Personal Insurance Federation of California
California's Personal Lines Trade Association
REPRESENTING THE LEADING AUTOMOBILE AND HOMEOWNERS INSURERS
State Farm • Farmers • 21st Century Insurance Group • SAFECO • Progressive

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MEMORANDUM

Date: March 22, 2005

To: The Honorable Dave Jones, Chair
Members, Assembly Judiciary Committee

From: Dan C. Dunmoyer, President
Michael A. Gunning, Senior Legislative Advocate
Michael A. Paiva, Senior Legislative Advocate

Re: AB 1042 (Harman): Floating Interest Rate
Assembly Judiciary Committee Hearing: March 29, 2005
PIFC Position: Support

The Personal Insurance Federation of California (PIFC), representing insurers who write over 50% of all personal lines insurance sold in California, **supports AB 1042** authored by Assembly Member Harman.

AB 1042 would modify *Code of Civil Procedure §3291* from a fixed interest rate on pre-judgment and post judgment damage awards to a floating interest rate. Section 3291 currently provides for an interest rate of 10% on pre-judgment and post judgment awards. The proposed change would be set at set at 3% above the federal short-term rate as recognized by the Controller of the State of California on the 15th of October of each year. The federal short-term rate is a rate that is currently paid on the average market yield of a marketable obligation of the United States which has a maturity of three years or less.

AB 1042 is a straightforward and equitable approach that connects the interest rate owed on unsatisfied pre-judgment and post judgment damage awards to the prevailing short-term interest rate plus 3%. Under current law, the interest rate is fixed at 10% regardless of the likely amount of interest available to the defendant, plaintiff and/or insurer. As a result, when interest rates are lower than 10%, which has been the case for the past decade, the defendant, cross-defendant, and sometimes the plaintiff, are being assessed a penalty in addition to the judgment entered against them.

Federal Short Term Rates for the Last 10 Years:

1991	*5.69*	*1998*	*5.35*
1992	*3.52*	*1999*	*4.97*
1993	*3.02*	*2000*	*6.24*
1994	*4.21*	*2001*	*3.88*
1995	*5.83*	*2002*	*1.67*
1996	*5.30*	*2003*	*1.13*
1997	*5.46*	*2004*	*1.35*

The interest rate on judgments should be a neutral mechanism; it should not be a mechanism that serves to penalize or reward a party over and above the judgment amount. A money judgment, along with any pre-judgment and post judgment interest, is designed to compensate and make the prevailing party whole. Under the current statutory fixed rate of 10%, the prevailing party receives a windfall by being able to collect interest on their money judgment at a rate over and above that available on the open market. Conversely, if the available market rate were greater than the current statutory rate, the losing party would have little and/or no incentive to satisfy the judgment.

AB 1042 Mirrors Federal Procedures.
United States Codes Title 28-Judiciary and Judicial Procedures Code Part V, Chapter 125, Section 1961. Interest, states in pertinent part as follows, "*Interest shall be allowed on any money judgment in a civil case recovered in a district court. Execution therefor may be levied by the marshal, in any case where, by the law of the State in which such court is held, execution may be levied for interest on judgments recovered in the courts of the State. Such interest shall be calculated from the date of the entry of the judgment at a rate equal to the weekly average 1-year constant maturity Treasury yield, as published by the Board of Governors of the Federal Reserve System".* Stated more simply, what is being contemplated in AB 1042 is very similar to how judgments in Federal courts are handled.

AB 1042 Reflects Similar Changes Made in Other States.
The state of Ohio recently made a change nearly identical to that which is contained in AB 1042 in an effort to bring balance and fairness to the system of post-judgment interest payments. California law currently provides a one-way incentive to plaintiffs with no down side to pursue litigation following a Code of Civil Procedure §998 (Offer of Compromise). For example, in the event that the plaintiff anticipates receiving a damage award that is simply one dollar in excess of the §998 offer of compromise, the plaintiff can count on collecting 10% interest on the final judgment from the date of the §998 offer, which in most cases is an insurer. As a result, this fixed 10% interest rate works as an incentive not to settle a case because of the potential windfall that accrues to the plaintiff should they prevail.

The California Constitution Recognizes the Merits of Tying Interest Rates to Federal Agencies. Article 15 of Section 1 of the California Constitution states that "the rate of interest upon a judgment rendered in any court of this state shall be set by the Legislature at not more than 10% per annum. *Such rate may be variable and based upon interest rates charged by federal agencies or economic indicators, or both but (emphasis added)* the absence of the setting of such a rate by the Legislature, the rate of interest on any judgment rendered in any court of this state shall be 7% per annum". The California Constitution itself recognizes the benefits of tying the interest rate on a money judgment to federal agencies or other economic indicators.

The legislature enacted the 10% interest rate found in *Civil Code §3291* back in 1982 when the average prime rate of interest was 13.625% for that year. The current prime rate is 5.5% as reported by the Federal Reserve.

Failure To Pass AB 1042 Means Higher Insurance Costs for California Consumers.
AB 1042 by tying the interest rate charged to the actual value of money creates a more accurate reflection of the risk taken by a party making, accepting, or rejecting a §998 offer of compromise. The current 10% rate results in insurers as well as uninsured parties paying out interest rates far in excess of rates available in the open market. As a result of this fact, when a plaintiff receives an award $1.00 in excess of the original §998 offer made, the insurer ends up paying interest on the judgment at a rate far in excess of any return they are capable of receiving by holding the moneys. It is understood fact that in litigation, a lawsuits value is less if settled than it's potential trial award because of the inherent risk associated with the trial process. However, under the current scheme the incentive to reach a settlement because of the risk associated with trial is diminished if the plaintiff can collect 10% interest on a final money judgment that exceeds his/her §998 offer of

compromise. As a result, insurers that work to settle a pending lawsuit pay out an amount greater than the true value of the case because of the potential windfall to the plaintiff in the event that a verdict is entered that is greater than the plaintiff's §998 offer of compromise. The end result is that justice is not achieved and policyholders are forced to pay for this additional cost through higher insurance premiums.

For the reasons stated above, PIFC believes that the method outlined in AB 1042 provides a balanced approach for post 998 judgment awards and creates a system of fairness between parties. For these reasons, **we urge your support of AB 1042** (Harman). If you have any questions, please contact Dan Dunmoyer at (916) 442-6646.

cc: Cynthia Alvillar, Assembly Judiciary Committee
Mark Redmund, Assembly Republican Caucus
Richard Costigan, Legislative Secretary for the Governor
Cynthia Bryant, Deputy Legislative Secretary for the Governor
Scott Reid, Office of the Insurance Advisor