The Law Commission

(LAW COM No 287)

PRE-JUDGMENT INTEREST ON DEBTS AND DAMAGES

Item 4 of the Eighth Programme of Law Reform: Compound Interest

Laid before Parliament by the Lord High Chancellor pursuant to section 3(2) of the Law Commissions Act 1965

Ordered by The House of Commons *to be printed 23 February 2004*

HC 295 London: TSO £xx.xx

The Law Commission was set up by the Law Commissions Act 1965 for the purpose of promoting the reform of the law.

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The terms of this report were agreed on 12 December 2003.

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THE LAW COMMISSION

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To the Right Honourable the Lord Falconer of Thoroton, Lord High Chancellor of Great Britain

PART I
INTRODUCTION

1.1 In this report, we consider the amount of interest the courts should award on debts and damages in court proceedings. We are concerned with "pre-judgment interest", that is the interest awarded from the day when payment fell due until judgment is entered or payment made (whichever is the earlier). We are not concerned with the different rules that apply "post-judgment" – that is, after judgment has been entered, but the money remains unpaid.[1]

1.2 At present, the courts' general powers to award interest are set out in section 35A of the Supreme Court Act 1981, and its county court equivalent, section 69 of the County Courts Act 1984. These give the courts wide discretion about the rate of interest to be awarded, but specify that interest must be simple rather than compound.

1.3 Concerns have been raised that limiting the power to award only simple interest fails to reflect commercial reality. Interest is intended to compensate claimants for the cost of being kept out of their money. Yet delay in payment means either that claimants need to borrow or that they lose the opportunity to invest, both at compound rates. In the past, this limitation has been justified on the grounds that it is easier to calculate. At a time of widespread access to computer-aided calculations, this argument no longer carries the force that it once did.

1.4 Our Seventh Programme recommended that "an examination be made of the courts' power to award compound interest" on pre-judgment debts and damages.[2] The issue had been raised in the 1996 case of *Westdeutsche Landesbank Girozentrale v Islington LBC*,[3] in which a bank sought restitution of money paid under a void swap transaction, together with compound interest. A majority of the House of Lords held that the courts had no power to award compound interest. Lord Browne-Wilkinson stated that while he fully appreciated "the strength of the moral claim of the bank… to receive full restitution, including compound interest", judicial law reform in this area would usurp the function of Parliament.[4] He

[1] For a brief description of post-judgment interest, see para 2.1, below.

[2] Item 4, Seventh Programme of Law Reform (1999) Law Com No 259, p 11.

[3] [1996] AC 669.

[4] *Ibid*, at p 717.

recommended that there should be a full review of the policy reasons for and against awarding compound interest, so that Parliament could look again at "the whole question".[5]

1.5 As we carried out our review, it became clear that we could not examine the question of whether interest should be simple or compound without also considering the rate that should be awarded. Usually, the decision over what rate to grant will have a greater effect on the outcome than a decision over whether interest should be simple or compound. At present, there is considerable confusion over the appropriate rate. In practice the courts often use the judgment interest rate of 8% - a rate which has not been changed since 1993, and which is now considerably greater than bank base rates.

1.6 To a limited extent, the courts' tendency to award high rates of simple interest offsets the lack of compounding. This, however, is rough justice. The effect is to over-compensate claimants in most short-running cases, while under-compensating them in the longest cases.

1.7 As well as discussing compound interest, we also consider whether the courts should be given greater guidance on what interest rate to award. Our aim is to reduce the current confusion over rates and to provide for interest at a rate that more closely compensates claimants for the loss they have suffered.

1.8 We published a Consultation Paper on 4 September 2002[6] and received 39 responses. These were invaluable in alerting us to the practical consequences of our proposals, which we explored further in ten face-to-face meetings. We also examined around 200 county court files to see what interest was currently being claimed. We are very grateful to all those who responded to our paper and who spoke to us about their concerns.

POLICY CONSIDERATIONS

1.9 Awards of interest are designed to compensate claimants for the cost of being kept out of their money. They should put claimants into the position they would have been in had the debt or damages been paid when they fell due. We wish to introduce a system of pre-judgment interest that provides fair compensation to claimants without unduly penalising defendants and which encourages faith in the civil justice system by meeting the legitimate expectations of litigants. On the other hand, we do not wish to increase disputes or legal costs. We consider below the main considerations that have guided our thinking.

Interest should not be seen as a penalty on debtors

1.10 Debt enforcement involves balancing the rights of creditors and debtors. As the Government's 2003 White Paper on effective enforcement puts it, "creditors who have established a legitimate claim should be able to pursue it through a straightforward and accessible system". On the other hand, "debtors who

[5] *Ibid*, at p 718.

[6] Compound Interest (2002) Consultation Paper No 167.

genuinely do not have the means to pay should be protected from the oppressive pursuit of their debts".[7]

1.11 A recent review of the reasons people fall into debt stresses that most debtors are unable rather than unwilling to pay what they owe:

> The great majority of people who fall into arrears with their household or credit commitments do so because they are in financial difficulty – resulting from a change of circumstances or living long-term on a low income. Only a minority of people might be considered won't pays, although the proportion generally increases across the debt recovery cycle and is highest among those facing court proceedings.[8]

1.12 We do not think that it is appropriate to use court interest as a general penalty on defendants, especially when many are genuinely unable to pay their debts. Nor do we wish to use excessive interest payments as a way of discouraging defendants from putting forward legitimate defences. If interest at penal rates is to be introduced, it should be through a clearly defined scheme, such as the Late Payment of Commercial Debts (Interest) Act 1998.[9] Interest granted through the courts' normal powers should compensate the creditor rather than penalise the debtor.

1.13 We are concerned that the continued routine use of an 8% interest rate means that many individual debtors are paying over the odds for short-term delays in payment, often at times when they face financial hardship. At the same time some claimants are under-compensated for their losses, especially in long-running claims.

Interest should provide fair compensation for claimants

1.14 Our review suggests that, by and large, lawyers pay scant regard to interest. Interest payments are often the last issue to be negotiated. It is common for solicitors and barristers to reach for a convenient sum, applying whatever rate they used last time. Interest payments, however, can be substantial, especially where there have been long delays between the loss arising and the resolution of the dispute. At present, litigants may find that the amount they are awarded in interest bears little relationship to their loss. This can cause resentment. The Bar Council told us that "claimants are justifiably aggrieved to learn that the law has deliberately set its face against awarding compensation for what everyone recognises to be the full extent of their losses".

[7] Lord Chancellor's Department, *Effective Enforcement: improved methods of recovery for civil court debt and commercial rent and a single regulatory regime for warrant enforcement agents* (2003) Cm 5744, para 1.1.

[8] N Dominy and E Kempson, *Can't Pay or Won't Pay? A review of creditor and debtor approaches to the non-payment of bills* (2003) Lord Chancellor's Department Research Series 4/03, p 5.

[9] See paras 2.37 – 2.43, below.

Interest should be seen to be fair

1.15 The current system of awarding interest is muddled and out-of-date. It is difficult to justify to litigants, and gives the impression that the legal system is living in the past.

The law on interest should minimise the scope for disputes

1.16 The main justification for using simple interest is that it is easier to calculate, and provides fewer opportunities for dispute. Given the recent advances in computer access, we do not think that this is a valid reason for preventing the courts from awarding compound interest. We are, however, sensitive to the need to minimise disputes. It is particularly important that compound interest is calculated in a set way – preferably through a generally available computer programme or authorised tables. If litigants were to carry out their own calculations on a pocket calculator, there would be many opportunities for reaching different results.[10]

1.17 At present, most interest awards are discretionary, with little formal guidance on how that discretion should be used. We recommend retaining this discretion, but wish to direct and structure it so as to make outcomes more certain.

SUMMARY OF RECOMMENDATIONS

1.18 The report makes two main recommendations, each designed to enable the courts to compensate claimants more accurately for being kept out of their money.

(1) There should be **a specified rate** set each year at 1% above the Bank of England base rate. This would be a useful starting point, though we think that the courts should have a discretion to depart from the rate where there is good reason to do so.

(2) The courts should have the power to award **compound** (rather than simple) interest in appropriate circumstances. In broad terms, we think that compound interest is usually appropriate in large cases, and recommend that in payments of £15,000 or more there should be a rebuttable presumption in favour of compound interest. For payments of less than £15,000 the rebuttable presumption would be that interest is simple.

1.19 In order to keep the interest calculations as simple as possible, we recommend that the Court Service should design a computer programme to calculate compound interest, and make it freely available on their website. The Court Service should also provide tables for those without access to computers, which would be particularly useful in court or in the court corridor.

THE EFFECT OF OUR RECOMMENDATIONS

1.20 In consumer claims, the introduction of a specified rate will result in small reductions of interest over large numbers of cases. In Part III we estimate that it will affect over 100,000 consumer debt actions a year, leading in most cases to a

[10] The most obvious potential for dispute lies in the choice between annual, quarterly, monthly or daily rests. Other choices lie between set date and anniversary compounding, and in whether February is treated as a twelfth of a year or 28 days.

reduction of less than £10. Given that most consumer claims are relatively small and quick, compound interest will have little effect on them.

1.21 In business debt cases, our proposals will have less effect because most debts for the supply of goods and services fall within the ambit of the Late Payment of Commercial Debts (Interest) Act 1998. The main effect will be in commercial damages claims, which are not covered by the 1998 Act. In short county court damages claims, most interest payments will be reduced. However, in larger long-running cases of more than 10 years' duration, the introduction of compound interest will result in increases in the interest awarded.

1.22 In most ordinary personal injury claims, there will be small reductions in interest. The increases will be in the longer cases. The main effect will be in the longest cases, which involve delays of 15 years or more from loss to settlement or trial. Here the difference between simple and compound interest becomes significant, and interest payments will increase substantially.

1.23 In practice, most of the very old cases are actions for clinical negligence brought by children or those under disabilities, where the normal limitation periods do not apply. We estimate that the introduction of compound interest will add between £20 million and £25 million a year to the cost of clinical negligence claims. Most of these costs would be met from public funds. Although we think that the introduction of compound interest to such cases is right in principle, it is up to the Government to decide how far it represents a priority for public expenditure. It would be possible to delay the introduction of compound interest to the clinical negligence field until the present backlog of long-standing cases has been resolved.

STRUCTURE OF THIS REPORT

1.24 The report is divided into ten parts:

(1) Part II outlines the existing law.

(2) Part III argues that there is a need to set a "normal" interest rate, to be used unless there is a good reason to depart from it. It considers what that rate should be

(3) Parts IV, V and VI discuss compound interest. We start with the issue of principle: should the courts have a power to award compound interest? We then go on to examine the scope of the power and how compound interest should be calculated.

(4) Part VII looks at the specific issues that arise in personal injury cases.

(5) Part VIII deals with offers to settle made under Part 36 of the Civil Procedure Rules.

(6) Part IX considers the transitional arrangements.

(7) Part X lists our recommendations.

1.25 This is followed by a draft Bill (in Appendix A). Appendix B sets out the main existing legislative provisions (that is, section 35A of the Supreme Court Act 1981 and section 69 of the County Courts Act 1984).

1.26 Subsequent appendices include information on the likely impact of our proposals. Appendix C shows the results of a county court data collection exercise, designed to illustrate the approach county courts currently take to interest. Appendix D uses existing data to consider the likely effect of our proposals, while Appendix E looks in more detail at the effect of our proposals on clinical negligence claims.

1.27 Appendix F gives examples of what our recommended compound interest tables would look like. Finally Appendix G lists the respondents to our consultation paper.

PART II
AN OUTLINE OF THE PRESENT LAW

2.1 In this Part we describe the various ways in which interest is awarded on debts and damages before judgment is entered. We are not concerned with post-judgment interest, which is available at a prescribed rate on all High Court judgments and on county court judgments over £5,000.[1] The judgment interest rate is set by order, and is currently 8%.[2]

2.2 We start with a brief history of pre-judgment interest, before outlining the seven different bases on which interest may be awarded.

HISTORY

2.3 The English courts have long been reluctant to award interest at common law. In 1893, the House of Lords held that no interest was due on a debt unless a contractual term or trade usage specifically provided for it.[3] This means that interest is largely a matter for either contract or statute. The courts' inherent power to award interest is confined to a few limited circumstances, such as where interest is claimed as special damages or under the equitable or Admiralty jurisdictions.

The 1934 Act

2.4 The first statute to give the courts a general power to award pre-judgment interest on debts and damages was the Law Reform (Miscellaneous Provisions) Act 1934.[4] Under section 3, a court of record was given a general discretion in any proceedings tried before it to grant interest

> at such rate as it thinks fit on the whole or any part of the debt or damages for the whole or any part of the period between the date when the cause of action arose and the date of the judgment.

2.5 Interest had to be simple. Section 3(1)(a) did not authorise the granting of "interest on interest". Nor did the statute apply when interest was already payable under a contract or other provision.

[1] In the High Court, judgment debts are governed by section 17 of the Judgments Act 1838. In county courts, judgment interest is governed by the County Courts (Interest on Judgment Debts) Order 1991 (SI 1991 No 1184). The order excludes a range of cases from judgment interest, including suspended orders for possession, debts regulated by the Consumer Credit Act 1974 and maintenance payments (except for lump sums of £5,000 or more). Interest does not run while an administration order or attachment of earnings order is in force.

[2] The Administration of Justice Act 1970, s 44 allows the Lord Chancellor with the concurrence of the Treasury to amend the interest rate. The power has been used eight times, of which the last was in 1993 (SI 1993 No 564).

[3] *London, Chatham and Dover Railway Co v South Eastern Railway Co* [1893] AC 429.

[4] A more limited power to award interest had been provided by the Civil Procedure Act 1833 (Lord Tenterden's Act). This provided that a jury could award interest on fixed debts under a written instrument, from the date specified for payment in the instrument or the date of the written demand.

2.6 Thus the 1934 provision had four principal features:

(1) It applied only to cases tried by the court. It did not apply to settlements or default judgments;

(2) It did not cover cases where interest was specified in the contract or was due under some other statutory provision;

(3) It gave the court very wide discretion – over whether to grant interest at all, over the rate to be awarded, over the amount of the debt to carry interest and over the period interest was to cover; but

(4) It specified that interest must be simple rather than compound.

Personal injury claims and the 1969 amendment

2.7 Judges proved reluctant to use this power in personal injury claims. In 1969, section 3 of the 1934 Act was amended to make interest mandatory in personal injury cases, unless there were "special reasons" why it should not be awarded. A new subsection 3(1A) was added to cover judgments exceeding £200 that included damages for personal injury or death. It stated that the courts "shall exercise" their power to award interest, unless they are "satisfied that there are special reasons why no interest should be given".

2.8 The statute provided no guidance on what would be a suitable rate of interest on personal injury damages, or for what period interest should be awarded. Those issues were left to the courts. In 1970, the Court of Appeal held in *Jefford v Gee*[5] that interest on past pecuniary loss should follow the rate of interest given on money paid into court (now called "the special investment account rate"). Where loss had arisen continuously over a period of time, interest should be granted at half the normal rate. Later, in 1982, *Birkett v Hayes* set out a separate rule for non-pecuniary loss – namely that interest should run at 2% from the service of the writ.[6]

2.9 In Part VII we examine the rules set out in these cases in more detail. For the present it is worth noting that personal injury cases are subject to a slightly different interest regime. There is a presumption that interest should be granted, and case law has set out clearer rules about the rates and calculations than is true for other types of litigation.

Law Commission's 1978 report

2.10 In 1978 the Law Commission carried out a general review of the courts' powers to grant pre-judgment interest on debts and damages. We found that the main problem with the 1934 Act was that it was too limited. It only applied to the small minority of claims that went to trial. It did not apply to debts that were paid late

[5] [1970] 2 QB 130.

[6] [1982] 1 WLR 816, CA. The decision was endorsed by the House of Lords in *Wright v British Railways Board* [1983] 2 AC 773.

but before proceedings were started; nor to payments made after proceedings were started but before judgment; nor to default judgments that did not involve a trial.[7]

2.11 The 1978 report made two proposals: one for debts and one for damages. For debts, creditors would have a right to interest without issuing court proceedings. Following a written demand, they would have a statutory entitlement to interest at the specified rate, set at 1% over the minimum lending rate. For damages, interest would only be available after court proceedings had started and would remain within the courts' discretion. However, the report recommended that the powers available under the 1934 Act should be widened so as to provide interest in cases resolved after proceedings were issued but before trial, whether through settlement or default judgment.

2.12 The report recommended that, under both schemes, interest should continue to be simple, on the grounds that a system of compounding is "bound to be either too crude to be fair in all cases or too intricate to be practicable".[8] The Law Commission thought that annual compounding would lead to arbitrary increases, while for more frequent compounding, the cost of doing the relevant calculations "would be out of all proportion to the sums involved".[9] However, since 1978, the technology for conducting such calculation has changed beyond recognition and this reason no longer holds the force that it did in 1978.

The Administration of Justice Act 1982

2.13 The Law Commission's proposals for statutory interest on debts were never implemented. In 1982, however, legislation provided litigants with a right to interest where proceedings had been started but resolved otherwise than by trial.[10]

2.14 The new provisions (discussed below) are now contained in section 35A of the Supreme Court Act 1981 (which applies to the High Court) and section 69 of the County Courts Act 1984 (which applies to county courts). Unlike the 1934 Act, these provisions are not confined to trials. They do, however, share the other main characteristics of the 1934 provisions. The courts continue to have a wide discretion over what interest to award – though any interest awarded must still be simple.

2.15 Section 3 of the 1934 Act continues to apply to other courts of record.[11]

The Arbitration Act 1996

2.16 The 1996 Arbitration Act was based on the UNCITRAL Model Law on International Commercial Arbitration (1995). Although the Model Law did not mention interest, it was decided that the Act should grant arbitrators broad

[7] Report on Interest (1978) Law Com No 88, para 13.

[8] *Ibid*, para 85.

[9] *Ibid*, para 85.

[10] The Administration of Justice Act 1982 inserted a new section 35A into the Supreme Court Act 1981 and a new section 97A into the County Courts Act 1959. On consolidation, the county court provision was reproduced as the County Courts Act 1984, s 69.

[11] See paras 5.59 – 5.67, below.

discretionary powers to grant simple or compound interest.[12] It was felt that this would reflect commercial reality and discourage respondents from delaying payment.[13] It is common for international organisations that provide arbitration services to include powers to award compound interest.[14]

2.17 The result is that arbitrators now have a power to award compound interest that the courts do not share.

THE CURRENT LAW

2.18 As a result of these developments, pre-judgment interest may now be awarded in one of seven ways:

(1) under a contract or trade usage (when it may be simple or compound according to the agreement or usage);

(2) as special damages (simple or compound);

(3) under the equitable or Admiralty jurisdictions (simple or compound);

(4) where proceedings have been commenced, under section 35A of the Supreme Court Act 1981 or its county court equivalent[15] (which is limited to simple interest only);

(5) as of right under certain other statutes (simple only);

(6) by arbitrators, exercising their discretion under the Arbitration Act 1996 (which may be simple or compound); or

(7) after trial, where the defendant has been held liable for more than a refused claimant's offer, under Part 36 of the Civil Procedure Rules (simple only).

We summarise each below.[16]

Interest under a contract or trade usage

2.19 Commercial lenders usually include provisions for compound interest in their contracts. In fact, so common is this arrangement that the courts have accepted that bankers are entitled to compound interest even in the absence of a specific

[12] Arbitration Act 1996, s 49 (see para 2.44, below).

[13] See Report on the Arbitration Bill of the Departmental Advisory Committee on Arbitration Law (February 1996) para 236.

[14] For example, World Intellectual Property Organization, Arbitration Rules art 60; London Court of International Arbitration, Arbitration Rules art 26.6; North American Free Trade Agreement art 1135(1)(a).

[15] County Courts Act 1984, s 69.

[16] For a fuller account, see Consultation Paper No 167, Part II.

contractual term, on the basis of an implied trade usage.[17] Thus a borrower with a bank loan or mortgage, credit card or store card debts will usually be required to pay compound interest up until the date of judgment.[18] However, many other claimants are not protected by contractual terms in this way.

Interest as special damages

2.20 In some circumstances, claimants may recover interest as "special damages", on the grounds that, as a result of the defendant's breach of contract, they have incurred a loss through having to pay interest. The courts have taken a restrictive approach. Under the rule in *Hadley v Baxendale*,[19] damages may be awarded under two heads. The first is where losses "may fairly and reasonably be considered arising naturally, i.e. according to the usual course of things". The second is where they "may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract".[20] At first sight, the need to pay interest would appear to arise "naturally" under the first head, whenever a creditor is deprived of money. The House of Lords prevented such an interpretation in 1893, in *London, Chatham and Dover Railway*,[21] and no subsequent court has been prepared to overturn that ruling.[22]

2.21 Thus compound interest may only be payable as special damages in the much more limited circumstances where the parties specifically contemplated that, in the event of a breach, the claimant would need to borrow money at compound rates. An example is *Hartle v Laceys*.[23] Here a solicitor knew that his client had borrowed heavily from the bank at relatively high compound rates of interest and that he needed to sell property to reduce his borrowing. The solicitor acted negligently, and so lost his client the opportunity to sell. The court found that interest could be claimed at compound rates as special damages, because the issue was in the contemplation of both parties.

2.22 Where interest is claimed under the second limb of *Hadley v Baxendale*, it must be specifically pleaded as special damage.

[17] In *National Bank of Greece SA v Pinios Shipping Co (No 1)* [1990] 1 AC 637, the House of Lords held that, as implied by the usage of bankers, the bank was entitled to capitalise interest, and it was conceded that the bank was entitled to do so with quarterly rests.

[18] Normally, compound interest would not be allowed on post-judgment debts. However in *Director General of Fair Trading v First National Bank Plc* [2002] 1 AC 481, the House of Lords upheld an express contractual provision that allowed compound, variable interest rates on post-judgment debts. They rejected the OFT's argument that such a term was unfair within the definition of the Unfair Terms in Consumer Contracts Regulations 1994 (SI 1994 No 3159).

[19] (1854) 9 Exch 341, 156 ER 145.

[20] *Ibid*, at pp 354-5.

[21] *London, Chatham and Dover Railway Co v South Eastern Railway Co* [1983] AC 429.

[22] See, for example, *President of India v La Pintada Compania Navigacion SA* [1985] 1 AC 104.

[23] [1999] Lloyd's Rep PN 315, CA. See also *Araba Afedua Ata-Amonoo v Grant, Seifert and Grower* [2001] EWCA Civ 150 and *Amec Process & Energy Ltd v Stork Engineers and Contractors BV* (2000) WL 31413913. For further discussion, see *McGregor on Damages* (17th ed 2003) para 15-015.

Interest under the equitable or Admiralty jurisdiction

The equitable jurisdiction

2.23 The equitable jurisdiction gives courts an inherent power to award interest, which may on occasion extend to compound interest. The Law Commission's 1978 *Report on Interest* described the equitable jurisdiction as follows:

> Interest may be awarded as ancillary relief in respect of equitable remedies such as specific performance, rescission or the taking of an account. Furthermore the payment of interest may be ordered where money has been obtained and retained by fraud, or where it has been withheld or misapplied by an executor or a trustee or anyone else in a fiduciary position.[24]

2.24 It was noted that where money had been obtained by fraud or misapplied by someone in a fiduciary position, the court "may direct that such interest be compounded at appropriate intervals".[25]

2.25 This suggests two categories of interest. First, simple interest is available in respect of all equitable remedies. This power mirrors the statutory power available under section 35A (see below) and adds little to it. Second, compound interest is available, but is restricted to fraud or misapplication by someone in a fiduciary position.

2.26 This distinction between "simple only" cases (such as specific performance and rescission) and "possible compound" cases (fraud and misapplication by someone in a fiduciary position) was upheld in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council*.[26] As Lord Browne-Wilkinson put it:

> In the absence of fraud, courts of equity have never awarded compound interest except against a trustee or other person owing fiduciary duties who is accountable for profits made from his position.[27]

2.27 In *Westdeutsche*, the House of Lords majority considered that it would be inappropriate to extend the courts' powers to award compound interest to other areas. They thought that would usurp the function of Parliament.

The Admiralty jurisdiction

2.28 Unlike the common law courts, the Admiralty courts have been prepared to award interest. There is a long history of interest awards on damages for running down[28] and (more recently) salvage.[29] Again, however, the inherent jurisdiction adds little

[24] Report on Interest (1978) Law Com No 88, para 10.

[25] *Ibid*, para 21.

[26] [1996] AC 669. See also Consultation Paper, para 2.35 and Elliott, "Rethinking Interest on Withheld and Misapplied Trust Money" [2001] Conv 313.

[27] *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, at p 701.

[28] *The Dundee* (1827) 2 Hagg Adm 137, 166 ER 194.

[29] *The Aldora* [1975] QB 748.

to the statutory power. In *President of India v La Pintada Compania Navigacion SA* the House of Lords held that interest could be simple only.[30] Furthermore, interest under the inherent jurisdiction was only available on judgments, not on sums paid before judgment.[31]

Interest under section 35A of the Supreme Court Act 1981

2.29 In most cases, interest is awarded under the Supreme Court Act 1981, section 35A, or its county court equivalent, the County Courts Act 1984, section 69 (which is in very similar terms). Section 35A(1) states that

> Subject to the rules of court, in proceedings (whenever instituted) before the High Court for the recovery of a debt or damages there may be included in any sum for which judgment is given simple interest, at such rate as the court thinks fit or as rules of court may provide, on all or any part of the debt or damages in respect of which judgment is given, or payment is made before judgment, for all or any part of the period between the date when the cause of action arose and
>
> (a) in the case of any sum paid before judgment, the date of payment; and
>
> (b) in the case of the sum for which judgment is given, the date of judgment.

2.30 The section goes on to state that where proceedings are instituted, and the defendant pays the full sum before judgment, the defendant is also liable to pay simple interest in the same way (section 35A(3)). Unlike previous legislation, the section is not confined to court judgments but extends to all debts paid after the issue of proceedings. It is important to note, however, that proceedings must be instituted. There is no free standing right to interest on claims paid before issue.

2.31 Section 35A gives the court wide discretion. McGregor identifies five separate layers of discretion. Four are mentioned in subsection (1) above, namely: whether to award interest at all; the rate of interest; the proportion of the sum that should bear interest; and the period for which interest should be awarded. Section 35A(6) then goes on to confirm that "interest may be calculated at different rates in respect of different periods", giving a fifth discretion on whether to vary the rate.[32] Although the section allows for rules of court, these only apply to default judgments.[33] For the most part, the court's discretion is unfettered.

2.32 A limit to this wide discretion arises in cases of damages for personal injury or death. Here section 35A(2) states that the court shall include interest unless it is "satisfied that there are special reasons to the contrary".

[30] [1985] 1 AC 104, 119H, 120G-121B.

[31] *La Pintada* upheld *The Medina Princess* [1962] 2 Lloyds Rep 17, which found that no interest could be awarded on wages paid late but before trial.

[32] *McGregor on Damages* (17th ed 2003) para 15-005.

[33] See para 3.6, below.

2.33 The most important limitation in the whole section, however, is that the interest must be simple. The Act does not grant the courts a power to award compound interest. In this the section follows the Law Commission's 1978 report, which decided against allowing compound interest on the grounds of complexity of calculation.[34]

Interest under other statutes

2.34 Several statutes grant interest as of right (rather than as a matter of discretion, like section 35A). Under these statutes, interest is available at a prescribed rate before court proceedings are started.

2.35 For example, the Taxes Management Act 1970 specifies that unpaid income tax or capital gains tax "shall carry interest [at the applicable rate]... from the relevant date until payment.[35] Interest is also payable under various compulsory purchase statutes. For example, where an acquiring authority takes possession of land before agreeing compensation, the compensation ultimately awarded carries interest.[36] Another example is the interest payable to an outgoing partner on assets left within a partnership. Under section 42 of the Partnership Act 1890, the outgoing partner is entitled to either a share in the profits or interest at 5%.[37]

2.36 These statutory provisions share several characteristics. First, interest is available as of right, without the requirement that court proceedings should be brought. Second, interest is available at a prescribed rate. Third, interest is simple only. However, the interest rates differ. In December 2003, the prescribed rate under the Taxes Management Act was 6.5%,[38] the rate under the Partnership Act was 5% and the rate on compulsory purchase was only 3.25%.[39]

The Late Payment of Commercial Debts (Interest) Act 1998

2.37 The Late Payment of Commercial Debts (Interest) Act 1998 was introduced to protect small businesses against the late payment of commercial debts. The Act applies to contracts "for the supply of goods or services where the purchaser and

[34] Report on Interest (1978) Law Com No 88, para 85.

[35] s 86(1).

[36] Compulsory Purchase Act 1965, s 11. Other examples of interest on compulsory purchase arrangements include the right to interest on compensation where a general vesting declaration is used (under Compulsory Purchase (Vesting Declarations) Act 1981, s 10); and the right to interest on compensation for injurious affection (under the Land Compensation Act 1973, s 63). For a discussion of these provisions, see Towards a Compulsory Purchase Code: (1) Compensation (2002) Law Com Consultative Report No 165, paras 8.33-8.39. Also Towards a Compulsory Purchase Code: (1) Compensation – Final Report (2003) Law Com No 286, paras 10.12-10.28.

[37] See Report on Partnership Law (2003) Law Com No 283; Scot Law Com No 192, paras 8.15 and 8.32.

[38] See Taxes (Interest Rate) Regulations 1989 (SI 1989 No 1297), made under the Finance Act 1989, s 178.

[39] The Rate is prescribed under the Acquisition of Land (Rate of Interest after Entry) Regulations 1995 (SI 1995 No 2262) at 0.5% below the base rate quoted by the reference banks.

the supplier are each acting in the course of a business".[40] Interest starts to run on the day after the agreed date for payment,[41] and is available irrespective of whether court proceedings have been issued.

2.38 The Act is characterised by a high rate of interest. It has been set at 8% above the base rate, representing the rate of overdraft interest available to the smallest and most vulnerable businesses.[42] The rate is simple, rather than compound, on the grounds that it is easier to calculate. The Act is meant to protect businesses that have been deprived of their money for months rather than years, so in most cases the difference between simple and compound rates would be minimal.

2.39 When the Act was first introduced it only protected small business suppliers who were owed money by larger businesses. In 2000 the European Union adopted a Directive that required member states to introduce measures to protect commercial creditors against late payment.[43] As a result, the 1998 Act has been extended. For contracts entered into after 1 November 2000 small businesses can claim interest against other small businesses. For contracts entered into on or after 7 August 2002, late payment interest may be claimed by *all* commercial creditors – by both large and small businesses and by public authorities – who are owed money by commercial organisations.[44]

2.40 The Directive also requires a high rate of interest, to reflect the position of vulnerable borrowers. It states that the rate of interest must be set at not less than 7% above the rate set by the national central bank.[45] Although the Government could reduce the rate by one percent it has decided to preserve the interest rate at 8% above the Bank of England base rate. The Government has, however, simplified the way the interest is calculated. Before 2002, the rate tracked the base rate applicable immediately before payment day. Since 2002, the rate is set for six months at a time. For example, the rate that applied from 1 July to 31 December 2003 was 11.75% - that is, 8% above the base rate applicable on 20 June 2003.

2.41 Finally, as from August 2002, the Act entitles creditors to charge debtors a fixed sum to cover their enforcement costs. This becomes due as soon as statutory interest begins to run. The fixed sums are set out in the statute, and relate to the

[40] s 2(1). The definition specifically excludes consumer credit agreements and mortgages (s 2(5)).

[41] s 4(4). The date must be after the service has been performed. Where the contract does not specify a date, interest starts to run 30 days after supply or invoice, whichever is the later (s 4(5)).

[42] The Green Paper had originally proposed a rate of 4% above base, to represent the average rate of interest on bank loans to small businesses (*Improving the Payment Culture: A Statutory Right to Claim Interest on Late Payment of Commercial Debt*, URN 97/781). However, this was increased after consultation.

[43] Directive 2000/35/EC on Combating Late Payment in Commercial Transactions.

[44] The Late Payment of Commercial Debts (Interest) Act 1998 (Commencement No 5) Order 2002, SI 2002 No 1673.

[45] Directive 2000/35/EC, art 3(1)(d).

size of the debt. For debts of less than £1,000, the sum is £40; for £1,000 or more but less than £10,000, it is £70; and for £10,000 or more it is £100.[46]

2.42 The late payment legislation has a deterrent purpose. As the preamble to the Directive explains, "late payment represents an increasingly serious obstacle for the success of the single market".[47] This not only places "heavy administrative and financial burdens on businesses" but it is a "major cause of insolvencies", which threaten "the survival of businesses" and "result in numerous job losses".[48] The rationale behind the legislation therefore goes beyond providing fair compensation, and ventures towards imposing penalties for socially damaging behaviour. The preamble also makes clear that the ambit of the Directive is strictly limited. It does not apply to consumers or to compensation for damages.[49]

2.43 The Late Payment Act is important in its own field, but it does not provide a guide to the policy that should be applied outside its own parameters. In considering interest on damages or consumer debts, it would be inappropriate to apply similar principles or interest rates.

The Arbitration Act 1996

2.44 The Arbitration Act 1996 differs from the other statutory provisions in that it provides arbitrators with a discretion to grant interest. It is also the only statute to provide specifically for compound interest. Section 49 states that "the tribunal may award simple or compound interest from such dates, at such rates and with such rests as it considers meets the justice of the case" on the whole or part of the amount claimed.[50] This means that arbitrators have power to award compound interest where the courts do not.

2.45 We understand that practice in awarding interest differs, but that compound interest is frequently awarded in large commercial and maritime claims.[51]

Interest under Part 36 of the Civil Procedure Rules

2.46 Finally, interest may be used as a sanction where defendants have refused a formal claimant's offer and have had a judgment entered against them that is more advantageous to the claimant than the offer they have refused. Rule 36.21(2) of the Civil Procedure Rules states that the court may award additional interest from the date the defendant could have accepted the offer, at a rate not exceeding 10%

[46] Late Payment of Commercial Debts (Interest) Act 1998, s 5A, as inserted by the Late Payment of Commercial Debts Regulations 2002, reg 2 (SI 2002 No 1674).

[47] Directive 2000/35/EC on Combating Late Payment in Commercial Transactions, preamble para 5.

[48] *Ibid*, preamble para 7.

[49] *Ibid*, preamble para 13.

[50] s 49(3).

[51] The London Maritime Arbitrators Association told us that it was "the general practice" to award compound interest "quite simply because it seems commercially just to do so". The Worshipful Company of Arbitrators commented that "the power to award compound interest should be exercised unless there is good reason in the particular case not to do so; this, however, is noted not to be universal practice".

above base. Interest must be simple: the rules specifically exclude granting interest on interest.

2.47 This is an important part of the scheme for encouraging litigants to settle their differences by exchanging formal offers before trial. We return to this subject in Part VIII.[52]

CONCLUSION

2.48 Pre-judgment interest on debts and damages may be awarded in many different ways, at a variety of different rates. The statutory provisions alone range from 0.5% below base to 8% above base. The power the courts are most likely to use is contained within section 35A of the Supreme Courts Act and its county court equivalent, section 69 of the County Courts Act 1984. This gives the court a wide discretion to decide what rate to use, over what period.

2.49 Compound interest is awarded routinely under contracts. For example, contracts for bank loans, mortgages, credit or store cards will almost always include provisions for compound interest. Compound interest may also be awarded in arbitration. However, in the absence of specific contractual conditions or trade usages, the courts rarely award compound interest. The main statutory provisions do not permit it. Meanwhile, the courts have been reluctant to extend case law in favour of compound interest for fear that it would usurp the will of Parliament. Any reform in this area will require legislation.

[52] See paras 8.3 – 8.8, below, which describe the Rules and case law on this subject.

PART III
SETTING THE INTEREST RATE

3.1 The main criticism that can be made of the current system is that it operates in a way that is uncertain and arbitrary. As we shall see, there is considerable confusion over what rate of interest should be awarded. In practice, there is a strong tendency for litigants to claim and receive the judgment interest rate of 8%. This no longer bears any relationship to commercial interest rates and usually overcompensates the claimant. It can lead to unfairness, especially where struggling debtors pay large businesses who are able to borrow at much lower rates. At the same time, the limitation to simple interest may lead to under-compensation. This occurs in some long-running cases, when claimants either have been forced to borrow money at compound rates, or have been deprived of an investment opportunity, also at compound rates.

3.2 The result is that defendants in short cases often pay too much, while claimants in long cases may receive too little. To illustrate the effect, a simple interest rate of 8% would be the equivalent of a compound rate of 7% after five years, and the equivalent of a 6% compound rate after 11 years. After 19 years, a simple rate of 8% becomes the equivalent of only 5% compound.[1]

3.3 In this part we start with an account of current practice. We then discuss two questions. First, is there a need to set a "normal" interest rate, to be used unless there is a good reason to depart from it? Second, what should that rate be? We leave aside, for the moment, whether the interest rate should be simple or compound, and return to that question in Part IV.

INTEREST RATES: THREE APPROACHES

3.4 As we have seen, the main statutory provisions grant the courts considerable discretion to choose which interest rates apply.[2] An important question is how courts select the appropriate rate.

3.5 There are three basic approaches. The first is to use the judgment interest rate, which has been set at 8% since 1993. The second is to use the special investment account rate (currently 6%). The third is to use a commercial rate, usually set with reference to the bank base rate or LIBOR.[3] It is common for the Commercial Court to set a figure of 1% over base, which would currently amount to 4.75%.

Using the judgment interest figure

3.6 The appropriate simple interest rate for judgment debts is prescribed under section 17 of the Judgements Act 1838. Section 35A(5) grants a specific power to prescribe a rate for pre-judgment interest that is linked to post-judgment interest, but this has only been used in relation to default judgments. The Civil Procedure

[1] See Consultation Paper No 167, p 59.

[2] Supreme Court Act 1981, s 35A and County Courts Act 1984, s 69.

[3] London Inter Bank Offer Rate. For further discussion, see note 9, below.

Rules state that interest may be awarded on default judgments provided that it is claimed in the correct way and that "the rate is no higher than the rate of interest payable on judgment debts".[4] At first sight the Civil Procedure Rules do not appear to require interest to be granted at 8%; they merely state that it should be no higher than 8%. However, default judgments are made without judicial intervention, as a routine administrative procedure. The court will not exercise a discretion over the rate: if a claimant claims interest at 8% in the correct way, it will be granted.

3.7 Although the link between pre- and post-judgment rates in default judgments is quite limited, it has an important influence on court practice. When a claimant first completes a claim form they will not necessarily know whether the claim will be defended. As far as interest is concerned, it would be sensible for claimants to assume that the case will be dealt with as a default judgment and to claim interest at the highest rate available. Thus the Court Service's information leaflet, *How to Make a Claim*, gives advice on interest in the following terms:

> If you want to claim interest, you must include it in your 'particulars of claim'. Write your claim in the following way: '*The claimant claims interest under section 69 of the County Courts Act 1984 at the rate of 8% a year, from* [date when the money became owed to you] *to* [date you are issuing the claim] *of £* [put in the amount] *and also interest at the same rate up to the date of judgment or earlier payment at a daily rate of* [enter the daily rate of interest].[5]

3.8 It is an easy step from this simple advice to a general assumption that 8% is always the appropriate rate. Staff in one county court told us that they always advised claimants to claim interest at 8% simply because it was "the rate". Another judge remarked that "everyone has been working on 8% for so long that it's in the mind".

3.9 The judgment rate is inflexible. It was set at 8% in 1993 and has not been altered since, although base rates have fluctuated between 7.5% and 3.5% over this period. It has, therefore, been much more generous at some times than at others. The rate now appears to be high because base rates are particularly low. In February 2003, the Bank of England reduced its base rate to 3.75%; in July 2003 it was reduced further to 3.5%; and in November 2003 it was returned to 3.75%.

The special investment account rate

3.10 The traditional approach in personal injury cases has been to set interest on past pecuniary losses at the special investment account rate, which is the rate of interest granted on money paid into court.[6] From 1993 to 1999, this rate also remained at

[4] CPR r 12.6(1).

[5] Leaflet EX302, December 2002.

[6] *Jefford v Gee* [1970] 2 QB 130.

8%, leading a generation of law students to believe that 8% was always the appropriate figure.[7]

3.11 The special investment account rate has since been reduced twice: to 7% from August 1999 and to 6% in February 2002. The greater flexibility of the special investment account rate has encouraged judges to apply it in some contract cases as well.[8]

Commercial rates

3.12 An alternative approach is to link court interest rates to the bank base rate (or occasionally to LIBOR[9]). This is the usual approach in the Commercial Court, where case law suggests a rate of 1% over base, which is thought to reflect the actual cost of borrowing among commercial parties.[10] Other courts have also adopted this approach in cases of economic loss.[11]

3.13 The 1% over base figure has been described as "no more than a presumption" which could be displaced by evidence of the rates applying to borrowers with the general attributes of the claimant.[12] For example, in *Jaura v Ahmed*,[13] Rix LJ applied a rate of 3% above base, which he thought reflected a more realistic assessment of the rates at which small businesses borrowed. He said:

> It is right that defendants who have kept small businessmen out of money to which a court ultimately judges them to have been entitled should pay a rate which properly reflects the real cost of borrowing incurred by such a class of businessmen. The law should be prepared to recognise, as I suspect evidence might well reveal, that the borrowing costs generally incurred by them are well removed from the conventional rate of 1% above base (and sometimes even less) available to first class borrowers.[14]

[7] Harvey McGregor QC commented that even in personal injury cases the judgment rate has tended to "creep in": He wrote:

> "The former *Supreme Court Practice* used to have a footnote, admittedly unsupported by authority, stating that it was becoming common to award the judgment rate in personal injury and wrongful death cases. The other day a member of my Chambers told me that he had been arguing for special account rate at 6 per cent and his opponent for judgment rate at 8 per cent, and the judge dealt with the impasse by splitting the difference."

[8] *Harrison v Bloom Camillin (No 2)* [2000] Lloyd's Rep PN 404.

[9] Usually awarded by agreement of the parties rather than judgment, the London Inter Bank Offer Rate is the rate at which banks offer to lend money to one another. Daily LIBOR rates are set at 11am every morning by five major London banks, but the standard LIBOR figure is the three-month LIBOR. It is a better reflection of up-to-date commercial rates than the base rate, though long term figures suggest the two are linked.

[10] *FMC Meat v Fairfield Cold Stores* [1971] 2 Lloyd's Rep 221; *Miliangos v George Frank (Textiles) (No 2)* [1975] QB 487. See *McGregor on Damages* (17th ed 2003) para 15-093.

[11] *Metal Box Co Ltd v Currys Ltd* [1988] 1 WLR 175.

[12] *Shearson Lehman Hutton v Maclaine Watson & Co (No 2)* [1990] 3 All ER 723, per Webster J at 733.

[13] [2002] EWCA Civ 210.

[14] *Ibid*, para 26.

3.14 Over the period of the debt (August 1995 to March 2001) base had fluctuated from a low of 5% to a high of 7.5%, which meant that 3% above base represented a substantial increase over the 8% judgment rate. However, the court did not award as much as the claimant had paid on the money borrowed (4.5% over base). Rix LJ commented that the court did not have "enough evidence to support the case that the rate charged… was typical of small businessmen in his position".[15] Nor was it suggested that the court should award a higher rate of simple interest to compensate for the fact that commercial rates are compound ones.

INTEREST RATES IN PRACTICE

3.15 Judges and court staff suggested that county courts routinely award pre-judgement interest at 8%. In order to confirm this information, we visited Central London County Court to examine 239 court files. The results are set out in Appendix C.

3.16 The court files confirmed that 8% is the rate most commonly requested. Overall, 43% of claims included a request for interest at 8%. Its use was highest in business-to-business debt cases, where 60% of claims included a request for such interest. Although it was also common for claimants in business debt cases to ask for contractual interest, very little use was made of the Late Payment of Commercial Debts (Interest) Act 1998. We thought at least 25 cases could have used the 1998 Act, but only two did so. In consumer cases, around a third of claims did not ask for interest at all. When interest was specified, it was usually at 8%. We were surprised that interest at 8% was also asked for in around a quarter of personal injury claims – despite the case law on the issue.

THE PROBLEMS WITH THE CURRENT SYSTEM

3.17 The current system for selecting interest rates has three main problems. It is uncertain; it is often arbitrary; and many of the rates are too high.

It is uncertain

3.18 A major criticism of the present position is that there is considerable uncertainty over which rate should be applied. As Harvey McGregor QC told us, "one does not know where one is". He commented:

> The use of one [rate] as against another is largely historical but it would surely be better to rationalise the position and have a single rate; there is no good reason for having different rates for personal injury, professional negligence and shipping collisions.

He explained that even in commercial cases, "a variety of rates abound". Cases can be found to justify using 1% over base, or 1% over LIBOR, or judgment rate, or the special investment account rate.

It is often arbitrary

3.19 There is little logic to the present system of interest rates. Litigants perceive it as arbitrary, which in turn perpetuates the view that the legal system is out-of-date

[15] *Ibid*, para 25.

and irrational. The Personal Injuries Bar Association explained that the current hit and miss approach is difficult to justify to clients:

> The deficiencies in the present system for the calculation of interest have been obvious for many years. In the past the difficulty in the accurate calculation of interest led to the introduction of what can only be described as a rough and ready approach. The approach of the Bar to litigation has changed in recent years and a system with these characteristics does not lie easily with the greater degree of professionalism present in the modern approach to the calculation of damages. It is difficult to explain to clients why one may be able to calculate damages very accurately but then proceed to adopt principles for the calculation of interest which are distinctly hit and miss.

3.20 One of the Government's priorities is to increase litigants' levels of satisfaction with the civil justice system. Rationalising the system of interest payments would be a small step in this direction.

Many rates are too high

3.21 It is common for creditors to receive simple interest at 8%. This reflects the judgment interest rate set in 1993. When it was first set it was 2% over the then base rate of 6%. In December 2003, it was 4.25% over base rate. This is higher than either the return most investors would receive on their savings or the borrowing rates paid by those able to offer security.

3.22 Pre-judgment interest on debts and damages is intended to be compensatory, not penal. However, at present many debtors are being required to over-compensate creditors for the delay in payment. This can cause hardship to those debtors who are genuinely unable to pay. In some cases, poor and socially excluded debtors are being asked to over-compensate large and successful creditors. High rates are also an inappropriate penalty on those who defend cases in court.

3.23 We accept that not all interest rates are too high. The Law Reform Committee of the Bar Council told us that, in large claims, there was an increasing tendency to follow commercial practice and use a rate of base +1% simple. This can cause problems where claimants have been forced to borrow to make good their loss, as only the largest and most successful businesses are able to borrow money at this rate. The approach used in *Jaura v Ahmed* (to look at the class of borrower into which the claimant falls) is relatively rare, and even then does not necessarily reflect the actual rates at which many people are forced to borrow.

INTEREST RATES: THE WAY FORWARD

Setting a specified rate

3.24 There is a strong case for bringing greater certainty and rationality into the selection of appropriate pre-judgment interest rates. The Consultation Paper provisionally proposed that there should be a prescribed standard rate of interest, with discretion to depart from it where there are good reasons to do so. We suggested an amendment to section 35A of the Supreme Court Act 1981 (and its county court equivalent). This would apply to the general statutory discretion to grant interest but would not affect other statutory regimes (such as tax or the Late Payment of Commercial Debts (Interest) Act 1998). Our proposal drew

widespread support.[16] Most respondents agreed that there should be a specified rate, that the rate should be linked to bank base rate, and that there should be discretion to depart from it where appropriate.

3.25 There is a need to balance two objectives. On the one hand, the rate should reflect the commercial reality of borrowing and investing. On the other hand, litigants want a single clear rate, which they can discover easily and which does not change too often. It is important that the rate should be more flexible than the judgment rate (which has not changed for a decade). However, the rate should be less flexible that the bank rate itself, which changes at unpredictable times, so that parties and their representatives may not be alerted to what the current rate is.

3.26 This suggests a rate that changes on a set date each year. The rate should be clearly publicised on the Court Service website, on posters in court offices and in the legal press so that lawyers and litigants are aware of what it is.

3.27 Our first thought was that the rate should change on 1 January each year. However, the Court Service pointed out that it would be difficult for them to organise publicity over the Christmas and New Year holidays. As discussed in Part VI, the Court Service would also need to update computer programmes and produce interest tables to allow compound interest to be calculated easily. Given how important it is that the rate should be properly publicised and calculation tools made available, we think it would be better for the rate to change on 1 April. Many businesses and organisations start a new financial year on 1 April, and people are used to annual changes taking place on that date.

3.28 We wish to avoid the need for new secondary legislation each year. We therefore recommend that the rate should be specified by a formula that automatically introduces annual changes. The formula should specify that the April rate should be set with reference to the bank rate for the preceding February. If the reference date were 15 February each year, the rate could take into account any changes made by the February meeting of the Bank of England Monetary Policy Committee.[17] The Court Service would then have six weeks to organise publicity and changes to computer programmes and tables. This would suggest a formula along the following lines:

> For so much of the relevant period as falls in a period of 12 months ending with 31 March (a year), the specified rate consists of a percentage rate equivalent to x per cent above the base rate of the Bank of England in force at the beginning of 15 February in the preceding year.

[16] Only two respondents disagreed. One argued that the rate would need to be reviewed annually if it were not to go out-of-date, a point we have taken on board (see paras 3.26 - 3.29, below). The Canadian Supreme Court Law Branch suggested that statutory guidance may be unnecessary, and offered several examples where the Canadian courts have effectively decided the rate with no guidance.

[17] Monetary Policy Committee meetings generally take place early in the month. Since 1997, 25 out of 27 changes to the base rate have taken place between the 2nd and 10th of the month. The remaining changes took place on the 13th and 18th.

3.29 This system should work well in times of economic stability. At times of economic volatility, when interest rates fluctuate markedly, an interest rate set with reference to a base rate in February may be inappropriate a year later. We recommend that the Secretary of State for Constitutional Affairs should have power to set and change the formula by secondary legislation. In order to allow prompt changes at times of rapidly fluctuating rates, the draft Bill provides that this may be done through the negative resolution procedure.[18]

3.30 We recommend that section 35A of the Supreme Court Act 1981 and section 69 of the County Courts Act 1984 should be amended to allow a specified interest rate to be set through a formula.

3.31 The formula should provide that the rate be set with reference to the Bank of England base rate. It should run from a fixed date each year (such as 1 April), and be set with reference to the base rate prevailing on a date falling within the previous two months (such as 15 February).

3.32 The Secretary of State for Constitutional Affairs should have power to set and change the formula by secondary legislation

3.33 The courts should have discretion to depart from the rate where there is good reason to do so.

What should the rate be?

3.34 There is less agreement on what the rate should be. At present the courts use rates set at (at least) four different points:

(1) 1% above base: used in the Commercial Court to reflect borrowing by large "blue chip" borrowers;

(2) 3% above base: used in *Jaura v Ahmed*,[19] to reflect the rate at which small businesses borrowed;[20]

(3) 8% above base: set under the Late Payment of Commercial Debts (Interest) Act 1998, to reflect the interest rate paid by the smallest and most vulnerable businesses on their overdrafts;

(4) 10% above base, which is the maximum rate at which interest can be set where a defendant fails to accept a claimant's Part 36 offer.[21] This is intended as a sanction, to force defendants to take claimants' offers seriously.

[18] See clause 1 of the draft Bill in Appendix A, inserting new section 35B(3).

[19] [2002] EWCA Civ 210.

[20] This was also the figure proposed in 1990 by the Law Reform Commission of Hong Kong, as the rate commonly charged by banks to borrowers if other credit facilities have not been previously negotiated: the Law Reform Commission of Hong Kong, *Report on Interest on Debt and Damages*, topic 19 (1990) para 5.45.

[21] See CPR r 36.21(2) and the discussion in Part VIII.

3.35 The principle is clear: interest is intended to compensate the claimant for the delay in payment. The difficulty is that claimants' circumstances differ: some lose the opportunity to invest, while others need to borrow. Some borrow at favourable rates, others at higher rates. Our Consultation Paper suggested that we should attempt to strike the right balance between investment and borrowing rates. In reply, respondents fell into three broad camps:

(1) Some people argued that the rate should be set with reference to investment rates rather than borrowing rates, with discretion to increase if the claimant could show that they needed to borrow. The insurance company, Aviva, for example, suggested that the rate should reflect that "readily achievable by an investment readily available in the market place". The investment rates available to individuals currently range from below base rate (on some instant access building society and current accounts) to 1% above base (on cash ISAs and their equivalents).

(2) Both the Personal Injuries Bar Association and the Association of Personal Injury Lawyers suggested that the mortgage borrowing rate would be a suitable indicator. The logic is that many households have a mortgage, which they would repay if presented with an unexpected cash sum. The mortgage rate also represents a middle ground between investment and borrowing rates.

While we understand the reasoning behind this suggestion, it is not easy to identify the prevailing mortgage rate. A recent review of the mortgage market showed that lenders faced intense competition for new business, and were under pressure to offer deals that minimised the level of initial monthly payments.[22] The result was a wide variety of different deals and rates. In October 2003 the average price of a so-called "variable-rate for term" mortgage was around 4.5% - that is only 0.75% over base.[23] However, these low rates were generally only available to new borrowers. Most existing borrowers were paying the lender's Standard Variable Rate, which averaged 5.42% (or 1.67% over base).[24]

(3) Finally, several respondents argued that the rate should be linked specifically to the cost of borrowing. They pointed out that many claimants are forced to borrow, and suggested rates of 3% or 4% above base, to reflect the cost of borrowing to individuals in the High Street. The Bar Council agreed that any individual who had been obliged to borrow should be able to recover interest at a rate that reflected the cost of

[22] D Mills, *The UK Mortgage Market: Taking a Longer-Term View: Interim Report – Information, Incentives and Pricing* (2003) HM Treasury, p 53.

[23] Unlike discounted variable mortgages, these products did not offer explicit discounts for the first two years. Around half specifically tracked a reference rate, usually base. Mills commented that these products only made commercial sense if they were subsidised by existing customers or if there were an expectation that a substantial proportion of those taking out such mortgages would eventually switch to the Standard Variable Rates, despite the lack of redemption penalties (above, p 54).

[24] Mills, above, p 53.

borrowing. They favoured a flexible system, with interest rates gauged to the personal circumstances of the claimant.

3.36 We considered whether there should be two set rates, one for claimants who borrowed and one for claimants who lost the opportunity to invest. However, this would be unduly complicated, especially where claimants had borrowed for only part of the time.

3.37 After weighing the different arguments, we have concluded that the standard specified rate should be base +1%. This represents the rate paid by well-placed and well-informed borrowers. It is the rate most frequently used in the commercial courts, on the grounds that is reflects borrowing by the largest and most secure businesses. Our 1978 report on interest described this "as a very useful and fair model", and recommended that the rate should be applied generally to unpaid debts.[25] It also represents the rate paid by active, knowledgeable and reasonably affluent individuals borrowing on a mortgage.

3.38 We think this would be a suitable starting point across a range of different cases.

(1) For commercial claims, a rate of base +1% is already accepted practice.

(2) In standard debt-collection cases brought against individuals, it would adequately compensate large or successful business without penalising debtors.

(3) A rate of base +1% also approximates to the rate that has been used in personal injury cases since 1980. As discussed above,[26] the courts have held that interest on past pecuniary loss should be paid at the special investment account rate[27] (with continuous loss carrying interest at half that rate). Since 1980, the special investment account rate has fluctuated against base, from a maximum of 4.25% above base to a minimum of 3.5% below base. However, between January 1980 and November 2003, the special investment rate has been, on average, 1.18% higher than the base rate. The base +1% formula therefore reflects the level of interest traditionally awarded on past pecuniary loss in personal injury claims.

3.39 Where money is owed in a business context, Parliament has already provided for higher rates under the Late Payment of Commercial Debts (Interest) Act 1998, which would continue.

3.40 Clearly, many small businesses and individuals who are deprived of their money will be forced to borrow at much higher rates. It is important that the court has discretion to vary the interest rate so as to compensate claimants who have incurred greater losses. This would cover the *Jaura v Ahmed* type case[28] identified as a problem by the Bar Council. We are also mindful of research into the

[25] Report on Interest (1978) Law Com No 88, para 87.

[26] See paras 3.10 – 3.11.

[27] Formerly known as the short-term investment account rate.

[28] [2002] EWCA Civ 210.

experiences of personal injury victims, conducted for us by Hazel Genn in 1994. This found that a minority of accident victims had run up debts as a result of the accident, with levels of indebtedness greatest among those with the most severe injuries. Among those receiving compensation of £100,000 or more, one fifth (21%) had borrowed over £5,000 and 7% had borrowed £10,000 or more.[29] They had often borrowed at high rates, using bank loans, overdrafts and credit cards.[30] We think in these circumstances, claimants should be able to ask for a higher rate to compensate them for the interest they have necessarily incurred.

3.41 We recommend that the courts should have discretion to vary the specified rate, by both increasing and decreasing it. However, in practice applications are much more likely to be made to increase the rate than to reduce it. We envisage that most applications will be based on the difficulties faced by needy claimants. We would not wish to create a situation in which deprived defendants were routinely required to ask the court to reduce the rate because the claimant was well-resourced. We therefore think that it is more appropriate to recommend a relatively low rate, to be increased where necessary, than to recommend a high rate that would often need to be reduced.

3.42 We do not wish to increase the possibilities for dispute. Given the current level of uncertainty over interest rates, we believe that the introduction of a specified rate should decrease the amount of litigation on this issue rather than increase it. The courts will probably develop easy-to-apply guidelines on the circumstances in which they will entertain an application to increase the interest rate. However, in case problems do occur, we recommend that the Civil Procedure Rule Committee should be given a power to provide guidelines to the courts about how to deal with such applications.

3.43 We recommend that the specified rate should be set at one percentage point over Bank of England base rate.

3.44 The Civil Procedure Rule Committee should be given power to provide guidance to the courts on how to exercise their discretion on whether to depart from the specified rate.

THE LIKELY IMPACT OF SETTING A SPECIFIED RATE AT BASE +1%

3.45 We are conscious of the need to consider the impact of our proposals on litigants. Appendix D gathers together available data on how our proposals are likely to affect different classes of litigation. Here we summarise our conclusions, looking specifically at the effect of setting a specified rate. In Part V we discuss the effect of granting a power to award compound interest on general litigation, while in Part VII we consider the effect on personal injury claims in more detail.

The effect on consumer debtors

3.46 The main effect of setting a specified rate will be in debt-collection cases brought against individuals where the contract does not already include provisions for

[29] p 152.

[30] p 175.

interest. Our county court data collection exercise, described in Appendix C, confirmed respondents' views that interest is routinely awarded at 8% in an unthinking way. When we looked specifically at actions for unpaid goods and services brought against consumers, the data suggest that interest was claimed at 8% in almost half of claims. In a third of claims, interest was not claimed at all, while contractual interest was invoked only rarely. On the basis of the base rate applicable in December 2003, the main effect of our proposals would be to substitute an interest rate of 4.75% for the currently used rate of 8%.

3.47 Appendix D suggests that there will be a small effect on a large number of cases. The change may affect around 117,000 cases a year, but in most cases the reduction will be small. Over half of claims are for less than £500. On the assumption that claims last for less than six months, in most cases the reduction will be £8.12 or less. Where the defendant is particularly poor, however, even a small reduction may be significant to them.

3.48 The greatest effect will be in longer cases, which are typically those cases where the defendant contests the payment and enters a defence. We estimate that in around 14,570 such cases a year, the consumer defendant loses. Assuming that a claim for £3,000 lasted a year, the reduction in interest payments would be £97.50.

3.49 These figures are calculated at a time when the base rate is only 3.75%. This means that the change to a specified rate will be perceived as a "defendant-friendly" move. However, as interest rates increase the change will become progressively more "claimant-friendly". There have been times since 1993 when the base rate has been 7.5% while the judgment rate (at 8%) has been only 0.5% more.

Commercial claims

3.50 Since August 2002, businesses recovering debts against other business are usually entitled to claim the higher rates available under the Late Payment of Commercial Debts (Interest) Act 1998. Alternatively, they may make contractual provision for interest rates.

3.51 The available evidence suggests that many businesses do not take advantage of the 1998 Act, and continue to ask for interest at 8%.[31] It is not clear why the Act should be used so rarely. It may be that lawyers are unaware of its provisions; or that it has not yet had time to become embedded; or that creditors are reluctant to ask for interest at what is perceived to be a penal rate. In practical terms, our proposals may encourage use of the 1998 Act, partly because they will make creditors think about interest (rather than automatically reaching for the 8% rate). It will also increase the differential between ordinary court rates and those available under the 1998 Act.

[31] See Appendix C. Other surveys confirm the Act is not well used. For example, a recent survey conducted by Stevens and Bolton found that only a third of companies had used the Act: see "Businesses Show Reluctance to use Statutory Debt Collection Rights" (2003) 24 (9) *Company Lawyer* 274.

3.52 The main effect of our recommendations will be in claims for damages rather than debts, because damages claims are not covered by the 1998 Act. In damages claims, there tends to be a variation between the practice of the High Court (which often awards interest at base +1%) and the county courts, which routinely apply an 8% rate. Our recommendations will bring county court practice nearer to current High Court practice. The courts will start from the presumption that interest should be awarded at base +1%, but could award more where claimants show that they have been forced to borrow at higher rates.

3.53 The aim and overall effect of our proposals will be to provide more accurate interest payments on damages claims, particularly in commercial claims within the county court.

Personal injury claims

3.54 The effect on personal injury claims is discussed in detail in Part VII. For longer claims, we estimate that the effect of setting a specified rate will be broadly neutral. As we have seen,[32] since 1980 the special investment rate has averaged 1.18% above the bank base rate. For shorter cases, the move to a specified rate will lead to a reduction in interest rates. For example, as of December 2003 the special investment account rate was 6% while a rate of base +1% would be only 4.75%.

3.55 These reductions will be partially offset by the fact that some claimants may apply for higher rates on the grounds that they have been forced to borrow. Compound interest will also lead to increased payments in longer claims, which in practice tend to be claims for clinical negligence. In so far as interest represents a real loss, we think that personal injury claimants should be accurately compensated for the loss they have suffered. However, any additional costs in this area are clearly a cause for concern, and we return to this issue in paragraph 4.26 and Part VII.

SUMMARY OF RECOMMENDATIONS

3.56 We recommend that section 35A of the Supreme Court Act 1981 and section 69 of the County Courts Act 1984 should be amended to allow the Secretary of State for Constitutional Affairs to set a specified rate. This would affect the way the courts awarded interest under these sections, but would not affect other statutory interest regimes, such as the Late Payment of Commercial Debts (Interest) Act 1998 or provisions applying to tax, compulsory purchase or partnership dissolution.

3.57 The specified rate should be set at 1% above the Bank of England's base rate. The rate should change annually. It should run from a fixed date each year (such as 1 April), and should be set with reference to the bank rate prevailing on a date in the previous two months (such as 15 February).

3.58 The formula specifying the rate will be set out in an order, so that it can be changed in times of rapid changes to interest rates. For the present, we would recommend a formula along the following lines:

[32] See para 3.38(3), above.

> For so much of the relevant period as falls in a period of 12 months ending with 31 March (a year), the specified rate consists of a percentage rate equivalent to one per cent above the base rate of the Bank of England in force at the beginning of 15 February in the preceding year.

3.59 The courts should have discretion to vary the specified rate. The Rule Committee should have the power to use Civil Procedure Rules to provide guidance on how this discretion should be exercised.

PART IV
SHOULD THE COURTS HAVE A POWER TO AWARD COMPOUND INTEREST?

4.1 Here we consider the main arguments for and against granting the courts a power to award compound interest on debts and damages. We conclude that the courts should have such a power. Later parts consider more specific questions about which cases the power should extend to, and how it should be exercised.

THE ARGUMENT FOR A POWER TO AWARD COMPOUND INTEREST

4.2 As we said in the Consultation Paper, "the obvious reason for awarding compound interest is that it reflects economic reality":

> If a claimant should have had the money earlier, and in fact had it later, he or she has either missed an opportunity to invest it, or had to borrow to cover, in either case at compound interest.[1]

4.3 Compound interest is important in long-running claims, particularly those in which the loss occurred more than fifteen years before payment. Compound interest is also important when interest rates are high. A system which limits interest to simple interest will tend to either over-compensate claimants in short cases, or under-compensate them in long cases (or both).

4.4 The principle of compound interest drew wide support from all categories of respondents, including academics, practitioners, judges and insurers. For example, the Law Society stated that "simple interest never provides a full indemnity for the loss to the litigant". The International Underwriting Association agreed:

> The current legal position allowing for only simple interest (in the majority of cases) can be inequitable for both consumers and insurers alike. The consumer awaiting payment could have used the money owed to them for investment or borrowing purposes, thus in effect gaining interest on their interest. For insurers it is clear that, presently, the rate of simple interest can often lead to over-payments in cases with short disposal times.

4.5 The Bar Council felt that it was necessary to respond to commercial reality to maintain confidence in the legal system:

> The introduction of a power to award compound interest would remove one of the blots on the English civil justice system. At present, Claimants are justifiably aggrieved to learn that the law has deliberately set its face against awarding them compensation for what everyone recognises to be the full extent of their losses. This brings the law into disrepute.

[1] Compound Interest, Consultation Paper No 167, at para 4.1.

4.6 Several respondents drew our attention to arbitration practice, where compound interest is regularly awarded. It was argued that there was no reason why the powers of the courts and the powers of arbitrators should necessarily be the same.[2] However, the fact that arbitrators already have and use the power to award compound interest – apparently without ill-effect – encourages us to think that the courts should be allowed to do so too.

THE ARGUMENTS AGAINST A POWER TO AWARD COMPOUND INTEREST

4.7 Although the great majority of respondents supported a power to award compound interest, five respondents opposed the idea, while several others sounded notes of caution or concern. They put three arguments against our provisional proposals.

(1) The first, and most important, argument was that compound interest would be unduly complex to calculate. It was feared that it would increase legal costs and could lead to unnecessary disputes. Although only two respondents felt that compound interest would be so complex that it should never be permitted, many judges and others stressed the importance of ensuring that any new system would be simple and easy to operate.

(2) Secondly, it was argued that granting claimants compound interest would add to defendants' costs. The greatest effect of compound interest is in the longest running cases, which in practice tend to be clinical negligence cases.[3] Clinical negligence defendants opposed compound interest on the grounds that it would add to National Health Service expenditure.

(3) Finally, clinical negligence defendants and the Government expressed concern that in some circumstances compound interest may present claimants with an incentive to delay settlement.

4.8 We do not consider that these concerns should prevent the courts from having the power to award compound interest. However, we do take them seriously and we have borne them in mind in deciding how compound interest should be introduced. We discuss them in more detail below.

Undue complexity

4.9 When the Law Commission considered the issue of interest in 1978 we rejected compound interest on the grounds that it would lead to "undesirable complications".[4] The world has changed. We now live in an age of widespread access to computers, in which people's ability to carry out complex mathematical calculations has been transformed.

[2] Some arbitrators pointed out that arbitration was based on agreement between the parties. It was open to the parties, as "men of commerce", to confer greater powers on their arbitrators than those granted to the courts.

[3] See Appendices D & E, below.

[4] See Interest (1976) Working Paper No 66, para 114 and Report on Interest (1978) No 88, para 156.

4.10 That said, we do need to pay careful attention to the practical difficulties. Not everyone has access to a computer. Access is especially difficult for those standing in court corridors, attempting to negotiate last minute settlements.

4.11 Furthermore compound interest has the potential to generate disputes. Unlike simple interest calculations (which, if done correctly, produce the same figure), compound interest can be calculated in several different ways. The outcome will depend, for example, on whether one uses annual, quarterly or monthly rests, and whether rests occur on a set date (such as 1 January each year), or on the anniversary of the start of the debt. Different people, calculating compound interest according to different rules, will come up with different figures. A judge told us that this was already a problem when mortgage lenders and borrowers arrive at court each brandishing computer printouts showing that different amounts are owed.

4.12 The practicalities depend on who carries out the calculation. There are three possibilities: that interest should be calculated by the judge; by a court official; or by the parties themselves. We look at each in turn.

Calculations by judges

4.13 The Consultation Paper suggested that, when giving judgment, a judge might turn on a computer programme and type information onto a computerised form.[5]

4.14 Most of the judges who responded to the paper criticised this suggestion. They argued that typing should not be regarded as a judicial function. They feared that the computer programme would not work. They thought that valuable court time would be wasted as judges type figures in front of the assembled parties. Finally, the court would have no way of verifying the figures.

4.15 We can understand judges' reluctance to type figures into a computer programme at the end of a case, while the parties wait before them. Where judges lack confidence in their typing or computer skills, they fear that this would lead to embarrassing and potentially costly delays. We accept that if compound interest is to be introduced, some other way of carrying out the calculations must be found.

Court officials

4.16 The Consultation Paper suggested that, where interest calculations were too complicated to be made at the time of judgment, they could be referred to a court official for assessment.[6]

4.17 Judges were unanimous in rejecting this possibility. They told us that court staff were already overworked, and urged us to "take account of the realities of court resources and tight budgetary controls". It was argued that the judgment given at trial should be immediate and final. The parties would have "legitimate grounds for complaint" if delays in calculating interest meant that judgments were routinely postponed.

[5] Para 4.53(e).

[6] Para 4.12.

4.18 We sympathise with the desire to produce final judgments at the end of the case, and we do not wish to add to delays. We agree that calculations should normally be carried out before judgment, rather than by court staff after judgment.

The parties

4.19 The only realistic possibility is that the parties calculate compound interest, either themselves or through their legal representatives. Where the claimant seeks a judgment for compound interest, the onus should be on them to present the calculations to the court.

4.20 Organisations representing the legal profession supported compound interest and suggested that lawyers could carry out calculations without undue difficulties. The Personal Injuries Bar Association, for example, explained that representatives already took responsibility for interest calculations:

> On a practical note, in our experience, it is very rare indeed for a judge to undertake interest calculations himself. While judges are frequently asked to rule on points of principle in relation to interest, the calculations are always undertaken by the parties' representatives.

4.21 However, we accept the arguments put to us that compound interest is not suited to every case. The Council of Circuit Judges civil sub-committee argued that many litigants in person would have problems with compound interest. Furthermore, in all small claims, most fast track cases and many multi-track cases the amount of money at stake would not be worth the additional trouble. The Association of District Judges agreed:

> The vast majority of cases involve relatively small amounts of money, and are disposed of quite quickly, usually within one year. Most Claimants, we anticipate, would prefer to avoid the complications of computing compound interest by whatever method, and both Claimants and Defendants would prefer not to get involved in a dispute about its calculation.

4.22 We accept that not all claimants will want to carry out compound interest calculations. For example, a large creditor organisation explained that their billing systems could only cope with simple interest, and that it would be too expensive to switch to compound interest. This should not prevent claimants from having the option to claim compound interest in suitable cases. In Part V we argue that compound interest is most appropriate in claims of £15,000 or more, which have been outstanding for at least a year.[7]

4.23 We have concluded that compound interest would not be unduly complex, provided that it were used at the request of the claimant in suitable cases, with the claimant bearing responsibility for its calculation. It is important to stress that claimants would have a choice. They would not be required to calculate compound interest if they do not think it is worth their while.

[7] See paras 5.29 – 5.40, below.

The cost to defendants

4.24 The main impact of allowing compound interest will be to permit a more accurate measure of loss in large commercial actions. As discussed in Appendix D, it will very rarely affect debt actions brought against individuals.

4.25 The cost effect on personal injury cases is complex, because interest rules apply differently to the separate heads of damages. This matter is discussed in detail in Part VII, below. In summary, future loss carries no interest; non-pecuniary loss normally carries interest at 2% from the date of claim; and past pecuniary loss often carries interest at half rate, to allow for the fact that losses arise gradually over time. We recommend that compound interest should only apply to past pecuniary losses (which we estimate represent around 16% of total damages in larger claims). This means that the cost of compound interest only starts to become significant in very long running claims, in which the delay between loss and settlement is 15 years or more. In practice, these tend to be clinical negligence claims where the claimant is a child or under a disability, and so is not time-barred in bringing an action. We discuss the figures in paragraphs 7.30-7.43 and Appendix E.

4.26 Where clinical accidents have forced claimants to borrow, or have deprived them of the opportunity to save, they will have lost interest at compound rates. As a matter of principle, compound interest would be a more accurate measure of the loss. However, the burden of the changes will fall primarily on the health service. Whether this is a loss that the taxpayer should meet is a matter of political judgement. If the Government were to decide that compensating accident victims for their loss of investments was not a priority for public expenditure, it would be possible to exempt past clinical negligence claims from the compound interest regime.

The effect on delay

4.27 A few respondents expressed concern about the effect of interest on delay in bringing proceedings to court. The National Health Service Litigation Authority, for example, suggested that the introduction of compound interest would "provide a financial incentive to claimants' representatives to delay settlement". They feared that initiatives introduced to increase the speed of settlement would "be stopped in their tracks and possibly reversed".

4.28 There are many factors influencing delay in court proceedings, including legal costs, bargaining tactics and procedural complexity. In analysing the causes of delay, Lord Woolf suggested that

> In the majority of cases the reasons for delay arise from failure to progress the case efficiently, wasting time on peripheral issues or procedural skirmishing to wear down an opponent or to excuse failure to get on with the case.[8]

[8] *Access to Justice: Interim Report to the Lord Chancellor on the Civil Justice System in England and Wales* (1995) p 13.

4.29 Lord Woolf pointed out that delay sometimes benefited legal advisers, by increasing costs and allowing them to carry excessive caseloads "in which the minimum possible action occurs over the maximum possible timescale".[9] Delays fed on delays, producing a culture in which opposing sides' legal advisers tended to be "indulgent to each other's misdemeanours", and time-wasting was "too often condoned by the courts".[10]

4.30 Given the many and varied factors influencing delay, we do not think that interest rates have any great influence in either direction. This view was largely confirmed by the results of a questionnaire sent to professional and commercial organisations in January 2000.[11]

4.31 That said, in so far as interest rates do influence the time taken to conclude cases, they have a dual effect. Where interest rates are too high, they encourage claimants to postpone settlement in the hope of gaining a windfall investment. Where interest rates are too low, they encourage delay by defendants, who are effectively "borrowing" at cheap rates. To encourage early settlement, the ideal rate would be neutral – that is, one that replicates commercial reality sufficiently closely to provide no strong incentive in either direction. Our policy is to replicate commercial reality as far as is possible within a reasonably simple and certain system. We wish to do this primarily because it would be fair and seen to be fair, rather than because it would necessarily reduce delay. In so far as interest does influence the timing of settlements, however, we think the effect would be beneficial.

4.32 At present, the courts may use interest as a sanction against obvious and deliberate delay. Under the general statutory provisions, judges have discretion to disallow interest during a period of delay by the claimant, or to increase the rate during a period of delay by defendants. Recent decisions suggest that the courts are fully prepared to reduce interest payments where claimants are responsible for unwarranted delay.[12] We think interest-reduction is a useful weapon in the armoury to prevent delay, and we intend that this discretion should continue. The risk of losing interest should counter-balance any incentive that our proposals may give to claimants to delay settlement.

OUR CONCLUSIONS

4.33 The Consultation Paper summed up the arguments for and against reforms as follows:

> In the end, the question is a fairly narrow one. Compound interest is undoubtedly more correct in principle, but the practical gain may or may not be significant enough to justify the effort of the change.

[9] *Ibid*, p 12.

[10] *Ibid*, p 13.

[11] See Consultation Paper No 167, para 4.5.

[12] See *Spittle v Bunney* [1988] 3 All ER 1031, *Corbett v Barking, Havering and Brentwood Health Authority* [1991] 2 QB 408 and *Beahan v Stoneham* 2001 WL 272888. See also para 7.43, below.

4.34 Most respondents agreed with our provisional conclusion that the practical gains did outweigh the problems. As Lord Justice Dyson put it

> The present rough and ready system produces a reasonably just solution in many cases, but where the sums involved are large and the period of time in question is long, the awarding of simple interest can work a real injustice.

4.35 We agree with the Bar Council that the present system can leave litigants feeling aggrieved that rules of interest took no account of the commercial realities in which they operate. Interest can be substantial – and may run into tens of thousand of pounds.[13]

4.36 **We therefore recommend that the courts should be granted a power to award compound interest.**

4.37 It is important to be alive to the practical difficulties. In particular, any system should meet the following conditions:

(1) Wherever possible the calculations should be carried out by the parties themselves.

(2) Compound interest needs to be calculated in a prescribed way, so as to prevent unnecessary disputes about the calculations. We discuss this in more detail in Part VI.

(3) Compound interest should only be granted where the amount involved justifies the time taken to calculate it. We accept that in some small, short cases the effort may be disproportionate to the sum at stake. We return to this issue in Part V.

4.38 The main impact of compound interest is that it will provide a more accurate measure of loss in large commercial claims. In personal injury claims, the only significant impact will be in the longest running claims. In practice this means clinical negligence cases involving delays of 15 years or more from loss to payment. The cost of paying compound interest in long-running clinical negligence claims is explored in detail in Part VII and Appendix E.

[13] Harvey McGregor QC drew out attention to the patent case, *General Tire & Rubber Co v Firestone Tyre & Rubber Co* [1975] 1 WLR 819, in which the lower courts awarded £458,000 interest on a damages award of £930,000. The House of Lords reduced the damages award to £215,000 but still awarded £96,000 interest.

PART V
WHEN SHOULD COMPOUND INTEREST BE GRANTED?

5.1 In this Part we consider when a power to award compound interest should be used. This may be divided into three questions:

(1) Should the power be limited to (or exclude) any particular categories of claim?

(2) Assuming a general discretionary power to award compound interest, should that discretion be open, or be guided by a presumption in favour of (or against) compound interest?

(3) How should the power be implemented? Should it be confined to section 35A of the Supreme Court Act 1981 and section 69 of the County Courts Act 1984, or should it also apply to other powers to award interest?

A GENERAL OR LIMITED POWER?

5.2 The majority of respondents agreed with the proposal in our Consultation Paper that compound interest should be available in the generality of cases. Most thought it would be unduly confusing to create a two-tier system with an arbitrary cut-off point. The Bar Council's views were typical:

> the power to award compound interest should be available in all cases. The alternative, of having two separate interest regimes for two separate categories of cases, would inevitably led to unjustifiable anomalies and possibly also to a waste of time and effort spent in resolving disputes as to whether a particular case fell into one category or another.

5.3 Only six respondents thought that compound interest should be limited by subject matter, and there was little agreement between them about what those limits should be.

5.4 The main limitations we explored were to limit compound interest to large and long running cases; to limit it to debts rather than to damages; and to exclude consumer claims. Below we explain our reasons for rejecting these limitations.

Only large or long-running cases?

5.5 Most respondents saw no reason to limit the power to award compound interest to large or long-running cases. The Law Society argued that "there is no reason why compounding should only be done on longer, complex cases and the Society is of the view that it would be difficult to define such cases". The British Maritime Law Association made the same point: "compound interest is required to do justice in all cases – not just long running cases – and the amount involved in the litigation should be irrelevant in this context".

5.6 That said, the proposal in our Consultation Paper for compounding with annual rests meant that only claims for a year or more would be affected by our proposals. If we were to introduce monthly rests, there is a case for excluding all claims of a

year or less, where the benefit of compound interest may be insufficient to justify the costs of calculations.

5.7 A few respondents highlighted the particular difficulties of small claims. It was pointed out that where losses arose at different times or (as with business rent) continuously over a long period, interest calculations could be complex. Court time was already wasted in doing last minute calculations, and respondents did not wish to exacerbate the problem.

5.8 We accept that there will be many cases where the amount of money at stake is simply not worth the time and trouble of the calculations. These cases, however, could be dealt with through the appropriate use of the court's discretion, rather than through a statutory limitation on the court's powers.

Debts rather than damages?

5.9 The Consultation Paper pointed out that several foreign jurisdictions award compound interest more readily on debts rather than damages.[1] The argument was that compound interest should only run on fixed sums. Where the court has not yet determined the amount to be paid, the defendant could not be said to be wrongfully withholding the money and should not have to pay compound interest. We thought that this misunderstood the nature of the interest award, which is to compensate the claimant for the delay, rather than to penalise the defendant. We therefore provisionally proposed not to make a distinction between debts and damages.

5.10 With the exception of clinical negligence defendants, most respondents agreed with us. Those who responded on this issue pointed out that the greatest demand for compound interest often arose in commercial damages claims, especially in cases for misuse of intellectual property. Furthermore, a distinction between debts and damages would prove arbitrary and difficult to apply. The *Westdeutsche* case,[2] a claim for restitution, was a case that straddled this divide.

5.11 We agree that the power to award compound interest should not be confined to debts, but should also cover damages. The objective of compound interest is to compensate claimants for the costs they incurred in being kept from their money, and this applies equally to damages as to debts. In practice, our recommendations will have a greater impact on damages claims than on debt claims because damages claims are not covered by the Late Payment of Commercial Debts (Interest) Act 1998.

5.12 On the other hand, some respondents suggested that we should distinguish between pecuniary and non-pecuniary loss. Non-pecuniary damages are awarded in a variety of different actions, including defamation, fraud and some breaches of contract. They may compensate for disappointment, injuries to feeling, physical discomfort or disappointment. They are assessed as global sums to provide a rough approximation for losses than cannot be fully quantified in monetary terms. In defamation and fraud claims it has been held that they should not carry

[1] Consultation Paper, paras 3.3 and 3.7.

[2] *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669.

interest.[3] Non-pecuniary damages are assessed to be broadly correct at the time they are made, to cover both past and future loss. They are not necessarily the same as the sum that should have been paid at the time the cause of action arose.

5.13 In personal injury cases, the statutory provisions require the courts to award interest, unless there are special reasons not to.[4] This has led to the development of a special rule for the treatment of non-pecuniary awards in personal injury claims, which states that non-pecuniary damages should carry interest at 2% from the date of service of the claim form.

5.14 We agree that in most forms of action, damages for non-pecuniary losses should not carry interest. It therefore follows that they should not carry compound interest. In Part VII we consider whether compound interest should be awarded on non-pecuniary damages in personal injury claims. We conclude that it should not. There is no clear principled case for any form of interest. In practice, the interest payments are so small (only 2%) and for such short periods (since service) that the amounts at stake hardly justify the calculation.

Excluding consumer debts?

5.15 The Consultation Paper asked whether compound interest might bear unduly harshly on consumer debtors, who are unable rather than unwilling to pay. Generally, there was little support for making special provision for consumer debt, which was thought to introduce arbitrary and unnecessarily complex distinctions. However, the Department for Constitutional Affairs urged us to ensure that any recommendations in favour of compound interest do not exacerbate social exclusion.

5.16 We can understand that compound interest evokes deep-seated fears. Where people are too poor even to service a loan, interest can become "a slippery slope to a situation of hopeless debt".[5] Where interest is compound, interest increases in an exponential rather than a linear way, which can make the calculation appear frightening and unpredictable.

5.17 To allay these fears, it is important to understand how interest payments affect poor debtors at present. As described in Part II, in most loan claims, consumers already pay compound interest (often at high rates). Contracts for mortgages, bank loans, credit cards and store cards already routinely charge compound interest. Unless the rates are extortionate, the courts will not interfere with the operation of the market. In other poverty debts, on fuel or rent for example, interest is seldom charged at all. Following our recommendations, interest awards will remain discretionary. It will always be open to a court not to award any interest, or only to award it at a low rate.

5.18 Interest on fuel debts is subject to multiple layers of law and regulation. It is up to utility companies to decide whether to require interest on debts within their

[3] *Saunders v Edwards* [1987] 1 WLR 1116. See also McGregor on Damages (17th ed 2003) para 15-054.

[4] Supreme Court Act 1981, s 35A(2) and County Courts Act 1984, s 69(2).

[5] See Consultation Paper 167, para 4.10.

contractual terms. Any such terms must comply with Ofgem regulation, and may (subject to the views of the regulator) be at either simple or compound rates. The court is bound to honour an acceptable contractual term, and to order interest at the rate specified. If a utility fails to specify interest as a contractual term, the court has a discretion whether to allow statutory interest under section 35A. In practice, fuel debt is often an indicator of extreme poverty, as families struggle to pay for the necessities of life.[6] In these circumstances, courts will usually exercise their discretion against ordering interest, especially where the creditor could but failed to specify interest as a contractual term.

5.19 For example, British Gas told us that, under the terms set by Ofgem, gas and electricity companies are allowed to charge customers interest at the rate of 3% above base if they fail to respond to a reminder. The interest is payable from the date that payment was due to the date on which payment is received. In practice, British Gas charges interest to commercial customers, but does not charge domestic customers on the grounds that it may provoke an "adverse customer reaction". We understand that in the absence of any contractual term it would be rare for a court to award interest.

5.20 As far as rent arrears are concerned, we gleaned some indication of existing practice from a 1996 research report into rent arrears. This suggested that most rent arrears were of relatively short duration: eight out of ten tenants owed less than six months' rent and only one in twenty tenants owed more than 12 months' rent.[7] Judges exercised considerable discretion in deciding whether (and on what terms) to grant suspended possession actions, with little evidence that they ever imposed interest on rent arrears.[8]

5.21 Thus we do not believe that granting the courts the power to award compound interest would exacerbate the problems of poor debtors. In loan cases they already pay interest at compound rates. In other "poverty debt" cases, for rent or fuel arrears for example, the courts will generally exercise their discretion not to charge interest at all. Most other claims will be too small or dealt with too quickly to be worth calculating compound interest.[9] In those few cases in which it is imposed, the amounts would be small.

5.22 In conclusion, we wish to avoid fixed and arbitrary distinctions and see no reason to exclude consumer debts from the general power to award compound interest. However, as discussed above, the power will only be invoked against consumers in rare circumstances. The overall effect of our main recommendations (to set a specified rate and to allow compounding) will be to reduce the interest paid in debt actions brought against individuals.

[6] See R Berthoud and E Kempson, *Credit and Debt: the PSI Report* (1992).

[7] J Nixon, C Hunter, Y Smith and B Wishart, *Housing Cases in the County Courts* (1996) Policy Press, p 14.

[8] *Ibid*, pp 49-51. This was confirmed by the three District Judges we spoke to.

[9] See Appendix D.

DISCRETION: OPEN OR SUBJECT TO PRESUMPTIONS?

5.23 Assuming a general power to award compound interest, the Consultation Paper explored four possible ways in which that power could be framed. The options were

(1) a presumption in favour of simple interest, with a power to award compound interest where there were good reasons for it;

(2) a power for the courts to award either simple or compound interest as they saw fit, without any statutory indications that one was to be preferred over the other;

(3) a presumption in favour of compound interest, with a power to award simple interest where there was little difference between the two;

(4) a fixed rule that where interest is awarded at all it must be compound.

5.24 We rejected Option 4, on the grounds that it would import excessive complications into small cases. We expressed concerns about Option 2, as its effect would be uncertain. It might provide parties with another cause of dispute. In particular, defendants might find it more difficult to calculate an appropriate Part 36 offer (and claimants may find it more difficult to decide when to accept).

5.25 We concluded that the main choice was between Option 1 (a presumption in favour of simple interest) or Option 3 (a presumption in favour of compound interest). Our provisional proposal favoured Option 3, on the grounds that computer programmes would allow compound calculations in most cases.

5.26 During consultation, no one favoured a fixed rule, but strong arguments were put in favour of the three remaining options.

(1) Many barristers and solicitors involved in high-value litigation supported a presumption in favour of compound interest.

(2) Circuit judges, district judges and masters expressed concern about routine cases, especially where litigants were unrepresented, or where the representatives had not prepared the relevant calculations. They saw advantages in a presumption in favour of simple interest, especially in low value cases.

(3) Finally, several members of the higher judiciary wrote to recommend that the legislation should only give a general unfettered power. They thought that appropriate guidance could be established through practice directions or appellate court decisions. Lord Woolf, for example, suggested that the court should have a general discretion, with further guidance "best left to be dealt with by a practice direction or the decisions of the court".

5.27 Respondents highlighted three reasons for preferring simple interest to compound interest in any given case. These were

(1) to protect poor consumers

(2) to discourage claimants from deliberately delaying claims; and

(3) to avoid the cost of calculating compound interest where the difference between simple and compound interest did not justify it.

5.28 In most cases, however, the main way of protecting poor consumers is not to award interest at all (or only at a very low rate). The main way to discourage delay is for courts to exercise their existing discretion to award interest for only part of the period from cause of action to judgment or payment. The essential reason for preferring simple to compound interest lies in the cost of calculation. It therefore follows that there should be a presumption in favour of compound interest where the difference between the two is significant, and in favour of simple interest where the difference is insignificant.

A dual system

5.29 Several respondents suggested a dual system, in which the nature of the presumption would depend on the size of the award. For example, the Council of Circuit Judges suggested that simple interest should always be used in small claims (of £5,000 or less) where many litigants were unrepresented. They thought that simple interest should also be used in fast track claims of £15,000 or less. They gave three reasons: fast-track claims were usually fairly quick (concluded within a year of issue); trial time was strictly limited to one day, including judgment and summary costs; and saving litigation costs was a clear priority. The Council pointed out that many multi-track claims were also of small value, and would have been tried in the fast track if they could have been scheduled within a day.

5.30 A few people therefore suggested a presumption in favour of simple interest on awards of £15,000 or less, with a presumption for compound interest on awards of more than £15,000.[10] The distinction can be justified on the grounds that the award is too small to justify the cost of calculation; that cases below £15,000 are generally dealt with quickly; and that costs should be proportionate to the amount at stake.

5.31 Of course, it is difficult to lay down hard and fast rules, based only on the size of the award. The difference between simple and compound interest depends partly on the overall amount, partly on the length of time, and partly on the rate of interest. In most small to medium cases, the difference between simple and compound interest will be relatively small. As an indication, on a three-year case worth £15,000, at 6% interest, the difference between simple and compound interest (with monthly rests) would be £250. We are keen to introduce a system that is simple and easy to operate and (at least at first) confines compound interest to cases where the amount of money at stake is clearly worth the cost of calculation.

5.32 The Consultation Paper recommended compounding with annual rests. We thought that one of the main advantages of annual rests is that they would effectively remove any debt or damages outstanding for less than one year from the effects of compound interest. Most consultees agreed that this would be desirable.

[10] The Council of Circuit Judges, Judge Critchlow and District Judge Davidson suggested that the cut off should be around £15,000. Trevor Aldridge QC suggested a cut off at somewhere between £5,000 and £25,000.

In Part VI, we recommend using monthly rests, which means that any practice direction would need specifically to exclude debts or damages of one year or less in order to achieve the same effect.

Our favoured approach

5.33 We have been persuaded by the arguments put by senior judges that any guidance on how the power to award compound interest should be exercised would be best set out in the form of a Civil Procedure Rules and practice directions rather than in legislation. This would be much more flexible. One could learn from experience, and adapt to changing circumstances. A substantial rise in base rates, for example, would alter the balance in favour of compound interest.

5.34 We recommend that the Civil Procedure Rules should draw a distinction between awards or settlements of less than £15,000 and those of £15,000 or more. For those of less than £15,000, there should be a presumption that interest should be simple. This could be rebutted if the claim has been particularly long-running, or the claimant can show special reasons for compound interest, such as having to borrow money at compound rates. In claims of £15,000 or more, there should be a presumption in favour of compound interest, unless the claimant asks for simple interest, or there are other special reasons why simple interest would be more appropriate.

5.35 The £15,000 figure may need to be changed at some stage in the future, either because it has been eroded by inflation, or because the fast-track limit has been altered. The fact that the limit is contained within rules of court will allow the guidance to be kept up-to-date.

5.36 We do not think that it is normally worth calculating compound interest on payments outstanding for less than a year, however large. If annual rests were used, such payments would be excluded automatically. With monthly rests, the Civil Procedure Rules should exclude compound interest on any debts or damages that have been outstanding for less than a year, unless the claimant can show exceptional reasons why interest should be compounded. This would remove from the scheme many claims where the difference between simple and compound interest would be too small justify the additional complexity. For claims of a year or more, compound interest would be paid on the full life of the debt.

5.37 We envisage that a practice direction would also set out details of the evidence that claimants should file. For example, Lord Justice Dyson suggested that it might require the claimant to file an interest calculation with every schedule of loss, together with an up-to-date calculation at trial. The Association of District Judges suggested that in claims below £15,000, claimants should only receive compound interest if they specifically plead it in their particulars of claim. Whilst we would not wish to be overly formalistic, we think that a practice direction should include appropriate rules about pleading and filing evidence, based on judges' and lawyers' experiences.

5.38 The Civil Procedure Rule Committee should have power to provide the courts with guidance on when to award compound interest.

5.39 The rules should draw a distinction between awards or settlements of less than £15,000 and those of £15,000 or more. For the former, there should be

a rebuttable presumption that interest will be simple; for the latter there should be a rebuttable presumption that it will be compound.

5.40 The rules should exclude compound interest on any debts or damages that have been outstanding for less than a year, unless the claimant can show exceptional reasons why interest should be compounded.

THE SCOPE OF OUR RECOMMENDATIONS: WHEN SHOULD THE POWER TO AWARD COMPOUND INTEREST APPLY?

5.41 The simplest way of introducing a power to award compound interest would be to amend section 35A of the Supreme Court Act 1981 and section 69 of the County Courts Act 1984. Here we consider how this would interact with other forms of interest.

The scope of section 35A and section 69

5.42 As discussed in Part II, these sections provide the High Court and county courts with a general discretion to award interest on debts and damages. However, they do not apply when another form of interest "already runs". Under section 35A(4)

> interest in respect of a debt shall not be awarded under this section for a period during which, for whatever reason, interest on the debt already runs.[11]

5.43 This means that if the debt already attracts interest under some other contractual or statutory provision, sections 35A and section 69 are excluded. In particular, they do not apply where interest is already available:

(1) under a contract

(2) as special damages

(3) under a range of other statutes, including the Taxes Management Act 1970 and the Partnership Act 1890.

The interaction with the Late Payment of Commercial Debts (Interest) Act 1998 raises difficult issues and is dealt with below.[12]

5.44 However, sections 35A and 69 exist concurrently with the courts' inherent powers under the Admiralty and equitable jurisdictions. This is because the inherent powers are discretionary: interest does not run until it is awarded by a judge.[13] The

[11] Supreme Court Act 1981, s 35A(4) and County Courts Act 1984, s 69(4).

[12] Paras 5.53 – 5.58.

[13] In respect of the Admiralty jurisdiction, see *The Berwickshire* [1950] P 204 and *The Aldora* [1975] QB 748. As far as the equitable jurisdiction is concerned, in *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, Lord Woolf stated:

> The compound interest will not be payable as of right. The remedy of awarding interest, like other equitable remedies, will be discretionary. Interest will only be awarded when it accords with equitable principles to make the award (at p 722).

court therefore has a choice between making an award under statute or under the inherent jurisdiction.

5.45 It is also important to note that the sections apply only to debts and damages. They do not apply, for example, to unpaid legacies, which are neither debts nor damages. In actions for accounts of legacies, interest is payable under the equitable jurisdiction and has for many years has been governed by rules of court.[14]

Policy considerations

5.46 We have no wish to interfere with contractual agreements. As occurs at present, if a contract provides for pre-judgment interest at a specified compound rate, that rate should be awarded. Similarly, if the contract specifies that only simple interest should be paid, the courts should have no power to award compound interest.

5.47 The Consultation Paper recommended that tax and other comparable schemes should be omitted from the suggested reforms as they had their own dedicated enforcement machinery and there was no reason why it should be changed. Those respondents who addressed this issue agreed. There is a careful balance to be struck between taxpayers and the Revenue over penalties for the late payment of tax and we do not think it appropriate to alter that balance here.

5.48 Similar reasoning applies to other specific statutory provisions on interest. As noted in Part III, claimants differ considerably in how they are affected by late payment. If there are specific provisions that provide the correct compensation in defined circumstances, they should be left alone. If they do not provide the correct compensation, they should be reformed within the context of a review of that particular subject matter.[15]

5.49 During consultation, it was also suggested that we should refrain from interfering with interest on wills and unpaid legacies. One particularly difficult area concerns the rules on how trustees should apportion assets and liabilities between life tenants and remaindermen.[16] The Trust Law Committee has commented that the rules "are complex, calling for detailed calculations" yet often "yielding small amounts".[17] Fears were expressed that the introduction of compound interest could cause further, unwarranted complications.[18] The Law Commission has been

[14] We have traced these provisions back to 1955 (Order 55 rule 64). The present rules are contained in Practice Direction 40, para 15.

[15] The Law Commission has recently carried out reviews of partnership law and compulsory purchase. See Report on Partnership Law (2003) Law Com No 283; Scot Law Com No 192 and Towards a Compulsory Purchase Code: (1) Compensation – Final Report (2003) Law Com 286.

[16] Cases concern wasting assets (*Howe v Earl of Dartmouth* (1802) 7 Ves 137, 32 ER 56 and *Dimes v Scott* (1828) 4 Russ 195, 38 ER 778) and future assets (*Re: Earl of Chesterfield Trusts* (1883) 24 Ch D 643).

[17] Trust Law Committee, Capital and Income of Trusts, A Consultation Paper (1999). See http://www.kcl.ac.uk/depsta/law/tlc.

[18] Particular concern was expressed about the rule in *Allhusen v Whittell* (1867) LR 4EQ 295, which attempts to balance the interests of life tenants and remaindermen when paying debts out of the estate. This is already regarded as overly complex, causing disproportionate work and expense. It was suggested that the application of compound interest would further

asked to considering simplifications to these rules as part of its project on apportionment and we do not deal with these issues here.

5.50 As far as the Admiralty and equitable jurisdictions are concerned, we are content for the inherent and statutory jurisdictions to continue to operate alongside each other. We expect that the great majority of interest awards will continue to be made under section 35A. For Admiralty cases, this would be the only way in which compound interest could be awarded. In some equity cases, however, the inherent equitable jurisdiction may offer a more flexible way of awarding compound interest. For example, where a trustee has misapplied trust income, the court can order repayment of the interest actually gained, using whatever rests interest had been compounded at.[19] Similarly, courts would continue to be able to award interest as special damages, without being subject to any of the restrictions imposed by statute.[20]

5.51 Thus an amendment to section 35A and section 69 would have the desired effect. It would allow compound interest to be awarded on a wide variety of debts and damages, without interfering with contractual interest, specific statutory regimes or legacies. As far as the equitable jurisdiction is concerned, the statutory and inherent jurisdictions would continue to exist alongside each other.

5.52 This leaves only two remaining issues about the scope of our recommended power to award compound interest. First, how would it interact with the Late Payment of Commercial Debts (Interest) Act 1998? Second, is there a need to reform section 3 of the Law Reform (Miscellaneous Provisions) Act 1934? Below we consider each question in turn.

Late Payment of Commercial Debts (Interest) Act 1998

5.53 As described in Part II,[21] the 1998 Act covers business to business debts for the supply of goods and services. Originally the Act only protected small businesses, but since August 2002 it has been available to all commercial creditors. It provides a particularly high rate of interest (8% above base). The rate is simple rather than compound.

5.54 The interest rate is set to reflect the type of rate that may be charged on short-term distress lending to highly vulnerable businesses. Where both parties are large, successful businesses, the rate cannot be said to purely compensatory. It would appear to have some penal element in that it is designed to discourage delay rather than compensate claimants for their loss. It is likely to prove particularly advantageous to creditors in large long-term disputes, where the sums involved

complicate the calculations. See also *Re: Perkins* [1907] 2 Ch 596, which sets how the costs of annuities are to be apportioned.

[19] Our own proposals would restrict statutory compound interest under section 35A to monthly rests: see paras 6.18 - 6.23, below.

[20] For example, one could mirror the costs actually paid by the claimant so as to permit simple interest for part of the period and compound interest for the rest of the period. We recommend that this should not be permitted under statute: see paras 6.30 – 6.31 below.

[21] See paras 2.37 – 2.43, above.

could prove substantial.[22] As the payment is not intended to compensate claimants for an actual loss, we see no reason for it to be compound. In short cases, compound interest would add undue complexity, and in prolonged disputes the rate of interest would be too high.

5.55 Technically, where the 1998 Act applies, the courts' general powers to award interest under section 35A and section 69 are ousted. This is because, under the 1998 Act, the right to simple interest is treated as an implied term of the contract.[23] Interest "starts to run" from the relevant date,[24] without requiring any specific action by the creditor. Where interest "already runs", section 35A(4) states that "interest in respect of a debt shall not be awarded under this section".[25]

5.56 Despite these technical problems, it appears that the courts continue to award interest at 8% under section 35A and section 69, rather than the 8% over base (currently 11.75%) permitted by the 1998 Act. In our visit to Central London County Court we found many cases which seemed to be eligible for late payment interest under the Act, but where the claimant had instead asked for interest at 8%. The courts routinely grant the claimant's request, even though they appear to have no power to do so.

5.57 We think this practice should be regularised. Claimants should have the choice to forego late payment interest if they wish and instead claim interest under the court's general statutory powers. Under the reformed scheme, section 35A and section 69 will permit compound interest while the 1998 Act will grant only simple interest. It will therefore be possible for a claim under the general statutory powers to be higher than a claim under the 1998 Act. Clearly, this will be unusual, but it may occur where the claimant has been forced to borrow at particularly high rates over an extended period.

5.58 We recommend claimants should be entitled to forego interest under the Late Payment of Commercial Debts (Interest) Act and instead claim interest under the courts' general statutory powers.

Law Reform (Miscellaneous Provisions) Act 1934, section 3

5.59 In tracing the history of pre-judgment interest, we described section 3 of the Law Reform (Miscellaneous Provisions) Act 1934.[26] This provision has not been

[22] The Act permits interest to run for the full limitation period (up to six years) before proceedings are issued, and for however long thereafter it takes for the claim to come to trial or settlement. Given that the Act was only extended to large businesses in August 2002, the courts have not yet experienced its use in large long-running commercial litigation. It may be that over the next five years, interest payments in commercial disputes over debts (rather than damages) will increase substantially – from the 1% over base currently deemed to be appropriate, to the 8% over base granted by the Act. The implications for commercial litigation have yet to be felt.

[23] Late Payment of Commercial Debts (Interest) Act, s 1(1).

[24] Late Payment of Commercial Debts (Interest) Act, s 4(2). The relevant date is defined as the agreed date for payment (unless the obligation is for advance payment) or, where there is no agreed date, 30 days from performance or invoice, whichever is the later (s 4(3) and (4)).

[25] See also County Courts Act 1984, s 69(4), which is in identical terms.

[26] See paras 2.4 – 2.6, above.

repealed entirely. It has been replaced for the High Court by section 35A, and for county courts by section 69. However, section 3 continues to apply to any other "court of record"[27] that hears cases for the recovery of debts or damages and that does not possess its own specific interest granting powers. The section only covers cases that are tried (rather than settled) and any interest awarded under it must be simple.[28]

5.60 We have found it difficult to identify courts that use section 3. Most courts that hear cases for debts have their own provisions. For example, the Court of Appeal does not rely on it. Instead, Civil Procedure Rule 52.10(1) provides that "in relation to an appeal the appeal court has all the powers of the lower court". Under rule 52.10(2)(d) this specifically includes "the power to make orders for the payment of interest".

5.61 The main courts to which section 3 applies would appear to be the Employment Appeal Tribunal and the House of Lords.

5.62 The Employment Appeal Tribunal (EAT) is declared to be a "superior court of record" by statute.[29] It may exercise any of the powers of the employment tribunal from which the appeal is brought.[30] Employment tribunals are not courts of record and their powers to award interest are limited to those set out in regulations. There are two main provisions on interest. Under the Industrial Tribunals (Interest) Order 1990,[31] employment tribunal awards attract simple interest automatically at the judgment rate if they remain unpaid 42 days after the tribunal's decision. Under the Employment Tribunals (Interest on Awards in Discrimination Cases) Regulations 1996,[32] employment tribunals also have discretion to award simple interest on awards in discrimination cases from the time the discrimination took place, at the special investment account rate. When the EAT exercises this discretion, it would appear to run alongside its general discretion under section 3.

5.63 It is difficult to say how far the various awards made by the EAT can be said to be debts or damages within the meaning of section 3. There is case law to suggest that the phrase should be interpreted widely.[33] It would appear that section 3 applies to

[27] s 3(1).

[28] s 3(1)(a) excludes the granting of "interest on interest".

[29] Employment Tribunals Act 1996, s 20(3).

[30] Employment Tribunals Act 1996, s 35(1)(a).

[31] SI 1990 No 479.

[32] SI 1996 No 2803.

[33] In *The Aldora* [1975] QB 748, Brandon J stated that the words "any debt"

> are, as it seems to me, apt to cover sums, whether liquidated or unliquidated, which a person is obliged to pay either under a contract, express or implied, or under a statute. They would, therefore, cover a common law claim on a quantum meruit, or a statutory claim for a sum recoverable as a debt, for instance a claim for damage done to harbour works under section 74 of the Harbours, Docks and Piers Clauses Act 1847 (at p 751).

In *BP v Hunt* (No 2) BP [1983] 2 AC 352, Lord Brandon adhered to this view, reaffirming that the words "any debt or damages" were very wide and covered "any sum which is

the EAT's contractual jurisdiction, and it is at least arguable that it applies to unfair dismissal awards (and possibly statutory redundancy payments).

5.64 Despite its potential importance, we could find no evidence that the EAT had used section 3.[34] It appears anomalous that the EAT should possess a general discretion to award interest that employment tribunals do not share. It is an issue that the Department of Trade and Industry may wish to review, either by repealing section 3 in so far as it affects the EAT, or by granting employment tribunals a similar power to award interest on debts and damages.

5.65 The House of Lords is not declared to be a court of record by statute, but there is judicial authority to suggest that it is.[35] The House of Lords' powers and procedures are set out in the Appellate Jurisdiction Acts of 1876 and 1887 and in the House's own standing orders, known as the "Blue Book".[36] However, these make no mention of interest. If the House of Lords were to impose its own judgment (as distinct from re-instating the judgment of a lower court), its only power to award interest would be under section 3.

5.66 The only other courts we have identified to which section 3 might apply are minor ones: the Barmote Courts of the High Peak and Wirksworth (which have jurisdiction to deal with some mining disputes) and, possibly, the Admiralty Court of the Cinque Ports.[37] Once the House of Lords has been replaced by the Supreme Court and the EAT's powers have been reviewed, it may be that section 3 has no further uses and can be repealed. For the moment, however, we think that it is worth preserving a reserve power to grant interest that applies to courts other than the High Court and county courts. We see no reason why such a power should apply only to cases that are tried, or should grant only simple interest. We think such courts, including the House of Lords and its successor, should be able to exercise the same powers as the High Court.[38]

5.67 **We recommend that courts of record other than the High Court and County Court which do not have their own interest regime should possess the same powers to award interest as the High Court**.

recoverable under a statute of the kind here concerned" (that is, the Law Reform (Frustrated Contracts) Act 1943) (p 373).

[34] We were unable to find any reported decisions in which the EAT has been invited to exercise its discretion under section 3. Furthermore, as of December 2003, the provision was not mentioned in Harvey on Industrial Relations and Employment Law or Butterworth's Employment Law Handbook.

[35] In *R v Flower* (1799) 8 Term Rep 314, Lord Kenyon CJ stated (at p 323) "that the House of Lords when exercising a legislative capacity is not a Court of Record is undoubtedly true; but when sitting in a judicial capacity, as in the present case, it is a Court of Record" (see also 101 ER 1408, 1413).

[36] House of Lords Practice Directions and Standing Orders applicable to Civil Appeals, November 2002 (as amended 3 April 2003 and 1 July 2003).

[37] Most other courts of record (such as the Crown Court and Courts-Martial Appeal Court) do not hear claims for debts or damages.

[38] See clause 3 of the draft Bill contained in Appendix A.

SUMMARY OF RECOMMENDATIONS

5.68 We recommend that the courts should have a general power to award interest on debts or damages. The power should be implemented as an amendment to section 35A of the Supreme Court Act 1981, and section 69 of the County Court Act 1984. Guidance on how to exercise that power would be set out in rules of court.

5.69 We recommend that, at least initially, the Civil Procedure Rules should draw a distinction between awards and settlements of less than £15,000 and those of £15,000 or more. For the former, there would be a rebuttable presumption that interest should be simple. For the latter, there would be a rebuttable presumption that it should be compound. A practice direction could provide further guidance on what evidence a claimant would need to file, at what stage, to show that they had calculated compound interest correctly.

5.70 We do not think that it is normally worth calculating compound interest on payments outstanding for less than a year, however large. If monthly or quarterly rests are used, rules of court should exclude compound interest on any debts or damages that have been outstanding for less than a year, unless the claimant can show exceptional reasons why interest should be compounded.

5.71 Technically, the courts have no power to award interest under their general statutory powers where the Late Payment of Commercial Debts (Interest) Act 1998 applies. Nevertheless, the courts frequently award interest under section 69 of the County Courts Act 1984, even where a strict application of the 1998 Act would prevent them from doing so. We recommend that claimants should have the choice, it they wished, to forgo interest under the Late Payment of Commercial Debts (Interest) Act and instead claim interest under the courts' general statutory powers.

5.72 Courts of record other than the High Court and County Court which do not have their own interest regime should possess the same powers to award interest as the High Court.

PART VI
CALCULATING COMPOUND INTEREST

6.1 In this part we consider the practicalities of calculating compound interest. We first ask whether there should be a prescribed computer programme or tables. We then consider whether any prescribed system should use annual, quarterly or monthly rests.

COMPUTER PROGRAMME OR TABLES?

6.2 In the Consultation Paper we asked if compound interest should, in practice, be calculated through a computer programme, through tables or in some other way. We provisionally proposed a computer programme that would be common to all courts, suggesting that tables may be "somewhat cumbersome".[1]

6.3 Most of those who responded on this point favoured the creation of a computer programme, which could carry out a wide variety of calculations with minimal difficulties. It was suggested that most lawyers were familiar with using computers, and had ready access to them. The Association of Personal Injuries Lawyers said that a large proportion of their membership already used computer programmes to calculate interest, which could easily be adapted to calculate compound interest. We were also told that the Family Law Bar Association provides its members with a computer programme that can carry out compound calculations.

6.4 Many respondents on the other hand argued that tables should be available as well as or instead of a computer programme. Tables were thought to have two main advantages. First, they were more portable. Lawyers could take them to court for last minute calculations, either in court or at the door of the court. Second, they were transparent. The parties could refer to them and discuss them in the event of a dispute, rather than having to take the sums on trust.

6.5 Those involved in personal injury work were familiar with reading sums from published tables. As one lawyer put it, "we already have the Ogden Tables… and they are brimming over with multipliers". Several judges told us that they would be happy to read appropriate figures from tables, they though would be unhappy to refer to a computer programme. They were used to dealing with tables, and any anomalies or differences of perception could be discussed openly.

6.6 We are convinced that there is a need both for a prescribed computer programme (for complex or unusual calculations) and for prescribed tables (which will be readily accessible in court and during last minute settlements). We set out how each of these would work below.

A prescribed computer programme

6.7 As discussed in Part IV, compound interest calculations may be carried out in different ways to produce different results.[2] It is essential that the potential for

[1] Para 4.52.

[2] See para 4.11, above.

dispute is removed, by prescribing the way that calculations should be done. We see substantial advantages in the Court Service providing a simple, readily accessible computer programme. Lord Justice Dyson commented

> If a programme is used, it is essential that the same programme is used by and is available to, all those involved in the litigation process. One possibility might be to create an interest calculator and to place it on the public pages of the Court Service Website.

We endorse this suggestion. It would not preclude commercial providers from developing their own programmes, using the method of calculation prescribed. We think, however, that the programme should also be provided on a public service basis, so that litigants are not required to pay for access to it.

6.8 **We recommend that the Court Service should produce a computer programme to calculate compound interest and make it readily accessible on its website.**

6.9 The computer programme will perform many calculations that the tables cannot. First, it will give interest calculations that are correct to the day, while the tables (for reasons to be explained) give multipliers on a month by month basis. Second, it will be able to cope with variations from the specified rate. For example, a judge might award compound interest at one or two percentage points above the specified rate on all or some of the damages, for all or some of the period. The programme should be able to cope with this. Third, the programme will be able to deal with complex damages, arising at different times. For example, in personal injury cases it will be able to calculate interest on past losses from the time they arose, rather than assuming that they all date from the same time.[3]

6.10 The Personal Injuries Bar Association noted that, as most calculations would be carried out by the parties rather than by the judge, it was not necessary for the computer programme to be available in every courtroom. They suggested that it would be useful if at least one copy of the programme were available in each courthouse, so that the parties could use it for last-minute checking.

6.11 We are aware that the computer programme will take resources to develop. It will also need to be updated each year as the specified rate changes. It is important that compound interest is not introduced until the requisite plans are in place.

Prescribed tables

6.12 The tables are designed to cover only the basic calculation. The aim is to provide a multiplier that can be applied to the principal sum to give compound interest at the specified rate.

6.13 Appendix F provides sample tables. We think that it is important to keep the tables simple and easy to use, even at the expense of some loss of accuracy. We therefore recommend that the tables should calculate interest from the month in which interest started to the month in which interest finished.

[3] See Part VII, below.

6.14 For cases that start or finish in the middle of the month the tables will provide a fairly rough and ready figure, as they will ignore interest for the remaining days. However, the accuracy should be sufficient for most purposes. As Appendix F shows, on a debt of £100,000 over five years, at an interest rate that fluctuates from 4-5%, the tables give a result that is, at most, plus or minus £250 from the "pure maths" figure. By contrast, using simple rather than compound interest would produce a figure that is £2,862 less.

6.15 We think that in many cases the parties would be willing to tolerate some loss of accuracy in order to have a clear figure at the end of the case. Where the parties wish to have a more accurate result, they will need to use the computer programme.

6.16 A set of tables would need to be around 20 pages long, to cover awards or payments made in a two-year period and started anything up to twenty years earlier.[4] We do not think it would not be an unduly cumbersome document for judges to keep on their shelves, or for advocates to take to court. Judges would probably benefit from some training in using the tables, but we do not think that it would need to be time consuming.

6.17 We recommend that the Court Service publishes tables to allow the calculation of compound interest at the specified rate.

ANNUAL, QUARTERLY OR MONTHLY RESTS?

6.18 In the Consultation Paper we provisionally proposed that compound interest should be computed with annual rests unless there were good reasons for ordering rests at more frequent intervals. We thought that this would simplify calculations in short-running cases by effectively removing all cases of a year or less from the scheme.

6.19 Most respondents agreed with our proposal, without providing any independent supporting reasoning. However, both the Law Society and Bar Council argued for more frequent rests on the grounds that this would reflect existing commercial practice. The Law Society, for example, proposed monthly compounding as "this is the approach taken by most lenders on recovery, mortgage lenders and banks investing money, etc". The Law Reform Commission of Hong Kong took the same approach. Their own report recommended monthly rests to reflect the practice of the major banks in Hong Kong and they suggested that we should follow "general UK banking practice, whatever that may be". Other respondents pointed out that arbitrators almost always use quarterly rests.

6.20 The main argument given for annual rests is that they would be simpler to calculate. This is undoubtedly true if one is trying to work out compound interest from first principles using a pocket calculator. In our view, however, no-one should attempt to do this. It would be a recipe for confusion and dispute. As outlined

[4] This assumes two tables per page. If the tables also covered continuous loss, as discussed in paras 7.27 – 7.28 below, then the volume would be around 40 pages long. If the tables also track simple interest rates for both one-off and continuous loss, they would be 80 pages long.

above, compound interest should only be calculated using a prescribed computer programme or the official tables.

6.21 For debts of over a year, a computer programme or tables using monthly rests would be no more complicated to use than those using annual rests. In fact, the balance of convenience lies with monthly rests. The most confusing aspect of the system proposed above is the potential discrepancy between the computer programme (that calculates interest to an exact date) and the tables (that round to the relevant month). It is easier to add a few extra days of interest to a figure based on monthly rests than to one based on annual rests.[5]

6.22 The main reason why annual rests might be seen as simpler is that a compounding system based on annual rests would automatically exclude all awards or payments of less than a year. If one were to use quarterly or monthly rests, it would be necessary to exclude short debts through a specific provision to that effect.

6.23 The simplicity arguments are not conclusive either way, though on balance the monthly rest tables are slightly easier to use. In the absence of other considerations, our main aim is to reflect commercial reality: as the Hong Kong Law Commission put it, the question should be resolved by following normal banking practice. For borrowers, interest is usually compounded at least monthly.

6.24 We recommend that compound interest should be calculated using monthly rests.

A discretion to vary the compounding intervals?

6.25 The next question is whether the courts should have discretion to vary the compounding intervals, as we proposed in the Consultation Paper. The few respondents who commented on this proposal agreed with it, on the grounds that there may be cases in which other rests may be appropriate. If, for example, a judge wished to mirror the interest rate available on a building society investment account, it may be more accurate to use quarterly rests.

6.26 On the other hand, allowing judges a discretion over compounding intervals *will* add to the complexity of the system. The computer system would have to offer litigants the facility to vary the rests. If the facility is there, some parties will use it without understanding the implications, while others may be encouraged to make unwarranted applications for different rests.

6.27 On balance, we think that the added complication involved in allowing judges a further element of discretion to vary the compounding interval outweighs the increased accuracy it would provide. When one is using investment rates, the difference between annual and monthly rests is small (£800 on £100,000 at a rate

[5] For monthly compounded figures one can calculate a daily interest rate (for example, a 6% annual rate becomes 0.0164% per day) and can apply this percentage to the total sum owed (including interest). With annual compounding, however, if one applies the interest rate to the total sum one over-estimates the interest due (as the effect is to add a new, unjustified one-off compounding to the figures). If, on the other hand, one applies the rate only to the principal sum (without interest) one underestimates the amount.

of 5% over five years),[6] and does not justify adding another level of complexity to the system.

6.28 We recommend that the compounding interval should be set by rules of court. All interest under the new statutory regime would then be calculated in accordance with the prescribed interval.

6.29 This would not affect the courts' existing powers to award contractual interest or "interest as damages". For example, compound interest is available in accordance with a contractual term or trade usage;[7] as special damages under the second limb of *Hadley v Baxendale*;[8] or in equity in claims against those in a fiduciary position who are accountable for profits made from their position.[9] As discussed in Part V, in these cases judges would continue to be able to award the actual interest lost – at whatever compounding interval that might be. For example, if a contract specified quarterly rests, the debt would be calculated on the basis of quarterly rests.

"MIXED" AWARDS

6.30 We have considered how far a court should be able to mix simple and compound interest payments in a single judgment. Clearly, it should be open to a court to award simple interest on some heads of damages, while awarding compound interest on others. For example, in a personal injury claim, the court could award compound interest on past pecuniary damages, and only simple interest on the non-pecuniary damages. A court could also award compound interest on a long-standing debt, and only simple interest on a further debt that had been outstanding for less than a year.

6.31 A more difficult question is whether the court should have discretion to grant compound interest for part of the period and simple interest for the rest of the period. Our view is that mixing compound interest and simple interest in this way would substantially increase the complexity of the arrangements, without making much difference to the total sum awarded.

6.32 **We recommend that the courts should not be allowed to award compound interest for part of the period of the debt, and simple interest for the rest.**

SUMMARY OF RECOMMENDATIONS

6.33 We recommend that details of how compound interest should be calculated should be set out in rules of court. Calculations should be carried out in one of three ways: through use of an approved computer programme; through approved tables; or by following a detailed prescribed formula. Parties should not be allowed to carry out their own calculation in their own way.

[6] The difference is greater for higher, borrowing-related rates – for example, on an interest rate of 8% the difference between annual and monthly rests would be £2,000. However, for borrowing rates, monthly compounding will usually be appropriate.

[7] Para 2.19, above.

[8] Paras 2.20 – 2.22, above.

[9] Paras 2.23 – 2.27, above.

6.34 The Court Service should make an approved computer programme freely available on its website, and should ensure the publication of suitable tables.

6.35 On balance we consider that monthly compounding would best reflect commercial reality. However, it is not our intention to include short debts within the scheme: rules of court should exclude compound interest on any debts or damages that have been outstanding for less than a year, unless the claimant can show exceptional reasons why interest should be compounded.

6.36 We recommend that the compounding interval should be set in rules of court, so that if commercial practice changes, the intervals can also be changed. All interest under the new statutory regime would then be calculated in accordance with the prescribed interval. The courts would not have discretion to alter the interval. Nor would courts be permitted to award compound interest for part of the period and simple interest for the rest.

PART VII
COMPOUND INTEREST IN PERSONAL INJURY CLAIMS

7.1 In broad terms, personal injury damages can be divided into three types: non-pecuniary loss; past pecuniary loss (which often arises over time); and future loss. The courts have evolved particular rules for how interest should be awarded on non-pecuniary loss and continuing loss, which we consider below. Future loss does not carry interest, and does not need to be considered here.

INTEREST ON DAMAGES FOR NON-PECUNIARY LOSS

7.2 Non-pecuniary damages include damages for pain and suffering and loss of amenity. In personal injury claims they carry interest on the whole sum at the rate of 2% from the date of service of the claim until the date of trial or payment (whichever is the earlier). This rule was laid down by the Court of Appeal in 1982 in *Birkett v Hayes*,[1] and was later approved by the House of Lords in *Wright v British Railways Board*.[2] It does not apply to non-pecuniary damages for fatal accidents, which do not increase with inflation and which usually carry interest at the special investment account rate.[3]

7.3 The subject has proved controversial. As discussed in Part V, in many areas of law non-pecuniary damages do not carry interest.[4] The Pearson Commission, among others, argued that no interest should be payable on non-pecuniary loss in personal injury claims.[5] They put forward three main arguments. First, awards are made at current day prices and are therefore protected against the effects of inflation. Often an investor cannot do more than protect the value of their money, after inflation and tax are taken into account. Second, the figures relating to non-pecuniary loss are essentially arbitrary and it would be inappropriate to apply detailed financial calculations to them. Third, awards cover both the pain that a claimant has already suffered and the pain that they will suffer in the future. In theory, only the award for past suffering should carry interest, but it would be too difficult and artificial to distinguish between the two.

7.4 The 2% rate has been justified on the grounds that it represents the rate a standard investor could expect to receive over and above inflation. The limitation that interest only runs from the issue of the claim is justified on the grounds that

[1] [1982] 1 WLR 816.

[2] [1983] 2 AC 773.

[3] *Prior v Hastie* [1987] CLY 1219.

[4] See para 5.12 above, and Appendix D, paras D49 - 52.

[5] The Pearson Commission, *Report on Civil Liability and Compensation for Personal Injury* (1978) Cmnd 7054, vol 1, para 746. See also the discussion in Damages for Personal Injury: Non-Pecuniary Loss (1999) Law Com No 257, para 2.30.

pain and suffering takes place over time. Some will occur at the time of the injury; some between injury and settlement; some in the future.[6]

7.5 Both justifications can be described as rough and ready. First, the rate investors can expect over and above inflation also arises in the context of future pecuniary loss, where the full loss is discounted to reflect the fact that a claimant will invest the money at little or no risk. Currently, the discount rate is set at 2.5% by statutory instrument[7] to reflect returns above inflation from index-linked government stock, as suggested by the House of Lords in *Wells v Wells*.[8] Second, pain and suffering will occur at different times for different people – and bears no relationship to the date of the service of the claim. Under the civil justice reforms, the pre-action protocol procedure means that claims are now being served later,[9] which has reduced the amount of interest defendants are required to pay.

7.6 We examined the issue at length in our 1999 report on Damages for Non-Pecuniary Loss.[10] We noted that views were divided, with some arguing in favour of the 2% rate, some arguing that the discount rate for future loss should be used, and some arguing for an even higher rate to discourage delay. In the end, we recommended no change. We did not accept that the low interest rate led to delay. We felt that the rate based on index-linked government securities should be discounted to cover the fact that interest was being awarded for future suffering. Injustice could be done to defendants in particularly large and catastrophic cases if no allowance was made for the fact that some of the damages related to the future.[11]

7.7 In the Consultation Paper we did not seek to reopen the debate on interest on non-pecuniary damages. We accepted that the current rule would remain, and observed that given that both market interest rates and inflation operate in a compound fashion, "it would make sense for the inflation-free rate… also to be compounded". This observation generated little discussion in the responses we received.

7.8 This is not the place to reopen the difficult question of interest on non-pecuniary loss in personal injury claims. We have already consulted on this issue extensively and do not feel that we can usefully add to the full discussion set out in our 1999 report. The only question we need to consider here is whether the 2% rate should always be simple, or whether in some cases it should be compounded.

7.9 As a matter of principle, there is no reason to strive for precision in the calculation of interest on non-pecuniary loss. The loss figure itself is a global sum, aimed broadly to compensate for a loss that is difficult to pin down in monetary terms.

[6] Law Com No 257, paras 2.29-2.58.

[7] Damages (Personal Injuries) Order 2001, SI 2001 No 2301.

[8] [1999] 1 AC 345. The case itself suggested a figure of 3%.

[9] T Goriely, R Moorhead and P Abrams, *More Civil Justice? The Impact of the Woolf Reforms on Pre-action Behaviour* (2002) Law Society/Civil Justice Council Research Study 43, pp 160-1.

[10] Law Com No 257, paras 2.29-2.58.

[11] *Ibid*, para 2.54.

The interest rule is also imprecise, intended as broad compromise between providing no interest and providing interest at market rates.

7.10 In practice, compounding a rate as low as 2% would make little difference. Compound interest works exponentially, which means that the difference between simple and compound rates is much greater for high rates of interest than for low ones. It would take 22 years for a monthly-compounded rate of 2% to overtake a simple rate of 2.5%. As interest runs only from the date of service of the claim, the period to which it applies is short. This means that the amount of money at stake will be extremely low – too low to justify the costs of calculation.

7.11 In our view the "2% rate" of interest should continue to be simple, rather than compound. We say this partly because it would be unwise to attempt to apply commercial precision to such an imprecise award and partly because the amount of money at stake does not justify the calculations.

7.12 We recommend that the "2% interest rate" applying to non-pecuniary personal injury damages from the date of service of the claim should continue to be simple, rather than compound.

7.13 The draft Bill permits rules of court to exclude certain heads of damages from the compound interest regime[12] and we recommend that this power should be used to exclude non-pecuniary personal injury damages. The question of compounding could be reconsidered if, in the future, the courts were to reconsider the 2% rule and provide for a higher rate of interest for a longer period.

INTEREST ON PAST PECUNIARY LOSS

7.14 Loss of earnings and care costs often arise steadily over a period of time. In *Jefford v Gee*,[13] Lord Denning MR argued that it would be sensible to take a "broad brush" approach to continuing losses, ignoring small discrete items of loss and minor fluctuations in earnings. On this basis, he suggested that past pecuniary loss should carry interest for the full period between injury and trial, but at half the normal rate. The "half rate" approach has since developed into a general rule, although it is subject to exceptions.

7.15 In *Jefford v Gee*, Lord Denning linked the normal rate to the rate paid on money paid into court (now called the "special investment account rate"). For many years, this was 8%, which led the "half-rate" approach to be labelled the "4% rule". As discussed in Part III, the special investment account rate was reduced to 7% in August 1999 and to 6% in February 2002. However, we were told that the 8% rate has become so much part of the court culture that it is not unusual for claimants to continue to receive interest on continuing losses at 4%.

7.16 We examined the "half-rate" rule in detail in our 1999 report on medical, nursing and other expenses.[14] We thought that the half-rate approach to past losses was a

[12] See clause 1 of the draft Bill in Appendix A, inserting new s 35B(4)(b).

[13] [1970] 2 QB 130, CA.

[14] Damages for Personal Injury: Medical, Nursing and Other Expenses; Collateral Benefits, (1999) Law Com No 262.

useful starting point, but could often work injustice. We approved of case law suggesting that there should be wide-ranging exceptions:

> The use of a half-rate calculation is only an approximation, and is accurate only if the loss has accrued at a constant rate between the injury and the trial. Where losses have occurred over a period which has ended before trial or are discrete items of expenditure, the half-rate approach becomes inaccurate, and this inaccuracy is exacerbated where the loss occurs either very shortly after the injury, or not long before the trial.[15]

7.17 We welcomed the fact that practitioners were increasingly using computer programmes to work out the full interest on discrete individual losses from the date they occurred.

7.18 A further problem with the "half-rate approach" is that it only works accurately if the interest rate remains constant throughout the period of the loss. When the interest rate changes, the approach breaks down. If one calculates interest for each period during which the interest rate applies at half the rate on the whole sum, one ends up giving too much prominence to the early rates and too little prominence to the later rates.[16] As interest rates were much higher in the early 1990s than they are now, a crude application of the half rate rule tends to over-calculate interest.

7.19 Despite the problems with the half rate approach, several respondents supported it on the grounds that it was well known, easy to use and roughly fair.[17] We accept that on many occasions it is appropriate to treat continuous losses as arising evenly, and ignore slight variations in earnings and expenses. This will continue. However, we are concerned that the "half-rate" rule of thumb already causes serious inaccuracies when the rate varies over time, and ceases to apply when

[15] *Ibid*, para 7.5.

[16] To illustrate this with an example. Suppose losses occur at £10,000 a year for ten years. The simple interest rate for the first three years is 15%; for the next three years it is 10%; and for the final four years it is 6%.

- *For the first three years*, the losses are only £30,000, so interest for three years would be £6,750. However, if one applied half of 15% (7.5%) on the whole losses (£100,000) for three years, the result would be £22,500.
- *For the next three years*, interest is payable on the £30,000 that has already accrued (£9,000), and on the next £30,000 that arises over the period (£4,500) – that is a total of £13,500. If one applied half of 10% (5%) on £100,000 for three years the result would be £15,000.
- *For the final four years*, interest is payable on the £60,000 that has already accrued (£14,400), and on the next £40,000 that arises over the period (£4,800), a total of £19,200. If one applied half of 6% (3%) to the total losses of £100,000 for 4 years, the result would be £12,000.

Thus for the whole period, the total simple interest should be £39,450. A crude application of the half rate approach would place too much emphasis on the high earlier rates and too little emphasis on the low later rates, to produce a total figure of £49,500.

[17] The Medical Protection Society saw no benefit to replacing a reasonably simple system with one "which would be extremely laborious and over-complicated". The Medical Defence Union commented that "currently Solicitors/Counsel take a general approach to interest and the calculation is not precise". However, requiring a more detailed level of analysis would increase legal costs, "adding time, complexity and cost to the process".

interest is compounded. It should be possible to devise computer programmes or tables that reach a more accurate figure, using the same basic principles.

7.20 For present purposes, the first question is whether interest on past pecuniary loss should be simple or compound. Logic suggests that the rates should be compound. Pecuniary losses are real losses. Victims who have lost income or incurred increased care costs will have either increased their borrowing or lost the opportunity to save or pay off their mortgages. All these possibilities would have been at compound rates. In some cases, borrowing can be substantial. Hazel Genn's survey into the needs of accident victims found that the more serious the accident, the longer the wait, and the greater the victim's indebtedness. Among those receiving compensation of £100,000 or more, a fifth had borrowed £5,000 or more and 7% had borrowed £10,000 or more.[18]

7.21 Defendant organisations argued that many families will have simply foregone expenditure – which is not necessarily a compound loss. If one assumes, however, that individuals are economically rational they would only spend if they assessed the benefits to them of spending to be more than the benefits of saving at compound rates. Thus the subjective loss represented by forgoing expenditure is, by definition, higher than the loss represented by not investing (at compound rates).

7.22 We recommend that past pecuniary losses should be subject to the general scheme for compound interest outlined in Part V.

7.23 We accept that in smaller cases, it may not be worth calculating compound interest. In Part V we recommended that in claims of less than £15,000 there should be a presumption in favour of simple rates. We recommend that for the purposes of applying the £15,000 figure to personal injury cases, non-pecuniary loss, past pecuniary loss and future loss will each be looked at separately. Thus in a case involving £5,000 non-pecuniary damages, £10,000 past loss of earnings and £20,000 future loss, the court would start with the (rebuttable) presumption that interest on the £10,000 past pecuniary loss should be simple. In many cases past losses are substantial and endure over long periods, so the amount of money at stake justifies the calculation.

7.24 This leaves the practical problem of how the calculations will be carried out. We endorse the policy we reached in 1999. Where there are significant discrete elements (such as home adaptations), these should be treated separately. In most cases, though, a broad brush approach should be taken by assuming that the losses arose evenly over time. Many past pecuniary losses arise continuously, or approximate sufficiently closely to continuous loss for the assumption to be appropriate. We also accept that the basic principle is correct. Continuous loss should bear less interest than would be paid on a one-off loss, because not all the loss has endured for the whole period. The difficulty is that the "half-rate

[18] *Personal Injury Compensation: How Much is Enough? A study of the compensation experiences of victims of personal injury* (1994) Law Com No 225. Among those receiving compensation of £100,000 or more, a third waited at least six years from the date of the accident to settlement (p 71).

calculation" does not work for compound interest.[19] Nor does it allow rates to be tracked over time.[20] More sophisticated tools will be necessary. We think that if lawyers are given the right tools in terms of computer programmes and tables they will be able to reach more precise interest figures without any increase in legal costs or disputes.

7.25 Personal injury lawyers told us that they already routinely use computer programmes to calculate interest (including separate calculations for several discrete items of expenditure). There is no reason why such a computer programme should not use compound rates.

7.26 We recommend that the Court Service's prescribed computer programme should be able to calculate compound interest on losses that occur evenly over time. It should also be able to deal with compound interest on one or more discrete items of expenditure, arising at different dates.

7.27 Judges told us that it would also be helpful if interest on continuous loss could be calculated from tables, available for settlements at the door of the court and in court itself. This would not only be useful for personal injury claims, but may be used in several types of claim – including unpaid rent or breach of patent. As with the "one-off" loss tables they would provide a multiplier based on the month in which the award started and the month in which it concluded.[21]

7.28 **We recommend that the Court Service should consult practitioners on whether there is a demand for published tables to cover compound interest at the specified rate on continuous losses that occur evenly over time. The Court Service should also consider whether there is a demand for simple interest tables to track the specified rate in past years.**

7.29 These tables would be in addition to a computer programme able to carry out such calculations. They would also be in addition to the published tables to cover "one-off" losses recommended in Part VI.[22] Where losses cannot be treated as arising evenly, or where interest does not track the specified rate, the parties would need to use the computer programme.

THE COST TO THE TAXPAYER

7.30 The final argument made against compound interest is that it would lead to additional costs for the taxpayer. The Medical Protection Society observed that

[19] While simple interest increases steadily, compound interest increases exponentially. It will therefore involve more a sophisticated formula, which calculates compound interest on the assumption that the loss occurs at a steady rate over the whole period in question (see Appendix E, paras E17 – E23 below). Whilst this formula is important to the programmers, it need not concern the litigants, lawyers or judges who are using the programme to produce figures.

[20] See para 7.18, above.

[21] Continuous loss tables would therefore take the same amount of space. In other words, tables that covered interest at the prescribed rate on awards made in a two-year period and started anything up to twenty years earlier would be around 20 pages long.

[22] See paras 6.12 – 6.17, above.

the Government (and thereby the taxpayer) is probably the largest single personal injury compensator in England and Wales (including compensation for acts or omissions by employees in the National Health Service, the Ministry of Defence, Home Office, Police and Local Authorities).

7.31 The NHS litigation authority (NHSLA) told us that their estimate for future payments of all cases already on their database exceeded £4 billion: so "even an increase in expenditure of 10% would constitute a huge additional burden for the NHS". They feared that money spent on paying compound interest would take money away from new hospitals, doctors and nurses.

The exponential effect of compounding

7.32 In order to assess the cost effect of our proposals, it is important to understand the exponential effect of compound interest. Table 7.1 takes a hypothetical case with total damages of £1 million, of which £150,000 represents past pecuniary loss arising continuously since the cause of action. We were told that in large clinical negligence cases of this type, this was typical in that the past pecuniary element averaged around 15% of damages.

7.33 The first line of the table shows the interest that would be payable if one tracked the special investment account rate applying each year since the cause of action arose. The second line shows the effect of changing to a simple interest rate set at base +1% over the same period. It demonstrates that for recent cases (of ten years or less), this change would produce net savings. For the last decade the special investment account rate has been higher than base +1%.

7.34 The subsequent lines show the effect of compound interest. For cases of five years duration there are net cost savings. For cases of ten years duration the effect is minimal: compound interest adds less than half of one percent to total damages. After 15 years, damages increase by 2%; after 20 years, by 8%; and after 25 years, compound interest adds over a fifth to the total damages bill.

7.35 There are two main factors that contribute to this steeply rising curve. The first is the exponential effect of compounding. The second is that between 1979 and 1993 interest rates were much higher than they are now. With interest rates of 15%, there was more to compound.

TABLE 7.1: INTEREST PAYABLE IN A £1 MILLION CASE, WITH CONTINUOUS PAST PECUNIARY LOSSES OF £150,000

	5 Years	10 Years	15 Years	20 Years	25 Years
Special investment interest rate	£24,900	£54,915	£97,530	£141,525	£191,398
Simple interest at base +1%	£20,850	£47,100	£78,550	£118,594	£135,462
Compound interest at base +1%	£22,994	£59,309	£119,905	£238,451	£451,044
% increase in interest payments	-7.6%	+8.0%	+22.9%	+68.5%	+135.7%
Total payment including simple interest at special investment rate	£1,024,900	£1,054,915	£1,097,530	£1,141,525	£1,191,398
Total payment including compound interest at base + 1%	£1,022,994	£1,059,309	£1,119,905	£1,238,451	£1,451,044
% increase in total payments caused by compound interest at base +1% over simple special investment rate	-0.19%	+0.42%	+2.04%	+8.49%	+21.79%

7.36 The effect of these figures is that where an insurer defendant is settling claims that last 10 years or less, the effect of our proposals will be broadly neutral. Any small increases in the ten-year cases will be offset by interest reductions in the five-year cases. However, if a defendant pays large sums for claims in which more than 15 years have past from the loss arising to payment, then the effect of compound interest can be significant.

Clinical negligence claims

7.37 It is rare for personal injury claims to take more than 15 years to resolve. As discussed in Appendix D, most claims are resolved within three years.[23] Surveys have highlighted that clinical negligence claims take longer than other types of claim, but even so most are resolved well within 10 years. A survey of High Court litigation conducted before the Woolf reforms found that the average clinical negligence case took 65 months from when solicitors were first instructed to the conclusion of the case.[24]

7.38 The problem comes in cases of severe injuries to children, usually at birth. These represent only a small number of cases, but a high proportion of the money paid. The NHSLA told us that around two-thirds of all the compensation they pay is paid to children. In children's cases the limitation period does not begin to run until adulthood. If the child is under disability, there is presently no limitation

[23] P Pleasance, *Report of the Case Profiling Study: Personal Injury Litigation in Practice* (1998) Legal Aid Board Research Unit.

[24] H Genn, *Survey of Litigation Costs* (1996).

period at all.[25] This means that there may be lengthy delays from the incident to when the claim is first reported.

7.39 Interest claims are concerned with the time from loss to payment (rather than from the incident). A particular feature of children's cases is that losses may start to arise immediately following the incident, which means that there may be very lengthy delays between the loss and payment. This contrasts with industrial disease claims, where the incident may have been many years ago, but where the loss has only started to show recently.

7.40 In Appendix E we analyse the information provided by the main medical defence organisations. This shows that in 2002, the NHSLA spent just over £63 million on claims where the cause of action had arisen 15 or more years previously.[26] Over £32 million was spent on claims that were more than 21 years old. Old claims are also reported to the Medical Defence Union and Medical Protection Society, though not in such quantities. On the basis of the figures in Appendix E, we estimate that in 2002, between them, the MPS and MDU paid around £5.5 million on claims that were 15 or more years old. On the data we were given, it would appear that around 16% of total damages represent past pecuniary loss.

7.41 The NHSLA only covers England. We were not able to gather information about claims paid by NHS Wales. However, published data suggest that the cost of clinical negligence in Wales is just over a tenth of that in England.[27] We estimated Welsh expenditure on this basis.

7.42 In Appendix E we estimate that compound interest would add between £20 million and £25 million per year to the cost of clinical negligence claims. This figure consists of £19.1 million to the cost of NHSLA claims, £2.3 million a year to the cost of MPS and MDU claims combined, and £2 million in respect of Wales. These costs would, directly or indirectly, be borne by the taxpayer.

7.43 In arriving at these figures, we have assumed that interest is granted in full, rather than being reduced to penalise claimants for their delay in bringing the claim. The courts have shown themselves increasingly willing to reduce interest payments where there has been considerable delay in bringing infant claims.[28] For example, in *Corbett v Barking, Havering and Brentwood Health Authority*[29] the Court of Appeal upheld a reduction of four years' interest, where an infant whose mother

[25] In our report on Limitation of Actions we recommended that this rule should be revised, so that where a responsible carer was aware of the cause of action, actions must be brought within three years of the child attaining 18 (see (2001) Law Com No 270, paras 3.115-3.117).

[26] According the recent report by the Chief Medical Officer, the NHS faces up to £1,713 million in outstanding liability on claims that arose before 1990: Department of Health, *Making Amends* (2003) p 72.

[27] In 2001-02, the Welsh Risk Pool re-imbursed health authorities and NHS trusts around £46.3 million: see *The Finances of NHS Wales 2003: Report by the National Audit Office on behalf of the Auditor General for Wales* (2003) p 20. This compares with an annual expenditure in England of £446 million: *Making Amends* (2003) p 60.

[28] *Spittle v Bunney* [1988] 3 All ER 1031. See also *Beahan v Stoneham* 2001 WL 272888.

[29] [1991] 2 QB 408, CA.

had died at birth did not bring a claim for 11.5 years. They rejected the argument that this would penalise an innocent child rather than the adults and lawyers responsible for the delay. Clearly, there would be some reductions in interest payable to penalise claimants for delay, but it is difficult to know how much this would be.

Is compound interest for clinical negligence claims a political priority?

7.44 The medical defence organisations argued that it was not a political priority to compensate clinical negligence claimants for the cost of being kept out of their money for many years. First, they suggested that the losses were often not tangible in terms of money spent, but hypothetical constructs of the opportunity that has been forgone. Second, they pointed out that delay in reporting the incident was the claimant's responsibility rather than the defendant's. Defendants should not be penalised for that delay. Third, they suggested that there were better uses to which the money could be put in improving the health service now rather than attempting to remedy old wrongs.

7.45 As a matter of principle we think it right for the courts to have a power to award compound interest in clinical negligence claims. Many losses are far from hypothetical. Parents have often lost income, leading to increased borrowing or the loss of the opportunity to invest in pensions or other savings, to buy a property or to pay off the mortgage. Where a claimant has been guilty of unwarranted delay the courts already have the power to deny interest for this period. That does not mean that all delay is always unwarranted.

7.46 On the other hand, we cannot say how far granting compound interest to clinical negligence victims represents a political priority, compared with all the other calls on government expenditure. That must be a matter for the Government. There are arguments that the Government should wait until the current backlog is cleared before introducing compound interest for clinical negligence claims. Compound interest for clinical negligence might, for example, be delayed for five years after its introduction in other areas. If needs be, compound interest for clinical negligence claims could be introduced only prospectively, for causes of action that arise after the introduction date. We return to this issue when considering the transitional arrangements in Part IX.

SUMMARY

7.47 We recommend that compound interest should not be available on non-pecuniary damages for personal injury. The current rule should continue, by which non-pecuniary loss carries interest at 2% from the date of service of the claim. It is unnecessary to apply commercial precision to such an imprecise award, and the amount of money at stake does not justify the calculations.

7.48 Damages for past pecuniary loss should be subject to the general scheme for compound interest. The Court Service will need to ensure that the prescribed computer programme is able to calculate compound interest both on losses that occur evenly over time, and on discrete items of expenditure arising at different dates. The Court Service should also consult practitioners on whether there is a need for published tables to cover compound interest on continuous losses that arise evenly over time.

7.49 For most types of personal injury claim, the cost will be broadly neutral. Moderate increases in the interest paid on claims for between five and ten years will be offset by reductions in the interest paid in claims of less than five years duration. Compound interest makes a significant difference in claims that have been outstanding for 15 years or more. In the field of clinical negligence, significant sums are paid on a few very long-running claims – which sometimes arose 25 years or more before payment. We estimate that our proposals will result in net costs to clinical negligence defendants of between £20 million and £25 million per year. How far this represents a priority in terms of public expenditure is a matter for the Government to determine.

PART VIII
OFFERS TO SETTLE

8.1 Here we consider how our proposals will affect pre-trial offers made under Part 36 of the Civil Procedure Rules. We first consider the additional interest payments available to claimants who have made an unbeaten offer. At present such interest is subject to a cap of a simple rate of 10%. We ask whether this cap should be expressed in simple or compound terms.

8.2 We then look briefly at how claimant and defendant offers are expressed. Should offers be made inclusive or exclusive of interest, and does the offeror need to calculate interest precisely?

CLAIMANT OFFERS AND ADDITIONAL INTEREST PAYMENTS

The current law

8.3 As part of the civil justice reforms, Lord Woolf recommended that claimants should be encouraged to make formal offers, with significant financial incentives on both parties to take those offers seriously.[1] The Civil Procedure Rules 1998 therefore introduced the new concept of a formal claimant's offer. Where defendants refuse such offers only to have judgments made against them that are more advantageous to claimants than the offers they have refused, they face three possible sanctions: additional interest on the award, costs against them on an indemnity basis, and interest on those costs.

8.4 Rule 36.21(2) sets out the interest sanction in the following terms:

> The court may order interest on the whole or part of any sum of money (excluding interest) awarded to the claimant at a rate not exceeding 10% above base rate for some or all of the period starting with the latest date on which the defendant could have accepted the offer without needing the permission of the court.

8.5 Rule 36.21(3) permits interest on indemnity costs from the latest date that the defendant could have accepted the offer without permission, also "at a rate not exceeding 10% above base rate". Rule 36.21(4) states that the court will make such orders "unless it considers it unjust to do so". The following sub-section then sets out a list of factors that the court must take into account.

8.6 Thus the court has only limited discretion whether to grant additional interest at all. However, it does have wide discretion whether to award additional interest on all or part of the sum; and over the rate of interest (up to a maximum of 10% above base). At present, however, the interest must be simple.[2] It is worth noting that the maximum rate of 10% over base is a cap on

[1] Lord Woolf, *Access to Justice: Final Report* (1996) p 113.

[2] Rule 36.21(2) states that interest may be awarded "on the whole or part of any sum of money (excluding interest)". It therefore excludes the award of interest on interest, which is the essence of compounding.

all the interest awarded.[3] If base is 3.75%, interest cannot exceed 13.75%. If the claimant has already received interest at 6%, the maximum additional interest is 7.75%.

8.7 Technically, rule 36.21 only applies to cases that go to trial. However, in a recent case Lord Woolf suggested that courts may also increase the interest available when granting summary judgment. He explained that, where a claimant made an offer for a lesser sum,

> it is possible for the court, when exercising its general jurisdiction as to interest, to give a higher rate of interest than the going rate. It is important that courts bear this in mind otherwise claimants might be tempted not to obtain summary judgment in cases where it could be obtained with the objective of obtaining higher rates of interest at the conclusion of a trial. That would be entirely contrary to the whole ethos and policy of the CPR.[4]

In that particular case, he suggested 4% over base would be a suitable sum.

8.8 Research into the effect of the Woolf reforms found that claimant offers were widely welcomed as an important and helpful innovation.[5] However, few solicitors had experience of sanctions being applied, as most cases settle rather than proceed to trial. Solicitors acting for personal injury claimants criticised the sanctions for being inadequate. They complained that in large cases it was only possible to make a finely judged offer when all the evidence was available – which meant that most serious offers were made within a year of the trial. Thus the additional interest may amount to a relatively small sum. Greater penalties were imposed on claimants who refused defendants' offers, and who therefore risked the full costs of the trial.[6]

Should the maximum rate be expressed as a compound rate?

8.9 The Consultation Paper proposed to amend the CPR Rule 36.21 to turn the maximum limit of 10% above base into a compound rate. It was felt that this was needed to cater for the theoretical possibility that any compound rate awarded may, after enough years, exceed the simple interest ceiling.

8.10 Most of those responding on this issue agreed that the maximum limit should be expressed as a compound rate, for the reasons we gave. But a few disagreed.

[3] *McPhilemy v Times Newspapers Ltd and others* (No 2) [2002] 1 WLR 936. Chadwick LJ said at para 20:

> It is pertinent to note that paragraph (6) of CPR 36.21 expressly recognises that the court may make an order for the payment of interest under paragraph (2) notwithstanding that it also orders the payment of interest on the same sum and for the same period under some other power -- of which the power under section 35A of the 1981 Act is an obvious example. Paragraph (6) imposes an overall limit of 10% above base rate.

[4] *Petrotrade Inc v Texaco Inc* [2002] 1 WLR 947, CA.

[5] T Goriely, R Moorhead and P Abrams, *More Civil Justice? The Impact of the Woolf Reforms on Pre-Action Behaviour* (2002) p xxxiii.

[6] *Ibid*, pp 146-9.

The National Health Service Litigation Authority suggested that applying compound interest to Part 36 offers "would throw the whole system into confusion". The Medical Protection Society (MPS) felt that "there is no justification … whatsoever" for a compound rate:

> The interest applied under Part 36.21 of the CPR is designed to be punitive. Since it is not compensatory, MPS cannot see why interest should be charged on a compound basis.

The Society argued that the present maximum was already steep enough and any more would amount to a double penalty.

8.11 There is some confusion over the rationale behind Rule 36.21(2). Lord Woolf has specifically stated that the measure is not designed to be penal but is "a means of achieving a fairer result for a claimant".[7] On the other hand, there would appear to be some element of sanction involved. If the interest award were purely compensatory, rule 36.21(2) would not be needed: the court could simply exercise its discretion under section 35A, which does not include an upper limit. Part 36 is intended to place a disincentive on defendants who fail to take a claimant's offer seriously. It therefore provides for interest that is additional to the compensatory interest already awarded under the courts' general powers.

8.12 The principles behind the rule are still developing, as courts attempt to find a balance between imposing appropriate incentives on defendants and doing justice to claimants. In practice the courts have been reluctant to award anything like the maximum cap.[8] We do not intend to interfere with developing case law. That said, there are technical reasons for amending rule 36.21. In particular, we wish to avoid a situation in which the court ends up granting both compound and simple interest on the same sum. This would add a new dimension of complexity to the calculations, which would be outside the capacity of the computer programme or the tables. Interest under rule 36.21 is often granted at the very last minute, and we are keen that the calculation should be as simple as possible. If the award already bears compound interest, this will normally be achieved by increasing the compound rate for the period since the offer. If only simple interest has been granted, the increase would be simple.

[7] *Petrotrade Inc v Texaco Inc* [2002] 1 WLR 947, CA. See also the views expressed by Chadwick LJ in *McPhilemy v Times Newspapers Ltd and others* (No 2) [2002] 1 WLR 934, at para 19.

[8] In *Petrotrade Inc v Texaco Inc* [2002] 1 WLR 947, Lord Woolf stated:

> The amount of the claim is also a relevant factor. If a claim is small, enhanced interest has to be at a higher rate than if the claim is large, otherwise the additional advantage for the claimant will not be achieved. In this case the sum involved was neither particularly large nor particularly modest. The conclusion that I would come to is that, if the matter was one for my discretion at first instance, I would award in the region of 4 per cent above base rate for the appropriate period (para 77).

8.13 A further problem is that it is theoretically possible for any compound rate to exceed a simple rate, given a long enough time period. This means that if a claimant is awarded compound interest under (an amended) section 35A, and another award under rule 36.21, it is possible that the rate could exceed the simple cap. Although this would be extremely rare, it would require the courts to carry out unnecessary checks. Again, it would add an unwarranted layer of complexity to the court's decision-making.

8.14 A few respondents suggested that if the maximum limit were to be expressed as a compound rate, the overall limit should be lowered.[9] We have considered whether if the maximum rate is to be expressed as a compound rate it should be reduced (for example, to 8% or 9% above base). We do not recommend this because many offers are made quite soon before trial. Lord Woolf has accepted that in small cases, where offers are made shortly before trial, the interest rate may need to be higher than in other claims.[10] In such circumstances, a rate of base +8% compound would be substantially less than a rate of base +10% simple.

8.15 In practice, we do not think that expressing the maximum cap as a compound rate will increase the amount of interest awarded under rule 36.21. In practice, most awards will be for much less than the maximum. Furthermore, most are made for quite short periods, when the effect of compounding will be minimal. However, if the court is adding additional interest to a compound rate, it would reduce complexity to express the additional sum in compound terms, subject to a compound cap.

8.16 We therefore recommend that rule 36.21 should be amended to express the maximum cap as a compound rate of 10% above base. The prohibition on awarding interest on interest should also be removed, so as to allow the courts to award compound interest if this seems appropriate.

EXPRESSING CLAIMANT AND DEFENDANT OFFERS

8.17 Concerns have been expressed that compound interest could cause problems when the parties make offers. It is suggested that both claimants and defendants could be caught out by the complications of calculating compound interest so as make an offer that was slightly more (or slightly less) than the sum finally awarded. As a result, they could lose the advantages of Part 36.

8.18 At present, the rules state that unless a claimant or defendant offer indicates to the contrary it shall be treated as inclusive of all interest.[11] Under rule 36.22(2), where the offer specifically excludes interest, it must state whether

[9] Aviva, the Council of Circuit Judges, Consumer Credit Trade Association and British Maritime Law Association.

[10] *Petrotrade Inc v Texaco Inc* [2002] 1 WLR 947, para 77.

[11] CPR rule 36.22(1).

interest is offered and if so "the amount offered, the rate or rates offered and the period or periods for which it is offered".[12]

8.19 The requirement that an offer made exclusive of interest must not only specify the interest rate and periods but also "the amount" of interest offered could potentially cause problems. The wording suggests that the offeror must carry out their own interest calculations and, if they make a mistake, risk losing the protection of the offer. If the offer had to state the amount of compound interest where that was claimed or offered by a defendant, that would add to the risk that a mistake might be made.

8.20 In fact we are not convinced that the rule is intended to mean what it appears to say. Where the offer is expressed not to be inclusive of interest, and interest is offered as a separate item, it does not seem necessary to require the offeror to state both the amount of interest offered *and* the rate or rates and the period or periods for which it is offered. It would make more sense to require one or the other. However, we suspect that the provision was intended to permit an offer to be made which did not calculate the interest at all but merely stated what interest is offered on what sums.[13] This may save a good deal of time, since it may be that the offer will be rejected out of hand, with the result that the effort of calculating the amount of interest would be wasted. Thus we suspect that what was intended by the rule is that the offer, if it is not inclusive of interest, should state "the amount *or amounts on which interest is* offered, the rate or rates offered and the period or periods for which it is offered."

8.21 This would fit with what we believe should be the general principle: the recipient of the offer should be able to determine easily just what is being offered. This may be in the form of a global sum including interest;[14] or a principal sum with the rates of interest and periods of interest that are offered on the various components that make up that principal sum. We do not think it necessary to require those making offers to settle to carry out interest calculations; and we certainly would not wish to require this when compound interest is claimed or included in the offer. It would be sufficient for a party to make an offer of a principal sum expressed to be exclusive of interest, together with a statement of the amount or amounts on which interest is offered, the rate or rates offered, the period or periods for which it was offered, and whether it was simple or compound.

8.22 We therefore recommend that the Civil Procedure Rule Committee consider amending rule 36.22(b) to require that offers expressed as exclusive of interest should state the amount or amounts on which interest is offered, the rate or rates offered, the period or periods for which it is offered, and whether it is simple or compound.

[12] CPR rule 36.22(2)(b).

[13] If it sufficed to state the amount of interest alone, there would be little reason to allow for it to be stated separately from the principal sum.

[14] When a global sum is offered, the other party may have to 'disaggregate' the sum in order to work out how much is being offered in relation to the principal claim. We think this is unavoidable: it would not be right to prevent 'global' offers being made or accepted.

8.23 We are concerned lest an offer might be treated as invalid because it does not state whether the interest offered is simple or compound. Particularly when the scheme is still new and unfamiliar, this might happen often. Instead we suggest that the Rule Committee might consider providing that a failure to state this should not invalidate the offer, but that a series of presumptions should apply. These would reflect the claim made and the presumptions we have recommended as to whether any interest awarded should be simple or compound. Take the case where an offer said to be exclusive of interest states that interest is offered but does not specify whether it is simple or compound. It should be presumed that if the claimant has claimed compound interest,[15] and the principal amount offered is £15,000 or more, then interest is compound. On the other hand, if compound interest has not been claimed, or if the principal amount is less than £15,000, interest should be simple.

8.24 We recommend that the Rule Committee should consider establishing presumptions to apply to offers expressed as exclusive of interest which state that interest is offered but which do not specify whether interest is simple or compound.

SUMMARY OF RECOMMENDATIONS

8.25 We recommend that rule 36.21 be amended to

(1) express the maximum cap as a compound rate of 10% above base; and

(2) remove the prohibition on awarding interest on interest.

8.26 We also recommend that the Rule Committee consider

(1) amending rule 36.22(b) to provide that offers expressed as exclusive of interest should state the amount or amounts on which interest is offered, the rate or rates offered, the period or periods for which it was offered, and whether it was simple or compound;

(2) establishing presumptions where an offer expressed to be exclusive of interest states that interest is offered but does not specify whether it is simple or compound. It should be presumed that if the claimant seeks compound interest and the sum offered is £15,000 or more, then interest is compound; otherwise it would be simple.

[15] A claimant who wants compound interest will normally have to plead it specifically.

PART IX
TRANSITIONAL ARRANGEMENTS

THE POLICY ISSUES

9.1 The final issue is to what extent compound interest will apply retrospectively, to causes of action that have already arisen. This involves a difficult balance between the need to implement one single simple system, and the need to respect existing arrangements made on the basis of the current law.

A single system

9.2 On the one hand, it is important that litigants and their representatives should only have to deal with one interest regime. The continued dominance of the 8% figure suggests that many lawyers find it difficult to cope with more than one interest rate. It is important to provide a reasonably simple system that lawyers can grasp and implement without undue difficulty. We fear that if the old and new systems co-exist for a long transitional period, this will represent a complexity too far.

9.3 We particularly wish to prevent a system arising whereby the same damages carry interest under two separate regimes. This could bring the compound interest system into disrepute as, for the first few years, litigants were forced to carry out relatively complex calculations for paltry results.

9.4 Yet if compound interest is introduced only for causes of action that arise after a particular date, it would take many years for the system to have any real effect. By that time, many lawyers will have forgotten that compound interest has been introduced. The reforms could suffer from the same lack of awareness that has bedevilled the introduction of the Late Payment of Commercial Debts (Interest) Act 1998. Ideally, compound interest would be available for all cases issued after the start date, for the whole period of the debt or damages. This would mean that system would start with “a bang” and could be given maximum publicity.

Respect for existing arrangements

9.5 On the other hand, it is important to respect existing arrangements. Where defendants have organised their affairs on the basis of one law, it may be unfair to change that law retrospectively.

9.6 For example, if defendants have delayed paying their debts in the expectation that they will be required to pay only simple interest, would it be unfair to impose compound interest retrospectively? In most cases, the answer will be no. Unlike the 1998 Act, these reforms are not intended to impose a penalty. Defendants were aware that if they delayed payment, they would be liable to compensate the claimant for the loss. These reforms are simply intended to provide a more accurate measure of compensation. In many cases, reductions in the rate will offset the effect of compounding.

9.7 The argument is different, however, where defendants have insured against their loss for a specific premium, assessed on the basis of existing law, and where compound interest would add significantly to their costs. This problem

is most likely to arise in personal injury claims, where there have been long delays between the loss arising and the issue of the claim because the claimant is a child or under a disability. As discussed in Part VII, compound interest starts to add significantly to costs after 15 years. In practice, these very long cases tend to concern birth or other childhood injuries caused by clinical negligence.

9.8 Similar arguments do not apply to other areas. Although there may be some long-tailed professional negligence claims against lawyers or accountants, for example, they are much less common because the victim is unlikely to be a child or under a disability. In industrial disease claims, there may be long delays between accident and issue because the loss takes time to reveal itself. However, for current purposes, the crucial interval is between loss and payment, not between the accident and payment, so very long interest payments will only arise occasionally. Our concern here is not with the occasional individual case but where the possible cost increases are sufficiently large or widespread to disturb the basis on which the insurance is issued. Outside the area of clinical negligence, cost increases in a few very long-running claims will be offset by savings in the rate paid on more recent claims.

THE OPTIONS

9.9 There are several ways in which the reforms could be introduced. Furthermore, the recommendations for a specified rate and for compounding could be introduced in different ways. Either (or both) could apply

(1) only to cases in which the cause of action arises after the start date;

(2) to cases in which claims are issued after the start date, whenever that cause of action arose; or

(3) to any award or settlement that takes place after the start date.

9.10 In the case of (2) or (3), the specified rate and/or compounding may be available either

(1) to the whole debt or damages, from when the cause of action arose; or

(2) only to the period after the start date. This would mean that cases with a cause of action before the start date which were settled after the start date would carry simple interest for part of the time, and compound interest for part of the time.

9.11 In our view, the first option (applying only to causes of action after the start date) would seriously reduce the benefits of the reforms. On a practical level, the co-existence of two separate interest regimes for up to twenty years would be too complex for litigants, lawyers and the courts to cope. Similarly, we have rejected the final option, of mixing compound and simple interest in a single case. This would make the system so complex as to bring it into disrepute.

OUR VIEWS

9.12 We recommend that the specified rate should apply to all judgments or payments made after the commencement date. We do not think this would be an unwarranted retrospective change. At present, the rate is discretionary: our

reforms would simply replace an open-ended discretion with a more structured discretion. The rate we propose is the same as the rate most commonly used in large commercial cases, and averages out as very similar to special investment account rate since 1980. If there is a good reason for using another rate, the court may do so. The reform is designed to stop the court from using another rate (such as 8%) when there is *no* good reason to.

9.13 Our recommendations in Part VI are designed to ensure that tables are widely available showing the specified rate for the last 20 years. We expect that once the reforms are introduced, lawyers, judges and court staff will rapidly become used to tracking the specified rate over time.

9.14 Our reforms on compound interest should apply to most types of case (such as contract, intellectual property) where proceedings are issued after the commencement date.

9.15 For clinical negligence cases, the introduction of compound interest could be delayed for up to, say, five years. In other words, if in contract cases compound interest were available for any proceedings issued after 1 January 2006, for clinical negligence cases it might be available for any proceedings issued 1 January 2011. We hope that this would allow (and encourage) clinical negligence defendants to clear the current backlog of long-standing cases without incurring the expense of compound interest.

9.16 As a long-stop, the Secretary of State should have the powers to make special transitional provisions for particular classes of case. If it becomes clear that current level of long-running clinical negligence claims is unlikely to reduce in the medium-term, they could be treated differently. For example, clinical negligence claims could be subject to compound interest only if the cause of action arose after the commencement day.

9.17 We recommend that:

(1) the specified rate should apply to all judgments or payments made after the commencement date.

(2) in most types of case, compound interest should apply to any case where proceedings have been issued after the commencement date.

(3) The Secretary of State should have the power to make special provision for some classes of case, so that they are only subject to compound interest if the cause of action arose after the commencement day.

PART X
LIST OF RECOMMENDATIONS

10.1 We recommend that section 35A of the Supreme Court Act 1981 and section 69 of the County Courts Act 1984 should be amended to allow the Secretary of State for Constitutional Affairs to set a specified rate. (Paragraph 3.30)

10.2 The rate should be set with reference to the Bank of England base rate. It should run from on a fixed date each year (such as 1 April), and be set with reference to the base rate prevailing on a date in the previous two months (such as 15 February). (Paragraph 3.31)

10.3 The Secretary of State for Constitutional Affairs should have power to change the way the rate is set by secondary legislation. (Paragraph 3.32)

10.4 The courts should have discretion to depart from the rate where there is good reason to do so. (Paragraph 3.33)

10.5 The specified rate should be set at one percentage point over Bank of England base rate. (Paragraph 3.43)

10.6 The Civil Procedure Rule Committee should be given power to provide guidance to the courts on how to exercise their discretion on whether to depart from the specified rate. (Paragraph 3.44)

10.7 The Civil Procedure Rule Committee should have power to provide the courts with guidance on when to award compound interest. (Paragraph 5.38)

10.8 The rules should draw a distinction between awards or settlements of less than £15,000 and those of £15,000 or more. For the former, there should be a rebuttable presumption that interest will be simple; for the latter there should be a rebuttable presumption that it will be compound. (Paragraph 5.39)

10.9 The rules should exclude compound interest on any debts or damages that have been outstanding for less than a year, unless the claimant can show exceptional reasons why interest should be compounded. (Paragraph 5.40)

10.10 Claimants should be entitled to forego interest under the Late Payment of Commercial Debts (Interest) Act and instead claim interest under the courts' general statutory powers. (Paragraph 5.58)

10.11 Courts of record other than the High Court and County Court which do not have their own interest regime should possess the same powers to award interest as the High Court. (Paragraph 5.67)

10.12 The Court Service should produce a computer programme to calculate compound interest and make it readily accessible on its website. (Paragraph 6.8)

10.13 The Court Service should publish tables to allow the calculation of compound interest at the specified rate. (Paragraph 6.17)

10.14 Compound interest should be calculated using monthly rests. (Paragraph 6.24)

10.15 The compounding interval should be set by rules of court. All interest under the new statutory regime would then be calculated in accordance with the prescribed interval. (Paragraph 6.28)

10.16 The courts should not be allowed to award compound interest for part of the period of the debt, and simple interest for the rest. (Paragraph 6.32)

10.17 The "2% interest rate" applying to non-pecuniary personal injury damages from the date of service of the claim should continue to be simple, rather than compound. (Paragraph 7.12)

10.18 Past pecuniary losses should be subject to the general scheme for compound interest outlined in Part V. (Paragraph 7.22)

10.19 The Court Service's prescribed computer programme should be able to calculate compound interest on losses that occur evenly over time. It should also be able to deal with compound interest on one or more discrete items of expenditure, arising at different dates. (Paragraph 7.26)

10.20 The Court Service should consult practitioners on whether there is a demand for published tables to cover compound interest at the specified rate on continuing loss arising evenly over time. The Court Service should also consider whether there is a demand for simple interest tables to track the specified rate in past years. (Paragraph 7.28)

10.21 Civil Procedure Rule 36.21 should be amended to express the maximum cap as a compound rate of 10% above base. The prohibition on awarding interest on interest should also be removed, so as to allow the courts to award compound interest if this seems appropriate. (Paragraph 8.16)

10.22 The Rule Committee should consider

(1) amending rule 36.22(b). This would require that offers expressed as exclusive of interest should state the amount or amounts on which interest is offered, the rate or rates offered, the period or periods for which it is offered, and whether it was simple or compound; (Paragraph 8.22)

(2) establishing presumptions to apply to offers expressed as exclusive of interest which state that interest is offered but which do not specify whether it is simple or compound. (Paragraph 8.24)

10.23 The specified rate should apply to all judgments or payments made after the commencement date. (Paragraph 9.17)

10.24 In most types of case, compound interest should apply to any case where proceedings were issued after the commencement date. (Paragraph 9.17)

10.25 The Secretary of State should have the power to make special provision for some classes of case, so that they are only subject to compound interest if the cause of action arose after the commencement day. (Paragraph 9.17).

(*Signed*) ROGER TOULSON, *Chairman*
HUGH BEALE
STUART BRIDGE
MARTIN PARTINGTON
ALAN WILKIE

STEVE HUMPHREYS, *Chief Executive*
12 December 2003

APPENDIX A

Draft
Interest on Debts and Damages Bill

The draft Interest on Debts and Damages Bill begins on the following page with a Contents section. The draft Bill is then set out with the Clauses on left hand pages and Explanatory Notes on the corresponding right hand pages.

Interest on Debts and Damages Bill

CONTENTS

DRAFT

OF A

B I L L

TO

Amend the powers of courts to award interest on debts and damages; and for connected purposes.

BE IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

1 Award of interest by High Court

For section 35A of the Supreme Court Act 1981 (c. 54) (power of High Court to award interest on debts and damages) substitute—

"35A Power of High Court to award interest on debts and damages

(1) Subsection (2) applies where, during proceedings in the High Court for the recovery of a debt, the defendant pays the whole debt to the claimant.

(2) The court may award simple or compound interest on some or all of the debt for some or all of the period—

(a) beginning on the date when the cause of action arose, and

(b) ending on the date of the payment.

(3) Subsections (4) and (5) apply where, in proceedings for the recovery of a debt or damages, the High Court gives judgment to any extent in favour of the claimant.

(4) In relation to an action for damages for personal injuries or death in which the court gives judgment for damages exceeding £200, it must, unless it thinks there are special reasons why it should not, award simple or compound interest on—

(a) some or all of the damages for which it gives judgment, and

(b) if any sum is paid in respect of damages during the proceedings, some or all of that sum,

EXPLANATORY NOTES

CLAUSE 1

This clause replaces section 35A of the Supreme Court Act 1981.

New section 35A

In general, this section merely re-drafts and clarifies the current section. The only substantive change of policy between the old section 35A and the new section 35A is that the new section refers to "simple or compound interest" rather than only simple interest.

One of the more confusing aspects of section 35A, as currently drafted, is the way in which it applies to sums paid before judgment. Section 35A(3) states that where the whole of a debt is paid before judgment, the court has power to award interest on the sums already paid, at such rate and for such periods as it thinks fit. However, where damages are paid before judgment, interest may only be awarded as part of a court judgment (section 35A(1)).

In *Edmunds v Lloyds Italico*,[1] Sir John Donaldson MR explained the distinction as follows:

> Payment in full of a debt extinguishes the cause of action and leaves the Court with no basis for giving any judgment, save as provided by sub-s. (3). Payment in full of the amount of the damages still leaves the Court with power to give judgment on liability and to assess the damages and interest taking account of the fact that there has been a payment and acceptance on account of an amount equal to the full amount of the damages.

This means that even where damages are paid in full before judgment, the court retains the power to award interest on all or any part of the damages paid.

The new section 35A retains the distinction, though it reverses the order. New sub-section (1) deals with cases in which the whole debt has been paid, and the cause of action has therefore been exstinguished. New sub-section (3) deals with all other cases, including actions for damages and cases in which only part of the debt has been paid. Here the court may still give judgment. The sub-section makes it clear that the judgment does not have to be for the amount on which interest is awarded. A judgment that is to any extent in favour of the claimant will suffice, including one on liability alone.

[1] *Edmunds v Lloyds Italico & l'Ancora Compagnia di Assicurazioni & Riassicurazione SpA and another* [1986] 1 WLR 492.

for some or all of the relevant period.

(5) Otherwise, the court may award simple or compound interest on—

(a) some or all of the sum for which it gives judgment in respect of the debt or damages, and

(b) if any sum is paid in that respect during the proceedings, some or all of that sum,

for some or all of the relevant period.

(6) "Relevant period" means the period beginning on the date when the cause of action arose and ending—

(a) in relation to any sum for which the court gives judgment, on the date of the judgment, and

(b) in relation to any sum paid during the proceedings, on the date of the payment.

(7) This section is subject to rules of court.

35B Section 35A: rate of interest, &c.

(1) In relation to an action for damages for personal injuries, interest awarded under section 35A on damages for non-pecuniary loss runs for the period for which it is awarded at such rate (or rates) as the court specifies.

(2) Otherwise, subject to rules of court, interest awarded under section 35A runs for the period for which it is awarded—

(a) at such rate (or rates) as the Secretary of State may by order specify, or

(b) if the court decides there are good reasons for awarding interest at some other rate (or rates), at such rate (or rates) as the court specifies.

(3) An order under subsection (2)(a) must be made by statutory instrument, which is subject to annulment in pursuance of a resolution of either House of Parliament.

(4) Where interest is awarded under section 35A, rules of court may make provision as to—

(a) matters to which the court must have regard when deciding whether to award simple or compound interest;

(b) circumstances in which, or heads of damage on which, compound interest may not be awarded;

(c) the method of calculating any compound interest awarded (and, in particular, the rests to be used in the calculation);

(d) matters to which the court must have regard when making a decision under subsection (2)(b) above.

(5) The court may not award interest under section 35A on a debt for a period during which, for whatever reason, interest already runs on it.

(6) But where interest on a debt is statutory interest under the Late Payment of Commercial Debts (Interest) Act 1998—

(a) the court may, on the application of the claimant, award interest under section 35A for the period during which the statutory interest runs, and

EXPLANATORY NOTES

New Section 35B

This section includes much new material. It introduces the concept of a specified rate; it allows rules of court to give guidance on when the courts should grant compound interest; it clarifies the interaction with the Late Payment of Commercial Debts (Interest) Act 1998; and it limits the power to grant "mixed orders".

The specified rate

New sub-section (2)(a) introduces the concept of a specified rate, to be set by the Secretary of State by order. This order-making power replaces the existing provision in section 35A(5) to set the rate with reference to the Judgments Act 1838 or some other statute.

We anticipate that the order will contain a formula along the following lines:

> For so much of the relevant period as falls in a period of 12 months ending with 31 March (a year), a percentage rate equivalent to one per cent above the base rate of the Bank of England in force at the beginning of 15 February in the preceding year.

However, in times of rapidly changing interest rates, it may be necessary to change the rate more frequently than once a year. Under new sub-section (3) the statutory instrument by which the formula may be changed is subject to the negative resolution procedure.

New sub-section (1) provides that the specified rate will not apply to damages for non-pecuniary loss for personal injuries. This preserves the current law, in which case law provides that such damages should carry interest at 2% from the date of service of the claim.

Under new sub-section (2)(b) the court will grant interest at the specified rate unless it decides that there are good reasons for awarding interest at some other rate. Note that there only need to be "good reasons", not special reasons or unusual reasons. We anticipate that in most cases the reason for using a different rate will be that the claimant has been forced to borrow money at a higher rate.

The Civil Procedure Rule Committee may give the courts further guidance on this issue through rules of court or practice directions: see new sub-section (4)(d).

Guidance on when the courts should grant compound interest

New sub-section (4) permits the Rule Committee to make three kinds of rules about how the power to award compound interest should be used.

- Under paragraph (a), the Committee may give general guidance on what matters the courts should take into account when deciding whether to award simple or compound interest. We anticipate that the Civil Procedure Rules will draw a distinction between cases of less than £15,000 and those of £15,000 or more. In the former case, there will be a rebuttable presumption that interest should be simple. In the latter case, the rebuttable presumption will be that interest should be compound.
- Under paragraph (b), the Committee will have the power to specify that compound interest should not be granted on some heads of damages, or in some types of case. We anticipate that this power will be used to exempt non-pecuniary damages for personal injury from compound interest, and to prevent compound interest from being granted on losses that have been outstanding for less than a year.
- Under paragraph (c), the rules will lay down how compound interest is to be calculated, setting out the rests and mathematical formula to be used. It is important that the parties only calculate compound interest according to computer programmes or tables that use the formula specified by the Rule Committee. If the parties were to calculate compound interest in their own way this could lead to different results, which may cause unnecessary disputes.

New sub-section (4)(d) allows for guidance on the use of the specified rate: see above.

Interaction with the Late Payment of Commercial Debts (Interest) Act 1998

This Bill will not affect creditors' right to increased interest under the 1998 Act. New sub-section (6) simply regularises the current situation in which creditors who could use the 1998 Act choose to apply for interest under section 35A instead. Claimants will be allowed to choose which interest regime to apply for.

(b) if it does so, the claimant is not entitled to statutory interest under that Act for that period.

(7) Interest awarded under section 35A in respect of damages may be simple in respect of one head of damage and compound in respect of another.

(8) Interest under section 35A—

(a) may be calculated at different rates in respect of different parts of the period for which it runs, but

(b) may not be simple in respect of one part of that period and compound in respect of another.

(9) In section 35A and this section—

"claimant" means the person seeking the debt or damages,

"defendant" means the person from whom the claimant seeks the debt or damages, and

"personal injuries" includes any disease and any impairment of a person's physical or mental condition.

(10) Nothing in section 35A or this section affects the damages recoverable for the dishonour of a bill of exchange."

2 Award of interest by county courts

(1) For section 69 of the County Courts Act 1984 (power of county courts to award interest on debts and damages) substitute—

"69 Power to award interest on debts and damages

(1) Subsection (2) applies where, during proceedings in a county court for the recovery of a debt, the defendant pays the whole debt to the claimant.

(2) The court may award simple or compound interest on some or all of the debt for some or all of the period—

(a) beginning on the date when the cause of action arose, and

(b) ending on the date of the payment.

(3) Subsections (4) and (5) apply where, in proceedings for the recovery of a debt or damages, a county court gives judgment to any extent in favour of the claimant.

(4) In relation to an action for damages for personal injuries or death in which the court gives judgment for damages exceeding £200, it must, unless it thinks there are special reasons why it should not, award simple or compound interest on—

(a) some or all of the damages for which it gives judgment, and

(b) if any sum is paid in respect of damages during the proceedings, some or all of that sum,

for some or all of the relevant period.

(5) Otherwise, the court may award simple or compound interest on—

(a) some or all of the sum for which it gives judgment in respect of the debt or damages, and

EXPLANATORY NOTES

"Mixed" orders

Under new sub-section (7), the court may award compound interest on some heads of damages (such as past pecuniary loss) but only simple interest on another head (such as non-pecuniary loss).

However, under new sub-section (8)(b), the court may not award simple interest for part of the period and compound interest for the other part. This would add an unnecessary layer of complexity.

Retained elements

The new section also retains some elements from the current section 35A. New sub-section (5) replicates the current sub-section 35A(4). It states that power to award interest is ousted where interest already runs under a contract or other statute.

The definitions are set out in sub-section (9). The Bill uses the modern term "claimant" rather than the archaic term "plaintiff" used in the present section 35A.

New sub-section 35B(10) replicates the current sub-section 35A(8).

CLAUSE 2

This makes corresponding changes to section 69 of the County Courts Act 1984, dealing with the county courts' powers to award interest on debts and damages. It replaces the existing section 69 with two new sections.

(b) if any sum is paid in that respect during the proceedings, some or all of that sum,

for some or all of the relevant period.

(6) "Relevant period" means the period beginning on the date when the cause of action arose and ending—

(a) in relation to any sum for which the court gives judgment, on the date of the judgment, and

(b) in relation to any sum paid during the proceedings, on the date of the payment.

(7) This section is subject to rules of court.

69A Section 69: rate of interest, &c.

(1) In relation to an action for damages for personal injuries, interest awarded under section 69 on damages for non-pecuniary loss runs for the period for which it is awarded at such rate (or rates) as the court specifies.

(2) Otherwise, subject to rules of court, interest awarded under section 69 runs for the period for which it is awarded—

(a) at such rate (or rates) as the Secretary of State may by order specify, or

(b) if the court decides there are good reasons for awarding interest at some other rate (or rates), at such rate (or rates) as the court specifies.

(3) An order under subsection (2)(a) must be made by statutory instrument, which is subject to annulment in pursuance of a resolution of either House of Parliament.

(4) Where interest is awarded under section 69, rules of court may make provision as to—

(a) matters to which the court must have regard when deciding whether to award simple or compound interest;

(b) circumstances in which, or heads of damage on which, compound interest may not be awarded;

(c) the method of calculating any compound interest awarded (and, in particular, the rests to be used in the calculation);

(d) matters to which the court must have regard when making a decision under subsection (2)(b) above.

(5) The court may not award interest under section 69 on a debt for a period during which, for whatever reason, interest already runs on it.

(6) But where interest on a debt is statutory interest under the Late Payment of Commercial Debts (Interest) Act 1998—

(a) the court may, on the application of the claimant, award interest under section 69 for the period during which the statutory interest runs, and

(b) if it does so, the claimant is not entitled to statutory interest under that Act for that period.

(7) Interest awarded under section 69 in respect of damages may be simple in respect of one head of damage and compound in respect of another.

EXPLANATORY NOTES

New section 69A

This introduces the equivalent changes for county courts as new section 35B introduces in the High Court. The previous notes apply.

(8) Interest under section 69—

(a) may be calculated at different rates in respect of different parts of the period for which it runs, but

(b) may not be simple in respect of one part of that period and compound in respect of another.

(9) In section 69 and this section—

"claimant" means the person seeking the debt or damages,

"defendant" means the person from whom the claimant seeks the debt or damages, and

"personal injuries" includes any disease and any impairment of a person's physical or mental condition.

(10) Nothing in section 69 or this section affects the damages recoverable for the dishonour of a bill of exchange.

(11) In determining whether the amount of any debt or damages exceeds that prescribed by or under an enactment, no account is to be taken of any interest payable as a result of section 69 except where express provision to the contrary is made by or under that or another enactment."

3 Award of interest by other courts of record

(1) Section 3 of the Law Reform (Miscellaneous Provisions) Act 1934 (c. 41) (power of courts of record to award interest on debts and damages) ceases to have effect.

(2) A court to which that section applied immediately before the commencement of this section has such powers in relation to the award of interest on debts and damages as the High Court has.

4 Consequential amendments and repeals

(1) In section 24 of the Crown Proceedings Act 1947 (c. 44) (interest on debts and damages), for subsection (3) substitute—

"(3) The following provisions (which give courts power to award interest on debts and damages) apply to judgments given in proceedings by and against the Crown—

(a) sections 35A and 35B of the Supreme Court Act 1981 (award by High Court),

(b) sections 69 and 69A of the County Courts Act 1984 (award by county courts),

(c) section 3(2) of the Interest on Debts and Damages Act 2004 (award by other courts of record)."

(2) In section 329 of the Income and Corporation Taxes Act 1988 (c. 1) (interest on damages for personal injuries is not taxable income), in subsection (2)—

(a) omit paragraph (a),

(b) in paragraph (c), for "section 35A" substitute "sections 35A and 35B",

(c) in paragraph (d), for "section 69" substitute "sections 69 and 69A", and

(d) after paragraph (d), insert—

"(da) section 3(2) of the Interest on Debts and Damages Act 2004;".

EXPLANATORY NOTES

CLAUSE 3

Section 3 of the Law Reform (Miscellaneous Provisions) Act 1934 still applies to courts of record other than the High Court and county courts that award debts and damages and that do not possess their own interest jurisdiction. The only such courts we have been able to identify are the House of Lords, the Employment Appeal Tribunal, the Barmote Courts (which have jurisdiction to deal with some mining disputes in Derbyshire) and, possibly, the Court of Admiralty of the Cinque Ports (which has jurisdiction to deal with some salvage claims).

The current law is limited in that section 3 only applies to cases that are tried. This new clause would give other courts of record the same powers to award interest as the High Court.

CLAUSE 4

Clause 4 deals with consequential amendments and repeals.

(3) In section 1 of the Late Payment of Commercial Debts (Interest) Act 1998 (c. 20) (statutory interest), after subsection (2), insert—

"(2A) But that is subject to—

(a) section 35B(6) of the Supreme Court Act 1981 (power of High Court to award interest under section 35A instead of statutory interest), and

(b) section 69A(6) of the County Courts Act 1984 (power of county courts to award interest under section 69 instead of statutory interest)."

(4) The enactments specified in the first column of the Schedule are repealed to the extent specified in the second column.

5 Commencement, extent and short title

(1) The preceding provisions of this Act come into force on such day as the Secretary of State may by order made by statutory instrument appoint.

(2) Different days may be appointed for different provisions and in relation to different cases.

(3) Compound interest may not be awarded on a debt or damages in consequence of a provision of this Act if the proceedings to recover the debt or damages were issued before the commencement of the provision.

(4) An amendment or repeal contained in section 4 or the Schedule has the same extent as the enactment to which it relates.

(5) Otherwise, this Act extends to England and Wales only.

(6) This Act may be cited as the Interest on Debts and Damages Act 2004.

EXPLANATORY NOTES

Clause 4(3) inserts a new provision into the Late Payment of Commercial Debts (Interest) Act 1998. It refers to a creditor's right to use section 35A or section 69 if they prefer.

CLAUSE 5

Under clause 5(2), the Secretary of State for Constitutional Affairs may introduce the Act in segments. For example, the provisions for a specified rate may be introduced at a different time from the provisions for compound interest. It would also allow compound interest to be introduced into personal injury cases several years after its introduction into other types of action.

Clause 5(3) limits the extent to which compound interest could be applied retrospectively.

SCHEDULE

Section 4

REPEALS

Short tile and chapter	*Extent of repeal*
Law Reform (Miscellaneous Provisions) Act 1934 (c. 41)	Section 3.
Administration of Justice Act 1969 (c. 58)	Section 22. In section 34, the words from ", and section 22" to the end.
Income and Corporation Taxes Act 1988 (c. 1)	Section 329(2)(a).

APPENDIX B
THE CURRENT LEGISLATION

This appendix sets out the two main statutory provisions on interest in their current form. Section 35A of the Supreme Court Act 1981 deals with the High Court's powers to award interest on debts and damages. Section 69 of the County Courts Act is the equivalent provision for county courts.

SUPREME COURT ACT 1981, SECTION 35A

Power of High Court to award interest on debts and damages

(1) Subject to rules of court, in proceedings (whenever instituted) before the High Court for the recovery of a debt or damages there may be included in any sum for which judgment is given simple interest, at such rate as the court thinks fit or as rules of court may provide, on all or any part of the debt or damages in respect of which judgment is given, or payment is made before judgment, for all or any part of the period between the date when the cause of action arose and—

(a) in the case of any sum paid before judgment, the date of the payment; and

(b) in the case of the sum for which judgment is given, the date of the judgment.

(2) In relation to a judgment given for damages for personal injuries or death which exceed £200 subsection (1) shall have effect—

(a) with the substitution of "shall be included" for "may be included"; and

(b) with the addition of "unless the court is satisfied that there are special reasons to the contrary" after "given", where first occurring.

(3) Subject to rules of court, where—

(a) there are proceedings (whenever instituted) before the High Court for the recovery of a debt; and

(b) the defendant pays the whole debt to the plaintiff (otherwise than in pursuance of a judgment in the proceedings),

the defendant shall be liable to pay the plaintiff simple interest at such rate as the court thinks fit or as rules of court may provide on all or any part of the debt for all or any part of the period between the date when the cause of action arose and the date of the payment.

(4) Interest in respect of a debt shall not be awarded under this section for a period during which, for whatever reason, interest on the debt already runs.

(5) Without prejudice to the generality of section 84 rules of court may provide for a rate of interest by reference to the rate specified in section 17 of the

Judgments Act 1838 as that section has effect from time to time or by reference to a rate for which any other enactment provides.

(6) Interest under this section may be calculated at different rates in respect of different periods.

(7) In this section "plaintiff" means the person seeking the debt or damages and "defendant" means the person from whom the plaintiff seeks the debt or damages and "personal injuries" includes any disease and any impairment of a person's physical or mental condition.

(8) Nothing in this section affects the damages recoverable for the dishonour of a bill of exchange.

Inserted by Administration of Justice Act 1982 (c.53), s. 15(1), Sch. 1 Pt. I

COUNTY COURTS ACT 1984, SECTION 69

Power to award interest on debts and damages

(1) Subject to county court rules, in proceedings (whenever instituted) before a county court for the recovery of a debt or damages there may be included in any sum for which judgment is given simple interest, at such rate as the court thinks fit or as may be prescribed, on all or any part of the debt or damages in respect of which judgment is given, or payment is made before judgment, for all or any part of the period between the date when the cause of action arose and—

(a) in the case of any sum paid before judgment, the date of the payment; and
(b) in the case of the sum for which judgment is given, the date of the judgment.

(2) In relation to a judgment given for damages for personal injuries or death which exceed £200 subsection (1) shall have effect—

(a) with the substitution of "shall be included" for "may be included"; and
(b) with the addition of "unless the court is satisfied that there are special reasons to the contrary" after "given", where first occurring.

(3) Subject to county court rules, where—

(a) there are proceedings (whenever instituted) before a county court for the recovery of a debt; and
(b) the defendant pays the whole debt to the plaintiff (otherwise than in pursuance of a judgment in the proceedings),

the defendant shall be liable to pay the plaintiff simple interest, at such rate as the court thinks fit or as may be prescribed, on all or any part of the debt for all or any part of the period between the date when the cause of action arose and the date of the payment.

(4) Interest in respect of a debt shall not be awarded under this section for a period during which, for whatever reason, interest on the debt already runs.

(5) Interest under this section may be calculated at different rates in respect of different periods.

(6) In this section “plaintiff” means the person seeking the debt or damages and “defendant” means the person from whom the plaintiff seeks the debt or damages and “personal injuries” includes any disease and any impairment of a person’s physical or mental condition.

(7) Nothing in this section affects the damages recoverable for the dishonour of a bill of exchange.

(8) In determining whether the amount of any debt or damages exceeds that prescribed by or under any enactment, no account shall be taken of any interest payable by virtue of this section except where express provision to the contrary is made by or under that or any other enactment.

APPENDIX C
COUNTY COURT DATA COLLECTION EXERCISE

C1. The county court judges who responded to our consultation paper told us that it was normal practice for county court claimants to request interest at 8%. This, they said, was usually granted as a matter of routine. They also suggested that the Late Payment of Commercial Debts (Interest) Act 1998 was rarely if ever used. In order to verify this information, we decided to carry out a small data collection exercise in a county court.

METHODOLOGY

C2. In September 2003 we visited Central London County Court to gather data from around 200 case files. We wished to see how many claimants had requested interest – and if interest had been requested, at what rate. Central London County Court has a reputation for dealing with large quantities of business-to-business litigation, and we were particularly interested to see what rates of interest were claimed in business debts.

C3. We collected information from a total of **239** cases. Of these, 99 cases had been issued in January 2002 and 140 had been issued in February 2003. We hoped that the 2002 cases would have had sufficient time to reach a conclusion. Meanwhile, cases issued in 2003 may be able to take advantage of the amendments to the Late Payment of Commercial Debts (Interest) Act introduced for contracts made after 6 August 2002.

C4. We drew cases sequentially, in the order in which they had been issued. There was no attempt to search for particular categories of case, or to select cases that had ended in a particular way. As can be seen from Table 1, our sample consisted of 83 personal injury claims, 81 business claims, 53 consumer claims and 22 other claims.

C5. Unfortunately, it was often not possible to find out how a case had ended, and we did not succeed in gaining useable data on the interest actually awarded. We did, however, find it relatively easy to find out what rate was asked for. In those cases where details of a judgment were available, it would appear that the interest rate asked for is usually granted, at least in default judgments.

THE OVERALL FINDINGS

C6. Table 1 shows that overall, 43% of claimants claimed interest at 8%. Out of the 184 cases in which interest was claimed, over half (55%) claimed interest at 8%, just over a fifth did not specify a rate and just over one in ten claimed interest at the contractual rate. The remaining cases used a wide variety of different approaches.

TABLE 1: INTEREST CLAIMED BY TYPE OF CASE

	Business		**Personal injury**		**Consumer**		**Other**		**All**	
	No	%	No	%	No	%	No	%	No	%
8% claimed	49	**60**	20	**24**	24	**45**	9	**41**	102	***43***
No interest claimed	11	**14**	18	**22**	19	**36**	7	**32**	55	***23***
Interest – no rate specified	2	**2**	31	**37**	6	**11**	2	**9**	41	***17***
Contractual interest	17	**21**	0	**0**	3	**6**	1	**5**	21	***9***
Special investment rate	0	**0**	8	**10**	0	**0**	0	**0**	8	***3***
7% claimed	0	**0**	3	**4**	1	**2**	0	**0**	4	***2***
6% claimed	0	**0**	3	**4**	0	**0**	0	**0**	3	***1***
Taxes Management Act	0	**0**	0	**0**	0	**0**	3	**14**	3	***1***
Late Payment Act	2	**2**	0	**0**	0	**0**	0	**0**	2	***1***
All	**81**	**100**	83	**100**	**53**	**100**	**22**	**100**	239	***100***

C7. Approaches to interest differed according to subject matter, and it is worth looking at the four main categories separately.

BUSINESS CLAIMS

C8. The business cases in our sample were mainly claims in which one business sued another for unpaid goods and services: 69 (85%) were clearly in this category. In eight cases, landlords were suing for business rent, and at least two claims were for breach of contract.

C9. In most cases (60%) the claimant claimed interest at 8% from the date of the payment. In just over a fifth of cases (21%), the claimant claimed at a contract rate. Most other claims either did not claim interest at all (14%) or did not specify a rate (2%). Only two cases in our sample used the Late Payment of Commercial Debts (Interest) Act 1998.

C10. A wide range of contractual rates was used. The most popular rate (used in 9 cases) was 24% a year (or 2% a month), compound. The other rates were all lower than this. In six cases, the contractual rate was directly linked to base rate: in two cases it was 2% above; in two 3% above; and in two 4% above.

C11. Many claims that could have used the 1998 Act failed to do so. It was not always possible to tell whether a case was eligible because we did not know the total number of employees, and not all claims gave the date on which the contract was made (as opposed to the date on which the invoice was submitted). However, it appeared to us that at least 25 cases could have used the 1998 Act. They were all claims for unpaid goods and services and either the contract had been made after 6 August 2002 or the claimant appeared to be a small local firm. Out of these 25 cases, four asked for interest at the contract rate, and two cited the Act. Of the rest, one did not ask for interest. However, most (18) asked for interest at 8%. Late Payment Act interest would have been substantially higher: in January 2002 it was 14% interest, and in February 2003 it was 12%.

C12. It is difficult to understand why claimants should deliberately forgo interest in this way. It would seem either that claimants and their lawyers did not know of the Act, or that did not consider it an appropriate rate to ask for. The Late Payment Act is not yet an established part of legal culture.

PERSONAL INJURY CLAIMS

C13. The most common approach in personal injury claims was for the particulars of claim simply to request "interest pursuant to section 69 of the County Courts Act 1984". Over a third of claims copied words of this type, without specifying what the rate should be. In eight cases, the claimant's solicitor was more specific, and recited the rules set out in Part VII – asking for half the special investment account rate on past pecuniary losses and 2% on non-pecuniary losses from the date of the claim.

C14. However, it appeared that some lawyers were confused or ignorant about interest in personal injury claims. In 18 cases, the particulars of claim failed to ask for interest at all, while in 20 cases they asked for interest at 8% (using the same formula commonly used in business and consumer claims). Table 1 shows that three claims asked for 6% interest and three asked for 7% interest. But there was not always much logic behind these requests: in January 2002, when the special investment account rate was 7%, one claim asked for 6%; while in February 2003, when the special investment rate was 6%, two claims asked for 7%.

C15. These figures suggest that when drafting particulars of claim, lawyers do not always pay great attention to interest. The 8% figure is still commonly asked for in personal injury claims, despite the specific rules laid down by the courts.

CONSUMER CASES

C16. As with business cases, the majority of claims concerned unpaid goods or services. In all 41 out of 53 (77%) were in this category. The most common scenario was for a provider to sue a consumer for an unpaid service – such as car repairs, building work or unpaid legal bills. Very few cases in our sample were for outstanding loans, which accounts for the low use of contractual interest. In five cases the consumer was suing the business for defective work and three cases concerned disputes over the service charges in long leases.

C17. Again, 8% was the most commonly requested interest rate, used in 24 out of the 53 cases. In three cases, the claimant was a solicitor suing for fees who cited the Solicitors' Remuneration Order 1994.[1] Section 14(3) states that "subject to any agreement made between a solicitor and his client, the rate of interest must not exceed the rate for the time being payable on judgment debts". This was taken as authority for charging the judgment debt rate – namely 8%.

[1] Solicitors' (Non-Contentious Business) Remuneration Order 1994, SI 1994 No 2616.

C18. It was also fairly common not to claim interest against consumers. In a third of cases (19) no interest was claimed. The use of contractual interest was rare – in only 3 cases (one of which was a loan case). It would seem that suppliers are more reluctant to insert interest clauses in their contracts with consumers than with businesses.

OTHER CASES

C19. The "other" category included eight housing claims, five actions against public authorities and three debt actions brought by the Inland Revenue. The three inland revenue cases all cited the rate under the Taxes Management Act 1970.

CONCLUSION

C20. This exercise can be no more than a toe in the water. It deals with only a limited number of cases, in one county court at two points in time. However, it does bear out what we were told during consultation. In particular:

(1) Litigants and their lawyers commonly use the 8% rate across a broad range of cases – including some (such as personal injury claims) where it is not necessarily appropriate.

(2) The Late Payment of Commercial Debts (Interest) Act 1998 is not used as often as it could be. It has not yet become an established part of legal culture.

(3) Interest is often fairly far down lawyers' lists of priority. It is common for there to be anomalies and confusions in the way that interest is asked for.

APPENDIX D
CONSIDERING THE LIKELY IMPACT OF OUR PROPOSALS

D1. The report recommends replacing the existing statutory discretion with a presumption in favour of a specified rate, set each year at 1% above the bank base rate prevailing at the time. The courts would be able to depart from this rate where there are good reasons to do so. In larger cases (over £15,000) there would also be a presumption that the interest rate should be compound rather than simple.

D2. These proposals have the potential to affect a wide range of commercial and consumer debt and damages actions, together with some personal injury and professional negligence claims. A broad estimate suggests than around **500,000 court actions** a year would be affected, though in most cases the impact would be small.

D3. This appendix is a first attempt to assess the impact of these proposals, looking separately at consumer debt, commercial debt, personal injury and professional negligence litigation.

D4. There are four reasons why assessing the impact is difficult:

(1) Our knowledge of court business is patchy. In the discussion that follows we have relied on a mixture of court statistics and one-off studies. Both sets of data should be treated with care. Court statistics often mask important differences between cases, while one-off studies are limited in both place and time. For example, we have attempted to interpret 2001 national figures[1] by applying findings from a detailed study of the business of the Sheffield courts in 1996-7.[2] Such an approach is suggestive only. Sheffield may not be a typical court, and much may have changed since 1997.

(2) We lack reliable quantitative data on how often interest is currently awarded, or at what rate. The data collection exercise in Central London County Court described in Appendix C is an attempt to plug this gap. However, it is based on a small and limited sample, and must be treated with care.

(3) We do not know how the courts would adjust to low interest rates in the absence of statutory reform. Some adjustment is likely – but would probably take place in an uncertain and *ad hoc* way.

[1] Lord Chancellor's Department, *Judicial Statistics Annual Report 2001* (2002) Cm 5551.

[2] J Shapland, A Sorsby and J Hibbert, *A Civil Justice Audit* (2002) Lord Chancellor's Department Research Series 2/02.

(4) We do not know what will happen to commercial interest rates in the future – whether the bank base rate will continue low or will rise again. If we assume low interest rates, our proposals are essentially "defendant-friendly". As interest rates rise, however, they become progressively more "claimant-friendly".

These caveats need to be borne in mind in the discussion that follows.

THE EFFECT ON CONSUMER DEBTORS

D5. Before looking at cases that will be affected, it is important to stress which cases will not be affected. Three types of consumer debt will not be affected:

(1) any contract that already specifies an interest rate – such as mortgage contracts, bank loans, store or credit card debts;

(2) any statutory debt (such as income tax) where the interest rate is specified by statute;

(3) debts where interest is not currently awarded. Our understanding is that in practice, District Judges very rarely award interest on debts associated with poverty, such as domestic rent, water or fuel debts.

D6. The main type of debts that will be affected are those owed for unpaid goods and services. Often these are owed to small firms or traders – for building work, car repairs, solicitors' bills etc.[3]

D7. In 2001, **1,461,105** default actions were issued in the county court.[4] How many of these represent debt actions brought against consumers of the type that may attract interest at a rate set by the court? Although this is a difficult question to answer with any precision, some answers are suggested by the audit of work in Sheffield County Court in 1996-7. This found that out of all default actions issued, 72% were liquidated; of which 52% were brought by firms or organisations against individuals. Of these, 23% were for work

[3] An analysis of legal aid files closed in 1998/9 found that the most common consumer disputes were over building work in its widest sense (including bills owed to electricians, plumbers, home improvement etc). Other common areas of dispute were leasehold services, car repairs and professional bills. See T Goriely and P Das Gupta, *Breaking the Code: The Impact of Legal Aid Reforms on General Civil Litigation* (2001) Institute of Advanced Legal Studies. The data collection exercise in Central London County Court also included claims for building work, car repairs, leasehold services and legal fees.

[4] *Judicial Statistics 2001*, table 4.2, p 39. A default action, unlike fixed date actions for recovery of land or goods, is not automatically listed for a court hearing. Instead, if the defendant fails to defend the hearing, the claimant may ask for a "default judgment" to be entered as a purely administrative procedure. Although default actions account for the majority of county court business, they do not include possession actions, family matters (such as divorce or adoption) or bankruptcy or winding-up petitions.

done or services rendered and 9% were for goods not paid for.[5] This would suggest that around **175,000** actions for unpaid goods and services brought against consumers each year.[6] The number is likely to fluctuate with changes in the economy.

D8. In our own data collection exercise, we gathered data on 41 actions brought against consumers for unpaid goods and services. Of these 13 did not ask for interest, and one asked for contractual interest. On this basis, we have made a rough estimate that one third of such claims will not be affected, whereas the remaining two-thirds will be affected. This would suggest that our proposals will affect **117,000** consumer cases per year.

County court default actions: small, quick and routine

D9. Most consumer debt actions are small. The Sheffield study found that over 90% of county court liquidated claims in 1996-7 were for £3,000 or less. Most of the bigger claims related to the repayment of loans. Among claims for work done or goods delivered, less than 2% exceeded £5,000.[7]

D10. Most of these claims were also quick. Looking at liquidated claims as a whole, only 19% were defended. Most ended with default judgments (44%), or were withdrawn (23%) or settled (14%) before a defence was entered. This meant that consumer claims completed their passage through the county court within a few months. Almost two thirds were completed within 8 weeks and 85% were completed within 24 weeks.[8]

D11. The picture is one of many small, quick cases processed as a matter of routine. Consumer defendants were very unlikely to be represented. The Sheffield study found that defendants were represented in less than 3% of county court default actions for work done or goods delivered.[9] This suggests that interest rates will also be imposed as matter of routine, with few opportunities for discussion.

Consumer actions in the High Court

D12. In theory, consumer debt actions may also be started in the High Court. However, the Sheffield study found that the High Court was overwhelmingly used by businesses against businesses. Only 10% of liquidated actions brought in 1996-7 were against individuals.[10]

[5] Most of the rest were either in connection with public sector debts (eg income tax, repayment of housing benefit) or related to money lent. See Shapland et al, n 2 above, p 31.

[6] ie 1,461,105 x 0.72 x 0.52 x (0.23 + 0.09).

[7] Shapland et al, p 34.

[8] Shapland et al, p 65. This does not include delay before the action is brought (for which interest is payable) or for the further delays between judgment and payment (which is subject to a different interest regime).

[9] Shapland et al, p 36.

[10] Shapland et al, p 43.

D13. Liquidated High Court claims were for surprisingly small amounts. Overall, 65% were for less than £3,000. Among liquidated claims brought against individual defendants, only 7% exceeded £10,000.[11] Most High Court debt claims could have been brought in the county court.

Cases that proceed to a small claims hearing

D14. The consumer debt cases that will be most strongly affected by our proposals will be those in which the debt is disputed. The Judicial Statistics show that in 2001 **20,520** debt-related small claims hearings took place in which the defendant was an individual.[12] These cases last longer than undisputed claims, so interest payments will be higher. On average it takes **28 weeks** for a debt claim to proceed from issue to hearing.[13] If one assumes that it will take several months for the claimant to pursue the debt before issue, one may hazard a guess that such cases would take, on average, around a year from cause of action to judgment.

D15. Most defendants to small claims hearings lose. In Baldwin's study of small claims hearings, 62% of claimants succeeded wholly or in large part, and 9% succeeded in some part.[14] It is therefore common for consumer defendants to small claims hearings to end up with a judgment made against them. The figures suggest around **14,570** such judgments each year. In many cases the judgment will bear interest under the County Courts Act 1984, section 69.

D16. Not all judgments are actually paid. Baldwin points out that six months after the hearing, only half had been paid in full. In a quarter of cases, no payment at all had been received.[15] However, consumers may be concerned about the size of any court judgment entered against them even they are unable to pay it. (They may be *especially* concerned about those they are unable to pay.) It is important that court judgments are perceived as just, whether or not they are actually paid.

The effect of interest proposals on consumer debtors: conclusion

D17. On a rough estimate, our proposals may affect up to **117,000** consumer debt actions each year. In the main, these will be cases brought by small firms and traders in respect of work done and (to a lesser extent) goods delivered. The amount of interest consumers will be required to pay will be reduced from 8% to 4.75%.

D18. Most of these actions are fairly small and quick. Thus the amount of money at stake is not great. The Sheffield study found that the median value claim

[11] Shapland et al, p 44.

[12] *Judicial Statistics 2001*, table 4.9.

[13] *Judicial Statistics 2001*, table 4.11.

[14] J Baldwin, *Small Claims in the County Courts in England and Wales: the Bargain Basement of Civil Justice* (1997) p 28.

[15] *Ibid*, p 134.

was less than £500. We may also assume that most claims are concluded within six months of the cause of action arising. This would suggest that in the majority of cases, the reduction would be **£8.12** or less. [16]

D19. The cases most affected will be where the defendant enters a defence and proceeds to a hearing. It is especially important that interest rates should not be perceived as way of discouraging defendants to put forward a legitimate defence. Even if the defendant eventually loses (as they do in around 14,570 cases a year) the interest entered in judgment against them should be perceived as compensatory rather than penal. Assuming a claim of £3,000 lasting for a year, the difference in interest from 8% to 4.75% would amount to **£97.50**.[17]

D20. The proposals allow the court to adjust rates, if for example, a debtor has deliberately delayed payment and the trader has been forced to borrow money at high interest rates. Given the routine nature of most debt collection, and the low level of representation, these provisions will probably be used relatively rarely.

D21. Finally, it would appear that the introduction of compound interest will have very little effect against consumers. It is rare for actions to be brought against consumers for more than £15,000. Where such actions are brought they will usually be for money lent, where the interest rate (and compounding intervals) are already set by contract.

COMMERCIAL DEBT RECOVERY

D22. The Sheffield study suggests that out of county court liquidated default actions, around a third (32%) are brought by firms against firms specifically for unpaid goods or services. Applying this proportion to the *Judicial Statistics* figures would suggest that in 2001 around **337,000** commercial debt cases were started in the county court.[18]

D23. The High Court is also commonly used for commercial debt recovery. In 2001, 16,491 Queen's Bench Cases were started in District Registries.[19] The Sheffield study found that these were overwhelmingly commercial debt recovery. In all, 93% of cases started were liquidated claims, and 82% were classic commercial debts brought by firms against firms for the recovery of money owed for goods or services. This would suggest that in 2001 around **13,500** commercial debt claims were brought in District Registries for the price of goods or services.

[16] £500 x (0.08 – 0.0475)/2.

[17] £3,000 x (0.08 - 0.0475).

[18] Out of 1,461,105 default actions, 72% were liquidated (1,052,000) of which 32% were brought by firms against firms in respect of unpaid goods and services: see *Judicial Statistics 2001*, table 4.2 and Shapland et al, p 31.

[19] Judicial Statistics, table 3.1.

D24. The *Judicial Statistics* show that another 5,122 cases were started in the Royal Courts of Justice in London. However, the profile of these cases is different, with only a minority concerning debt. The Judicial Statistics suggest that only 29% (**1,483**) were for goods or services. Other prominent categories included personal injury, breach of contract, professional negligence and defamation.

D25. Taken overall, it would appear that large numbers of court cases are debt actions brought by firms against firms for the supply of goods and services. At a rough guess, in 2001, over **350,000** such actions were brought in either the county court (around 337,000) or High Court (around 15,000).

The effect of the Late Payment of Commercial Debts (Interest) Act 1998

D26. This category of cases (debt recovery by businesses from businesses in respect of goods and services) attracts a higher rate of interest under the 1998 Act, to discourage late payment. This rate, set every six months at 8% above base, is currently 11.75%.

D27. The 1998 Act does not appear to be widely used, though it is not entirely clear why this should be. There are several possible explanations.

(1) It may take time for the Act to become known, and for cases to work their way through the system. When first introduced in November 1998, the Act only applied to small businesses (50 or fewer employees) collecting debts from big businesses. Such cases are relatively rare. For example, Baldwin's study of small claims found that that only 0.6% of small claims fell into this category.[20] It is more common for small businesses to sue other small businesses: Baldwin found that in almost a quarter of small claims (24%) a small business or trader was suing another small business or trader.[21] However, it is only since 7 August 2002, with the inclusion of large businesses. that the Act has reached its full potential.

(2) It may reflect lawyers' lack of interest in interest. Solicitors may be unaware of the Act, and may have failed to grasp its advantages.

(3) Creditors may be reluctant to invoke the Act. It may be thought overly aggressive, or difficult to enforce.

Commercial debts: conclusion

D28. Our proposals will not affect creditors' rights to claim under the 1998 Act directly. However, in practical terms they may encourage creditors to use the 1998 Act for two reasons. First, it will make creditors think about interest (rather than reaching for the 8% rate on auto-pilot). Secondly, it

[20] Baldwin, p 26.

[21] *Ibid*.

will increase the differential between the normal court rate and the enhanced rate under the 1998 Act, making the 1998 Act appear more advantageous.

D29. In cases not covered by the 1998 Act, our proposals will ensure that interest rates more accurately reflect commercial reality. In most small, short cases, the rate the debtor is required to pay will be reduced. In large, longer cases, there are likely to be small increases to reflect compound interest.

D30. Overall, the greatest effect of our proposals will be in large commercial litigation involving damages rather than debt, which are not covered by the 1998 Act or by contractual terms. The action that spurred this review was a restitution case for money had and received. We were told that interest may also be substantial in breach of patent cases, where losses may spread over many years.[22] In this type of litigation it is important that English law is regarded as fair, up-to-date and sensitive to commercial realities. It is difficult to justify the lack of compound interest simply on the grounds that the statute does not allow it.

PERSONAL INJURY LITIGATION

D31. For the purposes of discussion over interest, personal injury damages may be divided into three types.

(1) The most important element is future loss. This does not carry interest at all.

(2) Non-pecuniary damages are subject to special rules – and carry interest at 2% from the date of the claim. The amount of interest at stake is small, and we are not proposing any changes.

(3) Past pecuniary loss carries interest from the date the loss arises. Where loss is continuous (as in loss of earnings) the courts may simplify the calculation by granting interest at half the normal rate. Although case law suggests that they should grant interest at half the special investment rate (ie 3%) we were told that it is often granted at half the judgment rate (ie 4%).

D32. Our proposal is to reduce the normal rate granted on past pecuniary loss. However, where the amount of the past-pecuniary loss exceeds £15,000, there will be a presumption that the rate should be compound. The rate may also be raised where the claimant can show that they have been forced to borrow money at high rates.

Standard cases

D33. In order to assess the impact of these proposals, it is important to bear in mind that most personal injury cases settle for relatively small damages. The largest study of "ordinary" personal injury cases is an analysis of over

[22] See Part IV, n 13, above.

80,000 legally-aided cases closed in 1996-7 (when legal aid was still generally available for this type of work).[23] It showed that 70% of successful cases resulted in damages of less than £5,000 and 80% resulted in less than £10,000. These figures are for total damages. Only very serious injuries would result in past pecuniary losses of more than £15,000.

D34. The study also showed that most cases were concluded within three years. In road, tripping and occupiers' liability cases, most victims consulted solicitors within a month of the accident. The mean duration for work and road accidents thereafter was 29-30 months.

D35. These figures suggest that in the great majority of cases, our proposals will lead to small savings in the amount of interest paid on past pecuniary loss. To take a couple of examples:

(1) The first would be a small case, where a £500 loss of earnings arises in the week or two immediately following the accident. The case settles 18 months later. If one applies the current base rate plus 1% (4.75%) the interest payable on £500 would be **£35.63** compared with £45 if one applied the special investment rate, or £60 if one applied the judgment rate.

(2) In a mid range case, where past pecuniary losses of £10,000 arise continuously over a three-year period, the interest payable under our proposals would be **£711**, compared with £900 if one applied the special investment rate, or £1,200 if one applied the judgment rate.

However in many cases interest is not calculated precisely, and will be factored into the negotiations in a global way.

Long cases

D36. Two factors made cases last longer.

(1) First, the more severe the injury, the longer the case duration. On average, severe injuries took twice as long to conclude as minor injuries. [24]

(2) Secondly, irrespective of severity, clinical negligence cases took longer to resolve at each step of the process. The legal aid study found that claimants generally took between one and two years to instruct a solicitor – and solicitors then took a mean of 33 months

[23] P Pleasance, *Report of the Case Profiling Study: Personal Injury Litigation in Practice* (1998) Legal Aid Board Research Unit. It is difficult to say how far legally aided cases were typical of all cases, but one might expect that legal aid would attract the larger (and therefore longer and more expensive) claims. This is for two reasons. First, the more severely disabled clients would be more likely to meet the means test. Secondly, solicitors would be less prepared to cover such cases on a speculative basis.

[24] *Ibid*, p 68.

to conclude the case.[25] It was therefore common for clinical negligence claims for take four or more years to resolve. Similarly, a survey of cases submitted to the Supreme Court Taxing Office found that clinical negligence took an average of 65 months from the time the claimant first consulted a solicitor to judgment or payment, compared with 56 months for other personal injury cases.[26]

D37. The longest cases of all were the most severe clinical negligence claims. The NHS Litigation Authority expressed particular concerns about cases involving children (especially those concerning birth-related injuries), where the normal limitation periods do not apply, and claims may be brought to their attention a decade or more after the original incident.

D38. It is important to look at the impact on clinical negligence cases in greater depth, and these are dealt with in Appendix E.

PROFESSIONAL NEGLIGENCE

D39. There is evidence to suggest that professional negligence cases are also ranked among the most lengthy cases.

D40. For example, Genn's survey of Supreme Court Taxing Office Bills in 1995 found that professional negligence actions were the next slowest to resolve, after clinical negligence and personal injury actions. She found that the mean duration for professional negligence cases in the survey was 33 months for non-legal aid cases, rising to 52 months for legally aided cases.[27]

D41. An analysis of general legal aid files closed in 1998-9 confirmed that professional negligence cases were particularly slow.[28] The average case took 46 months from legal aid application to conclusion:[29] a quarter took five years or more, with longest taking almost 10 years.

D42. The survey of legal aid bills showed that in practice most cases (78%) were brought against solicitors, with most of the rest brought against surveyors, architects or vets. Damages were in the mid-range. The median amount was £13,750. A quarter were for £5,000 or less, with a quarter for £30,000 or more.

[25] *Ibid*, p 44. The time measured is from the issue of the legal aid certificate to the submission of the final bill. This should be treated with care – the legal aid certificate may be issued some time after solicitor is first instructed, and the bill may be submitted after the final work on the case.

[26] H Genn, *Survey of Litigation Costs* (1996) (conducted for Lord Woolf's Inquiry into Access to Justice).

[27] *Ibid*, p 49.

[28] See T Goriely and P Das Gupta, *Breaking the Code: The Impact of Legal Aid Reforms on General Civil Litigation* (2001) Institute of Advanced Legal Studies.

[29] The mean time was 46 months, the median 45: p 100. This is slightly less than the Genn survey, but is still within the same order of magnitude. Genn relied on High

D43. It is difficult to know exactly how the courts treat interest payments on these cases, but the strong culture in favour the judgment rate would suggest that most currently attract interest at 8%.

D44. In most cases, the reduction of interest rate from 8% to 4.75% will result in a reduction in interest awarded. But this is an area where claimants may well show that they needed to borrow at higher rates to make good the damages – so the judge may well order a higher rate.

D45. Where damages are over £15,000, we propose a presumption in favour of a compound rate. Where 11 years have elapsed between the cause of action and settlement/trial, a compound rate of 6% will exceed a simple rate of 8%. It is therefore possible for our proposals to increase the total interest payable, though this would only happen in unusual cases.

Professional negligence cases: conclusion

D46. The effect of our proposals is likely to be a small reduction in interest payable to claimants in most standard cases. However, additional interest may be paid to those who can show particular need. More interest may also be paid in the very longest cases, where the effect of compounding becomes significant.

D47. Overall, it would appear that the effect is broadly neutral.

OTHER DISPUTES

D48. We have looked briefly at other areas of litigation. We do not consider that our proposals will affect actions against the police, judicial review or defamation cases. For housing repairs, the net effect is likely to be a small reduction in the interest paid.

Actions against the Police

D49. As far as actions against the police are concerned, these may also take a long time to resolve. The analysis of legal aid bills found that, like professional negligence claims, the mean time from legal aid application to resolution was 46 months, with the longest action taking almost 9 years.[30] The amounts at stake ranged from £400 to £635,000 – but large awards were very much the exception. Generally awards made against the police were small – half under £5,000 and three-quarters under £10,000.[31]

D50. Non-pecuniary damages for false imprisonment or malicious prosecution do not usually attract interest.[32] Although it is possible to include claims for

Court cases leading to contested taxations, which is likely to over-estimate the length and cost of disputes, as it attracts the most contentious and difficult disputes.

[30] *Breaking the Code,* p 109.

[31] *Breaking the Code,* p 110.

[32] *McGregor on Damages* (17th ed 2003) para 15-054.

pecuniary loss such as lost earnings, these will be minor. Thus our proposals are unlikely to have much effect in this area.

Judicial review

D51. Genn found that judicial review actions were resolved comparatively quickly. The average from instruction to settlement or trial was only 12 months.[33] As the outcome rarely involves a monetary amount, we do not envisage that our proposals would impact in this area.

Defamation

D52. Damages in defamation actions are largely damages for non-pecuniary loss, which do not normally attract interest of any kind.[34] Our proposals are unlikely to impact in this area.

Housing disrepair

D53. We have been unable to locate quantitative data on the duration of actions for housing disrepair or on the amount of the damages. The only recent research is a qualitative interview study on the effect of the Woolf reforms.[35] Here solicitors suggested a recent marked reduction in time taken. For example, one landlord lawyer suggested that on average unproblematic cases would now take five or six months, whereas previously it could take anything up to two years. Others repeated that whereas previously cases had often taken over 18 months, they could now take three to six months.[36] The six months is measured from the date at which solicitors become involved. Tenants may take much longer to attempt to resolve the issue directly with the landlord before contacting a solicitor.

D54. When solicitors were asked about the amount of damages, they suggested that a typical amount would be around £3,000. Some mentioned a range of £2,000 to £3,000,[37] while others mentioned £3,000 to £4,000.[38] Solicitors

[33] H Genn, *Survey of Litigation Costs* (1996) p 91.

[34] *Saunders v Edwards* [1987] 1 WLR 1116. Although this case related to fraudulent misrepresentation, Bingham LJ noted that damages for mental distress are analogous to defamation damages which, to his knowledge, never attracted interest. McGregor, states that the Court of Appeal has refused damages for non-pecuniary loss in a claim for wrongful arrest and false imprisonment. He added, however, that "interest is beginning to be allowed on the non-pecuniary element of awards, representing injured feelings, in the statutory tort of racial discrimination." He qualifies this by stating that "it is thought that these decisions would not survive a consideration of the matter by the Court of Appeal." See *McGregor on Damages* (17th ed 2003), paras 15-056 - 15-057.

[35] T Goriely, R Moorhead and P Abrams, *More Civil Justice? The Impact of the Woolf Reforms on Pre-Action Behaviour* (2002) Law Society/Civil Justice Council.

[36] *Ibid*, p 307-8.

[37] *Ibid*, p 310.

[38] *Ibid*, p 333.

also said that the housing actions were overwhelming small claims or fast track claims. Multi-track claims over £15,000 were very rare.[39]

D55. As we understand it, damages for a failure to repair are generally a continuing loss throughout the period between first notification and actual repair, and so would normally carry interest at half the standard rate.

D56. It is very unlikely that a tenant will be able to show that they have borrowed to cope with the effects of disrepair. It will also be very rare for damages to exceed £15,000 and attract compound interest. The main effect will be a small reduction of interest. Assuming a continuing loss over two years on £3,000, interest at half the 4.75% rate would be **£142.20**, compared with **£240** at half the 8% rate.

CONCLUSION

D57. The main effect of our proposals will be in commercial litigation. In standard debt collection matters, debtors will usually be required to pay lower rates of interest. However, this will be partially countered if creditors are encouraged to make greater use of the Late Payment of Commercial Debts (Interest) Act 1998. In lengthy disputed litigation, interest payments will more closely reflect commercial realities. The intention is to increase the reputation of English legal system as being fair, up-to-date and commercially realistic.

D58. In consumer debt cases brought by suppliers of goods and services, interest payments will decrease – but in most cases by only a small amount (under £10). The main effect will be for disputed claims that proceed to a small claims hearing (or almost to a hearing). Here defendants will no longer be penalised for defending the claim, but will be required to pay interest that more closely reflects the cost to the claimant.

D59. In most personal injury claims there will be a small reduction in the interest payable on past pecuniary loss. However, in the largest, longest cases the introduction of compound interest has the potential to increase interest payments. In practice the greatest effect will be in clinical negligence cases, and we investigate this in Appendix E.

[39] *Ibid*, p 287.

APPENDIX E
THE IMPACT ON CLINICAL NEGLIGENCE CLAIMS

E1. In order to assess the impact of our proposals on clinical negligence claims we contacted three medical defence organisations (MDOs): the National Health Service Litigation Authority (NHSLA), the Medical Defence Union (MDU) and the Medical Protection Society (MPS). All three institutions provided us with data on personal injury claims they had paid in recent years.

E2. The data we were given are set out in Tables 1 and 3 below. As can be seen, they show the damages paid by age of case, banding cases together in three year intervals, with all claims of 21 years or more at the end. Tables 2 and 4 show the effect of compound interest on these payments. At the end of this appendix, we provide details of the methodology used to calculate the compound interest due on continuous loss figures.

ASSUMPTIONS

E3. In undertaking these calculations we made certain assumptions. All of the cases in the three year bands were assumed to have settled or been adjudicated at the middle of the band. Figures in the band of 0-3 Years are therefore calculated as settling on 1.5 years.

E4. These assumptions do not apply to the last set of figures, which represented cases of 21+ years duration. For this band we assumed that the cases in question closed after 26 years duration. Whilst each of the MDOs was able to point to a case that had lasted longer than this we consider that these cases stick in the memory because of their unique nature. Most cases in the 21+ bracket had closed by 26 years. We also considered that the, admittedly exponential, effect of compound interest in the cases of greater than 26 years duration would be offset by the number of cases which were under that figure.

E5. All the data provided by the MDOs related to cases closed in 2001-2002. All cases are therefore assumed to have started on 1 April of the year in question and closed on 1 October 2002. This is with the exception of the cases in the 21+ years bracket which are assumed to have started on 1 April 1976 and closed on 1 April 2002.

E6. In addition, the MDU provided us with figures on interim payments, which have a potentially substantial impact in reducing the compound interest due. The figures given below, however, do not take interim payments into account.

E7. After looking at the MDO data we realised that it was often not possible to tell what proportion of total damages was taken up by past pecuniary loss, to which compound interest should be applied. After considering the data we had, our best estimate was that on average 16% of total damages represented past pecuniary loss, and the MDOs agreed with this figure.

Although this proportion may be greater in low-value claims and smaller in longer and higher-value claims, the figures below are calculated using the 16% figure.

E8. It is very difficult to discover how much interest is actually paid in clinical negligence claims at present. All three MDOs told us that interest is rarely calculated with any accuracy. It is usual for the parties to agree rough and ready figures at the end of the case. The files often do not distinguish between damages and interest. There are many factors that affect the interest payable including: whether loss did in fact arise continuously, or whether losses were greatest towards the beginning or end of the period; whether any penalty was imposed for delay in bringing the claim; or whether interim payments were made. Sometimes the calculations may be greater (or less) than the rules would suggest if, for example, lawyers have failed to track rates over time; have applied the half-rate rule inaccurately; or have used a figure that is not the special investment account rate.

E9. As a result of these factors, we decided not to attempt to compare compound interest with the interest currently granted. Instead we assume that the losses arose evenly over time; that no penalties were imposed; and that no interim payments were made. We then compare the interest that would have been granted had the special investment rate been correctly applied, compared with the interest that would be granted under our proposals.

TABLES

National Health Service Litigation Authority (NHSLA)

E10. Due to changes in the structure of claim handling within the NHS, the NHSLA were only able to give us figures for cases of over 9 years' duration. These cases were dealt with by the NHSLA directly under their Existing Liabilities Scheme, rather than being handled by NHS Trusts. They were all closed in 2002. In interpreting the tables it should be remembered that they do not include figures for cases up to 7 years' duration, which show a reduction in interest owed. Nor do they include cases of 7-9 years' duration, which show a markedly lower increase in interest than the figures below would suggest at first glance. Whilst we did not receive specific information on shorter cases, other studies into NHS costs show that total liabilities for 2001/02 totalled £446 million.[1]

[1] *Making Amends* (2003) p 60.

TABLE 1: CLAIMS OVER 9 YEARS OLD CLOSED BY NHSLA IN 2002 UNDER EXISTING LIABILITIES SCHEME

Claim Age	Total Damages	Damages in Period as % of Total Damages
9-12 Yrs	£69,347,879	36.0%
12-15 Yrs	£60,361,464	31.3%
15-18 Yrs	£14,574,856	7.5%
18-21 Yrs	£16,369,030	8.5%
21+ Yrs	£32,162,076	16.7%
Total	**£192,815,305**	**100.0%**

TABLE 2: EFFECT OF APPLYING COMPOUND INTEREST AT BASE +1% COMPARED WITH SIMPLE INTEREST AT SPECIAL INVESTMENT RATE

Claim Age	Total Damages	Increase in Interest as a % of Damages	New Total Damages	Cost of Compound Interest	Increase in Period as % of Total Increase
9-12 Yrs	£69,347,879	0.98%	£70,028,620	£680,741	3.6%
12-15 Yrs	£60,361,464	2.36%	£61,785,577	£1,424,113	7.5%
15-18 Yrs	£14,574,856	6.14%	£15,469,728	£894,872	4.7%
18-21 Yrs	£16,369,030	12.34%	£18,389,511	£2,020,481	10.6%
21+ Yrs	£32,162,076	43.83%	£46,257,316	£14,095,240	73.7%
Total	**£192,815,305**	**9.91%**	**£211,930,752**	**£19,115,447**	**100.00%**

E11. These tables suggest that our proposals would add £19.1 million a year to the cost of NHS clinical negligence claims. If we assume that that the total amount spent on such claims is £446 million, this represents an increase of 4.3%.

Medical Defence Union and Medical Protection Society

E12. Both the MDU and the MPS were able to supply us with figures for cases settled in both 2001 and 2002. After consulting both organisations we agreed that MDU and MPS have broadly comparable portfolios and as such they were happy for us to amalgamate the data they provided to give a larger and more representative sample base. The figures below are for both MDU and MPS. Unlike the NHSLA tables, they cover two years.

E13. For simplicity's sake we have calculated interest on the basis that the cases closed on 1 October 2002 and not, as would have been appropriate in some cases, 2001. The change in figures would, however, be small and we consider that the tables below are still acceptably accurate.

TABLE 3: ALL CLAIMS CLOSED BY MEDICAL DEFENCE UNION AND MEDICAL PROTECTION SOCIETY IN 2001 AND 2002

Claim Age	Total Damages	Damages in Period as % of Total Damages
<3 Yrs	£2,824,775	3.2%
3-6 Yrs	£31,710,853	35.9%
6-9 Yrs	£27,375,267	31.0%
9-12 Yrs	£10,670,985	12.1%
12-15 Yrs	£3,045,390	3.4%
15-18 Yrs	£1,916,027	2.2%
18-21 Yrs	£1,658,909	1.9%
21+ Yrs	£9,141,665	10.3%
Total	**£88,370,871**	**100.0%**

TABLE 4: EFFECT OF APPLYING COMPOUND INTEREST AT BASE +1% COMPARED WITH SIMPLE INTEREST AT SPECIAL INVESTMENT RATE

Claim Age	Total Damages	Increase in Interest as a % of Damages	New Total Damages	Cost of Compound Interest	Increase in Period as % of Total Increase
<3 Yrs	£2,824,775	-0.07%	£2,822,679	-£2,096	-0.05%
3-6 Yrs	£31,710,853	+0.004%	£31,711,968	£1,115	+0.03%
6-9 Yrs	£27,375,267	+0.37%	£27,477,713	£102,446	+2.22%
9-12 Yrs	£10,670,985	+0.98%	£10,775,726	£104,741	+2.27%
12-15 Yrs	£3,045,390	+2.36%	£3,117,228	£71,838	+1.56%
15-18 Yrs	£1,916,027	+6.14%	£2,033,680	£117,653	+2.55%
18-21 Yrs	£1,658,909	+12.34%	£1,863,697	£204,788	+4.45%
21+ Yrs	£9,141,665	+43.83%	£13,148,025	£4,006,360	+86.97%
Total	**£88,343,871**	**5.21%**	**£92,950,716**	**£4,606,845**	**100.00%**

E14. The tables show that compound interest will add between 4-5% to the total costs, resulting in an increase across the two organisations combined of £4.6 million in two years, or £2.3 million in one year.

Overall costs

E15. These tables do not include the cost of meeting NHS claims in Wales. Published data suggests that the cost of clinical negligence in Wales is around a tenth of that in England. In 2001-02, the Welsh Risk Pool re-

imbursed health authorities and NHS trusts around £46.3 million in respect of clinical negligence and personal injury claims.[2] This compares with an annual expenditure in England of £446 million.[3] Assuming that English and Welsh case profiles are similar, this would suggest that Welsh expenditure would be around £1.98 million.

E16. Based on these figures our best estimate is that our recommendations would add **between £20 million and £25 million** to the cost of clinical negligence claims each year. These sums would be reduced if judges exercised their discretion to disallow payments or if defendants made interim payments.

GENERAL METHODOLOGY

E17. The methodology for calculating compound interest, subject to the assumptions laid out above, is easiest viewed on a month by month basis. For each month interest is calculated at 1/12 the full rate for that year on the sum that had arisen at the start of the month and is added to that sum. Interest is then calculated on the sum arising during that month at half the monthly interest rate to account for the continuous nature of the loss. Finally the capital sum that has arisen during the month needs to be added. The calculation is then repeated for each month, changing the rates each year. This is best explained by an example.

Example

E18. An accident occurs on 1 April 2000 and is settled on 31 March 2003, giving rise to total past pecuniary loss of £36,000 (£12,000 per year). The interest rates for each year (a year being 1 April – 31 March) are the base rate in force on 15 February prior to the year commencing +1%. These are 7%, 6.75% and 5% for the years beginning 1 April 2000 – 2002 respectively.

April 2000

E19. No capital is owed at the start of the month (1 April 2000). By the end of the month (30 April 2000), £1,000 is owed. In addition interest has accumulated on that figure for one month (at ½ the full rate for the month to take account of the fact that it is continuous).

£1,000 + (£1,000 x 1/12 x 7/100 x ½)

= £1,002.92

May 2000 – March 2001

E20. In May, £1,002.92 is owed at the start of the month and must be taken into account along with a month's interest at the full rate. In addition the monthly accumulation also occurs with interest (at half the rate).

[2] The Finances of NHS Wales 2003: Report by the National Audit Office on behalf of the Auditor General for Wales (2003) p 20.

[3] *Making Amends* (2003) p 60.

(£1,002.92 + (£1,002.92 x 1/12 x 7/100)) +

(£1,000 + (£1,000 x 1/12 x 7/100 x ½))

= £2,011.68

E21. For June 2000 – March 2001 the same calculation as the one shown in May 2000 occurs, but the figure owed from the start of the month changes each month (so for June 2000 that figure is £2,011.68). The figure at the end of March 2001 is therefore **£12,428.72**.

April 2001 – March 2002

E22. With £12,428.72 owing at the start of the second year the same calculations are used as applied for April 2000 – March 2001, but with the monthly interest rate at 1/12 of 6.75%. This gives a figure of **£25,707.22** at the end of the second year.

April 2002 – March 2003

E23. Again the calculations above are repeated with the new monthly interest rate for the third year being 1/12 of 5%. This gives a final figure of capital and interest of **£39,328.19**. The interest alone is **£3,328.19**.

APPENDIX F
CALCULATING COMPOUND INTEREST FROM TABLES

F1. In Part VI we recommended that the Court Service should produce multiplier tables to be used to calculate compound interest where the parties do not have access to a computer. We envisage that such tables will be particularly useful in the court corridor and the court room.

F2. Here we illustrate what these tables might look like. During consultation we were keen to ensure that tables would be easy to use and given an acceptable level of accuracy. We therefore showed these tables to four county court kudges, who all thought that such tables would be useful.

F3. An important aspect of the tables is that they should specify each detail of the calculations, as even minor variations in calculation methods can lead to noticeably different results. Differences can arise for example, with even minor variations – whether, for example, February is treated as a twelfth of a year or 28 out of 365 days. Another difference is whether one uses "set date" or "anniversary" compounding. With annual compounding it can make a crucial difference whether one compounds on a set date each year (such as 1 January) or on the anniversary of the debt arising. With monthly compounding the difference is less, but still noticeable. We recommend that anniversary compounding is used as it eliminates one of the sources of inaccuracy noted in paragraph F7 below and allows easier and more accurate calculations of parts of the month.

F4. Table 1 below demonstrates what a compound interest multiplier tables might look like, though for convenience it only shows the first 6 months. The annual interest rate figures taken in calculation of the multipliers are 2002 at 4%, 2003 at 5%, 2004 at 4%, 2005 at 4%, 2006 at 5% and 2007 at 5%.

TABLE 1: COMPOUND INTEREST MULTIPLIERS AT ANNUALLY VARIABLE RATES USING MONTHLY RESTS

2002-2007												
	Jan07	Feb07	Mar07	Apr07	May07	June07	July07	Aug07	Sept07	Oct07	Nov07	Dec07
Jan02	1.2456	1.2508	1.2560	1.2612	1.2665	1.2717	1.2770	1.2824	1.2877	1.2931	1.2985	1.3039
Feb02	1.2414	1.2466	1.2518	1.2570	1.2623	1.2675	1.2728	1.2781	1.2834	1.2888	1.2941	1.2995
Mar02	1.2373	1.2425	1.2476	1.2528	1.2581	1.2633	1.2686	1.2738	1.2791	1.2844	1.2898	1.2952
Apr02	1.2332	1.2382	1.2435	1.2487	1.2539	1.2591	1.2643	1.2696	1.2749	1.2802	1.2856	1.2909
May02	1.2291	1.2342	1.2394	1.2445	1.2497	1.2549	1.2601	1.2654	1.2707	1.2760	1.2813	1.2866
June02	1.2250	1.2301	1.2352	1.2404	1.2456	1.2508	1.2560	1.2612	1.2665	1.2717	1.2770	1.2823

USING THE TABLE

F5. In order to understand the effect of the table, it useful to take an example. Assume that £100,000 has been owed from 11 March 2002 – 17 June 2007, with interest fluctuating as listed above.

F6. The rough table calculation may therefore be done as follows:

Figure given by table from March 2002 – June 2007 = 1.2633.

£100,000 x £1.2633 = **£126,330.00**

This compares with the pure maths calculation, which gives a final figure of **£126,433.80**. The table gives a figure that is around £100 less, which we consider to be acceptably accurate on a £100,000 loss over a five-year period.

F7. The discrepancy in the figures arises in two ways. Firstly the rough month based multipliers take no account of the number of days involved at the start and end of the compounding period. In the example given above the multiplier from March to June does not take account of the days between 12-17 June 2007. If set date compounding were used then the multipliers fail to take the periods 1-11 March and 17-30 June into account. The more significant of these two discrepancies would be the original one as it immediately inserts inaccuracies into the calculation which are then compounded. However anniversary compounding eliminates this discrepancy.

F8. Secondly the month-based figures take no account of the exact number of days to be calculated, but only the round month figure. In the example given above there is a discrepancy of 6 days away from the round month figure (11 March – 17 June). Six days at 5% per annum of £126,000 is itself £103, which accounts for much of the discrepancy.

F9. The multipliers can obviously be used with a little common sense such that if a period ends on the last day of the month the multiplier for the next month is a more appropriate one to use. At the extreme, the multipliers may provide a figure £500 away from the pure maths figure on £100,000 over five years. This does not seem an unacceptable amount.

F10. A further advantage of using the anniversary compounding process is that fractions of the figures given in the tables can be used to gain a more accurate figure. For example, using the same figures as above:

(1) Multiplier for 11 March 2002 – 11 June 2007 = 1.2633 x £100,000 = £126,330.

(2) Multiplier for March 2002 – July 2007 = 1.2686.

(3) 6 Days in June 2007 = (1.2686 – 1.2633) x 6/30 x £126330 = £133.91

TOTAL = £126,463.91.

F11. The tables provided will not be able to cope with calculations if judges vary the rates away from those specified. Whilst it is possible to publish multiplier tables to cover a variety of plausible situations, the resources required to cover all the

possible options are simply too great. Parties who are applying for a variation in the rate will need access to a computer to carry out the calculations.

CONTINUOUS LOSS

F12. Continuing future loss does not attract interest so is of no concern here. Continuous loss over a past period does attract interest, and we recommend that that interest be compounded. Although the traditional method of calculating continuous loss does not apply to compound interest it is mathematically possible to do it accurately. The calculation is relatively simple provided the interest rate does not fluctuate. If it does then the simple calculation becomes impossible. However, table multipliers can again be used.

F13. The tables produced will be in a similar format to those used above. An example is reproduced at Table 2 below, using the same annual interest rates as have been used in the above examples. To use it, one multiples the average monthly loss by the multiplier given.

TABLE 2: COMPOUND INTEREST CONTINUING LOSS MULTIPLIERS AT ANNUALLY VARIABLE RATES USING MONTHLY RESTS

2002-2007												
	Jan 07	Feb 07	Mar07	Apr 07	May07	June07	July 07	Aug07	Sept07	Oct 07	Nov07	Dec07
Jan 02	67.352	68.636	69.927	71.222	72.523	73.829	75.141	76.458	77.781	79.109	80.443	81.783
Feb 02	66.106	67.386	68.671	69.961	71.257	72.558	73.864	75.176	76.493	77.816	79.145	80.479
Mar02	64.865	66.139	67.419	68.704	69.994	71.290	72.591	73.898	75.210	76.528	77.851	79.179
Apr 02	63.627	64.897	66.171	67.451	68.736	70.027	71.323	72.624	73.931	75.243	76.561	77.884
May02	62.394	63.658	64.928	66.202	67.482	68.768	70.058	71.354	72.656	73.963	75.275	76.593
June02	61.165	62.424	63.688	64.958	66.233	67.513	68.798	70.089	71.385	72.687	73.994	75.306

F14. The table covers cases where interest is awarded at the specified rate for damages that are assumed to have arisen evenly over time. Even where the losses are not completely even, it is common for them to be treated as even for interest purposes. Where losses consist of discrete items, or where another interest rate is used, the parties will need to use the computer programme

APPENDIX G
RESPONDENTS TO CONSULTATION PAPER No 167

(1) RESPONDENTS TO THE CONSULTATION PAPER

ACADEMICS

Tony Ciro, La Trobe University
Professor AM Dugdale, Keele University
Professor GHL Fridman QC, University of Western Ontario
Professor John Y Gotanda, Villanova University School of Law
Professor Francis D Rose, University of Bristol

GOVERNMENT BODIES

Law Reform Commission of Hong Kong
National Health Service Litigation Authority
Supreme Court of Canada, Law Branch
Supreme Court Costs Office

NON-GOVERNMENTAL ORGANISATIONS

Association of Personal Injury lawyers
Association of District Judges
Aviva Plc
British Gas
British Maritime Law Association
Consumer Credit Trade Association
Council of Circuit Judges, Civil Sub-Committee
General Council of the Bar, Law Reform Committee
International Underwriting Association of London
Law Society
London Maritime Arbitrators Association
Personal Injuries Bar Association
Worshipful Company of Arbitrators

PRACTITIONERS

Judges

Lord Justice Brooke, Court of Appeal
Lord Justice Dyson, Court of Appeal
Mr Justice Etherton, with support from the Judges of the Chancery Division of the High Court
Lord Justice May, Court of Appeal
Master Weingarten, Chief Master of the Chancery Division of the High Court
District Judge Wilby, Bolton Combined Court
Lord Woolf, The Lord Chief Justice

Barristers

Dr Steven Elliott, 1 Essex Court
Harvey McGregor QC, 4 Paper Buildings
Andrew Ritchie, 9 Gough Square
James Sunnucks, Hogarth Chambers, 5 New Square

Solicitors
Trevor Aldridge QC
Marc Gelinas, Réseau Juridique du Québec
Andrew Turek, Treasury Solicitor

(2) FURTHER COMMENTS RECEIVED FROM

Department for Constitutional Affairs (responded as the Lord Chancellor's Department)
Medical Defence Union
Medical Protection Society
Mr Justice Burton and Judge Peter Clark, Employment Appeal Tribunal
National Health Service Litigation Authority
Lord Justice Clarke, Court of Appeal

(3) MEETINGS HELD WITH

The Better Payment Practice Group
The Court Service
Department for Constitutional Affairs, Civil Justice Division
District Judge Armon-Jones, Clerkenwell County Court
District Judge Davidson, Reading County Court
District Judge Frenkel, Bristol County Court
Judge Critchlow, Reading County Court
Medical Defence Union
Medical Protection Society
National Health Service Litigation Authority