Calculating Interest: Making the "Compound" "Simple"

Abstract: The Commonwealth of Pennsylvania does not provide guidance as to the proper method of calculating interest owed on past due workers' compensation benefits so attorneys must determine the proper calculation method.

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Insurers, self-insureds, and third-party administrators are often asked to calculate and pay interest owed on past due workers' compensation benefits. In the past, the Bureau of Workers' Compensation ("Bureau") advised parties on the amount of interest payable, and provided computations of both simple and compound interest. The Bureau has now removed the interest calculator from its website and has stopped giving advice on how to calculate interest. The Bureau, instead, now advises the parties to select their own methods of interest calculation.

The Workers' Compensation Act ("Act") does not provide a definite method for calculating interest. A critical but unanswered question is whether simple or compound interest, or perhaps both, should be applied.

Simple interest is an example of arithmetic growth where the amount of interest generated each term is constant; it is based on the starting principal amount only.

Compound interest, on the other hand, is an example of geometric growth where the amount of interest generated each term increases because it is based on both the starting amount and the previously earned interest.

Calculating simple interest is simple; you take the principal amount due, multiply by 10% (statutory interest rate under the Act), and multiply by the years since the amount was due. For example, $50,000.00 was due in 2000. To calculate the simple interest owed, you multiply $50,000.00 (Principal) x 10% (Interest Rate) x 6 (Years) = $30,000.00 (Total Interest). See Example 1.1.

Example 1.1:

| Year	Principal	Interest Rate	Interest Owed
1	$50,000.00	10%	$5,000.00
2	$50,000.00	10%	$5,000.00
3	$50,000.00	10%	$5,000.00
4	$50,000.00	10%	$5,000.00
5	$50,000.00	10%	$5,000.00
6	$50,000.00	10%	$5,000.00
		Total Interest	**$30,000.00**

Compound interest is more complex; you take the principal amount due and multiply by 10% (statutory interest rate under the Act) which equals the amount of interest for year one, added to the principal amount for a total ending balance. For year two, you take the ending balance for year one and multiply by 10% which equals the amount of interest for year two, added to the principal amount for a total ending balance for year two. These steps are repeated for the number of years that interest is due. Using the same example above, $50,000.00 was due in 2000, six years ago. See Example 1.2.

Example 1.2:

Year	Principal	Interest Rate	Interest Owed	Ending Balance
1	$50,000.00	10%	$5,000.00	$55,000.00
2	$55,000.00	10%	$5,500.00	$60,500.00
3	$60,500.00	10%	$6,050.00	$66,550.00
4	$66,550.00	10%	$6,655.00	$73,205.00
5	$73,205.00	10%	$7,320.50	$80,525.50
6	$80,525.50	10%	$8,052.55	$88,578.05
			Total Interest	**$38,578.05**

Using compound interest has a larger effect as the time period increases. This spread between simple and compound interest is represented graphically in the Example 2.1 assuming a 10% interest rate.

Example 2.1:
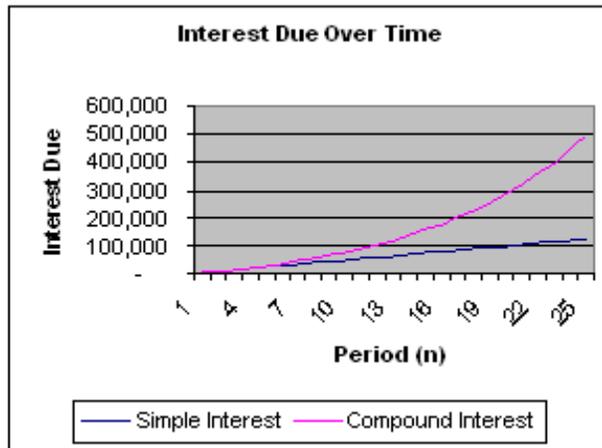
Consider the following example, based on a case currently being handled by my office.

The claimant filed a Claim Petition in 2001 for a 1999 injury. The litigation before the Workers' Compensation Judge (WCJ) took two years, and the Petition was denied in 2003. Claimant appealed to the Workers' Compensation Appeal Board (WCAB), which issued a Decision in 2005 remanding the case back to the WCJ. In 2006, the Petition was ultimately granted, with benefits running from the 1999 injury date. Supersedeas was requested pending appeal, but the request was denied. Claimant's compensation benefit rate was $500.00 per week. Therefore, the employer was obligated to pay, in an immediate lump sum, $182,000.00 of indemnity benefits.

Claimant argued that he was entitled to compound interest, which yielded a total amount of interest due of $81,000. In support of his argument, claimant asserted the Bureau had historically provided compound interest calculations, and because neither the Act nor the regulations were changed, compound interest must be awarded. The employer argued that only simple interest was applicable, and hence, the interest due was $63,000.

Section § 406.1 of the Pennsylvania Workers' Compensation Act provides in pertinent part: "Interest shall accrue on all due and unpaid compensation at the rate of ten per centum per annum."

Although the statute does not specify whether interest should be calculated using the simple or compound method, the courts have addressed this dilemma. As early as the 1930s, the courts simply stated that "[t]here is no authority under the statute for 'compounding' interest in a compensation case." Kessler v. North Side Packing Company et al., 186 A. 404 (Pa. Super. Ct. 1936). Thus, case law held that when the final adjudication is in the claimant's favor, the claimant is entitled to simple interest. Petrulo v. O'Herron Company et al., 186 A. 397 (Pa. Super. Ct. 1936); Ciotti v. Jarecki Manufacturing Company, 193 A. 323 (Pa. Super. Ct. 1937).

The Commonwealth Court has held that assessment of interest on compensation is intended to be a penalty for failure to make prompt payment and compensate the claimant for

loss of use of money during the delay. Glinka v. Workmen's Compensation Appeal Board (Sears, Roebuck and Company), 462 A.2d 909 (Pa. Cmwlth. Ct., 1983) citing C. & E. Trucking Corporation v. Luisser, 301 A.2d 127 (Pa. Cmwlth. Ct. 1973).

The Workers' Compensation Act is silent on the issue of which method of interest calculation, simple or compound, is "correct." Case law suggests that interest is added to fully compensate the claimant for the "time-use" of money, and to penalize the employer for withholding payment. If the claimant is denied the compounding of interest, is he granted full compensation for the loss of use of the money that was withheld during the delay in payment? On the other hand, isn't the interest rate itself (10%) so far over current market rates that even a simple interest calculation suffices as ample "punishment" of the employer?

Interestingly, in New Jersey, the method of interest calculation is specified in the Act leaving no room for inquiry and interpretation. Section 34:15-28 of the New Jersey Workers' Compensation Act calls for simple interest on each weekly payment for the period of delay. It is noted that New Jersey specifies the "period of delay", stating that interest shall have been withheld from a petitioner (claimant) for a term of three months or more following an award of benefits.

However, in contrast to Pennsylvania, New Jersey does not specify the rate of interest to be used in the calculation. It is stated that the annual rate of interest shall equal the average rate of return to the nearest whole or one-half percent for the corresponding preceding fiscal year. Yet, interest is at the discretion of the division and may be added to the amount due at the time of settlement.

Whereas the rate of interest is certain in Pennsylvania but not New Jersey, the computation methodology is certain in New Jersey but not in Pennsylvania. Due to the absence of any specific statutory requirement to use compound interest, and in light of the purpose of imposition of interest, it is not at all clear why, for so many years, workers' compensation practitioners accepted the Bureau's calculations and paid both simple and compound interest. Rather than paying compound interest out of habit, practitioners must now determine which method meets the current legal standard, provides the claimant with equitable interest on benefits due, and protects the employer from making payments beyond those required by the Act.

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