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OFFICE OF THE ATTORNEY GENERAL

October 28, 2009

MEMORANDUM OF LAW

To: Director, Department of Administration

From: Attorney General

Re: **COLA Interest Calculation**

Introduction:

You asked whether COLA awardees are entitled to promissory notes. The answer is yes, because the law allows for it.

You also asked whether payments to COLA awardees can be made in two separate installments, with the first applied to the entire net principal owed, and the second to the simple interest that accrued up until the time the principal was paid. The answer is no. Because the amounts owed began accruing simple interest with the COLA awardees' request for promissory notes on April 3, 2007, and continue to do so until paid in full, each payment to the COLA awardees must be apportioned between interest and principal until the amounts owed are paid in full. Partial payments are allocated first to interest and then to outstanding principal.

Background:

On November 21, 2006, the Court issued a judgment in the COLA case, Rios v. Camacho, Superior Court Case Special Proceedings Case No. SP0206-93, in favor of the petitioners. Counsel for the petitioners sent the Director of the Department of Administration a letter on April 3, 2007, requesting promissory notes for the amounts due his clients and his firm under the judgment. The Director of the Department of Administration did not dispute the claims. On September 24, 2007, the Guam Legislature enacted the COLA Relief Act, providing for the issuance of certificates of claim to the COLA awardees within thirty days of the law's enactment.

Based on information provided by petitioners' counsel, the Government of Guam began paying the judgment on August 29, 2007; payments ceased on July 22, 2009. Based on information provided by the Government of Guam Retirement Fund, the amount of the payment to each COLA awardee consisted of the principal amount owed, less attorneys fees and costs, and taxes withheld (if any, in accordance with each COLA awardee's tax withholding forms). The payments did not purport to include any interest.

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Analysis:

Guam law provides for the issuance of promissory notes to Government of Guam creditors under the following circumstances:

> Any creditor of the government of Guam (other than a tort claimant with an unadjudicated claim) who is not paid within thirty (30) days of filing his claim may request that the Director of Administration issue a registered, nontransferable promissory note in the amount of his claim from the government of Guam, bearing interest . . . and maturing one year from its date of issue.

5 G.C.A. § 22415(a).

The Supreme Court of Guam has held that the reference in the statute to "any creditor" includes a judgment creditor. Pacific Rock Corp. v. Perez, 2005 Guam 15, ¶ 35. In this case, the COLA awardees prevailed over the governmental respondents and were awarded a judgment. The COLA awardees are therefore judgment creditors of the Government of Guam. See Black's Law Dictionary 980-81 (4th ed. 1968) (defining a judgment creditor as "[o]ne who has obtained a judgment against his debtor, under which he can enforce execution").

On September 24, 2007, the Guam Legislature enacted Public Law No. 29-18, the COLA Relief Act, codified at 5 G.C.A. § 6404(d). The purpose of the Act is to see to the payment of the judgment issued on November 21, 2006, in Rios v. Camacho, Superior Court Case Special Proceedings Case No. SP0206-93. 5 G.C.A. § 6404(d)(1). To that end, the Act orders the issuance of a certificate of claim to each COLA awardee for the principal amount owing, less attorneys fees and costs, plus interest at a rate of seven percent per annum. 5 G.C.A. § 6404(d)(2).

Guam law defines a COLA awardee as "a retiree of the Retirement Fund who is a member of the COLA Class designated in Superior Court Case No. SP0206-93 entitled to receive a Cost of Living Allowance." 11 G.C.A. § 44101. The COLA Relief Act states that the COLA awardees' certificates are "in addition to any other available remedies". 5 G.C.A. § 6404(d)(2). The Act also explicitly provides that "[n]othing in this Subsection[, i.e., 5 G.C.A. § 6404(d),] restricts or eliminates any legal remedies available to COLA claimants as obligees of the Rios Judgment, including the remedies provided by Title 5 GCA § 22415." 5 G.C.A. § 6404(d)(5).

Thus, the COLA Relief Act specifically provides that the issuance of certificates does not preclude the COLA awardees from using other remedies available to them. The COLA awardees sought another available remedy by requesting, through counsel, promissory notes on April 3, 2007. As a result, the COLA awardees are entitled to promissory notes for the amounts owed to them.

Simple interest began to accrue on the amounts due the COLA awardees when they requested promissory notes on April 3, 2007. In order to discharge the entire amount due to the COLA awardees, the Government of Guam must pay the principal owed plus interest. Because the Government of Guam paid the principal but not the interest, the Government of Guam made a partial payment to the COLA awardees. Thus, "the United States rule" applies. See Devex

Corp. v. General Motors Corp., 749 F.2d 1020, 1024 n.6 (3d Cir. 1984) (referring to rule by name), cert. denied sub nom. Technograph, Inc. v. General Motors Corp., 474 U.S. 819 (1985).

Under the United States rule, partial payments are allocated first to accrued interest, and then to outstanding principal, until the amounts due are discharged in full, unless the parties agree otherwise, by "clearly expressed intention to handle allocation some other way." Devex Corp., 749 F.2d at 1025 (quoting Nat G. Harrison Overseas Corp. v. American Barge Sun Coaster, 475 F.2d 504, 507 (5th Cir. 1973)) (precluding party from beneficial application of United States rule where it agreed to allocate payments to principal rather than to interest); see In re Dep't of Energy Stripper Well Exemption Litig., 944 F.2d 914, 917 (Temp. Emer. Ct. App. 1991) (finding the United States Rule inapplicable where there was an express understanding as to how to allocate deposits in escrow account between principal and interest). The United States rule applies "to cases where interest is stated as a lump sum, . . . as well as cases where interest is stated in a percentage." Nat G. Harrison Overseas Corp., 475 F.2d at 507 (footnote omitted).

In Ohio Sav. Bank & Trust Co. v. Willys Corp., 8 F.2d 463 (2d Cir. 1925), the Second Circuit Court of Appeals addressed the issue of "the proper method to be pursued in making payment of debts of an estate being administered by receivers appointed in an equity proceeding." Id. at 465. At issue were two opposing methods of calculating unpaid balances owed to creditors and the interest thereon. Id. at 466. Under the first method, payments would be treated as "wholly on account of principal", the principal would therefore be paid in full, and only interest would remain to be paid. Id. Under the second method, the payments would be treated as first on account of accrued interest, with the remaining balance applied to reduce the principal. Id. The lower court instructed the receiver to use the second method, and the Second Circuit affirmed, articulating the United States rule:

> The correct rule, in general, is, that the creditor shall calculate interest, whenever a payment is made. To this interest, the payment is first to be applied; and if it exceed the interest due, the balance is to be applied to diminish the principal. If the payment fall short of the interest, the balance of interest is not to be added to the principal so as to produce interest. This rule is equally applicable, whether the debt be one which expressly draws interest, or on which interest is given in the name of damages.

Ohio Sav. Bank, 8 F.2d at 467 (quoting Story v. Livingston, 38 U.S. (13 Pet.) 359, 371 (1839)) (understanding this to be the rule in all federal courts "before and since that time"); see also Ohio Sav. Bank, 8 F.2d at 467 (collecting state law cases applying the same rule).

In Spang Indus., Inc. v. Aetna Casualty & Sur. Co., 512 F.2d 365 (2d Cir. 1975), a subcontractor sued its general contractor's surety for the balance owed on a construction contract, plus statutory interest. Id. at 371. The general contractor had made a partial payment on the total contract price, but refused to pay the remaining balance. The Second Circuit Court of Appeals held that the subcontractor did not waive its right to interest by accepting a partial payment and that the partial payment "did not extinguish the debt." Id. Instead, the appellate court ordered that the partial payment "be applied first to the interest then due, with the surplus discharging the principal pro tanto[, i.e., to the extent owed]." Id. at 371-72 (citing Ohio Sav. Bank, 8 F.2d at 466-67).

In an unpublished opinion, New York City Dist. Council of Carpenters Pension Fund v. On Par Contracting Corp., No. 06 Civ. 5643 (AKH), 2007 WL 1834706 (S.D.N.Y. June 25, 2007), the plaintiffs, a collection of employee benefit plans, sought a default judgment against the defendant, a party who had an obligation to make contributions to the plans but had failed to do so. Id. at *1. The district court entered default judgment, ordering the defendant to pay principal, interest, statutory damages, and costs and fees. The defendant moved to vacate the default judgment, arguing that it had made the necessary payments. The court ordered the parties to investigate the matter. Based on the parties' submission, the district court found that the defendant's payment did not satisfy all of the delinquencies or obligations owed by the defendant. Id. at *2. The court denied the defendant's motion to vacate and credited the defendant's payment against interest owed on the judgment. Id. (citing Spang Indus., 512 F.2d at 371, and Ohio Sav. Bank, 8 F.2d at 466-67 (1925)).

"Ohio Savings Bank involved the payment of debts where the court followed standard commercial practice of crediting payments first against interest." In re Crazy Eddie Sec. Litig., 948 F. Supp. 1154, 1169 (E.D.N.Y. 1996). "Spang Industries extended Ohio Savings Bank to a contract case where a specific payment was due on a specific date." In re Crazy Eddie Sec. Litig., 948 F. Supp. at 1169. On Par involved a payment credited to interest on a judgment. All of these cases, like the instant matter, "dealt with situations where there was a clear obligation or debt as of a date certain." In re Crazy Eddie Sec. Litig., 948 F. Supp. at 1169-70 (finding the United States rule inapplicable to prejudgment interest as overcompensating plaintiffs). Thus, the United States rule applies in this matter as well.

Conclusion:

Because the COLA Relief Act specifically provides that the COLA awardees are not precluded from seeking other remedies available to them, the COLA awardees, as judgment creditors of the Government of Guam, are entitled to promissory notes. However, this does not mean that the COLA awardees can recover the same amounts twice.

When making payments to COLA awardees, the Government of Guam must allocate payments first to the simple interest that has accrued and then to the remaining principal until the amounts owed are paid in full.

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