Interest for Thee but Not for Me?

By John A. Taylor Jr.

The Court of Appeal's decision in *Rossa* denies defendants of the possibility of being made whole for an analogous interest expense if they show on appeal that the judgment was unjustly imposed.

Your small family-owned construction company is hit with a verdict of $100,000 — less than one-sixth of what plaintiffs originally sought — but the trial court then awards plaintiffs over $680,000 in costs and fees. You appeal the fee award, persuade the Court of Appeal to reverse it, and are awarded your costs on appeal, to be determined by the trial court on remand.

One of your largest costs on appeal arose from the $1 million appeal bond you posted to prevent the plaintiffs from enforcing the fee award during the appeal. You had to pay a relatively small premium for the bond, roughly 2 percent of its face value. But as collateral for the bond, you had to obtain a letter of credit from your bank equal to the bond's value, which required you to deposit almost $1 million in your bank account. Since your small business didn't have that much cash on hand, you had to borrow the money from your existing lines of credit. During the two-year appeal, you paid almost $100,000 in interest.

So you are thrilled when the Court of Appeal says you can recover your costs on appeal. California Rule of Court 8.278(d)(1)(F) provides that a recoverable cost on appeal is the "cost to procure a surety bond, including the premium and the cost to obtain a letter of credit as collateral." Also, a prior decision, *Cooper v. Westbrook Torrey Hills*, 81 Cal. App. 4th 1294, 1300 (2000), had confirmed that interest paid on sums borrowed "to obtain a letter of credit as collateral" "to procure a surety bond" is a recoverable cost on appeal. Getting your $100,000 in interest payments back from your opponent should be a slam dunk, right?

Wrong. On remand, the trial court concluded that the interest expense was *not* a recoverable cost on appeal. The 1st District Court of Appeal then affirmed that conclusion in *Rossa v. D.L. Falk Construction*, 184 Cal. App. 4th 438 (2010). The court held that *Cooper*'s assumption that "interest paid on an appellate bond is recoverable" because it was one of the "costs" necessary to procure the bond was questionable and "dubious."

But in its analysis, *Rossa* focused on statutory provisions governing the recovery of costs incurred in the trial court, and overlooked California Code of Civil Procedure Section 1034(b), which provides that the "Judicial Council shall establish by rule allowable costs on appeal and the procedure for claiming those costs." In light of that provision, *Rossa* appears to have given insufficient consideration to the pertinent history of the rule promulgated by the Judicial Council to govern the recovery of costs on appeal.

The expense of obtaining an appeal bond was not a recoverable cost on appeal until 1959, when former Rule 26(c) was amended to allow recovery of "the premium on any surety bond procured by the party recovering costs." Subsequently, in *Geldermann Inc. v. Bruner*, 10 Cal. App. 4th 640 (1992), the court held that the fee paid for a letter of credit securing an appeal bond was not a cost "enumerated in the rule" and could not "be considered a 'premium' on the bond." However, the court recognized that the rule "ignores the commercial realities of today which may require an expenditure for a letter of credit to use as security" and suggested that "[f]airness...would compel" the recovery of such costs.

In 1994, the Judicial Council responded to *Geldermann* by amending former Rule 26 to allow the recovery of not just the appeal bond *premium*, but also any "*other* expense reasonably necessary to procure the surety bond, *such as* the expense of acquiring a letter of credit required as collateral for the bond." The use of "such as" in the amended rule suggested that the reference to "other expense reasonably necessary to procure the surety bond" was by way of example, rather than limitation. The pertinent language in Rule 26 was incorporated in slightly modified form in Rule 8.278 when the Judicial Council subsequently revised and renumbered the California Rules of Court.

Examining the current language of Rule 8.278(d)(1)(F), *Rossa* concluded that although the nominal premium payment on a letter of credit would be recoverable (e.g., in *Rossa*, the total premium was $950), an *interest expense* incurred on money borrowed to obtain a letter of credit would not be. The Court of Appeal did not explain why, under the plain language of the rule, one expense but not the other qualifies as a "cost to obtain a letter of credit as collateral" within the meaning of Rule 8.278(d)(1)(F).

Not surprisingly, on Aug. 11, 2010 by a 7-0 vote, the Supreme Court granted review in *Rossa* (No. S183523) to decide: "Does California Rules of Court, [R]ule 8.278(d)(1)(F), which permits a successful appellant to recover 'the cost to obtain a letter of credit as collateral,' allow the recovery of interest paid on sums borrowed to fund a letter of credit used to secure a surety bond?"

Why is the Supreme Court interested in deciding such an obscure issue of appellate procedure? A closer look at the clash between *Cooper* and *Rossa* may explain why.

In *Cooper*, the appellant had used an *alternative* to an appeal bond to stay enforcement of the judgment, by depositing $2.5 million in cash with the trial court, pursuant to California Code of Civil Procedure Section 995.710. As in *Rossa*, the appellant had borrowed the funds to make the cash deposit, and argued that the $200,000 in loan interest should be a recoverable cost on appeal. The trial court ruled that interest was not a recoverable cost, but the Court of Appeal reversed, holding that the appellant *was* entitled to recover the interest he had paid to obtain the loan for the cash deposit in lieu of bond.

Rossa thereafter created an anomaly between the treatment of appeal bonds and deposits in lieu of bonds that the Supreme Court apparently felt obligated to resolve. Under *Cooper*, the interest on money borrowed to make a cash deposit in lieu of bond is a recoverable cost, while under *Rossa* the interest on money borrowed to obtain a letter of credit as collateral to secure an appeal bond would not be recoverable. That would create a trap for unwary judgment debtors, who might unwittingly continue to use the simpler and more common surety insurer bond method of staying enforcement of judgments rather than the cash deposit method in *Cooper*. For more sophisticated judgment debtors, the *Rossa* decision would create incentives to bond judgments with cash or negotiable securities rather than appeal bonds.

That result would place new administrative burdens on the Superior Courts. Among other things, when a cash deposit is made, the Superior Court clerk becomes responsible for depositing the funds in an interest-bearing, FDIC-insured account, with periodic payments of interest to the defendant. See California Civil Procedure Code, Sections 995.710, 995.740. If a defendant chooses to deposit negotiable securities instead of cash with the court, the procedures are even more complicated, requiring the Superior Court to hold a hearing to determine the value of the securities, fixing their market value after considering supporting and opposing evidence. See Section 995.720. By contrast, an appeal bond is simply filed with the Superior Court, and is effective to stay the judgment without any further administrative burden on the court.

How is the Supreme Court likely to decide the issue? The smart money is on reversal of the Court of Appeal's decision. Rule 8.278's history shows the Judicial Council's intent, with respect to appeal bond costs, is to make appellants whole following the reversal of unjust money judgments. Holding that the nominal cost of a letter of credit fee is recoverable, while the greater expense of interest paid on sums borrowed to obtain a letter of credit is not, would undermine that intent.

Furthermore, if an appeal is unsuccessful, the prevailing plaintiff can expect to recover a higher-than-market 10 percent annual interest on the judgment under California Code of Civil Procedure Section 685.010(a) The Court of Appeal's decision in *Rossa* denies defendants of the possibility of being made whole for an analogous interest expense if they show on appeal that the judgment was unjustly imposed. Apart from being in conflict with the plain language of Rule 8.278(d)(1)(F), that seems to be an unfair result.

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