

COMMENTS

Full Compensation, Not Overcompensation: Rethinking Prejudgment Interest Offsets in Washington

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I. INTRODUCTION

If justice were immediate, prejudgment interest would never be awarded.¹ Justice, however, is not necessarily immediate: some parties must endure years of litigation in order to obtain compensation for their damages.² Because “compensation is a fundamental principal of damages” in litigation,³ varying types of interest may be awarded on such damage awards in order to fully compensate an injured party.⁴ To be sure, a sum of money today is not a complete substitute for the same amount that should have been paid years ago.⁵ One type of interest that

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1. Michael S. Knoll, *A Primer on Prejudgment Interest*, 75 TEX. L. REV. 293, 294 (1996).

2. See *In re Oil Spill by the Amoco Cadiz Off the Coast of Fr. on Mar. 16, 1978*, 954 F.2d 1279, 1334 (7th Cir. 1992) (spanning approximately thirteen years of litigation).

3. *Robertson Steel Co. v. Harrell*, 177 F.2d 12, 17 (9th Cir. 1949); see also *Chesapeake & Ohio Ry. Co. v. Elk Ref. Co.*, 186 F.2d 30, 35 (5th Cir. 1950); *Emery v. Tile Roofing Co.*, 195 A. 409, 412 (N.H. 1937).

4. See, e.g., *City of Milwaukee v. Cement Div., Nat'l Gypsum Co.*, 515 U.S. 189, 194 (1995) (discussing pre- and post-judgment interest).

5. *In re Oil Spill by the Amoco Cadiz*, 954 F.2d at 1331. “While inflation may offset the refusal to discount damages for future losses to present value, that process does not affect the disparity between a plaintiff who receives his trial and judgment the day after an injury and a plaintiff who receives his judgment after years of protracted litigation.” *Carlton v. H.C. Price Co.*, 640 F.2d 573, 576 (5th Cir. 1981).

courts may award is prejudgment interest—interest awarded on a legal judgment from the time the claim accrued until entry of that judgment.⁶

Although interest is not intended as a windfall,⁷ interest does serve an integral purpose in judicial remedies.⁸ In fact, many areas of the law award prejudgment interest as incident to a meritorious claim for damages.⁹ Moreover, prejudgment interest awards may be especially large—in some cases even exceeding the value of the principal claim.¹⁰ For example, the Seventh Circuit affirmed an award of more than \$120,000,000 in prejudgment interest on a principal claim of \$61,000,000.¹¹ More recently, the Supreme Court affirmed a decision awarding approximately \$5,300,000 in prejudgment interest on a principal claim of approximately \$1,670,000.¹² Accordingly, in any case, prejudgment interest may be a large, if not central, issue in litigation.¹³

Moreover, in many cases both the plaintiff and the defendant assert claims against each other, claims that may require awarding interest in order to fully compensate the respective claimant.¹⁴ Some of the opposing claims arise from the same contract or same operative facts, while others arise from entirely separate, collateral matters. Based on various factors discussed below, the relationship between these claims determines which claims receive interest awards and how those awards are calculated vis-à-vis the opposing claims.¹⁵ This Comment focuses on the situation where a liquidated claim is opposed by an unliquidated counterclaim. Although there are four different approaches to calculating prejudgment interest in this situation,¹⁶ two are of central importance. First, some states apply the “interest on the entire claim” or “interest on the

6. Knoll, *supra* note 1. See also discussion *infra* Part II.A.

7. Coleman Eng'g Co., Inc. v. N. Am. Aviation, Inc., 420 P.2d 713, 722 (Cal. 1966).

8. See discussion *infra* Part II.B.

9. Kansas v. Colorado, No. 105, 2000 WL 34508307, at *40 (U.S. 2000). “Many other areas of law besides patent law, including contract, tort, insurance, admiralty, employment, securities, and civil rights, also provide for prejudgment interest awards under both statutory and common-law authority.” *Id.* (internal citations omitted).

10. *Id.* at *42 (U.S. 2000). See also *Osterneck v. Barwick Indus., Inc.*, 825 F.2d 1521, 1536 (11th Cir. 1987).

11. *In re Oil Spill by the Amoco Cadiz Off the Coast of Fr. on Mar. 16, 1978*, 954 F.2d 1279, 1331–37 (7th Cir. 1992).

12. *City of Milwaukee v. Cement Div., Nat'l Gypsum Co.*, 515 U.S. 189, 194–99 (1995).

13. See *In re Oil Spill by the Amoco Cadiz*, 954 F.2d at 1330.

14. 1 DAN DOBBS, DOBBS LAW OF REMEDIES § 3.6(1) (2d ed. 1993). See also discussion *infra* Part II.B.

15. See discussion *infra* Parts II.C, III.

16. The four approaches were as follows: (1) Interest on the Balance Rule; (2) Conversion of Liquidated Claim Rule; (3) Interest on the Entire Claim Rule; and (4) Counterclaim as a Discount Rule. *Ralston Purina Co. v. Parsons Feed & Farm Supply, Inc.*, 416 F.2d 207, 211–12 (8th Cir. 1969); *Socony Mobil Oil Co. v. Klapal*, 205 F. Supp. 388, 390–93 (Neb. 1962).

whole” rule.¹⁷ Under that rule, prejudgment interest is calculated and awarded on the liquidated claim *prior* to deducting the opposing unliquidated counterclaim.¹⁸ Washington currently follows this rule.¹⁹

Second, some states apply the “interest on the balance” rule.²⁰ Under that rule, interest is calculated and awarded *only after* deducting the opposing unliquidated counterclaim.²¹ Accordingly, the liquidated claim is offset by the unliquidated claim prior to the calculation prejudgment interest, if any, on the liquidated claim under the interest on the balance rule.²²

As noted above, Washington applies the interest on the entire claim rule in calculating prejudgment interest offsets.²³ Although Washington courts rarely permit the offset of an unliquidated counterclaim prior to the calculation of prejudgment interest on a liquidated claim, this Comment argues that Washington should adopt the interest on the balance rule when both claims arise out of the same transaction, contract, or operative facts. Indeed, this rule is articulated by numerous treatises²⁴ and followed in many states.²⁵

17. See *Ralston Purina Co.*, 416 F.2d at 211; *Socony Mobil Oil Co.*, 205 F. Supp. at 391–92; *Robblee v. Robblee*, 68 Wash. App. 69, 81, 841 P.2d 1289, 1296 (1992).

18. See *Ralston Purina Co.*, 416 F.2d at 211; *Socony Mobil Oil Co.*, 205 F. Supp. at 391–92; *Robblee*, 68 Wash. App. at 81, 841 P.2d at 1296.

19. See generally *Mall Tool Co. v. Far West Equip. Co.*, 45 Wash. 2d 158, 273 P.2d 652 (1954).

20. See *Ralston Purina Co.*, 416 F.2d at 211; *Socony Mobil Oil Co.*, 205 F. Supp. at 390; *Robblee*, 68 Wash. App. at 81, 841 P.2d at 1296.

21. See *Ralston Purina Co.*, 416 F.2d at 211; *Socony Mobil Oil Co.*, 205 F. Supp. at 390; *Robblee*, 68 Wash. App. at 81, 841 P.2d at 1296.

22. See *Ralston Purina Co.*, 416 F.2d at 211; *Socony Mobil Oil Co.*, 205 F. Supp. at 390; *Robblee*, 68 Wash. App. at 81, 841 P.2d at 1296.

23. See generally *Mall Tool Co.*, 45 Wash. 2d at 158, 273 P.2d at 652.

24. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 354(1) (1981). “If the breach consists of a failure to pay a definite sum in money or to render a performance with fixed or ascertainable monetary value, interest is recoverable from the time for performance on the amount due less all deductions to which the party in breach is entitled.” *Id.*

47 C.J.S. *Interest & Usury* § 50 (2005).

Ordinarily, where the amount of a demand is sufficiently certain to justify the allowance of interest thereon, the existence of a setoff, counterclaim, or cross claim which is unliquidated will not prevent the recovery of interest on the balance of the demand found due from the time it became due, unless the plaintiff’s liquidated claim is less than the award to the defendant on his or her counterclaim.

Id. 1 DOBBS, *supra* note 14, § 3.6(1).

When the defendant’s counterclaim or set-off is successful and reduces his liability for reasons arising out of the same facts that give rise to the plaintiff’s claim, the plaintiff’s claim is still regarded as ascertainable and prejudgment interest still awarded, but in that case interest is computed on the net amount the plaintiff recovers after crediting the defendant.

Following this introduction, Part II explores the nature and purposes of prejudgment interest, focusing on the role that prejudgment interest plays in a claimant's remedy or damage award and exploring the historical distinction between liquidated and unliquidated claims. Part III builds on this historical distinction by examining two different approaches for calculating prejudgment interest where a meritorious liquidated claim is countered by a meritorious unliquidated counterclaim: (1) the Washington rule, also known as the interest on the entire claim or interest on the whole rule; and (2) the interest on the balance rule and its slight variation in California, which focuses on the distinction between a "payment" and a "discount". Based on those rules, Part IV argues that (1) Washington's continued reliance on *Mall Tool Co. v. Far West Equip. Co.*,²⁶ which applied the interest on the whole rule except in a very narrow situation,²⁷ leads to unjust results in many cases; and (2) the interest on the balance rule is the better reasoned approach. Finally, Part V concludes that Washington should replace the rule established in *Mall Tool Co.* with the interest on the balance rule for awarding and calculating prejudgment interest, thereby making interest on the whole the exception rather than the rule.

Id. 25 SAMUEL WILLISTON & RICHARD A. LORD, WILLISTON ON CONTRACTS § 66:110 (4th ed. 2005) [hereinafter WILLISTON].

Interest will normally be awarded on a liquidated claim even though it is subject to an unliquidated counterclaim or setoff. In such cases, the interest is generally computed on the balance found to be due to the plaintiff, on the theory that he or she was deprived only of this amount during the pendency of litigation.

Id.; Willett v. Schmeiser Mfg. Co., 255 P. 529, 531-32 (Cal. App. 1927) (as cited in York Plumbing & Heating Co. v. Groussman Inv. Co., 443 P.2d 986, 988 (Colo. 1968)).

25. See, e.g., Blasland, Bouck & Lee, Inc. v. City of North Miami, 283 F.3d 1286, 1299-1300 (11th Cir. 2002); N. States Power Co. v. ITT Meyer Indus., 777 F.2d 405, 413 (8th Cir. 1985) (recognizing Minnesota's interest on the balance rule); County Asphalt, Inc. v. Lewis Welding & Eng. Corp., 444 F.2d 372, 379 (2d Cir. 1971); *Ralston Purina Co.*, 416 F.2d at 212-13 (finding that it is not abuse of discretion to award interest on the balance to the plaintiff even though the defendant's counterclaim was not *directly* related to the plaintiff's claim); Sam Macri & Sons, Inc. v. U.S. for the Use of Oaks Constr. Co., 313 F.2d 119, 129-30 (9th Cir. 1963) (affirming the district court's award of prejudgment interest on the balance); Homes & Son Constr. Co., Inc v. Bolo Corp., 526 P.2d 1258, 1261-62 (Ariz. Ct. App. 1974); Waverly Taylor, Inc. v. Polinger, 583 A.2d 179, 184 (D.C. 1990); *York Plumbing & Heating Co.*, 443 P.2d at 988; Farrington v. Freeman, 99 N.W.2d 388, 392 (Iowa 1959); Misco Leasing, Inc. v. Bush, 490 P.2d 367, 370 (Kan. 1971) (finding that when "a plaintiff sues for a liquidated sum and the defendant establishes an offsetting claim" the offset is to be "credited against the liquidated claim" as of the due date of the original debt and the "balance bears interest from that due date.") (internal citations omitted); Spurck v. Civil Serv. Bd., 42 N.W.2d 720, 728 (Minn. 1950); Harmon Cable Commc'ns of Neb. LP v. Scope Cable Television, Inc., 468 N.W.2d 350, 371-72 (Neb. 1991); Deerhurst Estates v. Meadow Homes, Inc., 165 A.2d 543, 554-55 (N.J. Super. Ct. App. Div. 1960); H. & M. Heating Co. v. Andrae, 150 N.W.2d 379, 386 (Wis. 1967) (reaffirming interest on the balance rule); Hollon v. McComb, 636 P.2d 513, 517 (Wyo. 1981).

26. 45 Wash. 2d 158, 273 P.2d 652 (1954).

27. For example, interest on the balance rule may be applied only where the claims arise from the same unitary contract. See *id.* at 664, 178-79. See also discussion *infra* Part III.A.

II. THE NATURE AND PURPOSES OF PREJUDGMENT INTEREST HISTORICALLY

A. *The Historical Evolution of Interest*

Interest is the sum of money paid or payable for the use or detention of money or property.²⁸ Prejudgment interest, then, is interest that is awarded as part of a judgment, but which is calculated to accrue prior to the entry of that judgment.²⁹ Although calculated on the total amount awarded in a judgment, prejudgment interest runs only for, and with respect to, some certain period prior to the entry of that judgment.³⁰ This timeframe distinguishes prejudgment interest from any other interest awarded on the judgment, which runs from and after the entry thereof.³¹ In general, prejudgment interest may be awarded from the date of a breach of a contract,³² commission of a tort,³³ or in some cases, the commencement of the lawsuit.³⁴

Historically, societal prejudice and religious beliefs condemned the payment of interest as usury. As a result, interest was awarded to a meritorious claimant only in a limited number of circumstances and then only in the discretion of the jury.³⁵ Interest was “an abhorrence to the law, and a contract therefor was not only not enforceable, but criminal.”³⁶ By the nineteenth century, however, American courts awarded interest, but only

28. 1 DOBBS, *supra* note 14, § 3.6(1).

29. *See id.*

30. J. R. Kemper, Annotation, *Allowance of Prejudgment Interest On Builder's Recovery in Action for Breach of Construction Contract*, 60 A.L.R.3d 487 n.1 (1974).

31. *See* Kemper, *supra* note 30.

32. *See, e.g.,* Homes & Son Constr. Co., Inc v. Bolo Corp., 526 P.2d 1258, 1261 (Ariz. Ct. App. 1974).

33. *See, e.g.,* Boeing Co. v. Washington, 89 Wash. 2d 443, 453, 572 P.2d 8, 15 (1978) (recognizing an award of prejudgment interest for the commission of an intentional tort or breach of contract).

34. *See* 1 DOBBS, *supra* note 14, § 3.6(1); *see also* Kemper, *supra* note 30.

35. Richard T. Apel, Comment, *Interest as Damages in California*, 5 UCLA L. REV. 262, 264 (1958). *See also* 1 DOBBS, *supra* note 14, § 3.6(1) (“Both Jewish and Christian thinkers and moralists of some periods thought it wrong to charge interest. The medieval Christian world called it evil and prelates proscribed it.”); CHARLES TILFORD MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 51 (1935); 1 THEODORE SEDGWICK, A TREATISE ON THE MEASURE OF DAMAGES § 289 (9th ed. 1912).

36. Laycock v. Parker, 79 N.W. 327, 332 (Wis. 1899) (citing *Adriance v. Brooks*, 13 Tex. 279, 281 (1855)).

on liquidated claims.³⁷ At that time, "liquidated" meant that the amount of the claim was absolutely certain and payable at a specific date.³⁸

B. Historical Rationales for Awarding Interest

Courts have justified prejudgment interest on at least three different theories: (1) punishment for the wrongful detention of money or property; (2) full compensation of the claimant; and (3) disgorgement of profits to prevent unjust enrichment.³⁹ In light of the various theories relied on over the course of jurisprudence, courts continue to debate whether interest should be awarded as a matter of right.⁴⁰ Regardless, courts continue to utilize multiple rationales for awarding interest.⁴¹

1. Punishment for the Wrongful Detention of Money or Property

The theory that interest was awarded as punishment arose out of the common law dislike of interest as usury.⁴² With the increased importance of personal property and commerce, courts began to enforce contracts that awarded interest for non-payment.⁴³ The motivating rationale for allowing interest was a recognition that money was inherently valuable to the user and, consequently, it was a legitimate subject of compensation for the rightful owner.⁴⁴ "This concession [of the law] was followed by a recognition of the fact that a refusal to pay money legally due, like a refusal to perform any other legal duty to another, merited condemnation and punishment from the courts"⁴⁵ As a result, interest was awarded

37. *Prejudgment Interest as Damages: New Application of an Old Theory*, 15 STAN. L. REV. 107, 107 (1962) [hereinafter *Prejudgment Interest*]. See also 1 SEDGWICK, *supra* note 35, § 299.

38. *Prejudgment Interest*, *supra* note 37, at 107 n.6. See also 1 SEDGWICK, *supra* note 35, § 301.

39. See 1 DOBBS, *supra* note 14, § 3.6(3).

40. Compare Bd. of Comm'rs of Jackson County v. United States, 308 U.S. 343, 352 (1939) (interest awards are based in equity and given in response to considerations of fairness), and *La Paz County v. Yuma County*, 735 P.2d 772, 778 (Ariz. 1987) (interest runs as a matter of right), with *Deerhurst Estates v. Meadow Homes, Inc.*, 165 A.2d 543, 554 (N.J. Super. Ct. App. Div. 1960) (interest does not run as a matter of right).

41. Compare *Carlton v. H.C. Price Co.*, 640 F.2d 573, 576 (5th Cir. 1981) ("The purpose of prejudgment interest recognizes that the injured part was injured at the moment the cause of action accrued, and that the injured party is entitled to be made whole as of that moment."), and *La Paz County*, 735 P.2d at 778 (interest is generally awarded because the "party entitled to use of the money has been deprived of that use, and the party retaining it has been unjustly enriched."), with *Espin v. Allergan Pharm., Inc.*, 317 A.2d 778, 779 (N.J. Super. Ct. Law Div. 1973) (allowing prejudgment interest encourages settlement and payment by defendant).

42. 1 DOBBS, *supra* note 14, § 3.6(1); *Kemper*, *supra* note 30; *Prejudgment Interest*, *supra* note 37, at 107-08 n.7.

43. *Laycock v. Parker*, 79 N.W. 327, 332 (Wis. 1899).

44. *Id.*

45. *Id.*

to the rightful owner (for example, the meritorious creditor-claimant) in order to punish the debtor for the wrongful detention of money.⁴⁶

2. Full Compensation of Claimants for Lost Value

Following the punishment theory for awarding interest, full compensation of a meritorious claimant became central to interest awards.⁴⁷ Under this theory, prejudgment interest compensates the claimant for the delay between the date of injury and the date of payment.⁴⁸ Prejudgment interest was used to provide an adjustment converting time-of-accident damages into time-of-judgment damages, thereby achieving the goals of full compensation.⁴⁹ As Chief Justice Cardozo explained in *Prager v. New Jersey Fidelity & Plate Glass Insurance Co. of Newark*,⁵⁰ interest is held to be an incident to just compensation.⁵¹ Interest, then, “is a concomitant very nearly automatic” for actions on contracts.⁵² By the early nineteenth century, American courts awarded interest on tort claims as well as on contract theories of liability.⁵³

Central to this theory of interest as compensatory is a recognition of the use value, or time value, of money⁵⁴—recognition that both property

46. *Id.* But see *Fed. Deposit Ins. Corp. v. British-American Corp.*, 755 F. Supp. 1314, 1328 (E.D.N.C. 1991) (finding that awarding prejudgment interest did not penalize the defendants); *Hansen v. Rothaus*, 107 Wash. 2d 468, 475, 730 P.2d 662, 666 (1986) (“Prejudgment interest is not a penalty imposed on a defendant for wrongdoing nor is its purpose to deter wrongdoing.”).

47. See *Laycock*, 79 N.W. at 332. The court noted the following:

The idea of compensation to him who had been deprived of the use of his money may have been present, but was never prominent, while the thought that the debtor by interest was only paying for value in fact received by him from the use of the money of another is hardly suggested, as in recent cases.

Id.

48. *Jones v. Best*, 134 Wash. 2d 232, 242, 950 P.2d 1, 6 (1998) (prejudgment interest compensates a party for the loss of the use of money to which he was entitled). See also *Carlton v. H.C. Price Co.*, 640 F.2d 573, 576 (5th Cir. 1981).

49. Anthony E. Rothschild, Comment, *Prejudgment Interest: Survey and Suggestion*, 77 NW. U. L. REV. 192, 192 (1982).

50. 156 N.E. 76 (N.Y. 1927).

51. *Id.* at 77.

52. *Id.*

53. *Apel*, *supra* note 35, at 264–65.

54. The U.S. Supreme Court noted the following about the time value of money:

It is essential to recognize the effect of time, either past or future, when determining the value of any asset or liability. Thus, in economic transactions, an amount owed in the past cannot be paid off today by paying the same nominal value that would have been owed had it been paid in the past. Rather, the past nominal amount must be increased to a higher present nominal amount in order to account for the earning power of the original value during the time that has passed. Likewise, an amount owing in the future must be discounted to a lower present value in order to account for the future earning power of the value in question over the future period.

Kansas v. Colorado, No. 105, 2000 WL 34508307, at *38 (U.S. 2000) (citation omitted).

and money have the potential to produce more value.⁵⁵ Courts have recognized the mercantile privilege of money in the marketplace, stating that the debtor “cannot be heard to say that it is fair and equitable that it should enjoy such a financial advantage for so long, and not pay a cent for it.”⁵⁶ Further, because the “income-producing ability of money cannot be separated from the money itself,” a denial of interest would be a denial of “an inexorable economic fact.”⁵⁷ Today, many courts rest awards of interest primarily, if not solely, on the theory of interest as necessary to fully compensate a plaintiff for the losses sustained.⁵⁸

Even if a debtor does not actually invest the money, obtain interest, or profit otherwise from the money or property wrongfully withheld, courts nevertheless award interest to claimants on liquidated amounts.⁵⁹ The inquiry, then, is whether the *claimant could have* economically profited from the money to which she was entitled, not whether the *debtor did* invest, use, or profit from the money.⁶⁰ Accordingly, interest may be awarded regardless of whether or not the claimant actually realized any losses as a result of the delay in payment.⁶¹

3. Disgorgement of Profits to Prevent Unjust Enrichment of the Debtor

In addition to the two aforementioned theories, interest awards may be justified on the theories of disgorging profits and unjust enrichment.⁶² This justification rests upon two rationales. First, an “injurer allowed to keep the return on this money [held and invested] has profited by the wrong.”⁶³ Second, like the compensatory rationale, such justification rests upon the notion that a claimant has lost the use value of her

55. *Id.* See also *Blasland, Bouck & Lee, Inc. v. City of North Miami*, 283 F.3d 1286, 1299 (11th Cir. 2002) (time value of money generally calls for awarding prejudgment interest).

56. *Phillips Petroleum Co. v. Adams*, 513 F.2d 355, 370 (5th Cir. 1975). See also *Rothschild*, *supra* note 49, at 205.

57. *Prejudgment Interest*, *supra* note 37, at 109.

58. 1 DOBBS, *supra* note 14, § 3.6(3). See also *Gen. Motors Corp. v. Devex Corp.*, 461 U.S. 648, 655–56 (1983) (prejudgment interest is necessary to put plaintiff in rightful position); *Funkhouser v. J.B. Preston Co.*, 290 U.S. 163, 168 (1933) (finding that the injured party has suffered a loss which may be regarded as not fully compensated “if he is confined to the amount found to be recoverable as of the time of breach and nothing is added for the delay in obtaining the award of damages.”).

59. 1 DOBBS, *supra* note 14, § 3.6(1).

60. *Wisper Corp. N.V. v. Cal. Commerce Bank*, 57 Cal. Rptr. 2d 141, 147 (Cal. Ct. App. 1996) (“An award of prejudgment interest is intended to make the plaintiff whole ‘for the accrual of wealth which *could have been produced* during the period of loss.’”) (emphasis added).

61. 1 DOBBS, *supra* note 14, § 3.6(1).

62. *Id.*

63. *In re Oil Spill by the Amoco Cadiz Off the Coast of Fr. on Mar. 16, 1978*, 954 F.2d 1279, 1332 (7th Cir. 1992).

money.⁶⁴ To the extent that a debtor had the ability to freely use the claimant's money—as opposed to actually making use of such money—she has been unjustly enriched.⁶⁵ “To divest defendant of this unjustified benefit is not to penalize him, for it has been determined by the trial that it was never rightfully his.”⁶⁶ The claimant's loss, specifically the use value of the claim, is identical to the unjust enrichment of the debtor, specifically the income-producing ability of money or property.⁶⁷

As an extension, awarding interest to the claimant also serves to remove any incentive a debtor has to delay payment.⁶⁸ Absent an award of interest, a debtor has an incentive to delay the payment of a debt in order to recoup some value (that is, obtain profits from the use value of money prior to its “return” to the claimant).⁶⁹ An interest award to the claimant removes that incentive because any value received will be eclipsed by the interest award.⁷⁰ In this manner, allowance of prejudgment interest is a valuable judicial mechanism, inducing prompt consideration of settlement possibilities by the debtor.⁷¹

C. Prejudgment Interest Awards: The Historical Distinction Between Liquidated and Unliquidated Claims

The common law development of interest awards highlights the historical distinction between liquidated and unliquidated claims. In England, because ancient prejudices condemned interest payments as

64. *La Paz County v. Yuma County*, 735 P.2d 772, 778 (Ariz. 1987) (interest is generally awarded because “the party entitled to use of the money has been deprived of that use, and the party retaining it has been unjustly enriched.”).

65. *Id.*; *Prejudgment Interest*, *supra* note 37, at 109.

66. *Prejudgment Interest*, *supra* note 37, at 109.

67. *Rothschild*, *supra* note 49, at 205.

68. 1 DOBBS, *supra* note 14, § 3.6(1). *See also* *Espin v. Allergan Pharm., Inc.*, 317 A.2d 779, 780 (N.J. Super. Law Div. 1973) (allowing prejudgment interest encourages settlement and payment by defendant); *State v. Phillips*, 470 P.2d 266, 274 (Alaska 1970) (finding that a failure to “award prejudgment interest creates a substantial financial incentive for defendants to litigate even where liability is so clear and the jury award so predictable that they should settle.”).

69. *Caffey v. UNUM Life Ins. Co.*, 302 F.3d 576, 586 (6th Cir. 2002) (finding that defendants would have a “strong incentive to delay payment of prejudgment interest as long as possible, since they would be able to enjoy the benefit of continued use of the funds during any period of delay, and would bear a lesser financial burden once payment was ultimately made.”).

70. *Id.* This is especially true when the market interest rate is less than the statutorily prescribed interest rate. In such a situation, the debtor may actually incur a net loss by delaying payment because the interest return available in the market would be less than the interest the debtor would be required to pay for that same period. *Cf. In re Oil Spill by the Amoco Cadiz Off the Coast of Fr.* on Mar. 16, 1978, 954 F.2d 1279, 1331 (7th Cir. 1992) (“Prejudgment interest at the market rate puts both parties in the position they would have occupied had compensation been paid promptly.”); *Knoll*, *supra* note 1, at 297 (“With interest at a market rate, neither party would benefit from nor be injured by delay” resulting from litigation).

71. *Domangue v. E. Air Lines, Inc.*, 722 F.2d 256, 264 (5th Cir. 1984).

usury,⁷² “interest was generally allowed only in the discretion of the jury rather than by way of well defined rules, and even then only in a limited number of cases.”⁷³ For example, interest was only permitted “as a matter of law: *First*, on commercial paper; *Second*, on contracts expressly providing for it; *Third*, where an agreement to pay it is implied from usage, or the dealing of the parties.”⁷⁴ In other cases, it was permitted in the discretion of the jury only when provided for by statute or as special damages for the detention of money.⁷⁵

In contrast to English courts, American courts historically awarded interest more liberally.⁷⁶ In this country, courts allowed interest “at an early date in the case of ‘liquidated’ claims, but [interest] was denied when the amount due was considered ‘unliquidated.’”⁷⁷ Courts only awarded interest where the sum due was certain and demandable at a specific point in time.⁷⁸ By definition, then, this rule confined interest awards to strictly liquidated demands.⁷⁹ Accordingly, if a claim required calculation or was not fixed at the time when it became due, an award of interest was improper.⁸⁰ Any uncertainty respecting the plaintiff’s claim precluded the plaintiff from recovering prejudgment interest.⁸¹

By the early nineteenth century, however, the prevailing rule in the U.S. progressed beyond the limits of allowing interest only on strictly liquidated claims.⁸² “[I]f the amount of the plaintiff’s claim, even though not liquidated, could be determined by reference to well established market values or by computation, he was given interest as a matter of law.”⁸³ Accordingly, courts gradually extended interest as damages.⁸⁴ “Beginning with a denial of interest in any case except where it was allowed by contract, the law first gave discretion to the jury to give interest as

72. KENNETH H. YORK & JOHN A. BAUMAN, CASES AND MATERIALS ON REMEDIES 33 (2d ed. 1973).

73. *Id.*

74. 1 SEDGWICK, *supra* note 35, §291.

75. *Id.*

76. 1 SEDGWICK, *supra* note 35, §292.

77. YORK & BAUMAN, *supra* note 72.

78. *Laycock v. Parker*, 79 N.W. 327, 332–33 (Wis. 1899) (“Being punishment, [interest] would not be imposed if there were any uncertainty as to the defendant’s duty to excuse nonperformance of it.”). *See also McMahon v. N.Y. & Erie. R.R. Co.*, 20 N.Y. 463, 468 (N.Y. 1859) (highlighting shift from common law definite set standard to computation standard).

79. *Laycock*, 79 N.W. at 332.

80. *See McMahon*, 20 N.Y. at 469 (recognizing the old common law rule that required that a demand be ascertained prior to awarding interest, and the expansion to include claims capable of being ascertained by mere computation).

81. *See Laycock*, 79 N.W. at 332–33.

82. YORK & BAUMAN, *supra* note 72.

83. *Id.*

84. 1 SEDGWICK, *supra* note 35, §297.

damages, and then allowed it as a matter of law in a constantly increasing number of cases.”⁸⁵

Courts primarily relied on two reasons for broadening the strict requirement to allow claimants to recover interest on unliquidated claims when the amount could be determined by reference to well-established market values. First, given the importance of “certainty” in interest awards, expansion of prejudgment interest awards to include a simple calculation introduced very little uncertainty: only the “settling of market rates and prices.”⁸⁶ Second, because many market values are well-established and easily obtained, a debtor may easily obtain proximate knowledge of the amount owed.⁸⁷

Today, courts employ a similar, albeit somewhat broader, definition of “liquidated.”⁸⁸ The definition varies slightly by jurisdiction and is either codified as state statutory law⁸⁹ or has evolved through common law.⁹⁰ Generally, a claim is liquidated “if the evidence furnishes data which, if believed, makes it possible to compute the amount with exactness, without reliance upon opinion or discretion.”⁹¹ Conversely, “unliquidated” refers to those claims that require some reliance on opinion, discretion, or are not easily ascertainable by a debtor.⁹² The consequence of this distinction, however, has not changed over time: interest is typically only allowed on liquidated claims.⁹³

85. *Id.*

86. *McMahon v. New York & Erie R. R. Co.*, 20 N.Y. 463, 469 (N.Y. 1859).

87. *See Cox v. McLaughlin*, 76 Cal. 60, 68–69 (Cal. 1881).

88. *See Prier v. Refrigeration Eng'g Co.*, 74 Wash. 2d 25, 34, 442 P.2d 621, 627 (1968) (*quoting* *Laycock v. Parker*, 79 N.W. 327, 334 (1899) (“It may be safely said that the tendency has been in favor of allowing interest rather than against it, and that the degree of certainty or ease with which the approximate amount can be ascertained has [sic] grown less and less stringent.”)).

89. *See, e.g.*, CAL. CIV. CODE § 3287 (1997); *see also* 25 WILLISTON, *supra* note 24, §66:109 (citing cases).

90. *See In re Paragon Trade Brands, Inc.*, 324 B.R. 829, 866 (Bankr. N.D. Ga. 2005) (“[E]ntitlement to prejudgment interest is governed by case law, not statute.”); *Bailie Commc'ns, Inc. v. Trend Bus. Sys., Inc.*, 61 Wash. App. 151, 161–62, 810 P.2d 12, 19 (1991) (while interest on a judgment is allowed by statute, prejudgment interest is allowed by state law).

91. *Mall Tool Co. v. Far W. Equip. Co.*, 45 Wash. 2d 158, 170, 273 P.2d 652, 659 (1954) (*quoting* MCCORMICK, *supra* note 35, § 54).

92. *See id.* at 175, 273 P.2d at 662 (a claim is not liquidated if it is “necessary to establish by evidence the amount of services furnished, or the quantity of material supplied, and *not being able to establish these either by computation or by reference to a known standard*”) (citation omitted); *Hansen v. Rothaus*, 107 Wash. 2d 468, 473, 730 P.2d 662, 665 (1986) (an unliquidated claim is one where the “exact amount of the sum to be allowed cannot be definitely fixed from the facts proved, disputed or undisputed, but must in the last analysis depend upon the opinion or discretion of the judge or jury as to whether a larger or smaller amount should be allowed.” (*quoting Prier*, 74 Wash. 2d at 33, 442 P.2d at 626)).

93. *Mall Tool Co.*, 45 Wash. 2d at 174, 273 P.2d at 661 (As a general rule, “interest is not allowed upon unliquidated demands[, but courts] . . . will not hesitate to make it yield to the equities

Although a claimant is equally deprived of the use value of money as between an unliquidated and a liquidated claim, in the case of an unliquidated claim the law protects the debtor rather than simply compensating the claimant.⁹⁴ With respect to an unliquidated claim, the difficulty with forcing a debtor to pay prejudgment interest is that a debtor ought not to pay money unless it can be ascertained how much she ought to pay the claimant with reasonable exactness.⁹⁵ If a debtor, then, does not know what sum is owed, equitable principles suggest that the debtor cannot be in default for a failure to pay.⁹⁶ This "protection theory" denies prejudgment interest to a claimant and values a debtor's proximate knowledge over fully compensating a claimant or punishing a debtor.⁹⁷

Despite the well-recognized character of interest awards as primarily compensatory in nature, the distinction between liquidated and unliquidated claims is rooted in punishment—that a debtor should not be punished for failing to repay an unascertainable amount prior to judgment.⁹⁸ This is not to say, however, that interest is never compensatory; on the contrary, theories of punishment and compensation underlie interest awards as well.⁹⁹ In light of the foregoing principles, some courts focus solely on whether the debtor actually knew the amount owed or could have computed that amount with reasonable certainty based on information reasonably available to the debtor.¹⁰⁰ Where a debtor knew

of a given case.") (quoting *Modern Irrigation & Land Co. v. Neely*, 81 Wash. 38, 42, 142 P. 458, 459 (1914) (internal quotation omitted)). Although prejudgment interest is generally unavailable in breach of contract cases involving unliquidated claims, courts have ample discretion to include prejudgment interest in the damages award, if necessary to fully compensate the plaintiff. 25 WILLISTON, *supra* note 24, §§ 66:109, 111 (citing D.C. Code § 15-109 (2001)). See also RESTATEMENT (SECOND) OF CONTRACTS § 354(2) (1981); 22 AM. JUR. 2D *Damages* § 466 (2005); cf. 47 C.J.S. *Interest & Usury* § 45 (2005) (stating that exceptions exist to the general rule that unliquidated claims do not bear interest).

94. See *Apel*, *supra* note 35, at 266.

95. *Laycock v. Parker*, 79 N.W. 327, 335 (Wis. 1899). See also 22 AM. JUR. 2D *Damages* § 466 (2005) (citing cases).

96. *Bd. Of Comm'rs of Jackson County v. United States*, 308 U.S. 343, 353 (1939) ("[N]o claim of fairness calls upon her also to pay interest for the use of the money which she could not have known was not properly hers.").

97. See *La Paz County v. Yuma County*, 735 P.2d 772, 780 (Ariz. 1987) (Feldman, V.C.J. dissenting). See also *Rothschild*, *supra* note 49, at 197.

98. *Chesapeake Indus., Inc. v. Togova Enters., Inc.*, 197 Cal. Rptr. 348, 351 (Cal. Ct. App. 1983).

99. *Kemper*, *supra* note 30 (allowance of prejudgment interest on liquidated claims ought not to burden the debtor because the debtor knew the extent of the amount owed, while a denial thereof would necessarily result in a loss to the claimant). See also *Wisper Corp. N.V. v. California Commerce Bank*, 57 Cal. Rptr. 2d 141, 149 (Cal. Ct. App. 1996) (awarding interest based on compensation theory).

100. *Chesapeake Indus., Inc.*, 197 Cal. Rptr. at 351.

or could have known the amount owed, an award of interest may be proper.¹⁰¹

Of course, a difference of opinion as to an amount owed cannot preclude the award of interest,¹⁰² to do so would eliminate all interest awards necessarily.¹⁰³ Accordingly, whether a claim is characterized as liquidated or unliquidated turns not on the liability of the defendant, but rather on the underlying cause of action.¹⁰⁴ In this manner, courts distinguish uncertainty regarding the amount of damages from uncertainty regarding liability.¹⁰⁵ Disputes as to liability do not preclude interest awards.¹⁰⁶

*D. The Accrual of Prejudgment Interest Depends on
Whether the Claim Is Liquidated or Unliquidated*

1. Liquidated Claims

Generally, interest awarded on a liquidated claim runs from the time that the right to recover vested or accrued.¹⁰⁷ In a contract situation,

101. See, e.g., *Farmland Indus., Inc. v. Frazier-Parrott Commodities*, 111 F.3d 588, 592 (8th Cir. 1997) (citing *Fohn v. Title Ins. Corp.*, 529 S.W.2d 1, 5 (Mo. 1975)).

102. *Laycock v. Parker*, 79 N.W. 327, 335 (Wis. 1899). See also *Eastmount Constr. Co. v. Transport Mfg. & Equip. Co.*, 301 F.2d 34, 42–43 (8th Cir. 1962) (“The fact that there is a dispute between the parties as to materials furnished, work done, or extras does not necessarily have the effect of rendering a demand unascertainable by calculation so as to require a disallowance of interest.”) (citing *Lacy Mfg. Co. v. Gold Crown Mining Co.*, 52 Cal. App. 2d 568, 579 (Cal. Ct. App. 1942)).

103. A claimant and a debtor necessarily have different opinions as to liability, damages, or both—that is why they are at trial. Allowing this contest to preclude interest, then, would eliminate all prejudgment interest awards at trial. See *Beck v. Lawler*, 422 S.W.2d 816 (Tex. Civ. App. 1967). The court stated the following:

The fact that the amount of plaintiff’s recovery could not be ascertained until after a trial of the cause does not affect this right to interest on the sum of \$5,107.20 due on June 10, 1964, subject to any off-set, or counterclaim which the defendant might have established. If this were not true then pre-judgment interest would not be recoverable in any case where a counterclaim is filed and the amount sought to be recovered was placed in doubt or reduced to an unliquidated claim.

Id.

104. *Prier v. Refrigeration Eng’g Co.*, 74 Wash. 2d 25, 32–33, 442 P.2d 621, 626 (1968) (quoting *MCCORMICK*, *supra* note 35, §54 (dispute over the whole or a part of the claim does not change the character of that claim from liquidated to unliquidated); but see *Pocatello Auto Color, Inc. v. Akzo Coatings, Inc.*, 896 P.2d 949, 955 (Idaho 1995) (where a “liquidated” claim and unliquidated counterclaim are closely related, prejudgment interest can be precluded when the “liquidated” claim is unascertainable because the unliquidated claim challenges the value thereof).

105. *Fluor Corp., Ltd. v. United States ex rel. Mosher Steel Co.*, 405 F.2d 823, 829 n.14 (9th Cir. 1969).

106. *Homes & Son Constr. Co., Inc v. Bolo Corp.*, 526 P.2d 1258, 1261 (Ariz. Ct. App. 1974); *Arizona Title Ins. & T. Co. v. O’Malley Lbr. Co.*, 484 P.2d 639, 649 (Ariz. Ct. App. 1971).

107. 25 WILLISTON, *supra* note 24, § 66:112.

a claim accrues at the time of the breach¹⁰⁸ or at the time that payment or performance was due.¹⁰⁹ In situations in which no payment date was specified, prejudgment interest runs from the claimant's first demand.¹¹⁰ Similarly, in a tort action, prejudgment interest accrues at the commission of the tort, the first demand for the return of the money or property, or the commencement of the lawsuit.¹¹¹ Typically, the commencement of a lawsuit is the latest point in time from which prejudgment interest may accrue because the filing of the complaint constitutes a formal demand for payment.¹¹²

2. Unliquidated Claims

As noted above, unliquidated claims generally are not subject to prejudgment interest awards.¹¹³ But when interest on an unliquidated claim is allowed, it may run from the date of demand or from the date the action commenced because the suit is considered tantamount to a demand.¹¹⁴ In many situations, however, prejudgment interest on unliquidated claims is not allowed until commencement of the action unless the debtor's obligation was "unilateral and performance was due at a fixed time."¹¹⁵

III. PREJUDGMENT INTEREST OFFSETS: CALCULATING INTEREST ON A LIQUIDATED CLAIM WITH AN OPPOSING UNLIQUIDATED COUNTERCLAIM

The existence of an unliquidated counterclaim does not change a liquidated claim into an unliquidated claim.¹¹⁶ For that reason, a plaintiff-

108. See RESTATEMENT (SECOND) OF CONTRACTS § 354(1) (1981); 25 WILLISTON, *supra* note 24, § 66:112.

109. RESTATEMENT (SECOND) OF CONTRACTS § 354(1) cmt. b (1981); 25 WILLISTON, *supra* note 24, § 66:112. See also *Mall Tool Co. v. Far W. Equip. Co.*, 45 Wash. 2d 158, 172, 273 P.2d 652, 660 (1954).

110. RESTATEMENT (SECOND) OF CONTRACTS § 354 cmt. b (1981) ("If the performance is to be rendered on demand, interest does not begin to run until a demand is made, even though an action might be maintained without a demand."); 25 WILLISTON, *supra* note 24, § 66:112.

111. *In re NETtel Corp., Inc.* 327 B.R. 8, 12 n.5 (Bankr. D. Dist. Col. 2005); *New Eng. Ins. Co. v. Healthcare Underwriters Mut. Ins. Co.*, 333 F. Supp. 2d 87, 90 (E.D.N.Y. 2004) (in bad-faith action, prejudgment interest accrued at the moment plaintiff first lost the use of money); *Andre v. Case Design, Inc.*, 797 N.E.2d 132, 135 (Ohio App. 2003) (injured party in tort action entitled to prejudgment interest from the date that the cause of action accrues).

112. 22 AM. JUR. 2D *Damages* § 470 (2005). See also RESTATEMENT (SECOND) OF CONTRACTS § 354 cmt. b (1981).

113. See, e.g., *Mall Tool Co.*, 45 Wash. 2d at 174, 273 P.2d at 661.

114. 25 WILLISTON, *supra* note 24, § 66:113 (internal citations omitted). However, most courts are reluctant to award prejudgment interest on unliquidated claims. See discussion *supra* Part II.C.

115. 25 WILLISTON, *supra* note 24, § 66:113.

116. See discussion *supra* Part II.C.

claimant may receive prejudgment interest on a liquidated claim despite the defendant-debtor's unliquidated counterclaim.¹¹⁷ As a practical matter, however, an issue arises as to the amount of plaintiff-claimant's liquidated demand that is entitled to an interest award vis-à-vis the defendant-debtor's unliquidated counterclaim. This Comment focuses on the situation where a liquidated claim is opposed by an unliquidated counterclaim.¹¹⁸ Faced with this situation, courts have taken one of two primary approaches.¹¹⁹ The first major approach, known as the interest on the entire claim, or interest on the whole rule, awards interest on the entire amount of the liquidated claim *prior* to the deduction of debtor's unliquidated counterclaim.¹²⁰ The second major approach, known as the interest on the balance rule, awards interest on the liquidated claim only *after* deducting the unliquidated counterclaim.¹²¹ Algebraically, then:

Interest on the Whole Rule = (Plaintiff's Liquidated Damages * Statutory Interest Rate) – Defendant/Counter-Claimant's Unliquidated Damages

Interest on the Balance Rule = (Plaintiff's Liquidated Damages – Defendant/Counter-Claimant's Unliquidated Damages) * Statutory Interest Rate

Although it may seem that there is little difference between these two rules, mathematically there may be a significant difference. The slight change in the order of operations may result in two considerably different damage awards. By way of illustration, Table 1 lists several

117. 47 C.J.S. *Interest & Usury* § 50 (2005).

Ordinarily, where the amount of a demand is sufficiently certain to justify the allowance of interest thereon, the existence of a setoff, counterclaim, or cross claim which is unliquidated will not prevent the recovery of interest on the balance of the demand found due from the time it became due, unless the plaintiff's liquidated claim is less than the award to the defendant on his or her counterclaim.

Id.; 1 DOBBS, *supra* note 14, § 3.6(1) ("When the defendant's counterclaim or set-off is successful and reduces his liability for reasons arising out of the same facts that give rise to the plaintiff's claim, the plaintiff's claim is still regarded as ascertainable and prejudgment interest still awarded"); 25 WILLISTON, *supra* note 24, §66:110 ("Interest will normally be awarded on a liquidated claim even though it is subject to an unliquidated counterclaim or setoff.").

118. It is true that a plaintiff could assert an unliquidated claim and a defendant could cross-complain with a liquidated claim. This situation, however, rests on exactly the same analysis argued herein and has been eliminated for simplicity. *See generally* Burnett & Doty Dev. Co. v. Phillips, 148 Cal. Rptr. 569 (Cal. Ct. App. 1978). Moreover, if both plaintiff and defendant assert liquidated claims, and if each party is meritorious upon the respective claim, both plaintiff and defendant would be entitled to prejudgment interest. Similarly, if both plaintiff and defendant asserted unliquidated claims against each other, neither party would be entitled to prejudgment interest.

119. *See supra* note 16.

120. *See supra* notes 17, 18.

121. *See supra* notes 20–22.

cases in which the amount of prejudgment interest varied significantly depending on which rule the court used.

**Table 1—Estimated Difference of Prejudgment Interest Awards
Between the Interest on the Whole Rule and the
Interest on the Balance Rule, in Dollars.¹²²**

Case Name	Interest on the Whole Rule (unadjusted)	Interest on the Balance Rule (unadjusted)	Difference (unadjusted)	Difference (adjusted 2007 dollars) ¹²³
Giant Food, Inc. v. Jack I. Bender & Sons ¹²⁴	\$43,642.37 ¹²⁵	\$31,203.47 ¹²⁶	\$12,438.90	\$34,680.89
Indu Craft, Inc. v. Bank of Baroda ¹²⁷	\$3,048,561.63 ¹²⁸	\$2,264,698.62 ¹²⁹	\$783,863.01	\$1,041,118.21
Socony Mobile Oil Co. v. Klapal ¹³⁰	-\$152,298.31 ¹³¹	-\$153,735.72 ¹³²	\$1437.41	\$9,634.26
Blasland, Bouck & Lee, Inc. v. City of N.Miami ¹³³	\$556,234.72 ¹³⁴	\$389,488.71 ¹³⁵	\$166,746.01	\$190,581.93

122. Note: this table is approximated based on the judgment and interest data provided in the respective cases and may not be identical to the exact amount of prejudgment interest or principal claims awarded by the respective court. Table 1 merely illustrates the difference that may exist in prejudgment interest awards depending on which rule the court applied. Table 1 does not discuss the decisions of the cases listed, nor does Table 1 reflect which rule the court ultimately applied or the rationale for that award.

123. United States Dep't of Labor, Bureau of Labor Statistics Data, Consumer Price Index (CPI) Inflation Calculator, <http://data.bls.gov/cgi-bin/cpicalc.pl> (last visited Feb. 28, 2007).

124. 399 A.2d 1293 (Ct. App. D.C. 1979).

125. = (liquidated principal)*(rate)*(time) + (liquidated principal) – (unliquidated counter-claim) = {[((\$500)(.015)(60)) + ((\$40,139.92-\$500)(.01)(60))] + \$40,139.92 – \$20,731.50}.

126. = (liquidated principal-unliquidated principal)*(rate)*(time) = (\$500)(.015)(60) + [(\$40,139.92-\$20,731.50-\$500)(.01)(60)] + (\$40,139.92-\$20,731.50).

127. No. 87-cv-7379SHS, 1995 WL 479516 (S.D.N.Y. Aug. 10, 1995), *aff'd*, 87 F.3d 614 (2d Cir. 1996).

128. = [(\$3,250,000)(.09)(5)] + \$3,250,000 - \$1,700,000.

129. = [(\$3,250,000 - \$1,700,000)(.09)(5)] + (\$3,250,000 - \$1,700,000).

130. 205 F. Supp. 388 (D. Neb. 1962).

131. = [(\$8,384.11)(.06)(3)] + \$8,384.11 - \$162,119.83.

132. Plaintiff is not entitled to interest on the balance because there remains nothing upon which to calculate interest. *See Deerhurst Estates v. Meadow Homes, Inc.*, 165 A.2d 543, 554–55 (N.J. Super. Ct. App. Div. 1960). Accordingly, net judgment is for the defendant, which is \$162,119.83 - \$8,384.11.

133. 283 F.3d 1286 (11th Cir. 2002).

134. *See* Brief of Appellant City of North Miami at 31, *Blasland, Bouck & Lee, Inc. v. City of N. Miami*, 283 F.3d 1286 (11th Cir. 2001) (No. 00-14975-AA), 2001 WL 34091583.

135. = [(\$380,283.51 - \$114,000)(.11)(4.206)] + (\$380,283.51 - \$114,000).

Case Name	Interest on the Whole Rule (unadjusted)	Interest on the Balance Rule (unadjusted)	Difference (unadjusted)	Difference (adjusted 2007 dollars) ¹²³
Mall Tool Co. v. Far West Equip. Co. ¹³⁶	\$17,624.98 ¹³⁷	\$15,696.43 ¹³⁸	\$1,928.55	\$14,511.87
Ralston Purina Co. v. Parsons Feed & Farm Supply, Inc. ¹³⁹	\$79,568.78 ¹⁴⁰	\$72,803.04 ¹⁴¹	\$6,765.74	\$44,177.23
Jet Boats, Inc. v. Puget Sound Nat'l Bank ¹⁴²	\$14,751 ¹⁴³	\$4,297.20 ¹⁴⁴	\$10,453.80	\$19,306.72

This difference between the two formulas is compounded by the statutory interest rate¹⁴⁵ or the market interest rate.¹⁴⁶ For example, Washington applies a twelve percent interest rate for prejudgment interest awards.¹⁴⁷ As a result, many parties litigate the slight difference in the order of operations between the interest on the whole rule and the interest on the balance rule.¹⁴⁸

136. 45 Wash. 2d 158, 273 P.2d 652 (1954).

137. = $[(\$23,730.94)(.06)(3.083)] + \$23,730.94 - \$10,475.05$.

138. = $[(\$23,730.94 - \$10,475.05)(.06)(3.083)] + (\$23,730.94 - \$10,475.05)$.

139. 416 F.2d 207 (8th Cir. 1969).

140. = $(\$116,471.60)(.06)(2.1667) + \$116,471.60 - \$52,044.13$.

141. = $(\$116,471.60 - \$52,044.13)(.06)(2.1667) + (\$116,471.60 - \$52,044.13)$.

142. 44 Wash. App. 32, 721 P.2d 18 (1986).

143. = $\$29,658 + \$11,667 - \$26,574$.

144. = $(\$29,658 - \$26,574)(.39338) + (\$29,658 - \$26,574)$, where 0.39338 is the interest rate and time coefficient calculated from the trial court's award.

145. This interest rate varies by jurisdiction. For example, in Washington, "[e]very loan or forbearance of money, goods, or thing in action shall bear interest at the rate of twelve percent per annum where no different rate is agreed to in writing between the parties . . ." WASH. REV. CODE § 19.52.010(1) (2004). Moreover, any rate of interest "shall be legal so long as the rate of interest does not exceed the higher of: (a) Twelve percent per annum; or (b) four percentage points above the equivalent coupon issue yield . . . of the average bill rate for twenty-six week treasury bills." WASH. REV. CODE § 19.52.020(1) (2004).

146. Knoll, *supra* note 1, at 297; *In re Matter of Oil Spill by the Amoco Cadiz Off the Coast of Fr.* on Mar. 16, 1978, 954 F.2d 1279, 1332 (7th Cir. 1992).

147. See *supra* note 157.

148. See *supra* note 134, Table 1.

*A. Prejudgment Interest Offsets in Washington:
The Interest on the Whole Rule*

1. *Mall Tool Co. v. Far West Equipment Co.*: The Foundation Case

For the last fifty years, Washington has utilized the interest on the whole rule for calculating prejudgment interest.¹⁴⁹ In *Mall Tool Co. v. Far West Equipment Co.*,¹⁵⁰ the Washington Supreme Court established that “only when the amount to which a defendant is entitled as a counterclaim or setoff is for defective workmanship or other defective performance by the plaintiff” may a plaintiff receive interest on the balance of the two claims.¹⁵¹ *Mall Tool Co.* represents the current state of Washington law regarding prejudgment interest offsets.¹⁵²

In *Mall Tool Co.*, the plaintiff-manufacturer brought an action on an open account against the defendant-distributor for chain saws sold and delivered to the defendant-distributor.¹⁵³ The defendant-distributor cross-complained for violation of the exclusive distributorship clause.¹⁵⁴ At trial, the defendant-distributor conceded that it owed the plaintiff-manufacturer \$23,730.94 for chain saws and other equipment previously sold and delivered to the defendant-distributor.¹⁵⁵ The controversy centered on the amount the defendant-distributor was entitled to in offsets and the amount due to plaintiff-manufacturer subject to interest.¹⁵⁶ Both parties appealed the judgment of the trial court.¹⁵⁷

The contract at issue contained an exclusive distributor clause that established a protected area for the defendant-distributor.¹⁵⁸ Pursuant to that contract, the plaintiff-manufacturer could terminate the contract provided that the plaintiff-manufacturer gave at least a thirty-day notice to the defendant-distributor.¹⁵⁹ The contract, however, did not expressly provide a clause allowing modification.¹⁶⁰ Both parties adhered to the contract until the plaintiff-manufacturer unilaterally modified the

149. See generally *Mall Tool Co. v. Far W. Equip. Co.*, 45 Wash. 2d 158, 273 P.2d 652 (1954).

150. *Id.*

151. *Id.* at 177, 273 P.2d at 663 (emphasis added).

152. See, e.g., *Gemini Farms LLC v. Smith-Kem Ellensburg, Inc.*, 104 Wash. App. 267, 269, 16 P.3d 82, 84 (2001) (using *Mall Tool Co.* to determine prejudgment interest).

153. *Mall Tool Co.*, 45 Wash. 2d at 160–61, 273 P.2d at 654.

154. *Id.* at 160, 273 P.2d at 654.

155. *Id.* at 161, 273 P.2d at 654.

156. *Id.* at 160–61, 177, 273 P.2d at 654, 663.

157. *Id.* at 161, 273 P.2d at 654.

158. *Id.* at 162, 273 P.2d at 655.

159. *Id.*

160. See *id.* at 162–63, 273 P.2d at 655. Here, when plaintiff-manufacturer proposed a modification, defendant-distributor had the opportunity to accept or reject the modification, knowing full well that a refusal would mean a termination of the exclusive distributorship agreement.

agreement without notice to the defendant-distributor, allowing a third-party distributor to sell chain saws in the defendant-distributor's protected area.¹⁶¹ Subsequent to this modification, the plaintiff-manufacturer also withdrew its commission and payments to the defendant-distributor without notice.¹⁶² On cross-appeals, the supreme court held that the plaintiff-manufacturer breached its exclusivity distributorship agreement with the defendant-distributor.¹⁶³ In addition to disputing the amount of the defendant-distributor's cross-complaint, the plaintiff-manufacturer asserted on appeal that it was entitled to prejudgment interest on the entire amount for chain saws and equipment sold and delivered to the defendant-distributor.¹⁶⁴ The court agreed.¹⁶⁵

In calculating the prejudgment interest component of the plaintiff's damage award, the court began with the premise that interest prior to judgment was allowable only on liquidated claims.¹⁶⁶ The existence of the defendant-distributor's unliquidated counterclaim did not preclude awarding the plaintiff-manufacturer prejudgment interest "since the [defendant-distributor] may not defeat the creditor's right to interest on such a claim by setting up an unliquidated claim as a setoff."¹⁶⁷ As a general rule then, the court stated that the plaintiff-manufacturer may receive interest on its whole claim prior to deducting the defendant-distributor's counterclaim.¹⁶⁸ Importantly, the court recognized one narrow exception to this rule:

There is a rule, however, applicable under certain circumstances, that the amount found to be due on a liquidated or determinable claim may be reduced by the amount found to be due on an unliquidated counterclaim or setoff, and that interest will be allowable only on the balance remaining after the reduction has been made. *This rule is applicable only when the amount to which a defendant is entitled as a counterclaim or setoff is for defective workmanship or other defective performance by the plaintiff, of the contract on*

161. *Id.* at 163, 273 P.2d at 655–56.

162. *Id.* at 163–64, 273 P.2d at 656.

163. *Id.* at 179, 273 P.2d at 664.

164. *Id.* at 169, 273 P.2d at 659. Plaintiff-manufacturer only sought interest from the date of the last delivery of goods on the open account. *Id.* Defendant-distributor's cross-complaint for breach previously vested, and accordingly, was actionable at the same time as plaintiff-manufacturer's complaint. *Id.* at 169, 273 P.2d at 658–59. No reason for defendant-distributor's delay in filing was provided. *See generally id.* at 160–179, P.2d at 654–64.

165. *Id.* at 179, 273 P.2d at 664.

166. *Id.* at 171–76, 273 P.2d at 660–62.

167. *Id.* at 177, 273 P.2d at 663 (stating that if the counterclaim or setoff be liquidated or be determinable, such claim could bear interest in its own right from the time it or the various items that comprise it become due and payable) (*citing Hansen v. Covell*, 24 P.2d 772, 776 (Cal. 1933)).

168. *Id.* at 179, 273 P.2d at 664.

which his liquidated or determinable claim is based, of a character such that the award of damages as compensation is regarded as constituting either a reduction of the amount due the plaintiff or a payment to him.¹⁶⁹

The court reasoned that in those stated situations the plaintiff has been deprived only of the use of the balance of the claims, not the plaintiff's entire claim.¹⁷⁰ By extension, since the plaintiff had a right to only the balance thereof, the defendant should not have to pay interest on the amount to which the plaintiff was never entitled.¹⁷¹

Applying that rule to the parties before it, the court held that the plaintiff-manufacturer was entitled to interest on the entire liquidated claim despite the existence of the defendant-distributor's meritorious cross-complaint.¹⁷² The court established the narrowness of the exception to Washington's interest on the whole rule by stating that the plaintiff-manufacturer's "breach of its exclusive distributorship contract with [the defendant-distributor] involved a separate (bilateral) feature of the contract and had nothing directly to do with the sale of goods, wares, and merchandise to [the defendant-distributor] or the amount due therefor."¹⁷³ In this fashion, *Mall Tool Co.* utilized the "interest on the entire claim" rule while noting a narrow "interest on the balance" exception to that rule.¹⁷⁴

2. Post *Mall Tool Co.*: Contemporary Application of Interest on the Whole Rule and *Mall Tool Co.*'s Narrow Exception

Since *Mall Tool Co.*, Washington courts have continued to recognize the narrow exception to the interest on the whole rule.¹⁷⁵ For example, in *Westinghouse Electric Corp. v. CX Processing Laboratories, Inc.*,¹⁷⁶ the Ninth Circuit applied the logic from *Mall Tool Co.* to uphold the unliquidated setoff of a liquidated claim.¹⁷⁷ There, the court held that unliquidated damages incurred as a result of the manufacturer's breach of

169. *Id.* at 177, 273 P.2d at 663 (emphasis added).

170. *Id.*

171. *Gemini Farms LLC v. Smith-Kem Ellensburg, Inc.*, 104 Wash. App. 267, 269, 16 P.3d 82, 84 (2001) ("And the amount the *seller* owes the *buyer* is not funds it is deprived of the rightful use of.").

172. *Mall Tool Co.*, 45 Wash. 2d at 178-79, 273 P.2d at 664.

173. *Id.* at 179, 273 P.2d at 664.

174. *See id.* at 177-79, 273 P.2d at 663-64.

175. *See Westinghouse Elec. Corp. v. CX Processing Labs., Inc.*, 523 F.2d 668, 679 (9th Cir. 1975) (reaffirming *Mall Tool Co.*'s unitary contract requirement as unchanged); *Gemini Farms LLC*, 104 Wash. App. at 269, 16 P.3d at 84; *Buckner, Inc. v. Berkey Irrigation Supply*, 89 Wash. App. 906, 919, 951 P.2d 338, 345-46 (1998) ("It is clear that the *Mall Tool* exception is a narrow one.").

176. 523 F.2d 668 (9th Cir. 1975).

177. *Id.* at 680.

a master purchase contract should be setoff against the manufacturer's liquidated claim for payment for certain goods sold and delivered to the buyer *prior* to the calculation of prejudgment interest.¹⁷⁸ In contrast to the "bilateral" nature of the contract in *Mall Tool Co.*, the court stated that the contract was, in fact, a "unitary contract."¹⁷⁹ Underlying this distinction was the court's recognition that the master purchase contract expressly stipulated that such goods were to be delivered in four separate shipments.¹⁸⁰ Failure to meet this contract directly resulted in the buyer's damages.¹⁸¹ In this sense, both claims arose from the "same contract provision,"¹⁸² which created the necessary unitary contract mandated by the Washington Supreme Court in *Mall Tool Co.*¹⁸³ Applying *Mall Tool Co.*'s narrow exception to the interest on the entire claim rule, the Ninth Circuit awarded interest only on the balance of the meritorious claims.¹⁸⁴

In light of the aforementioned cases, although an unliquidated counterclaim must be "related to the plaintiff's claim,"¹⁸⁵ the Washington rule, in practice, is much narrower than simply requiring a connection between the opposing claims.¹⁸⁶ On the contrary, Washington courts require the existence of a unitary contract and damages proximately resulting from the same provision.¹⁸⁷ Moreover, central to the *Mall Tool Co.* exception is the requirement that "[o]nly the value of defective product[s]

178. *Id.*

179. *Id.* See also *Gemini Farms LLC*, 104 Wash. App. at 270, 16 P.3d at 84 ("The question is whether the counterclaims arose out of the same unitary contract.").

180. *Westinghouse Elec. Corp. v. CX Processing Labs., Inc.*, 523 F.2d 668, 680 (9th Cir. 1975); but see *Gemini Farms LLC*, 104 Wash. App. at 270, 16 P.3d at 84 ("The fact that serial deliveries are separately invoiced is not dispositive" as the parties did not contract for each delivery.).

181. *Westinghouse Elec. Corp.*, 523 F.2d at 680.

182. As applied in *Westinghouse Elec. Corp.*, as long as plaintiff's claim and defendant's counterclaim arise "from the same contract provision," *Mall Tool Co.*'s unitary contract requirement is met. *Id.* The term unitary is used in contrast to "separate," or "bilateral." *Id.* at 679–80. See also *Mall Tool Co. v. Far W. Equip. Co.*, 45 Wash. 2d 158, 178–79, 273 P.2d 652, 664 (1954).

183. *Westinghouse Elec. Corp.*, 523 F.2d at 680.

184. See *id.*

185. *Jet Boats, Inc. v. Puget Sound Nat'l Bank*, 44 Wash. App. 32, 41, 721 P.2d 18, 24 (1986); *Mitchell Int'l Enters., Inc. v. Daly*, 33 Wash. App. 562, 567–68, 656 P.2d 1113, 1117 (1983) (focusing on defective workmanship and substantially late performance as within *Mall Tool Co.*'s narrow exception).

186. *Buckner, Inc. v. Berkey Irrigation Supply*, 89 Wash. App. 906, 919, 951 P.2d 338, 345 (1998) ("[T]he *Mall Tool* exception is a narrow one, [and deducting] unliquidated offsets from a liquidated claim prior to calculating prejudgment interest is normally improper.").

187. See *Westinghouse Elec. Corp.*, 523 F.2d at 680. Cf. *Mall Tool Co. v. Far West Equip. Co.*, 45 Wash. 2d 158, 179, 273 P.2d 652, 664 (1954) (stating "breach of its exclusive distributorship contract with [defendant-distributor] involved a separate (bilateral) feature of the contract and had nothing directly to do with the sale of goods, wares, and merchandise to [defendant-distributor] or the amount due therefore.").

may be deducted from a liquidated amount.”¹⁸⁸ In all other situations, the counterclaim must be a *credit* toward plaintiff’s judgment award, to be applied subsequent to calculating prejudgment interest rather than a *deduction* to be made in arriving at the judgment.¹⁸⁹ Today, Washington courts uniformly recognize the interest on the whole rule.¹⁹⁰

B. Prejudgment Interest Offsets in California: The Interest on the Balance Rule

1. The Origin: *Hansen v. Covell*

California, like Washington, recognizes the historical difference between liquidated and unliquidated claims.¹⁹¹ Contrary to Washington, however, California courts generally apply the interest on the balance rule.¹⁹²

The seminal case in California is *Hansen v. Covell*,¹⁹³ which established the interest on the balance rule.¹⁹⁴ In *Hansen*, the plaintiff-contractors brought an action to recover unpaid balances due under a contract in addition to certain other items and damages.¹⁹⁵ The construction contract at issue stipulated that certain progress payments were due from the defendant-owner over the course of the project.¹⁹⁶ The plaintiff-contractors commenced an action to recover the final two payments in addition to certain charges for damages and delays allegedly caused by

188. *Buckner, Inc.*, 89 Wash. App. at 920, 951 P.2d at 346.

189. *See id.*

190. *See, e.g., Gemini Farms LLC v. Smith-Kem Ellensburg, Inc.*, 104 Wash. App. 267, 269, 16 P.3d 82, 84 (2001) (applying the *Mall Tool* exception to a contract for defective farm chemicals and negligence, the same goods giving rise to plaintiff’s claim as defendant’s claim); *Buckner, Inc.*, 89 Wash. App. at 917, 951 P.2d at 344 (“Deducting unliquidated offsets from a liquidated claim prior to calculating prejudgment interest is normally improper.”); *Mitchell Int’l Enters., Inc. v. Daly*, 33 Wash. App. 562, 567, 656 P.2d 1113, 1117 (1983) (“Generally, an unliquidated counterclaim cannot affect the opposing party’s right to interest on the full amount of its liquidated claim.”).

191. *See, e.g., Cox v. McLaughlin*, 76 Cal. 60, 68 (Cal. 1881).

192. This is not to say that California courts do not award interest on plaintiff’s entire claim; rather, the interest on the whole rule is applicable only in those situations where the defendant-debtor’s claim for deduction was not demandable when plaintiff-claimant’s original liquidated claim became due. 23 CAL. JUR. 3D *Damages* § 102 (2005). In that situation, defendant-debtor’s claim is instead properly asserted as a cross-claim for damages, not a prejudgment discount/payment. *Id. See also Ralston Purina Co. v. Parsons Feed & Farm Supply, Inc.*, 416 F.2d 207, 211 (8th Cir. 1969) (interest on the entire claim rule is an exception to the interest on the balance rule); *Socony Mobil Oil Co. v. Klapal*, 205 F. Supp. 388, 391 (D. Neb. 1962) (interest on the balance rule is applied as the general rule).

193. 24 P.2d 772 (Cal. 1933).

194. *Id.* at 775–76.

195. *Id.* at 773.

196. *Id.* at 774.

the defendant-owner.¹⁹⁷ The defendant-property owner filed a cross-complaint, alleging that the plaintiff-contractors abandoned the construction of a hotel building which resulted in damages from the cost of completion.¹⁹⁸ Several contractors also filed mechanics liens and, accordingly, were made parties to the litigation.¹⁹⁹

After a protracted trial on numerous issues, the trial court awarded the plaintiff-contractors the two final payments plus certain other damages.²⁰⁰ In addition, the trial court held that the defendant-owner was entitled to an offset for amounts paid by the defendant-owner to satisfy the subcontractors' liens and the plaintiff-contractor's defective workmanship.²⁰¹ Despite this "offset," the trial court awarded the plaintiff interest on the plaintiff's entire claim from the time it became due.²⁰² As a result, both parties appealed.²⁰³

On appeal, the California Supreme Court modified the trial court's judgment in certain respects, rejecting the defendant's "contention, inter alia, that interest was incorrectly awarded to the plaintiffs."²⁰⁴ In so doing, the court rejected the defendant's argument that whenever a contractually-owed liquidated sum is subject to deduction by reason of an unliquidated offset, the balance due is not a sum capable of being made certain by calculation.²⁰⁵ Underlying the court's reasoning was the concept that a debtor may not defeat a creditor's right to prejudgment interest on a liquidated sum simply by setting up an unliquidated claim as an offset.²⁰⁶

The court, however, also rejected the plaintiff's contention that the court should award interest on the plaintiff's entire claim.²⁰⁷ "Where the amount of a claim under a contract is certain and liquidated, or is ascertainable but is reduced by reason of the existence of an unliquidated set-off or counterclaim thereto, interest is properly allowed on the balance found to be due from the time it became due."²⁰⁸ In so doing, the court rejected the plaintiff's contention that by awarding interest on the

197. *Id.*

198. *Id.* at 773.

199. *Id.* at 774.

200. *Id.* at 774-75; see also Kemper, *supra* note 30.

201. Hansen, 24 P.2d at 774. See also Kemper, *supra* note 30.

202. Hansen, 24 P.2d at 774.

203. *Id.*

204. Kemper, *supra* note 30.

205. Hansen, 24 P.2d at 775.

206. *Id.* at 775-76.

207. See *id.*

208. *Id.* at 776 (quoting 3 A.L.R. 809 (1919)).

balance, as opposed to interest on the entire claim, the court is effectively awarding interest on the unliquidated claim.²⁰⁹

Applying the interest on the balance rule, the court expressly distinguished the interest on the entire claim rule as utilized by the trial court.²¹⁰ The interest on the entire claim rule, the court expressed, is only “applicable in cases where the claim for deduction could not be said to be demandable at the time when the original liquidated claim became due, but was rather the proper subject of a counterclaim for damages than of an offset in the nature of a payment.”²¹¹

2. Modern Application of *Hansen v. Covell*

Since the decision in *Hansen v. Covell*, California courts have wrestled with the application of the interest on the balance rule. For example, in *Burgermeister Brewing Corp. v. Bowman*,²¹² the plaintiff-manufacturer commenced an action to recover monies owed for beer sold and delivered to the defendant-distributor.²¹³ The defendant-distributor admitted the debt, but cross-complained for certain damages allegedly caused by the plaintiff-manufacturer’s repudiation of an oral exclusive-distributor contract.²¹⁴ The first trial resulted in a jury verdict for the defendant-distributor;²¹⁵ however, this decision was reversed and remanded.²¹⁶ On retrial, the defendant-distributor again received a favorable verdict on his breach of exclusive-distributor contract.²¹⁷ Calculating the final damage award, the trial court awarded the plaintiff-manufacturer interest on the liquidated claim for beer sold and delivered.²¹⁸ Subsequently, that amount was offset by the defendant-distributor’s jury award on the unliquidated claim.²¹⁹ In light of the trial court’s judgment, both parties appealed: the plaintiff-manufacturer as to the cross-complaint and the defendant-distributor as to the court’s award

209. *Id.* at 777.

210. *Id.* at 776.

211. *Id.* See also 23 CAL. JUR. 3D DAMAGES § 102 (2005) (“[T]his principle appears to be applicable *only* in those cases where the defendant’s claim for deduction was not demandable when the plaintiff’s original liquidated claim became due”) (emphasis added); *Shore v. Crail Jr.*, 123 P.2d 840, 843 (Cal. Ct. App. 1942) (interest on the balance properly denied where defendant’s claim may have been acquired subsequent to plaintiff’s claim).

212. 38 Cal. Rptr. 597 (Cal. Ct. App. 1964).

213. *Id.* at 598–99.

214. *Id.* at 599.

215. *Id.* Because defendant stipulated to liability on the open beer account, the trial consisted solely of defendant’s cross-complaint. See *id.*

216. *Id.* The first verdict was reversed and remanded for an error in instructions. *Id.*

217. *Id.* Interestingly, the award on defendant’s claim was nearly \$10,000 more on retrial than awarded in the first trial. See *id.* at 599 n.1 (\$36,040 in first trial as compared to \$46,000 on retrial).

218. *Id.* at 603–04.

219. *Id.* at 604.

of prejudgment interest to the plaintiff-manufacturer on the open account.²²⁰

On appeal, the California Supreme Court held that the trial court erred in calculating the award of prejudgment interest.²²¹ Noting *Hansen's* holding that “‘defective workmanship’ or ‘defective performance’ of the contract is the distinctive factor in the curtailment (or denial) of interest,” the *Burgermeister* court, nevertheless, established that there is no distinction between defective performance and no performance.²²² Consequently, the court broadened the reach of the interest on the balance rule, stating that if a plaintiff renders defective performance and is not entitled to prejudgment interest, then there is “no sound reason not to apply the same rule when the breach consists of a refusal (by wrongful termination) to perform the plaintiff’s obligations under the contract at all.”²²³

Moreover, the court established that the fact that the defendant’s unliquidated counterclaim exceeded the plaintiff’s liquidated claim is of no moment; the simple fact that the plaintiff would then receive no prejudgment interest on the balance does not affect the determination of whether the defendant is entitled to an offset.²²⁴ The court noted, “[a]s we see it, if, when the day of reckoning is reached, it has been decided that a defendant is entitled to an offset, this is a finding that the plaintiff was never entitled to more than the net amount.”²²⁵ The court emphatically supported this offset prior to calculating prejudgment interest, stating “[p]alpable inequity attends the assertion of the contrary rule [that is, the interest on the entire claim].”²²⁶ The defendant-distributor “was therefore justified in withholding payment” on the open account even though his claim had not yet been judicially determined.²²⁷

When an unliquidated claim exceeds a liquidated claim, California courts award the unliquidated demand offset by only the liquidated claim: no interest is calculated on either claim.²²⁸ For example, in *Burnett & Doty Dev. Co. v. Phillips*,²²⁹ the plaintiff-contractor sued the defen-

220. *Id.* at 599.

221. *Id.* at 604.

222. *Id.*

223. *Id.*

224. *Id.* See also *Burnett & Doty Dev. Co. v. Phillips*, 148 Cal. Rptr. 569, 573 (Cal. Ct. App. 1978) (since the amount of the unliquidated counterclaim exceeds the value of plaintiff’s liquidated claim, there remains nothing on which to calculate or allow interest).

225. *Burgermeister Brewing Corp.*, 38 Cal. Rptr. at 604.

226. *Id.*

227. *Id.*

228. *Burnett & Doty Dev. Co. v. Phillips*, 148 Cal. Rptr. 569, 573 (Cal. Ct. App. 1978).

229. 148 Cal. Rptr. 569 (Cal. Ct. App. 1978).

dant-subcontractor for damages incurred after the defendant-subcontractor allegedly failed to complete performance on a housing development that the plaintiff-contractor was helping construct.²³⁰ In response, the defendant-subcontractor cross-complained for balances due on the contract.²³¹ After a bench trial, the trial court awarded the plaintiff \$33,707 on the plaintiff-contractor's unliquidated claim,²³² an amount that was subsequently reduced by \$22,365 due to the defendant-subcontractor's liquidated set-off on the cross-complaint.²³³ No interest was awarded on either claim.²³⁴

On cross-appeals, the court affirmed the trial court's verdict and damage award.²³⁵ Relying upon *Burgermeister*, the court held that the defendant-subcontractor's liquidated claim for balance due under contract was reduced by the unliquidated offset, the damages resulting from the defendant-subcontractor's breach of contract.²³⁶ Because the unliquidated damages exceeded the liquidated damages, nothing remained upon which to calculate interest for the defendant-subcontractor.²³⁷ Accordingly, the plaintiff-contractor received the difference between its unliquidated claim (without interest) and the defendant-subcontractor's liquidated claim.²³⁸

The common law interest of the balance rule, espoused in *Hansen v. Covell*, is now codified in California law where an unliquidated counterclaim constitutes a payment of a liquidated claim.²³⁹ Applying California Civil Code § 3287 in Arizona, a common law prejudgment interest

230. *Id.* at 570-71.

231. *Id.*

232. *Id.*

233. *Id.*

234. *See id.* at 570-71, 573.

235. *Id.* at 570.

236. *Id.* at 573.

237. *Id.*

238. *Id.*

239. *Fluor Corp. v. United States ex rel. Mosher Steel Co.*, 405 F.2d 823, 829 (9th Cir. 1969); *see also* CAL. CIV. CODE § 3287 (1997). The code provides the following:

(a) Every person who is entitled to recover damages certain, or capable of being made certain by calculation, and the right to recover which is vested in him upon a particular day, is entitled also to recover interest thereon from that day, except during such time as the debtor is prevented by law, or by the act of the creditor from paying the debt. This section is applicable to recovery of damages and interest from any such debtor, including the state or any county, city, city and county, municipal corporation, public district, public agency, or any political subdivision of the state.

(b) Every person who is entitled under any judgment to receive damages based upon a cause of action in contract where the claim was unliquidated, may also recover interest thereon from a date prior to the entry of judgment as the court may, in its discretion, fix, but in no event earlier than the date the action was filed.

CAL. CIV. CODE § 3287 (1997).

jurisdiction,²⁴⁰ the Ninth Circuit held that “[i]f the unliquidated set-off or counterclaim is based upon a breach unrelated to the sum due under the primary claim, interest is allowed on the entire claim.”²⁴¹ On the other hand, if the “unliquidated set-off or counterclaim constitutes a partial payment of the primary claim, interest is allowable on the balance due after deducting the amount of the set-off or counterclaim as determined at trial.”²⁴² The court treated the California statute and the common law interest on the balance rule identically.²⁴³

3. Distinguishing Between a Payment and a Discount in California

California courts continue to distinguish between those claims that constitute a “payment” and those claims that are merely “discounts.”²⁴⁴ If an unliquidated counterclaim is considered a payment, then it is setoff against plaintiff’s claim prior to the calculation of interest.²⁴⁵ Conversely, if the claim is considered a discount, it is setoff against plaintiff’s claim after the calculation of interest.²⁴⁶

The distinction between “payments” and “discounts” is predicated on the relationship between the opposing claims and, more importantly, the time at which the unliquidated claim became demandable vis-à-vis the liquidated claim.²⁴⁷ Where defendant’s unliquidated counterclaim accrues after the point in time at which plaintiff’s claim became demandable or if the unliquidated claim is unrelated to plaintiff’s claim, the unliquidated claim will be treated as a discount, not as a payment.²⁴⁸

Moreover, California courts are careful to distinguish between characterizing defendant’s unliquidated claim as a discount and as a payment.²⁴⁹ This distinction is important in two respects. First, because

240. *Fluor Corp.*, 405 F.2d at 829.

241. *Id.* at 830.

242. *Id.*

243. Compare *id.* at 829–30, with *Hansen v. Covell*, 24 P.2d 772, 776–77 (Cal. 1933).

244. See, e.g., *Hunt Foods, Inc. v. Phillips*, 248 F.2d 23, 27 (9th Cir. 1957).

245. *Russell v. Rogers*, 10 S.C.L. (1 Nott & McC.) 24, at *1 (S.C. Ct. App. 1817) (“The plaintiff, as I before observed, was entitled to interest on his demand, and the discount set up by the defendant was regarded as a discount, and not as a payment; an independent unliquidated demand which did not carry interest.”).

246. See, e.g., *Hunt Foods, Inc.*, 248 F.2d at 27.

247. *Id.* (plaintiff receives interest on her full claim when defendant’s unliquidated demand is treated as a discount and not a payment “where the claim for deduction could not be said to be demandable at the time when the original liquidated claim became due, but was rather the proper subject of a counter claim for damages than of an offset in the nature of a payment”).

248. See *id.*; *California Lettuce Growers, Inc. v. Union Sugar Co.*, 289 P.2d 785, 793 (Cal. 1955).

249. See *California Lettuce Growers, Inc.*, 289 P.2d at 793; *Muller v. Barnes*, 294 P.2d 505, 507 (Cal. Ct. App. 1956).

the claim is not treated as a payment, the unliquidated claim does not affect the character or nature of plaintiff's claim as liquidated.²⁵⁰ The existing unliquidated claim does not, then, render plaintiff's claim undeterminable prior to the fact finder's determination of liability and damages.²⁵¹ Consequently, the plaintiff's claim is properly subject to an interest award.²⁵²

Second, even though California courts characterize a defendant's unliquidated claim as a discount, the courts consistently only award plaintiff-claimants interest on the balance.²⁵³ The deduction of the unliquidated claim from the liquidated claim occurs prior to the calculation of interest so long as both claims arise out of the same contract or defective performance thereof.²⁵⁴

4. California Today: The Current Doctrine and Rationale

Under current California law, prejudgment interest is allowed only on the balance due after offsets, not the gross amount due prior to offset calculation.²⁵⁵ "In choosing between these rules [the] court is guided by its rationale for awarding prejudgment interest: to compensate plaintiffs for the loss of use of their investment capital."²⁵⁶ Thus, where the plaintiff had use of the funds for the duration of the litigation, the interest on the balance rule more closely approximates the realities of the setoff.²⁵⁷ But where defendant paid partial settlements within months of trial, the interest on the entire claim rule would more closely approximate the setoffs.²⁵⁸

250. See *California Lettuce Growers, Inc.*, 289 P.2d at 793; *Muller*, 294 P.2d at 507.

251. See *Hunt Foods, Inc.*, 248 F.2d at 27.

252. See *California Lettuce Growers, Inc.*, 289 P.2d at 793; *Muller*, 294 P.2d at 507.

253. See *California Lettuce Growers, Inc.*, 289 P.2d at 793; *Muller*, 294 P.2d at 507.

254. See *Muller*, 294 P.2d at 506-07 (awarding interest on the balance when plaintiff's claim was for breach of contract for the sale of fourteen horses and defendant-debtor asserted unliquidated counterclaim alleging fraud and misrepresentation); *Union Sugar Co. v. Hollister Estate Co.*, 47 P.2d 273, 280-81 (Cal. 1935) (unliquidated contract breach for defective growing of a crop).

255. *Davis & Cox v. Summa Corp.*, 751 F.2d 1507, 1522-23 (9th Cir. 1985) (applying state law in diversity action). See also *Koehler v. Pulvers*, 614 F. Supp. 829, 851 (9th Cir. 1985) ("The 'interest on the balance due rule' properly applies to recovery upon the state based claims.").

256. *Koehler*, 614 F. Supp. at 851.

257. *Id.*

258. *Id.*

IV. INTEREST ON THE BALANCE: THE BETTER REASONED APPROACH
FOR PREJUDGMENT INTEREST OFFSETS WHEN BOTH CLAIMS ARISE
FROM THE SAME TRANSACTION, CONTRACT, OR OPERATIVE FACTS

Washington should adopt the interest on the balance rule when both claims arise out of the same transaction, contract, or operative facts. This rule is articulated by numerous treatises²⁵⁹ and followed in many states,²⁶⁰ like California, when both claims arise from the same transaction, contract, or operative facts.

The simple premise underlying the interest on the balance rule is that the defendant owed the plaintiff a liquidated amount as of a certain time, but as of that same time, the plaintiff owed the defendant for its own breach.²⁶¹ Thus, the plaintiff was only deprived of the use of the difference between the two claims.²⁶² As a result, awarding prejudgment interest on plaintiff's entire claim effectively confers a windfall to the plaintiff—a windfall to which the plaintiff is not entitled.²⁶³ Accordingly, Washington should replace *Mall Tool Co.*'s interest on the whole rule and its narrow exception with the more equitable and logical interest on the balance rule—awarding interest on the difference between the liquidated and the unliquidated claims when both claims arise from the same transaction, contract, or operative facts.

*A. The Interest on the Balance Rule Adequately
Compensates Plaintiffs and Protects the Right to
Prejudgment Interest on Liquidated Claims*

Concededly, a legitimate concern is raised with allowing unliquidated claims to offset legitimate liquidated claims: “[c]ertainly a debtor cannot defeat the running of interest against him for a part of a debt which he admits that he owes, and which would otherwise draw interest,

259. See *supra* note 24.

260. See *supra* note 25.

261. *Ralston Purina Co. v. Parsons Feed & Farm Supply, Inc.*, 416 F.2d 207, 212–13 (8th Cir. 1969) (Throughout the contested period plaintiff was obligated to defendant and was deprived only of the value of the difference between the two claims.).

262. 25 WILLISTON, *supra* note 24, §66:110.

263. See *Interstate Brands Corp. v. Lily Transp. Corp.*, 256 F. Supp. 2d 58, 62 (D. Mass. 2003) (“The common law was particularly sensitive to the possibility that a liberal award of prejudgment interest could result in a windfall for plaintiffs amounting, in essence, to an award of punitive damages.”); *Sterilite Corp. v. Cont’l Cas. Co.*, 494 N.E.2d 1008, 1011 (Mass. 1986) (holding that where a party is not deprived of the use of its money, no interest is due upon such sums. Any other rule would result in a windfall to that party).

by simply making a claim of an unliquidated set-off against the whole debt."²⁶⁴ To be sure, the sole fact that the defendant has *some* claim against that plaintiff should not necessarily entitle the defendant to offset the plaintiff's interest on the liquidated claim. Allowing a debtor to assert an unliquidated counterclaim that precludes a claimant from recovering prejudgment interest would encourage debtors to plead unnecessary and frivolous counterclaims.

This concern, however, is addressed by the interest on the balance approach. First, merely allowing an unliquidated counterclaim does not preclude all prejudgment interest on the plaintiff's claim—the plaintiff may still receive interest on the liquidated claim.²⁶⁵ Second, only legitimate, meritorious claims arising from the same transaction, contract, or operative facts preclude the plaintiff from recovering interest on the entire claim.

Accordingly, if the unliquidated counterclaim is based upon a breach unrelated or collateral to the sum due under the primary claim, interest should be calculated on the plaintiff's entire claim.²⁶⁶ The defendant's counterclaim, if meritorious, should be deducted after such calculation.²⁶⁷ If, on the other hand, the unliquidated counterclaim constitutes a payment against the liquidated claim or arises from the same operative facts or contract, interest should be allowable on the balance due after deducting the amount of the defendant's unliquidated counterclaim as determined at trial.²⁶⁸ Consequently, the interest on the balance rule protects the plaintiff's right to prejudgment interest, but only as to the amount that the plaintiff was actually deprived of the use of that money or property.

264. *Harmon Cable Commc'ns of Nebraska LP v. Scope Cable Television, Inc.*, 468 N.W.2d 350, 371 (Neb. 1991). *See also* *York Plumbing & Heating Co. v. Groussman Inv. Co.*, 443 P.2d 986, 987 (Colo. 1968) ("Debtors cannot avoid the payment of interest by disputing the account" (quoting *Florence & Cripple Creek R. Co. v. Tennant*, 75 P. 410, 411 (Colo. 1904))).

265. Unless plaintiff's entire claim is subsumed by defendant's claim. In such a case there remains nothing upon which to calculate prejudgment interest. *See Deerhurst Estates v. Meadow Homes, Inc.*, 165 A.2d 543, 554–55 (N.J. Super. Ct. App. Div. 1960).

266. *Fluor Corp., Ltd. v. United States ex rel. Mosher Steel Co.*, 405 F.2d 823, 830 (9th Cir. 1969).

267. *See id.*

268. *Id.*

*B. Because Mall Tool Co.'s Rationale Is Identical to the
Rationale Employed by Interest on the Balance Jurisdictions,
Washington's Unitary Contract Requirement Is Too Narrow*

As noted above, *Mall Tool Co.*²⁶⁹ established Washington's use of the interest on the balance rule as an exception; its application is narrow "on the theory that the plaintiff is entitled to interest only in the amount of which it has been deprived of the use during the period of default."²⁷⁰ Nevertheless, the court in *Mall Tool Co.* found that an exclusive distributorship clause was a separate bilateral feature distinct from the price terms for chain saws.²⁷¹ The rationale that *Mall Tool Co.* fundamentally relied upon, the right to the use value of money, is exactly the same rationale on which jurisdictions following the interest on the balance rule rely.²⁷² Other courts considering distributorship contracts,²⁷³ or liquidated and unliquidated claims arising from the same transaction,²⁷⁴ have awarded prejudgment interest for the very same reason: prejudgment interest awards compensate a claimant for the lost use value of money or property.

Neither *Mall Tool Co.* nor the subsequent cases have offered any valid reason why the plaintiff is only deprived of money on a unitary

269. *Mall Tool Co. v. Far W. Equip. Co.*, 45 Wash. 2d 158, 177, 273 P.2d 652, 663 (Wash. 1954).

270. *Id.* In fact, prejudgment interest is awarded in Washington only to compensate a claimant for lost use value of money (that is, full compensation), not to act as a punishment for wrongdoing. *Hansen v. Rothaus*, 107 Wash. 2d 468, 474–75, 730 P.2d 662, 666 (1986); *Buckner, Inc. v. Berkeley Irrigation Supply*, 89 Wash. App. 906, 916–17, 951 P.2d 338, 344 (1998). *See also* *Cavnar v. Quality Control Parking, Inc.*, 696 S.W.2d 549, 555 (Tex. 1985) (finding that the purpose of prejudgment interest is full compensation, not punishment of defendant's misbehavior).

271. *Mall Tool Co.*, 45 Wash. 2d at 179, 273 P.2d at 664.

272. *Compare id.* at 177, 273 P.2d at 663, with *Ralston Purina Co. v. Parsons Feed & Farm Supply, Inc.*, 416 F.2d 207, 212–13 (8th Cir. 1969) (throughout the contested period the plaintiff was obligated to the defendant and was deprived only of the value of the difference between the two claims), and *Blasland, Bouck & Lee, Inc. v. City of North Miami*, 283 F.3d 1286, 1300 (11th Cir. 2002) ("[T]he purpose of prejudgment interest is to provide the prevailing party with the time value of money it should have had at the time it was wronged—to restore the party to an unwronged position . . .").

273. *See, e.g., Infra-Pak (Dallas), Inc. v. Carlson Stapler & Shippers Supply, Inc.*, 803 F.2d 862, 866 (5th Cir. 1986); *Socony Mobil Oil Co. v. Klapal*, 205 F. Supp. 388, 393 (Neb. 1962).

274. *See, e.g., Phelps Dodge Copper Prods. Corp. v. Alpha Constr. Co.*, 455 P.2d 555, 560–61 (Kan. 1969). The court stated the following:

When a plaintiff sues for a liquidated sum and the defendant establishes an offsetting claim based upon defective workmanship or defective performance of the same contract by the plaintiff, the amount of the former is to be offset against the latter as of the due date of the original debt and only the balance bears interest.

Id. (quoting *Burgermeister Brewing Corp. v. Bowman*, 227 Cal. App. 2d 274, 285 (1964)); *Harmon Cable Commc'ns of Nebraska LP v. Scope Cable Television, Inc.*, 468 N.W.2d 350, 371 (Neb. 1991) ("same general transaction"); *Deerhurst Estates v. Meadow Homes, Inc.*, 165 A.2d 543, 554–55 (N.J. Super. Ct. App. Div. 1960); *Hollon v. McComb*, 636 P.2d 513, 517 (Wyo. 1981).

contract as opposed to a bilateral contract.²⁷⁵ Indeed, in the case of *Mall Tool Co.*, both terms were essential.²⁷⁶ If both parties agree to include material terms, albeit on separate pages or sections of a multi-page contract, why should one be distinct from the other? Establishing such a distinction by requiring the terms at issue to be part of the same provision²⁷⁷ effectively means that a plaintiff rightfully detained payment to the defendant for the plaintiff's breach and that the defendant, to obtain any unliquidated damages, must go to court. During that trial, the plaintiff may use any money wrongfully detained. In contrast, the defendant incurs the full cost of trial to obtain "full compensation" through litigation. The defendant is not afforded the same luxury to use the wrongfully detained money like the plaintiff because the defendant must compensate the plaintiff in the form of prejudgment interest. Where both parties damage each other at the same time, each injured party is due the damages as of that point in time because both claims are demandable at that point in time.²⁷⁸ To award the plaintiff interest calculated prior to the defendant's offset effectively means the plaintiff rightfully detained money from the defendant through the pendency of trial, while the defendant wrongfully withheld money from the plaintiff over the exact same period of time.

C. The Interest on the Whole Rule Confers a Windfall to the Plaintiff, Making the Plaintiff More than Whole, to the Defendant's Detriment

Awarding prejudgment interest on the entire claim confers a windfall upon the plaintiff; the plaintiff should only be equitably entitled to prejudgment interest on the net wrong suffered, not the gross wrong.²⁷⁹ "It simply would not make good sense to charge [unliquidated claimants] interest on money they do not owe."²⁸⁰

It is well established that prejudgment interest is awarded to fully compensate the plaintiff for the loss of the use value of money from the

275. The rationale for the narrow exception in *Mall Tool Co.* is that the balance is the only amount plaintiff was deprived of. See *Mall Tool Co. v. Far W. Equip. Co.*, 45 Wash. 2d 158, 177, 273 P.2d 652, 663 (1954). There is nothing in such a rationale to confine this logic so narrowly.

276. See generally *id.* at 158, 273 P.2d at 652.

277. See *Westinghouse Elec. Corp. v. CX Processing Labs. Inc.*, 523 F.2d 668, 680 (9th Cir. 1975).

278. This is the logical extension of the compensation theory of awarding prejudgment interest. See discussion *supra* Part II.B.2. Such a theory does not depend on whether or not the injured party is in fact plaintiff or defendant, but rather whether the party asserts a liquidated claim. See discussion *supra* Part II.C.

279. See *Blasland, Bouck & Lee, Inc. v. City of North Miami*, 283 F.3d 1286, 1299-1300 (11th Cir. 2002); *Coleman Eng'g Co., Inc. v. N. Am. Aviation, Inc.*, 420 P.2d 713, 722 (Cal. 1966) ("Interest is not intended to be a windfall.").

280. *Hollon v. McComb*, 636 P.2d 513, 517 (Wyo. 1981).

date interest accrued throughout the pendency of trial.²⁸¹ Assuming a meritorious plaintiff should be returned to her unwronged state,²⁸² the award of prejudgment interest, then, functions as a means to make a party whole for the wrongful detention of money or property, and the use value thereof.²⁸³

The amount of money, however, that would restore a plaintiff to this unwronged position is the value of the plaintiff's damages minus the defendant's damages.²⁸⁴ Assuming both the plaintiff's and the defendant's claims are meritorious, each party has suffered some injury and is owed some value of damages. The debt of both parties, although determined through trial, accrued at the time of breach or injury. At that point, plaintiff is in no better position than the defendant to claim the lost use value of money wrongfully detained. Yet, simply because of the type of claim that a party asserted, the plaintiff is restored to a pre-injury position and the defendant is not.

Although "full compensation" is typically applied to plaintiff-claimants, when a defendant suffers injuries at the hands of a plaintiff, the defendant is also entitled to full compensation. During the period that the defendant owed the plaintiff damages the plaintiff also owed the defendant the amount of the defendant's counterclaim. Between the accrual of both the plaintiff's and the defendant's claims and the entry of judgment, each party is deprived of the use of money only to the extent of the difference between the two claims.²⁸⁵ Throughout this period, the plaintiff is obligated to the defendant for the amount of the defendant's damages and thus, the plaintiff was not deprived of the use of this money.²⁸⁶ As the money was never rightfully the plaintiff's, it is irrelevant that the defendant needed a trial to determine the extent of its damages. In this manner, the verdict merely functions as an ex post facto determination of

281. See discussion *supra* Part II.B.2.

282. See *id.*; see also *Blasland, Bouck & Lee, Inc.*, 283 F.3d at 1299–1300. The *Blasland* court noted the following:

If the purpose of prejudgment interest is to provide the prevailing party with the time value of money it should have had at the time it was wronged—to restore the party to an unwronged position—the only money that [the plaintiff] equitably should have had since the time it was wronged was the value of the award to it minus the value of [the defendant's] counterclaim award against it. [The plaintiff] is equitably entitled to prejudgment interest only on the net wrong it suffered, not the gross wrong [The plaintiff] is not entitled to a windfall on its windfall.

Blasland, Bouck & Lee, Inc., 283 F.3d at 1299–1300.

283. *Id.* at 1299–1300. See also discussion *supra* Part II.B.2.

284. See *Blasland, Bouck & Lee, Inc.*, 283 F.3d at 1299.

285. *Ralston Purina Co. v. Parsons Feed & Farm Supply, Inc.*, 416 F.2d 207, 212 (8th Cir. 1969).

286. *Id.* at 213.

liability and the extent thereof.²⁸⁷ To award interest upon the plaintiff's entire claim confers a windfall to the plaintiff, rewarding it with the use value of money to which it was never entitled, and in fact, which it owed to defendant.²⁸⁸

The interest on the balance rule avoids this problem, eliminating a windfall to either party.²⁸⁹ Neither party obtains prejudgment interest on money wrongfully detained and owed to the other party; rather, only liquidated damages in excess of that claimant's liability are awarded prejudgment interest.

Moreover, when both claims arise from the same transaction, operative facts, or contract, the plaintiff would never have access to the money owed to the defendant.²⁹⁰ To be sure, both claims are equally demandable at the same point in time irrespective of whether the claim is characterized as liquidated or unliquidated.²⁹¹ It would not make sense, then, to award a plaintiff compensatory prejudgment interest for money that was never rightfully the plaintiff's.²⁹² As one state court noted:

A contractor should not be allowed to perform his obligations poorly, and thus force a purchaser to make expenditures correcting the shoddy work, and still collect interest on all the monies owed to him under the contract. Since the contractor should have expended the money the purchaser paid to repair the purchase, the contractor should not be entitled to prejudgment interest on that amount. The money the purchaser properly used to correct the defects in the contractor's work should be viewed as having been paid to the contractor, thus canceling any debt up to that amount It simply would

287. *Prejudgment Interest*, *supra* note 37, at 107–08 n.7.

288. *See Ralston Purina Co.*, 416 F.2d at 212–13 (throughout the contested period plaintiff was obligated to defendant and was deprived only of the value of the difference between the two claims).

289. *Indu Craft v. Bank of Baroda*, No. 87-civ-7379(SHS)(LB), 1995 WL 479516, at *2 (S.D.N.Y. Aug. 10, 1995), *aff'd*, 87 F.3d 614 (2d Cir. 1996).

290. *Ralston Purina Co.*, 416 F.2d at 212–13 (throughout the contested period plaintiff was obligated to defendant and was deprived only of the value of the difference between the two claims); *Koehler v. Pulvers*, 614 F. Supp. 829, 851 (S.D. Cal. 1985) (applied interest on the balance rule partially because interest on the entire claim rule assumes plaintiffs were denied use of the funds until judgment).

291. *See Prejudgment Interest*, *supra* note 37, at 107–08 n.7 (“[T]he trial was merely an ex post facto determination of liability”). *See also* discussion *supra* Part II.C.

292. This is the converse of the rule that plaintiffs are entitled to prejudgment interest: the defendant's wrongful detainer of money that was never rightfully hers. *See Prejudgment Interest*, *supra* note 37, at 109. *See also* *Gemini Farms LLC v. Smith-Kem Ellensburg, Inc.*, 104 Wash. App. 267, 269, 16 P.3d 82, 84 (2001) (“And the amount the seller owes the buyer is not funds it is deprived of the rightful use of.”); *Hollon v. McComb*, 636 P.2d 513, 517 (Wyo. 1981) (awarding setoff does not award interest on an unliquidated claim; rather, it denies plaintiff's prejudgment interest on that part of the award that should have been expended in furtherance of their duties).

not make good sense to charge [debtors] interest on money they do not owe.²⁹³

If the plaintiff was not wrongfully deprived of this money, an award of prejudgment interest on the plaintiff's entire claim effectively confers a windfall to the plaintiff.²⁹⁴ The plaintiff is made "more whole" to the detriment of the defendant in an amount equal to the prejudgment interest awarded above the interest on the balance.

Neither the plaintiff nor the defendant should be able to receive the economic benefits of money wrongfully detained throughout trial.²⁹⁵ As a matter of legal definition, this would amount to unjust enrichment.²⁹⁶ In addition, if key functions of prejudgment interest are the promotion of settlement and the prevention of unjust enrichment,²⁹⁷ awarding interest on plaintiff's entire claim would create unjust financial incentives for plaintiff to delay settlement or slow the litigation process.²⁹⁸ "Equity and fairness dictate that interest should be awarded to plaintiff on the net balance after the setoff."²⁹⁹

D. Application of Mall Tool Co. Leads to Absurd Results

The narrow unitary contract requirement, as established in *Mall Tool Co.*, in many situations leads to absurd results. Although a defendant-debtor may have a valid reason for withholding payment from a plaintiff-claimant given the same transaction or occurrence, the Washington approach would calculate interest upon the plaintiff's entire

293. *Hollon*, 636 P.2d at 517.

294. For example, at the moment that defendant injures plaintiff, she is liable to the plaintiff for the damages directly and proximately resulting from the conduct. Defendant then owes the exact amount of damages to plaintiff at that time. By waiting for a trial to determine liability, defendant has withheld this money from plaintiff. The money then is rightfully the plaintiff's and the defendant should not be credited with the use value of this amount. Prejudgment interest compensates for this, redistributing the use value of money from defendant to plaintiff. Accordingly, when each party has injured the other party, each party is liable to the other party for the exact amount of damage caused by their respective conduct. Neither party then should have use of the money, which has been wrongfully detained from the other party, during the pendency of the trial. *See, e.g., Ralston Purina Co.*, 416 F.2d at 212-13 (throughout the contested period, plaintiff was obligated to defendant and was deprived only of the value of the difference between the two claims); *Koehler*, 614 F. Supp. at 851 (applying interest on the balance rule partially because interest on the entire claim rule assumes plaintiffs were denied use of the funds until judgment).

295. *See* discussion *supra* Part II.B.3.

296. *See* discussion *supra* Part II.B.3.

297. *Cavnar v. Quality Control Parking, Inc.*, 696 S.W.2d 549, 555 (Tex. 1985) (Kilgarlin, J. dissenting).

298. *See id.*

299. *Indu Craft, Inc. v. Bank of Baroda*, 87-civ-7379(SHS)(LB), 1995 WL 479516, at *1 (S.D.N.Y. Aug. 10, 1995) (noting that the Court of Appeals permitted recovery on net balance in order to avoid a windfall to plaintiff), *aff'd*, 87 F.3d 614 (2d Cir. 1996).

claim despite defendant's valid meritorious, and even more valuable, counterclaim.

For example, suppose that manufacturer *M* produces a specialized widget that is projected to be very profitable. Distributor *D* supplies many retail stores various products and is looking for a new product to reinvigorate its corporation. *D* contacts *M* regarding the new and improved specialized widget. *M* is interested, but is seeking a substantial wholesale price for the widgets, \$50. *D* is skeptical and, in order to ensure that it can cover this cost, requires an exclusive distributor contract for the widgets throughout all of *D*'s markets and a few others. Pursuant to this clause, no other corporation or entity may sell or distribute any widgets from *M* in this vast area. *M* agrees and understands, as does *D*, that the contract price is predicated on the exclusive distributorship right. Both terms were freely negotiated and mutually agreed upon. The contract is then signed by both parties and is to be in effect for ten years.

For five years, all goes well; both *M* and *D* enjoy high profit levels. But, soon thereafter, profits begin to decline. In response to this decline, *D* seeks other markets, and *M* responds accordingly. But believing that *D* may not be doing an effective job selling the widgets, *M* sells 25,000 widgets to *D*'s major distributing competitor *C*. *C* is located in, and sells within, *D*'s region. Not oblivious to this transaction, *D* refuses to pay for the latest shipment of 25,000 widgets.³⁰⁰ At this point, both parties have breached the contract: *D* failed to pay pursuant to the contract, and *M* breached the exclusivity clause.³⁰¹

Both parties recognize the other's breach, and soon after the parties attempt to negotiate a solution. During the next three years, *D* fails to pay for the original sum due and subsequent deliveries of the widgets and *M* continues to sell widgets to *C*. Consequently, both parties continue to breach. Neither initially commences a lawsuit because of the extreme cost of lawyers and the existence of the other party's claim. *D* believes it has a valid claim that is worth more than *M*'s claim because of its precipitous decline in market share from increased competition. *M* believes it has a meritorious claim against *D* for failure to pay for widgets sold and delivered.

At the end of the three years,³⁰² all negotiations breakdown and an angry *M* brings suit for the value of all widgets sold and delivered since *D*'s original failure to pay \$1,250,000, for a grand total of \$3,000,000.

300. 25,000 widgets at \$50 each = \$1,250,000 due on the contract (not including any other costs, late fees, taxes, etc.).

301. In fact, *M* breached the contract first.

302. Under Washington law, the statute of limitations for a written contract is six years. WASH. REV. CODE § 4.16.040(1) (2005).

Upon receiving the complaint, *D* promptly counterclaims for the damages resulting from *M*'s continued breach of the exclusivity clause, alleging \$4,500,000 in damages resulting from the high volumes of specialized widgets sold to *C* over the three years.

At trial, *D* admits liability for \$3,000,000 for widgets sold and delivered. Although *M* contests liability and the extent of damages, after a jury trial, *D*'s claim for \$4,500,000 is meritorious in toto. *M* then moves for prejudgment interest. (Assume, hypothetically, the trial lasted two years from commencement until entry of the verdict).

As an initial matter, *M*'s claim is liquidated—it is easily calculated based on the written contract and simple arithmetic—and therefore is subject to an award of prejudgment interest on its own.³⁰³ On the other hand, *D*'s claim for market damages and damages resulting from breach of the exclusive distributor clause is unliquidated—necessarily entailing some jury discretion in its calculation—and as a result, is not historically subject to a prejudgment interest award.³⁰⁴ Notwithstanding these facts, the interest on the balance rule and Washington's interest on the whole claim rule result in vastly different amounts of awards. Although the interest on the balance approach balances the equities of this case better, Washington, if faced with this situation, would award *M* prejudgment interest on its entire claim prior to deducting *D*'s meritorious claim.³⁰⁵

Relying on *Mall Tool Co.*, a Washington court would award *M* \$300,000³⁰⁶ even though *D*'s meritorious claim was worth \$1,500,000 more than *M*'s claim.³⁰⁷ Both claims arose out of the same contract and even the same operative facts. However, because of the unitary contract requirement in Washington, the exclusivity clause and the price terms are understood to be bilateral features of the contract: *D* never alleged faulty workmanship or defect by *M*.³⁰⁸

303. See discussion *supra* Part II.C.

304. See *id.*

305. See generally *Mall Tool Co. v. Far W. Equip. Co.*, 45 Wash. 2d 158, 273 P.2d 652 (1954).

306. M 's award = $[(\$3,000,000) + (\$3,000,000 * 12\% \text{ interest} * 5 \text{ years prejudgment (2 for trial, 3 for pre-complaint))}] - (\$4,500,000 \text{ defendant counterclaim}) = \$300,000$.

307. Some courts may look to plaintiff's undue delay in bringing suit. In some cases, it has been held that undue delay would preclude plaintiff from interest on the entire claim. See *Blasland, Bouck & Lee, Inc. v. City of N. Miami*, 283 F.3d 1286, 1297–98 (11th Cir. 2002); *Seattle-First Nat'l Bank v. Wash. Ins. Guar. Ass'n*, 94 Wash. App. 744, 760–61, 972 P.2d 1282, 1292 (1999) (unexplained four year delay between trial court judgment and order for prejudgment interest held unreasonable award). Here, however, there is no evidence of undue delay; in fact, both parties attempted to reconcile the claims, neither acquiescing in their own claim or maliciously holding out for litigation. It is also important to note that the doctrine of laches and statutes of limitations already await those who willfully refrain from filing suit. *Rothschild*, *supra* note 49, at 212–13.

308. See *Mall Tool Co.*, 45 Wash. 2d at 178–79, 273 P.2d at 664.

On the other hand, if a Washington court were to use the interest on the balance rule, *M* would not recover any prejudgment interest. Because *D*'s counterclaim proved more valuable than *M*'s liquidated claim, nothing remains upon which to calculate interest.³⁰⁹ Accordingly, *M* is denied prejudgment interest, and *D* is awarded \$1,500,000.³¹⁰ Because *D*'s claim was unliquidated, *D* does not recover prejudgment interest on any part of its claim.³¹¹ Comparing the two rules, then, the net monetary difference is \$1,800,000.³¹²

Remembering that their claims arose from the same contract, the same operative facts, and most importantly, at the same time, under the interest on the entire claim rule, *M* would effectively receive a substantial windfall. By the time that *D* wrongfully withheld payment for widgets from *M*, *M* had already wrongfully breached the contract by supplying *C* with 25,000 widgets. At that point, *M* was liable to *D* for damages. The only difference between the two claims is that the jury must determine the extent of the damage to *D*.³¹³ Such a decision, however, does not negate the fact that *M* wrongfully withheld *some* amount from *D* or that *D*, at least initially, withheld monies due under the contract in response to *M*'s breach of the exclusivity clause. The amount of this determination is irrelevant as *M* would not have had use of the money during the pendency of the trial anyway. *M* should not be rewarded for this breach or be entitled to interest upon amounts that it never lost the use value of because the money was never *M*'s to begin with.³¹⁴ Accordingly, the interest on the balance rule is more equitable: by avoiding a windfall to *M*, the interest on the balance rule puts both parties in the position they would have been in at the point when the damages accrued.

E. The Interest on the Whole Rule Is the Minority View When Opposing Claims Arise from the Same Transaction, Contract, or Operative Facts

Washington's interest on the whole claim rule is a minority rule.³¹⁵ For some reason, Washington clings to that rule, allowing only a narrow unitary contract exception where the interest on the balance rule may be

309. *Deerhurst Estates v. Meadow Homes, Inc.*, 165 A.2d 543, 554–55 (N.J. Super. Ct. App. Div. 1960).

310. *D*'s award = \$4,500,000 defense verdict – \$3,000,000 plaintiff verdict = \$1,500,000.

311. See discussion *supra* Part II.C.

312. Net difference = \$300,000 for *M* under Washington law + \$1,500,000 for *D* under the interest on the balance rule.

313. "[T]he trial was merely an ex post facto determination of liability." *Prejudgment Interest*, *supra* note 37, at 107–08 n.7.

314. See *Ralston Purina Co. v. Parsons Feed & Farm Supply, Inc.*, 416 F.2d 207, 212–13 (8th Cir. 1969).

315. *Local Okla. Bank, N.A. v. United States*, 59 Fed. Cl. 713, 723 (2004).

applied.³¹⁶ Washington should abandon the unitary contract requirement and should make interest on the balance the general rule rather than the exception to the rule when both claims arise from the same transaction, contract, or operative facts.

Other courts have recognized the difficulty posed by prejudgment interest. For example, in holding that the law and equities favor the application of the interest on the balance rule, the District of Columbia Court of Appeals noted the following:

The appropriate inquiries to be made appear to be two: (1) whether the “claim for deduction (due to the counterclaim or setoff) could . . . be said to be demandable at the time when the original liquidated claim became due and thus, requiring interest on the balance”; or (2) whether the breach of warranty claim was “the proper subject of a counterclaim for damages (rather) than an offset in the nature of a payment,” requiring interest to be awarded on the entire claim.³¹⁷

The court there limited the interest on the entire claim rule to counterclaims that do “not directly concern the plaintiff’s claim, that is, when the unliquidated counterclaim arises out of a collateral matter.”³¹⁸ Central to this reasoning is the fact that if the two claims arise from the same general transaction—there two separate contracts—then the plaintiff was only deprived of the use of the money—a value equal to the difference between the two claims.³¹⁹ In this sense, a related, non-collateral counterclaim functions as an offset in the nature of the payment, thus entitling a plaintiff-claimant to interest only on the net balance.³²⁰

Many jurisdictions outside of Washington, moreover, apply the interest on the balance approach when the claims arise from the same general transaction. For example, Nebraska courts have established the following:

[T]he better rule permits the offset of an unliquidated claim against a liquidated claim before the computation of interest, at least in situations in which the two claims arise out of the same general transaction. “Where a claim under an agreement is certain and liquidated, but is reduced because of the allowance of an unliquidated

316. See discussion *supra* Part III.A.

317. *Giant Food, Inc. v. Jack I. Bender & Sons*, 399 A.2d 1293, 1302 (D.C. Ct. App. 1979) (citations omitted).

318. *Id.*

319. *Id.* at 1302–03.

320. *Id.* at 1303.

off-set or counterclaim, *interest may be allowed only on the balance due.*"³²¹

Accordingly, Nebraska uses the "same transaction" test for determining an offset.³²²

Other courts have framed the inquiry slightly differently, asking whether the claims are attributable to the same contract.³²³ The fact that claims arise from multiple contracts, however, does not change the inquiry so long as the unliquidated claims come from the same contracts forming the basis of the liquidated claims.³²⁴ In light of the aforementioned jurisdictions and analysis, Washington should join the majority of jurisdictions by abandoning its unitary contract requirement and instead apply the interest on the balance rule when both the plaintiff's and the defendant's claims arise from the same transaction, operative facts, or contract.

V. CONCLUSION

A central theme in American jurisprudence is a commitment to fully compensate injured parties by restoring them to an unwronged state. Prejudgment interest is a meaningful part of fully compensating an injured party. Prejudgment interest offers claimants a means by which they can be fully compensated and not lose the economic value of money or property. However, situations arise when a claimant has also caused damage arising from the same operative facts, transaction, or contract. In such situations, both injured parties' interests must be taken into consideration.

The Washington approach to awarding prejudgment interest when a liquidated claim is offset by an unliquidated counterclaim is too narrow. As a result, plaintiffs who assert liquidated claims may be overcompensated at the expense of defendants who are also injured but assert unliquidated claims. Washington should abandon the approach laid out in

321. *Harmon Cable Commc'ns of Neb. LP v. Scope Cable Television, Inc.*, 468 N.W.2d 350, 371 (Neb. 1991) (quoting *York Plumbing & Heating Co. v. Groussman Inv. Co.*, 443 P.2d 986, 988 (Colo. 1968)).

322. *Harmon Cable Commc'ns of Neb. LP*, 468 N.W.2d at 371.

323. *Homes & Son Constr. Co., Inc. v. Bolo Corp.*, 526 P.2d 1258, 1261-62 (Ariz. App. 1974) (noting that it appears to be the "well-recognized rule" that if the amount due under a contract is ascertainable, but is "reduced by the existence of an unliquidated set-off or counterclaim, attributable to the contract, interest is properly allowable on the balance found due from the due date.").

324. *Hollon v. McComb*, 636 P.2d 513, 517 (Wyo. 1981) ("[I]f the unliquidated counterclaim offsets are attributable to the same *contracts* which are the basis of the primary liquidated claims, those claims and the unliquidated counterclaims are offset and prejudgment interest is allowed only on the net difference.") (quoting *Fairway Builders, Inc. v. Malouf Towers Rental Co., Inc.* 603 P.2d 513 (Ariz. 1979)) (internal quotations omitted) (emphasis added).

Mall Tool Co. and instead follow the majority of jurisdictions and treatises. Washington should generally apply the interest on the balance rule. The interest on the balance rule more closely approximates the plaintiff's appropriate compensation while upholding the principles underlying prejudgment interest awards. Faced with a meritorious unliquidated counterclaim, a plaintiff asserting a liquidated claim was never deprived of the use of the amount of the unliquidated counterclaim. To award plaintiff interest upon the entire claim when both claims arise out of the same operative facts or contract awards the plaintiff an unjust and inequitable windfall in the form of prejudgment interest at the defendant's expense. If such an approach continues to be followed, Washington courts will continue to put plaintiffs in a better position through litigation than they would have occupied had the also-wronged-defendant not breached. Equity mandates that Washington discard the *Mall Tool Co.* rule in favor of the generally recognized interest on the balance rule.