7]

The Law in Arkansas

Previously, the Arkansas Constitution set a cap on the rate of interest that could be awarded, and that was viewed as the cap applicable to the pre-judgment interest rates. With the enactment of Amendment 89 in 2011, this cap disappeared. In 2013 the legislature enacted legislation providing that the rate of interest under a contract in which a rate of interest is not specified is set at 6%.[8] And there are statutes setting the rate of pre-judgment interest at specific rates in specific situations.[9] Further, in the case of post-judgment interest, the legislature has generally set the rate at 10%.[10] There is not, however, a statute on the books that sets a general pre-judgment interest rate.

Interest Rates in the Economy

At the beginning of 2018, with the Fed holding interest rates unchanged at 2%, and with many banks offering commercial lending rates well below 6%, a rate of return of 6% may seem like it would create a windfall for a prevailing party in litigation if the desired rate to be applied is the one in use "by those lending money." However, several factors cut against this conclusion. First, pre-judgment interest in Arkansas is applied using a simple interest formula,[11] whereas elsewhere in the economy an interest rate is likely to recognize some form of compounding. Thus, if a plaintiff had not been deprived of the use of her money and had invested it herself, some level of compounding would almost always be assured. And second, with some awards of pre-judgment interest, the prevailing party might not be guaranteed that the accumulated pre-judgment interest will ever be collected. In such an instance, the higher rate of 6% may be some type of inherent reward for risk taken. Nonetheless, even if these reasons justify a 6% rate of pre-judgment interest in an economy with rates at or below 6%, this still leaves the practice of relying on century old precedent at odds with the underling rationale that the rate should mirror that in use by those lending money. Interestingly, on average 6% might not seem like an unreasonable estimate of interest when looking across decades.[12] However, that figure is still merely an average, meaning that when economic interest rates are high, a losing defendant would get the benefit of an artificially low rate at 6%, whereas when economic interest rates are low a winning plaintiff who receives the payment of interest would get the benefit of an artificially high rate at 6%.

Impact on Litigation

Pre-judgment interest can substantially increase the amount at stake in litigation, especially in complex commercial cases that take years to resolve. Given the variances between the law in Arkansas and elsewhere, the pre-judgment interest may be a factor that weighs into decisions about choice of forum. Although given the gap in this area of Arkansas law, litigating the issue presents further risks to the parties involved. These risks should be weighed not just as a question of the dollar value amount of pre-judgment interest, but rather how the 6% rate of pre-judgment interest applied by a court stacks up to the rate that a party would otherwise receive or have to pay in the economy. And at times, as now, when there is a wide gap between a 6% rate of pre-judgment interest and market rates, there is additional reason to pause for analysis. As such, in some situations, pre-judgment interest is an important consideration for litigants and their attorneys.

Conclusion

Despite its simplistic appeal, the longstanding practice of consistently applying pre-judgment interest at 6% is misaligned with the underlying rationale for ordering such an award, and it creates economic winners and losers not based on the merits of a case but rather dependent on unrelated macroeconomic variables. While some awards of interest in Arkansas are based on the constitutional or statutory mandate, generically awarding pre-judgment interest at 6% is not based on set authority. Since the 2011 to 2013 shifts in this area of the law described above, the Arkansas Supreme Court has affirmed such an award when the issue was not raised by the parties,[13] and even when the issue was raised, the Court seemed reluctant to address the issue and declined to do so.[14] Given this reluctance and the absence of constitutional or statutory authority, this issue presents an opportunity for the Arkansas Legislature to clarify the law, either making the award of pre-judgment interest more fair for the parties involved, or at the very least eliminating the risk of this unknown so that parties can conduct business and litigate with more complete information. In the meantime, pre-judgment interest is an important factor to be considered when maximizing a recovery or limiting potential exposure.

[1] *See e.g., Chambers v. McDougald*, 2017 Ark. App. 357, 520 S.W.3d 740 (2017), *reh'g denied* (July 19, 2017) (involving pre-judgment interest of $159,698.63); *see also Carnegie Mellon Univ. v. Marvell Tech.*

Grp., LTD, No. 2:09-cv-290 (Doc. 789) (W.D. Pa. 2013) (seeking pre-judgment interest in the amount of $321,767,068.17).

[2] *Mo. & N. Ark. R.R. Co. v. Entergy Ark., Inc.,* No. 1:10-CV-8, 2013 WL 5442099 (E.D. Ark. Sept. 27, 2013).

[3] As a Federal Court applying state substantive law in an unsettled area, Judge Marshall was charged with determining the law as he believed the Arkansas Supreme Court would have ruled. *See Erie R. Co. v. Tompkins,* 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 1188 (1938); 19 Charles Alan Wright, et al., *Federal Practice and Procedure* § 4507 (3d ed. 2017).

[4] There, the issue was which interest rate should apply in a specific 18-month gap when no statutory or constitutional authority existed providing for the rate of interest to be awarded in a contract case with no set rate. Given the current law as explained below, determining the appropriate rate of pre-judgment interest today, although less vexing than the precise issue examined by Judge Marshall, is still problematic because it is at odds with its underlying rationale.

[5] *Lovell v. Marianna Fed. Sav. & Loan Ass'n,* 267 Ark. 164, 167, 589 S.W.2d 577, 578 (1979).

[6] 1 Howard W. Brill, *Arkansas Law of Damages* § 10:4 (2017).

[7] Id.

[8] Ark. Code Ann. § 4-57-101(d).

[9] *See e.g.,* Ark. Code Ann. § 23–81–118(b)(1) (setting the rate of pre-judgment interest at 8% in the event that an insurer fails to pay the proceeds of a life insurance policy within a reasonable time after the death of the insured); 2 David Newbern et al., *Arkansas Practice and Procedure* § 31:10 (5th ed. 2017).

[10] Ark. Code Ann. § 16-65-114.

[11] Brill, *supra* note 6, at n.10.

[12]The average interest rate over the past 200+ years is 5.18%. https://www.cnbc.com/2016/11/17/200-years-of-us-interest-rates-on-one-chart.html

[13] *See e.g., Gerber Prod. Co. v. Hewitt,* 2016 Ark. 222, 14, 492 S.W.3d 856, 864 (2016), *reh'g denied* (July 21, 2016) (affirming an award of 6% pre-judgment interest without analysis when the rate was not an issue on appeal).

[14] *Hotel Assocs., Inc. v. Rieves, Rubens & Mayton,* 2014 Ark. 254, 435 S.W.3d 488 (2014).