

SCOTTISH LAW COMMISSION  
Discussion Paper No 127

# Discussion Paper on Interest on Debt and Damages

January 2005

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## NOTES

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<sup>1</sup> Amended by the Scotland Act 1998 (Consequential Modifications) (No 2) Order 1999 (SI 1999/1820).

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# Part 1 Introduction

## Terms of reference

1.1 In November 2003 we received the following reference<sup>1</sup> from the Minister for Justice, Cathy Jamieson MSP:

"To examine the law of Scotland relating to interest on claims for payment of money arising from contractual and other obligations, including claims within the jurisdiction of tribunals and courts or submitted for decision to arbitration, adjudication or some other form of dispute resolution, and to make recommendations as to possible reform of the law."

This Discussion Paper is issued as the first part of our work on this reference. In preparing it we have been greatly assisted by an Advisory Group whose members are listed below.<sup>2</sup>

## Background to the reference

1.2 The law in relation to entitlement to interest on claims for payment of money has evolved in a piecemeal fashion over a period of many centuries. To begin with, interest could only be demanded in limited circumstances which were regarded as acceptable departures from the general prohibition of usury. Interest has since come to be regarded as an appropriate means of compensating a person for the loss of the use of money which he ought to have had but at no time has there been a comprehensive statutory statement of entitlement to interest. In recent years there has been legislation dealing specifically with interest on damages and on commercial debts. The result is a system which, subject to these exceptions, has become crystallised around rules laid down in the latter half of the 19<sup>th</sup> century and reflecting even earlier social attitudes. It lacks principle and consistency. Interest may or may not run on a claim for payment depending upon whether it is categorised as a debt or as a claim for damages. In the case of debt arising under a contract which contains no express stipulation for interest, an entitlement to interest will not generally commence unless and until a court action for payment has been raised. If however the claim is categorised as a contractual claim for damages, interest may run, depending upon the exercise of the court's discretion, from any time from the date when the right of action arose. In *Elliott v Combustion Engineering Ltd*,<sup>3</sup> Lord Hamilton, delivering the Opinion of the Extra Division, observed:

"It may be a matter of concern that in modern commercial contexts the law does not in general allow for interest to run on debts from a date earlier than judicial demand. However, reform of the law on interest on debt is a matter for the legislature, as was reform of the law on interest on damages."

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<sup>1</sup> Under the Law Commissions Act 1965, s 3(1)(e).

<sup>2</sup> Mr John Downie, Head of Press and Parliamentary Affairs, Federation of Small Businesses in Scotland; Dr Lucy O'Carroll, Head of UK Macroeconomics, Royal Bank of Scotland plc; Mr David Stevenson, Solicitor, Thompsons; Mr Michael Wood, Solicitor, Simpson & Marwick; Sheriff James Taylor.

<sup>3</sup> 1997 SC 126 at 133.

Other anomalies arising out of the law as it presently stands are discussed in more detail in this paper.

### **Scope of the Discussion Paper**

1.3 Most claims for interest arise either out of a claim for payment under a contract or out of a claim for damages for breach of a contractual or other obligation. The discussion in this paper is primarily concerned with those types of claim. In particular, we discuss entitlement to interest on contractual debt where the contract itself contains no provision creating or excluding an entitlement to interest in the event of delayed payment. There are however other circumstances in which claims for payment arise: for example, where a claim based on unjustified enrichment is made or where a person holding funds on behalf of another delays in making them over after payment has fallen due. We have regarded it as falling within our terms of reference to examine such circumstances in addition to the more common contractual and delictual claims with a view to proposing the creation of a comprehensive system of entitlement to interest which does not depend upon the legal classification of the claim.

1.4 On the other hand, we are not concerned in this Discussion Paper with circumstances in which interest is sued for as a head of damages: for example, where a pursuer in an action for damages asserts that the defender's negligence has resulted in his requiring to borrow money upon which he has incurred overdraft interest. The principles which determine the recoverability of interest as a head of damages are those which apply generally to damages for breach of contract<sup>4</sup> or for delict,<sup>5</sup> as the case may be, and it would in our view be anomalous to introduce special rules in relation to interest.

1.5 Nor are we concerned with challenges to contractual terms which impose exorbitant interest charges. Statutory provisions regulating the charging of interest already exist in consumer protection legislation,<sup>6</sup> and it is not within the scope of this project to review the adequacy of that protection.

### **Research: rates of interest claimed**

1.6 For the purpose of this project we have carried out a study of claims made in court in order to ascertain what kind of interest is usually claimed in practice. Our methods and an analysis of our results are set out in Appendix C to this paper. In April, May and September 2004 we conducted research at the Court of Session. We examined 454 court processes which had been indexed<sup>7</sup> in March 2004. In addition, we examined all the ordinary actions and commercial actions which were lodged at the Court of Session in March 2004, mainly in order to see if any reference was made to the Late Payment of Commercial Debts (Interest) Act 1998. 87 summons were examined.<sup>8</sup> In June 2004, during a visit to Aberdeen Sheriff Court, all summary cause actions and small claims which were due to call in the Summary Court on 24 June were examined. The results of these research exercises have been

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<sup>4</sup> See eg *Caledonian Property Group Ltd v Queensferry Property Group Ltd* 1992 SLT 738, applying the first rule in *Hadley v Baxendale* (1854) 9 Ex 341.

<sup>5</sup> On the basis of foreseeability.

<sup>6</sup> Eg Consumer Credit Act 1974, s 137 (extortionate credit bargains).

<sup>7</sup> Ie put in to storage after the case has been concluded or "fallen asleep".

<sup>8</sup> Of the 87, 61 were cases in which both parties were involved in business. 14 commercial summons actions were also examined, making a total sample of 75 cases.

somewhat inconclusive. There is some evidence that interest under the Late Payment of Commercial Debts (Interest) Act 1998 is not always claimed by pursuers in circumstances where it appears prima facie that a claim would be valid. However, it is not always clear from a summons or initial writ whether the Act would apply to a particular debt or not. For example, it may not be clear whether the debt arises before August 2002 when the Act came fully into force. Where interest under the 1998 Act is not claimed, it is not known whether this is due to an omission by the creditor's legal advisers or due to forbearance on the part of the creditor. In other cases, a variety of interest rates are claimed in summons and initial writs, which seem to bear little relation to the nature of the claim. For example, in exercise 1,<sup>9</sup> 79.54% of the sample were actions for damages, mainly relating to personal injury. Of those cases, 44.90% sought interest from the date of the accident; 11.43% sought interest from the date of citation; 36.73% from the date of decree; and 4.49% made no claim for interest at all. If any conclusion can be drawn from our research, it is perhaps that entitlement to interest is not always considered carefully by court practitioners at the point where the writ is drafted and lodged.

### **Structure of the Discussion Paper and outline of our proposals**

1.7 In Part 2 we provide a summary of the present law on interest including a brief historical background. In Part 3 we set out the guiding principles which we have followed in considering the need for reform and we also discuss in detail our criticisms of the present law. In Parts 4, 5 and 6 we make proposals for reform in relation to interest on contractual debt, interest on damages, and interest falling due in other circumstances respectively. Parts 7 and 8 address the issues of rates of interest and compound interest, and Part 9 considers the need for reform of the present law in relation to tenders in court actions. Parts 10 and 11 deal respectively with tribunals and with arbitration, adjudication and other forms of dispute resolution, and Part 12 deals with the question of transition to the proposed new regime. Part 13 contains a summary of our questions and proposals.

1.8 The guiding principles which we have followed may be stated as follows:<sup>10</sup>

- (i) So far as practicable, interest should run on different types of pecuniary claim during the same period and at the same rate regardless of whether the claim is for payment of a contractual debt, a non-contractual debt or damages.
- (ii) The primary goal of an award of interest should be the realistic compensation, in commercial terms, of the creditor for loss of the use of money or property. Interest should not as a general rule be payable at a punitive rate.
- (iii) An award of interest should compensate the creditor for loss of the use of money or property throughout the period during which that loss has subsisted.

1.9 With regard to contractual debt, we propose the introduction of a statutory entitlement to interest.<sup>11</sup> Such an entitlement exists already<sup>12</sup> in relation to certain types of contract where both parties are acting in the course of a business. Our proposals would apply to a wider range of contracts and in particular to contracts where at least one of the parties is not

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<sup>9</sup> Court of Session cases indexed in March 2004. See Appendix C for full details of the research exercise.

<sup>10</sup> See paras 3.1-3.6.

<sup>11</sup> See para 4.8.

<sup>12</sup> Under the Late Payment of Commercial Debts (Interest) Act 1998.

acting in the course of a business. We propose a general rule that interest should run from the date when payment is due. In relation to contracts for the supply of goods and services we suggest the adoption of the same commencement dates for the running of interest as are used in the 1998 Act, namely the date for payment agreed by the parties or, failing such agreement, 30 days after the later of the day on which the supplier's obligation is performed and the day on which the purchaser has notice of the amount claimed by the supplier.<sup>13</sup> However, we believe that the rate of interest should simply compensate the creditor and should not be punitive like the rate under the 1998 Act.<sup>14</sup> We propose that the general rule should also apply to sales and leases of land and to earnings from employment. We suggest that the statutory scheme could be further applied to non-contractual pecuniary claims such as claims based on unjustified enrichment,<sup>15</sup> claims for salvage,<sup>16</sup> and claims for alimony.<sup>17</sup>

1.10 The statutory entitlement which we propose would not apply where the parties have made express provision in their contract in relation to entitlement to interest. In particular, it would remain open to the parties to agree that no interest would be payable on debts due by one party to the other.<sup>18</sup> Nor would it apply to any circumstances in which provision for payment of interest is made by any other statutory provision. Thus, for example, interest on taxes and duties, and on compensation for compulsory purchase, which is already provided for by legislation, would be unaffected by our proposals.

1.11 With regard to interest on damages, we propose a change in the existing statutory provisions which determine the commencement date for the running of interest. At present the court has a *discretion* to award interest for any part of the period since the date when the right of action arose and a *duty* to award interest on damages or solatium for personal injury unless satisfied that there are reasons special to the case why no interest should be given. Under our proposals, this commencement date would be replaced by an entitlement to interest on each head of loss from the date when the loss in question was sustained.<sup>19</sup> For some types of loss this is not intended to lead to any change from existing practice but we believe that it will clarify the law in relation to others. We invite comment on the extent, if any, to which judicial discretion to award interest from a later date or on a lesser sum should be retained.<sup>20</sup>

1.12 In Part 7 we address the question of identification of an appropriate rate of interest, bearing in mind our guiding principle that an entitlement to interest should be compensatory and not punitive. We propose that the rate, to be prescribed by statute, should be a specified percentage, say 1%, above the official dealing rate of the Bank of England, but invite views as to whether some other rate would be more appropriate as the basis of the prescribed rate.<sup>21</sup> We invite comment as to whether the rate of interest payable after decree has been pronounced should also be at the prescribed rate.<sup>22</sup>

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<sup>13</sup> See paras 4.15-4.17.

<sup>14</sup> See para 3.19 and Pt 7.

<sup>15</sup> See paras 6.4-6.11.

<sup>16</sup> See paras 6.12-6.13.

<sup>17</sup> See paras 6.25-6.26.

<sup>18</sup> See paras 4.34-4.38.

<sup>19</sup> See paras 5.3-5.7.

<sup>20</sup> See paras 5.21-5.27.

<sup>21</sup> See paras 7.12-7.22.

<sup>22</sup> See paras 7.43-7.52.

1.13 At present where interest is awarded, both pre- and post-decree, it is almost always simple and not compound interest. Indeed, the existing legislation applicable to interest on damages expressly prohibits the awarding of compound interest. However, compound interest is the accepted method of charging or paying interest in the financial services market. If an entitlement to interest is to be truly compensatory then it ought to be an entitlement to compound interest. In Part 8 of this paper we discuss the arguments for and against the introduction of a statutory entitlement to compound interest<sup>23</sup> and suggest methods of alleviating the additional complexity of the calculation.<sup>24</sup>

1.14 The terms of our reference include claims within the jurisdiction of tribunals, or submitted for decision to arbitration, adjudication or some other form of dispute resolution. Our view in relation to tribunals is that the interest-awarding powers of tribunals should generally be excluded from the scope of our proposals and left to be regulated by measures which are tailored to the tribunal in question. We suggest, however, that the rate of interest awarded by tribunals could be aligned with that which we propose for other forms of claim.<sup>25</sup> As regards arbiters, we invite comment as to whether arbiters' powers to award interest should be the same as those conferred on the courts, or, alternatively, whether arbiters should have a wider discretion in recognition of the less formal nature of arbitration proceedings.<sup>26</sup> Finally, we invite comment as to whether any change is needed in relation to the interest-awarding powers of adjudicators of construction contract disputes.<sup>27</sup>

### **Legislative competence**

1.15 The proposals put forward in this Discussion Paper generally lie within the legislative competence of the Scottish Parliament. None of our proposals would result in amendment to any of the enactments set out in Schedule 4 to the Scotland Act 1998 which are protected from modification by the Scottish Parliament. If any of our proposals were to be treated as relating to reserved matters, any implementing legislation would have to be enacted by the UK Parliament.

1.16 In our view our proposals if enacted would not give rise to any breach either of the European Convention on Human Rights or of Community law.

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<sup>23</sup> See paras 8.22-8.31.

<sup>24</sup> See para 8.43.

<sup>25</sup> See paras 10.4-10.6.

<sup>26</sup> See paras 11.2-11.7.

<sup>27</sup> See para 11.10.

## Part 2            The Present Law

### Interest on debt

#### *Historical background*

2.1     The origins of the rules of Scots law relating to interest lie in the Canon law prohibition of usury. Prior to the Reformation the taking of interest for the use of money was at best unenforceable and at worst a criminal offence.<sup>1</sup> By the 14<sup>th</sup> century, however, methods had been found of obtaining interest on money lent. The most common was a bond of annualrent,<sup>2</sup> whereby a right to the whole or part of the income from a debtor's lands was granted to a creditor as a means of repaying a loan or of paying interest upon it.<sup>3</sup> After the Reformation, attitudes to the charging of interest relaxed and instead attention became focused upon the demanding of exorbitant rates of interest. The Usury Act 1587<sup>4</sup> stated that any person taking interest at more than 10% would be punished as a usurer "according to the existing laws". Further Acts of 1594 and 1597<sup>5</sup> clarified this to mean that the penalties for demanding interest at a rate in excess of 10%<sup>6</sup> would be (i) unenforceability of the claim for interest, (ii) discharge of any loan or security, and (iii) confiscation of the lender's moveable goods and gear. By the time Stair wrote in 1681, contracts were described as "usurious" only where the interest charged was unlawful or exorbitant.<sup>7</sup>

2.2     The Usury Acts were concerned with interest payable in pursuance of an agreement between debtor and creditor. Before the end of the 16<sup>th</sup> century there had also appeared the first example of interest being made payable as a matter of law without having been specified in the parties' agreement. An Act of Sederunt of 1590 directed that annualrent would be payable to a cautioner by the principal debtor from the date when the cautioner made payment to the creditor.<sup>8</sup> Another Act of Sederunt to the same effect was made in 1610.<sup>9</sup> During the 17<sup>th</sup> century there were further legislative interventions to impose a charge of interest in certain circumstances: on foreign bills of exchange which were dishonoured<sup>10</sup> and subsequently on inland bills;<sup>11</sup> on debts in respect of which the debtor had

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<sup>1</sup> Walker: *A Legal History of Scotland*, Vol II, p 546-7.

<sup>2</sup> The word "annualrent" came to mean what would now be referred to as interest. See eg the title "Annualrent" in Morison's Dictionary 473ff.

<sup>3</sup> Walker, *op cit*, p 680-83.

<sup>4</sup> APS iii, 1587 c 35.

<sup>5</sup> Usury Act 1594 (APS iv, 1594 c 32); Usury Act 1597 (APS iv at p119-121).

<sup>6</sup> This appears to be the origin of the notion of a "legal rate" of interest, although it began life as a statutory maximum. Erskine observes (Institute III.iii.76), under reference to the Act of 1587, that "interest has been, since the aforesaid Act, gradually reduced, till at last, by 12 Ann. stat.2 c 16, it is brought down to the rate of five per cent". The rate of 10 per cent had been reduced to eight per cent in 1633 (APS v, 1633 c 21) and to six per cent in 1649 (APS vi, 1649 c 29; revived APS vii, 1661 c 49). The Act 12 Ann. stat.2 c 16 – the Usury Act 1713 – was itself repealed, along with the Scots Acts mentioned above, by the Usury Laws Repeal Act 1854 (17 & 18 Vict C 90), but the idea of a legal rate of interest persisted.

<sup>7</sup> Stair, *Institutions* I.15.7.

<sup>8</sup> See *Waughton v Innerweek* (1627) M 519; *Black of Largo v Dick* (1627) M 520.

<sup>9</sup> See *Cranston v Crichton* (1627) M 519. A further Act of Sederunt of 1613 is referred to in *Lockerbie v Applegirth* (1662) M 524.

<sup>10</sup> 1681 (APS viii,c 20).

been denounced by horning;<sup>12</sup> and on factors on sequestrated estates who received rents but had not distributed the estate within one year.<sup>13</sup>

2.3 As attitudes to usury changed, the courts began to hold that interest was due in a variety of circumstances where there was neither contractual stipulation nor express statutory entitlement. A series of cases established the principle that where a purchaser of land took possession without paying the price, interest was due from the date of entry.<sup>14</sup> In three other cases<sup>15</sup> the purchaser took entry but refused to pay the price because the seller could not deliver the whole titles to him. It was held in each case that the purchaser must pay either interest on the price or the profit of the lands, at his option. This principle was extended to apply more generally in circumstances where a person received monies belonging to another, interest being held to run from the time when the monies were received.<sup>16</sup> At the same time a parallel principle developed, analogous to the statutory right accorded to cautioners, that a person who paid a sum of money on behalf of another was entitled not only to reimbursement of the sum paid but also to interest from the date of payment.<sup>17</sup>

2.4 With regard to loans of money, it took some time for any presumption to emerge that interest was due though not stipulated for by the lender. Early cases found that payment of interest over a period of years constituted sufficient reason for the obligation to pay to continue so long as the principal remained outstanding,<sup>18</sup> but in other cases interest was refused in absence of express agreement.<sup>19</sup> Writing in the middle of the 18<sup>th</sup> century, Erskine makes no reference to a legal implication that interest was payable on loans. Bell, however, was able to state<sup>20</sup> that "the doctrine is gradually extending, so as to recognise a claim of interest in all cases of loan and debt in which one enjoys the use of money belonging to another". The case cited by Bell in support of this proposition is *Garthland's Trs v McDowell*.<sup>21</sup> Sums of money had been remitted over a period of years by an individual in India to his brother in Scotland who was in financial difficulty. In an action raised after the death of both brothers, it was held that the sums had been paid by way of loan and not donation, and that they carried interest from the respective dates of payment.<sup>22</sup> The report of the arguments presented for and against the allowance of interest affords a useful illustration of the stage of development of the law at that time. The debtor's representatives argued:

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<sup>11</sup> 1696 (APS x, c 36), extended to promissory notes by the Bills of Exchange (Scotland) Act 1772 (12 Geo. III c 72), s 36.

<sup>12</sup> 1621 c 20. "Horning" was a procedure whereby the debtor was denounced as an outlaw at the market cross by an officer of the court.

<sup>13</sup> Act of Sederunt, 31 July 1690.

<sup>14</sup> *Durie v Ramsay* (1624) M 542, followed in *Home v Renton* (1628) M 545, and later in *Cadzow v Wilson* (1830) 5 Mur 98. For the present law see para 2.21 below.

<sup>15</sup> *Stirling v Paunter* (1627) M 544; *Balnagoun v McKenzie* (1663) M 545; *Baillie v Walker* (1707) M 546.

<sup>16</sup> *Vallange's Tutor v Forrester* (1630) M 490; *Parkhill v Batchelor* (1748) M 550; Erskine, Institute III.iii.79, and cases cited there; Bell, Commentaries, Vol I, 5<sup>th</sup> edn, 647-8.

<sup>17</sup> Erskine, Institute III.iii.80. cf *Laird of Stanhope v Heritors of Tweedsmuir* (1676) M 525, criticised by Dirleton in *Stenhouse v The Heritors of Tweedsmuir* (1676) M 526.

<sup>18</sup> *Forrester v Clerk* (1628) M 482; *Hepburn v Congleton* (1671) M 483; *Cathcart v Row* (1671) M 483; *Carnegie v Durham* (1676) M 484; *Earl of Wintoun v Seatoun* (1669) M 484 and 486.

<sup>19</sup> *Loggie v Loggie* (1662) M 489; *Houston v Schaw* (1702) M 487; *Garden v Rigg* (1748) 1 Pat 409.

<sup>20</sup> Bell, Commentaries Vol I, 5<sup>th</sup> edn, 648.

<sup>21</sup> 26 May 1820, FC, 140. The decision is criticised in More's Notes on Stair, Lxxix, but does seem to have been influential on the subsequent development of the law as regards interest on loans.

<sup>22</sup> It is not stated explicitly in the report that interest was awarded from the dates of payment, but this seems to follow from the fact that of the sum of £16,233 claimed, only £10,065 was principal, and this is how the decision was interpreted by More (above) and by Lord Justice Clerk Inglis in *Cuninghame v Boswell* (1868) 6M 890.

"That, by the rules of law, and principles of justice, it was impossible to give effect to the claim for interest. No doubt the ancient rules of law, with regard to interest, are somewhat relaxed in modern practice, but still interest does not follow as a matter of course because a debt is due. ...However equitable the claim for interest may be, it will be awarded only, if due, by paction, express or implied, or by law or usage."

The creditor's representatives argued:

"The ancient notions relative to interest have yielded to more improved and rational views, as money now produces its fruits as well and certainly as lands and houses. ...Our courts have gradually more and more recognised the doctrine, that the person who has the use of another man's money must pay for it. Whether the party is a borrower, or, though not strictly a debtor, enjoys the use of money belonging to another, justice requires that a fair remuneration should be made."

The report unfortunately does not record the court's reasons for deciding that interest was due. The creditor's argument seems to have been more widely stated than was necessary for the circumstances of the case.

2.5 Although there were subsequent decisions finding interest due on sums advanced,<sup>23</sup> there was no explicit judicial statement of Bell's "doctrine", as regards loans, until 1861 when Lord Justice Clerk Inglis stated:<sup>24</sup>

"It admits of no doubt, that an acknowledgement of money generally presumes that the money was advanced in loan, and it follows that there is, first, an obligation on the party granting it instantly to repay the sum; and secondly, another obligation that, so long as the sum remains unpaid, the party shall pay legal interest. The acknowledgement itself does not express these obligations; but these are obligations which result in law from the loan. This is the general case."

In *Blair's Trs v Payne*<sup>25</sup> it was regarded as settled law that loans of money as a matter of legal implication, where the contrary is not stipulated, bore interest as if there had been an express provision to this effect.<sup>26</sup> The legal implication was still capable of being overcome by proof of circumstances indicating absence of an intention to charge interest.<sup>27</sup>

2.6 Another line of judicial development which has had enduring consequences concerned entitlement to interest on a trade or professional account. There are references in three 18<sup>th</sup> century cases<sup>28</sup> to a custom that tradesmen operating an open account were entitled to interest after expiry of one year from the date of the last article of the account. This entitlement was extended to professional accounts,<sup>29</sup> although by 1837 there was no "general and inflexible rule" that interest was due on a trade or professional account from

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<sup>23</sup> Eg *Young v Baillie* (1830) 8S 624.

<sup>24</sup> *Thomson v Geekie* (1861) 23D 693 at 701. Lord Inglis' observations were *obiter*, made in the course of a dissenting opinion. They were referred to with approval by Lord Justice Clerk Patton in *Cuninghame v Boswell* (1868) 6M 890 at 894.

<sup>25</sup> (1884) 12R 104, discussed further at para 2.11 below.

<sup>26</sup> *Ibid* per Lord Craighill at 108, referring to Bell, *Principles*, s 32(4).

<sup>27</sup> Eg *Christie v Matheson* (1871) 10M 9; for the present law see para 2.20 below.

<sup>28</sup> *Muirhead v Town of Haddington* (1750) M 532; *Creditors of Dick of Frackfield* (1756) M 498; *Angus & Co's Assignee v HM Advocate* (1758) M 499. Each was decided, on its facts, on different grounds. In *Aubray & Co v Ross's Exrs* (1737) M 528, however, the report of which includes a lengthy narrative of the arguments, there was no mention of a one-year credit period.

<sup>29</sup> *Henry v Sutherland* (1801) M Appendix Part 1, sv Annual-Rent, No 1; *Young v Baillie* (1830) 8S 624; *Walls v Speirs* (1865) 3M 536.

any particular date.<sup>30</sup> This remained the position in 1884 when the court decided *Blair's Trs v Payne*,<sup>31</sup> the case in which the law regarding interest received its most detailed judicial examination to date and in which the principles which remain applicable today were enunciated. The "one year" rule was referred to by Lord Fraser<sup>32</sup> as "the old rule".

2.7 Against this background of fragmented development, it is not surprising that the Institutional writers found it difficult to achieve a satisfactory categorisation of entitlement to interest. Stair<sup>33</sup> deals in turn with the statutory provisions restricting contractual entitlement to interest and with circumstances in which interest falls due by law or otherwise "without paction", but attempts no categorisation. Erskine begins with the general statement<sup>34</sup> that "interest is the profit due by the debtor of a sum of money to the creditor for the use of it", but his treatment of the subject betrays its piecemeal development. Having asserted that Scots law, unlike Roman law, does not recognise an entitlement to interest *ex mora*, but only *ex lege* or *ex pacto*, he divides entitlement *ex lege* into (i) entitlement by statute or act of sederunt and (ii) entitlement "from the nature of the transaction". This latter category encompasses many of the judicial developments discussed above, including, in particular, the right to reimbursement, with interest, of one who pays a sum of money on behalf of another. In this latter context, Erskine states<sup>35</sup> that "by analogy, interest has been found due *nomine damni*, on a debt payable on demand, from the citation against the debtor in an action for payment, which is equivalent to a demand": one of the earliest references to interest running from the date of citation.<sup>36</sup> Interest *ex pacto* may arise from either express or implied agreement, although the only example of implied agreement given by Erskine is that a promise to pay interest accrued to date implies a general promise to continue to pay so long as the debt remains outstanding.

2.8 Bell took a different approach, classifying interest as falling due *nomine damni*, from statute, or from contract, express or implied.<sup>37</sup> His category of implied contract includes most of the case law dealt with by Erskine as examples of entitlement to interest arising *ex lege* "from the nature of the transaction". Although Bell's implied term analysis may be a convenient way to view these examples, there is little support for it in the reports of the cases themselves.

2.9 It is therefore easy to agree with the observations made by the court in *Blair's Trs v Payne*<sup>38</sup> that "nothing can be conceived as less amenable to a settled general principle than our law upon a creditor's right to interest";<sup>39</sup> and that "claims for interest cannot be brought under any general rule".<sup>40</sup>

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<sup>30</sup> *Bremner v Mabon* (1837) 16S 213; see also *Cardno & Darling v Steuart* (1869) 7M 1026.

<sup>31</sup> (1884) 12R 104, discussed below at para 2.11.

<sup>32</sup> At 112, having noted the absence of statement of any such rule by Bell or in Brodie's Notes on Stair.

<sup>33</sup> Stair, Institutions I.15.7-8.

<sup>34</sup> Erskine, Institute III.iii.75.

<sup>35</sup> *Ibid* III.iii.80.

<sup>36</sup> For other early instances of interest being held due from the date of citation, see *Moncrieff v Moncrieff* (1751) M 478 (bill payable on demand held to bear interest from date of citation; similarly a promissory note payable on demand was held to do so *ex bono et aequo*, "though in this last, the Lords were far from unanimous" – see Kilkerran's report at 481); *Drummond & Co v Croom* (1823) 2S 608 (cautioner suing for relief) and *Lord Dundas v Scott Moncrieff* 24 November 1835, FC at 42 (arrears of rent). In *Jolly v McNeill* (1829) 7S 666 it was stated that on an ordinary contract debt, if interest has not been stipulated, it runs from the date of citation.

<sup>37</sup> Bell, Commentaries, Vol I, 5<sup>th</sup> edn, 645ff.

<sup>38</sup> (1884) 12R 104.

<sup>39</sup> *Ibid*, Lord Craighill at 108.

<sup>40</sup> *Ibid*, Lord Fraser at 109.

## *Foundations of the modern law*

2.10 The modern law of interest, except in so far as it has been altered by statutory intervention, is founded largely upon dicta pronounced in two cases: *Carmichael v Caledonian Railway Co*<sup>41</sup> and *Blair's Trs v Payne*.<sup>42</sup> *Carmichael* concerned the amount of compensation payable to a landowner by a railway company, which had acquired land by compulsory purchase, for being prevented from quarrying stone within the railway boundary. The relevant special Act of Parliament specified a method for determining compensation by reference to the value of stone opposite a face of rock worked up to the boundary. The conditions for entitlement to compensation were fulfilled in 1852, but it was not until 1864 that the parties applied to the sheriff, in accordance with the specified procedure, to summon a jury and fix the amount of compensation. The proprietor of the land obtained decree from the Court of Session for the sum fixed by the jury, together with interest since 1852, and the railway company appealed on the question of entitlement to interest. The House of Lords held by a majority that the court had had no jurisdiction to award interest. In the course of his speech, Lord Westbury made the following observation which, given the ratio of the decision, was clearly *obiter*.<sup>43</sup>

"Interest can be demanded only in virtue of a contract, express or implied, or by virtue of the principal sum of money having been wrongfully withheld, and not paid on the day when it ought to have been paid."

In a dissenting speech the only Scottish judge sitting, Lord Colonsay,<sup>44</sup> took the opposite view, agreeing with the course adopted in the courts below:

"It does not require a special contract for it in order to make interest due, nor does it require that there be any clear *culpa* or blame on the part of the person who has not paid the price at the proper date; as, for instance, the vendor may not be in condition to give a clear title, but the purchaser may have been put in possession of the property purchased."

Lord Westbury's view has however prevailed and his reference to a principal sum of money having been "wrongfully withheld" has formed the foundation of much of the subsequent law on entitlement to interest.

2.11 The main point at issue in *Blair's Trs v Payne*<sup>45</sup> was whether interest was chargeable on the professional fees of a law agent who had died without rendering an account for work carried out over a period of years. It is important to note that in this case no account at all was presented by the law agent's representatives until after commencement of judicial proceedings in the form of a multiplepinding. Lord Craighill, with whom Lord Rutherford Clark concurred, decided the case on the basis that interest could not run on an open account until the account had been rendered because, until then, it could not be said that payment had been asked or could be expected.<sup>46</sup> The majority of the court<sup>47</sup> thus found it

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<sup>41</sup> (1870) 8M (HL) 119.

<sup>42</sup> (1884) 12R 104.

<sup>43</sup> At 131.

<sup>44</sup> *Ibid* at 133; For further discussion see Prof J Murray, "Interest on Debt" 1991 SLT (News) 305.

<sup>45</sup> (1884) 12R 104.

<sup>46</sup> This was consistent with *Stirling and Dunfermline Railway Co v Edinburgh and Glasgow Railway Co* (1857) 19D 598, in which interest was held not to run in circumstances where an amount payable termly was unknown and could not be ascertained.

<sup>47</sup> Only three judges were present.

unnecessary to consider the question whether, prior to commencement of legal proceedings, interest would run from the date of rendering an account. Lord Fraser went further, however, and considered the effect of rendering an account, expressing the following view:<sup>48</sup>

"In my opinion no interest ought to be allowed on such claims on open account, except when there is a judicial demand, or some such intimation given in writing as is required by the English statute, viz., that interest will be claimed from the date of the demand. In such a case the Court would in its discretion allow interest prior to the period of citation."

Earlier in his opinion, Lord Fraser had cited Lord Westbury's *dictum* in *Carmichael v Caledonian Railway Co*, with apparent approval, as support for the proposition that the mere fact of delay in payment after payment could have been made or had been demanded would not necessarily ground a claim for interest.

2.12 Lord Fraser's opinion received no express support from any other member of the court and was, moreover, stated in the specific context of an open or current account. It is debatable whether it was an accurate statement of the law as it stood at the time when *Blair's Trs v Payne* was decided, at least as regards debts other than on open accounts. Nine years later Lord Shand, sitting in an English House of Lords appeal, observed:<sup>49</sup>

"...In [Scotland] it is the common and ordinary practice, in bringing an action for money which is due, to conclude not only for the payment of that money but for the payment of interest upon it from the date of citation or service of the summons, and interest is decreed as a matter of course on whatever balance is found to be due. I may even say that it is a rule which has received general effect, that where money is shewn to have been due and to have been demanded, interest runs if the demand or request of payment is not acceded to. That is the case, even although too large a sum may have been demanded. If it be found that a sum short of what was demanded is due, still the law gives interest unless the amount really due has been tendered. It is not necessary that an intimation must be made that interest will be demanded in order that interest shall run..."

Lord Shand's view finds some support in the earlier case of *Forrest & Barr v Henderson*,<sup>50</sup> in which the Court declined to interfere with the verdict of a jury awarding interest from a date four years prior to the raising of a court action. Nevertheless, it is Lord Fraser's formulation which has regularly received judicial approval.

2.13 Lord Westbury's criterion of wrongful withholding came to be regarded as a statement of the general principle according to Scots law.<sup>51</sup> It was reconciled with Lord Fraser's opinion in *Blair's Trs v Payne* on the basis that as a general rule money is not wrongfully withheld unless and until a *judicial* demand for payment has been made: ie an action has been raised, at which time wrongful withholding begins.<sup>52</sup> This general rule was subject to the exception stated by Lord Fraser, namely where intimation was given in writing

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<sup>48</sup> At 112.

<sup>49</sup> *London, Chatham and Dover Railway Co v South Eastern Railway Co* [1893] AC 429 at 443-4.

<sup>50</sup> (1869) 8M 187.

<sup>51</sup> *Durie's Trs v Ayton* (1894) 22R 34 at 38; *Greenock Harbour Trs v Glasgow & South Western Railway Co* 1909 SC (HL) 49, per Lord Shaw of Dunfermline at 51; *Kolbin v Kinnear* 1931 SC (HL) 128 (a claim for damages) per Lord Atkin at 137; *United Collieries v Lord Advocate* 1950 SC 458 at 475; *Elliott v Combustion Engineering Ltd* 1997 SC 126; *Wisely v John Fulton (Plumbers) Ltd* 2000 SC (HL) 95 per Lord Hope of Craighead at 98.

<sup>52</sup> *Winestone v Wolfson* 1954 SC 77; *Dean Warwick Ltd v Borthwick* 1983 SLT 533 at 535, rejecting an argument that a distinction should be drawn between the two.

that interest would be payable from the date of demand.<sup>53</sup> Much of the 20<sup>th</sup> century case law was concerned to define with some particularity the circumstances in which money may or may not be said to be wrongfully withheld.<sup>54</sup>

2.14 The case law referred to above developed without recourse to the notion of an implied contractual term that interest would begin to run from a particular time. Even in the case of interest on loans and cash advances the language used is that of legal presumption rather than implication of a contractual term.<sup>55</sup> Similarly, the allowance of interest to a seller who has granted possession to the purchaser without receipt of the purchase price is justified by application of equitable principles rather than by an implied term.<sup>56</sup> There is, however, one instance of implication of a term being used as justification for an award of interest in circumstances where the court clearly regarded it as equitable to make an award. In *Haddon's Exx v Scottish Milk Marketing Board*,<sup>57</sup> a levy was paid to the Board under protest (in order to avoid legal action being taken against Colonel Haddon), pending the outcome of a litigation between the Board and another party. The levy was subsequently found not to have been due and was repaid. It was held that the agreement whereby the sum was paid was subject to an implied term that not only the principal sum but also interest would be paid if it turned out to have been paid in error. The court expressly distinguished this situation from that of wrongful withholding. Entitlement to interest by implied term thus survived as an alternative to entitlement by virtue of wrongful withholding. In a different context, implication of a contractual term has more recently been used as the basis for entitlement to statutory interest under the Late Payment of Commercial Debts (Interest) Act 1998.<sup>58</sup>

#### *Summary of the present law*

2.15 As discussed above, the law of Scotland in relation to interest on debt has evolved in a piecemeal fashion and without any general underlying principle. The best that can presently be done is to state the various categories of circumstances in which a sum owed by one person to another will carry interest. These are reasonably clear and are as follows: interest may be due on a debt

- (a) by agreement between the parties;
- (b) by express statutory provision;
- (c) by implication at common law; or
- (d) by virtue of a principal sum being wrongfully withheld.

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<sup>53</sup> This exception was applied in *Linlithgow Oil Co Ltd v North British Railway Co* (1904) 12 SLT 421, and referred to with approval, though not applied, in *Bunten v Hart* (1901) 9 SLT 476, *Somervell's Tr v Edinburgh Life Assurance Co* 1911 SC 1069, and *British Railways Board v Ross & Cromarty County Council* 1974 SC 27. In the *British Railways Board* case intimation of an intention to charge interest was given, but it was held that interest did not run as the amount of the principal had not been agreed or ascertained by an arbiter or judge, and in any event because the debtor was exercising a right of retention.

<sup>54</sup> See para 2.23.

<sup>55</sup> See eg *Smellie's Exx v Smellie* 1933 SC 725; *Neilson v Stewart* 1991 SC (HL) 22.

<sup>56</sup> Eg *Grandison's Trs v Jardine* (1895) 22R 925; *Tiffney v Bachurzewski* 1984 SC 108 per Lord Hunter at 113, echoing the early cases referred to at para 2.3 above.

<sup>57</sup> 1938 SC 168, applying *Glasgow Gas-Light Co v Barony Parish of Glasgow* (1868) 6M 406, in which, however, there had been no mention of implication of a contractual term.

<sup>58</sup> See para 2.18.

Where no rate has been specified by the parties or by a relevant statutory provision, interest will run at the judicial rate.

(a) *Interest due by agreement*

2.16 In general it is open to the parties to a contract expressly to agree that interest will be payable in particular circumstances, at a particular rate and during a particular period.<sup>59</sup> The parties may agree that interest will be at a fluctuating rate and that it be compounded at specified intervals. The law will intervene if the rate demanded is exorbitant<sup>60</sup> or is unenforceable at common law as being in the nature of a penalty clause.<sup>61</sup> An obligation to pay interest may be implied as a term of a contract (subject to meeting the usual common law tests for implication of contractual terms), but there have been few cases in which such an implied term has been held to exist.<sup>62</sup>

(b) *Interest due by statute*

2.17 A large number of statutory provisions impose an obligation to pay interest on debts. Some of these debts arise out of contract or breach of contract, others do not.<sup>63</sup> Some affect relationships between private persons; others are concerned rather with payments due to an individual by local or central government, or vice versa. Those concerned with payments due by one private person to another include the following:

- Where a bill is dishonoured, a person paying who has a right of recovery may recover "as damages" the amount of the bill plus interest from the time of presentment for payment, if payable on demand, or, in any other case, from maturity.<sup>64</sup> No rate of interest is specified. Interest may be withheld "if justice require it",<sup>65</sup>
- A partner who makes an advance to the firm beyond the capital which he has agreed to subscribe is entitled to interest at 5% per annum from the date of the advance.<sup>66</sup> An outgoing partner is entitled at his option to a share of profits attributable to the continuing partners' use of his share of the assets, or to interest on his share of the assets at 5% per annum.<sup>67</sup>

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<sup>59</sup> Contractual entitlement will override the principle of "wrongful withholding" discussed at para 2.23 below: see eg *Charles Brand Ltd v Orkney Islands Council* 2001 SC 545.

<sup>60</sup> Eg Consumer Credit Act 1974, s 137-140.

<sup>61</sup> In *Eurofi Ltd v CMB Packaging* (6 July 2001, QBD, unreported; affd [2002] EWCA Civ 1109), a term agreed in 1994 that sums unpaid after 21 days would carry interest at 5% over bank base rate was held not be unconscionable nor a penalty clause.

<sup>62</sup> For an example see *Haddon's Exx v Scottish Milk Marketing Board* 1938 SC 168. Another may be where a commercial usage specifies a period of credit at the end of which interest starts to run: *Findlay, Bannatyne & Co's Assignee v Donaldson* (1864) 2M (HL) 86. This is not the same as interest due by implication at common law (see para 2.19 below) which does not depend on implication of a term into a contract.

<sup>63</sup> For a non-exhaustive list of statutory provisions imposing an obligation to pay interest, see Appendix B.

<sup>64</sup> Bills of Exchange Act 1882, s 57(1). The Act distinguishes between "interest proper", ie due as a debt as a consequence of the terms of the bill, and interest as damages under s 57 following dishonour.

<sup>65</sup> *Ibid* s 57(3).

<sup>66</sup> Partnership Act 1890, s 24(3).

<sup>67</sup> *Ibid* s 42(1).

- Where a trustee advances a sum improperly on inadequate security, he is liable to make good the sum advanced in excess of what would have been a proper investment, with interest.<sup>68</sup> No rate of interest is specified.
- Under the standard conditions of a standard security, a creditor who performs a debtor's obligation is entitled to recover expenses and charges (including interest) reasonably incurred. Interest is due at the rate at which advances are secured under the standard security, or at the "bank rate" if none is specified.<sup>69</sup>
- A liability to pay interest may be incurred in various circumstances in relation to the allotment of shares in a company.<sup>70</sup>
- Where there are sufficient funds, interest is payable on a bankrupt's debts from the date of sequestration, at the higher of the judicial rate or the rate which would have been applicable to the debt but for the sequestration.<sup>71</sup>
- Where an officer or liquidator of a company has misused company funds and requires to make a payment to the company, interest is payable at such rate as the court thinks just.<sup>72</sup>
- Interest is due on sums paid or repaid under earnings arrestments and current maintenance arrestments at the rate applicable to sheriff court decrees.<sup>73</sup>
- Where funds of an incapable adult held under a fiduciary duty are misused, interest is payable at the rate applicable to sheriff court decrees.<sup>74</sup>

Examples of interest due by local or central government include the following:

- Interest is payable on compensation payable under various statutes for compulsory purchase or lesser interferences with property rights, from specified dates until payment;<sup>75</sup>
- Compound interest is payable on a variety of payments due under public sector pension schemes.

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<sup>68</sup> Trusts (Scotland) Act 1921, s 29.

<sup>69</sup> Conveyancing and Feudal Reform (Scotland) Act 1970, Sch 3, para 7.

<sup>70</sup> Companies Act 1985, ss 99-105.

<sup>71</sup> Bankruptcy (Scotland) Act 1985, s 51(1)(g); s 51(7); SI 1985/1925 as amended by SI 1993/439.

<sup>72</sup> Insolvency Act 1986, s 212(3).

<sup>73</sup> Debtors (Scotland) Act 1987, s 50(5), s 55(7); s 73(1).

<sup>74</sup> Adults with Incapacity (Scotland) Act 2000, s 81.

<sup>75</sup> Eg Land Compensation (Scotland) Act 1973, s 16; Roads (Scotland) Act 1984, s 149; Housing (Scotland) Act 1987, Sch 7, para 13; Planning and Compensation Act 1991, ss 78, 80; Town and Country Planning (Scotland) Act 1997, Sch 15, para 30. Most of these provide for compensation to be paid at the rate prescribed by regulations made under the Land Compensation (Scotland) Act 1963, s 40. The current regulations are the Acquisition of Land (Rate of Interest after Entry) (Scotland) Regulations 1995 (SI 1995/2791), specifying a rate of 0.5% below the base rate quoted by the reference banks.

Examples of interest due to local or central government include the following:

- Interest is due on unpaid taxes and duties;<sup>76</sup>
- A large number of statutory instruments provide for overpayments of agricultural and other grants and subsidies to be repaid, with interest at a rate 1% above the LIBOR (London Inter-Bank Offer Rate) in force during the period in question.

2.18 More recently, the Late Payment of Commercial Debts (Interest) Act 1998<sup>77</sup> has provided a general entitlement to interest in the event of late payment of certain commercial debts. The Act applies to contracts for the supply of goods and services where the purchaser and the supplier are each acting in the course of a business.<sup>78</sup> All contracts to which the Act applies include an implied term that debts created by the contract will carry "statutory interest",<sup>79</sup> ie simple interest at a specified rate which is set high to act as a deterrent to late payment of debts.<sup>80</sup> Interest begins to run on the date agreed by the parties for payment of the debt or, failing agreement, 30 days after

- (a) the date when the obligation to which the debt relates is performed; or
- (b) the day on which the purchaser has notice of the amount claimed,

whichever is the later.<sup>81</sup> Special provision is made for advance payments.<sup>82</sup> Entitlement to "statutory interest" under the 1998 Act is overridden by an entitlement to interest under any other enactment or rule of law,<sup>83</sup> or by an alternative contractual term affording the supplier a "substantial contractual remedy" for late payment.<sup>84</sup> The court has power to remit statutory interest for the whole or part of the period for which it would otherwise run or to order it to run at a reduced rate, if "the interests of justice" so require.<sup>85</sup>

(c) *Interest due by implication at common law*

2.19 Three broad sets of circumstances may be identified where entitlement to interest is implied at common law, ie it is said to be due *ex lege* but without any express statutory provision. These are:

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<sup>76</sup> Eg Taxes Management Act 1970, s 86 as regards income tax and capital gains tax. The full list is contained in the Finance Act 1989, s 178(2) as amended from time to time.

<sup>77</sup> As amended by the Late Payment of Commercial Debts (Scotland) Regulations 2002 (SSI 2002/335). The Act as amended is reproduced in Appendix A. It gives effect to the UK Government's obligation to implement Directive 2000/35/EC of the European Parliament and Council of 29 June 2000 on combating late payment in commercial transactions. The 1998 Act pre-dated the entry into force of the Directive, although it had plainly been influenced by the draft Directive. The amendments to the Act by the 2002 Regulations were made to render it fully compliant with the requirements of the Directive.

<sup>78</sup> S 2(1).

<sup>79</sup> S 1(1) and (2).

<sup>80</sup> S 6.

<sup>81</sup> S 4.

<sup>82</sup> S 11.

<sup>83</sup> Ss 3(2) and (3).

<sup>84</sup> S 8.

<sup>85</sup> S 5.

- (i) loans of money;
- (ii) possession of heritable property by a purchaser without payment of the purchase price; and
- (iii) use of funds belonging to another person.

**2.20 Loans.** There is a presumption that where money is advanced on loan, interest is payable from the time when the loan was made until the date of repayment.<sup>86</sup> The presumption may be rebutted by circumstances demonstrating that the parties did not intend interest to be payable although, even in cases concerning loans between close relatives, the court has sometimes been reluctant to find the general rule displaced.<sup>87</sup> As regards the rate of interest, it was formerly the case that interest would run at the "legal rate",<sup>88</sup> but that expression is no longer recognised as having any meaning.<sup>89</sup> In *Neilson v Stewart*,<sup>90</sup> Lord President Hope stated in the Inner House that where no rate of interest is stipulated on a loan, the court will normally award interest at the judicial rate for the time being.<sup>91</sup> The presumption does not apply to an IOU because it cannot be said that the granting of an IOU necessarily implies a loan of money; it may vouch a different type of debt. Accordingly, unless the IOU can be proved to vouch a loan, interest does not run until the date of judicial demand.<sup>92</sup>

**2.21 Possession of heritable property without payment.** It has long been established that where the purchaser of heritable property takes possession without paying the price, interest is due by legal implication from the date when possession is taken until payment.<sup>93</sup> The fact that the purchaser has good reason for withholding payment, for example because the seller is unable to produce a marketable title, does not prevent interest from running.<sup>94</sup> The case law does not make clear whether the entitlement to interest is properly to be regarded as a return by the purchaser (equivalent to rental) for having the use of the property,<sup>95</sup> or as compensation to the seller for not having received the price.<sup>96</sup> Although

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<sup>86</sup> *Thomson v Geekie* (1861) 23D 693, Lord Justice Clerk Inglis at 701; *Blair's Trs v Payne* (1884) 12R 104, Lord Craighill at 108; *Neilson v Stewart* 1991 SC (HL) 22, Lord Jauncey of Tulliechettle at 40.

<sup>87</sup> Eg *Cunninghame v Boswell* (1868) 6M 890. Cf *Christie v Matheson* (1871) 10M 9 and *Smellie's Exx v Smellie* 1933 SC 725, in both of which the presumption was displaced.

<sup>88</sup> *Thomson v Geekie supra*.

<sup>89</sup> *Kearon v Thomson's Trs* 1949 SC 287, Lord President Cooper at 293-4.

<sup>90</sup> 1991 SC (HL) 22.

<sup>91</sup> *Ibid* at 35.

<sup>92</sup> *Winestone v Wolfson* 1954 SC 77, applying *Thiem's Trs v Collie* (1899) 1F 764.

<sup>93</sup> *Durie v Ramsay* (1624) M 542: "It is against reason and conscience both to retain the money, without paying annual therefor, and to bruik also the whole profits of the land."; *Prestwick Cinema Co Ltd v Gardiner* 1949 SC 645 (affd 1951 SC 98). The principle was applied to compulsory purchase in *West Highland Railway Co v Place* (1894) 21R 576 and to a contract of excambion in *Greenock Harbour Trs v Glasgow & South-Western Railway Co* 1909 SC (HL) 49. Cf also *Tiffney v Bachurzewski* 1984 SC 108.

<sup>94</sup> *Stirling v Paunter* (1627) M 544 and other cases cited at para 2.3 above, fn 15; Erskine, Institute III.iii.79; *Grandison's Trs v Jardine* (1895) 22R 925.

<sup>95</sup> See *Greenock Harbour Trs v Glasgow & South-Western Railway Co* 1909 SC 1438, Lord McLaren at 1441 for this view.

<sup>96</sup> *Stirling & Dunfermline Railway Co v Edinburgh & Glasgow Railway Co* (1857) 19D 598, Lord Cowan at 621; *Greenock Harbour Trs v Glasgow & South-Western Railway Co* 1909 SC (HL) 49, Lord Shaw of Dunfermline at 51-2; *Prestwick Cinema Co Ltd v Gardiner* 1951 SC 98; *Geddes v Geddes* 1993 SLT 494, Lord President Hope at 500.

Bell<sup>97</sup> treated this principle as applying to heritable and moveable property alike, there is no direct authority for applying the principle to moveable property.<sup>98</sup>

**2.22 Use of funds belonging to another.** Where a person holds funds in respect of which he has an obligation to account to another person, he will normally be liable to account also for interest which has accrued on the principal during the period for which the funds were held. In older cases, interest was held to be due by a wife who intromitted with her late husband's estate,<sup>99</sup> on arrears of a child's aliment,<sup>100</sup> on sums held by the factor of a landed estate who placed funds in his own bank account,<sup>101</sup> and, more generally, where a person has in his hands another person's money which is recoverable by repetition.<sup>102</sup> Trustees are bound to invest trust funds in their hands and, if they fail to do so, will be held liable for the interest which the funds would have earned if properly invested.<sup>103</sup> A more recent example of the principle is to be found in the case of *Drummond v Law Society of Scotland*<sup>104</sup> in which it was held that where counsel's legal aid fees were acknowledged to be due and payable but for administrative convenience were not paid immediately, interest was due *ex lege* from the date when they were acknowledged to be due.

(d) *Interest due on money wrongfully withheld*

**2.23** In addition to all of the above categories, interest can be demanded "...by virtue of the principal sum of money having been wrongfully withheld and not paid on the day when it ought to have been paid".<sup>105</sup> Contrary to first impression, this dictum does not confer upon the courts a broad discretion to assess whether or not a sum of money has been wrongfully withheld. The general rule is that money is not wrongfully withheld unless and until a judicial demand for payment has been made<sup>106</sup> and, accordingly, interest will normally run from the date of citation.<sup>107</sup> The rule has not always been regarded as invariable. In many cases, the task faced by the court has been to attempt to identify a time from which money could be said to have been wrongfully withheld. The results have not been consistent. In some cases, it has been accepted by the court that interest could not begin to run until the amount due has been agreed by the parties, or certified by an architect, or ascertained by a third

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<sup>97</sup> Bell, Commentaries, Vol I, 5<sup>th</sup> edn, 648. Erskine, on the contrary, appears to treat it as applying to heritage only: Institute III.iii.79.

<sup>98</sup> In *Forrest & Barr v Henderson* (1869) 8M 187, the purchasers of a crane began to use it but did not formally accept it for four years. A jury verdict that interest was payable from a date four months after the crane began to be used was regarded by the court as fair and not disturbed, but there is no discussion of the principle upon which interest could run prior to the date of judicial demand. In *Morton v Cameron & Co* 1987 SLT (Sh Ct) 44, Sheriff Principal FWF O'Brien refused to apply the principle to moveable property (in this case hay and silage) on the ground that there was no authority for it applying to anything other than heritage.

<sup>99</sup> *Vallange's Tutor v Forrester* (1630) M 490.

<sup>100</sup> *Hill v Gilroy* (1821) 1S 33.

<sup>101</sup> *Wellwood's Trs v Hill* (1856) 19D 187. The factor also made cash advances to the estate, on which he was held entitled to charge bank interest, but he himself has to pay interest on the estate funds which he held at "the highest legal rate".

<sup>102</sup> *Parkhill v Batchelor* (1748) M 550. On repetition, see para 2.37 below.

<sup>103</sup> *Melville v Noble's Trs* (1896) 24R 243. As regards interest on legal rights in succession, see para 2.39.

<sup>104</sup> 1980 SC 175.

<sup>105</sup> *Carmichael v Caledonian Railway Co* (1870) 8M (HL) 119 per Lord Westbury at 131. For a fuller discussion of the context of this dictum in the *Carmichael* case, see para 2.10.

<sup>106</sup> *Blair's Trs v Payne* (1884) 12R 104, Lord Fraser at 112 (for a fuller discussion of this case, see paras 2.11-2.12); *Dean Warwick Ltd v Borthwick* 1983 SLT 533, Lord Cameron at 535, cited below.

<sup>107</sup> Or, where a claim is added by amendment in the course of proceedings, from the date when the amendment is made and incorporated into the record: *HMV Fields Properties Ltd v Skirt 'n' Slack Centre of London Ltd* 1987 SLT 2, Lord Ordinary (Clyde) at 6.

party such as an arbiter;<sup>108</sup> in others, that even when the amount claimed was thus ascertained, interest could not begin to run until the date of citation.<sup>109</sup> On the other hand, it has sometimes been accepted that interest might, depending upon the whole circumstances of the case, begin to run before the date of citation.<sup>110</sup> The latter decisions are difficult to reconcile with the opinion of the court in *Dean Warwick Ltd v Borthwick*,<sup>111</sup> in which it was stated in forthright terms that

"There is here a rule of law, a rule that interest runs from citation, and one which does not admit of modification by the exercise of judicial discretion. The pursuer, ex hypothesi of the court's decree, has been deprived of the use and fruit of the sum for which decree has been granted during the period of non-payment, ie since the formal judicial demand was made, while conversely the defender wrongfully has enjoyed that use and fruit."

There is a further exception in relation to open, ie running or current, accounts, noted by Lord Fraser in *Blair's Trs v Payne*, namely where intimation has been given in writing that interest shall henceforth be payable.<sup>112</sup>

## Interest on damages

### *Historical background*

2.24 The law regarding entitlement to interest on damages developed in parallel with interest on debt until interest on damages was subject to statutory interventions in 1958 and 1971. At first no reference was made in the case law to wrongful withholding as a criterion, but the underlying rationale behind the decisions seems to have been the same: interest did not begin to run until the claim had been liquidated, usually by application of the verdict of a jury. The earliest clear statement of the general rule was in *Flensburg Steam Shipping Co v Seligmann*.<sup>113</sup>

"The rule that interest does not run on damages is well fixed. The damages are not liquidated till after the verdict. It certainly is not usual that interest should run on damages even from the date of the verdict, because, until the verdict is applied it is not final; therefore it is only from the date of the application of the verdict that interest properly runs."

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<sup>108</sup> *British Railways Board v Ross & Cromarty County Council* 1974 SC 27; *Farrans (Construction) Ltd v Dunfermline District Council* 1988 SC 120; *Robertson Construction Co (Denny) Ltd v Taylor* 1990 SLT 698; *John G McGregor (Contractors) Ltd v Grampian Regional Council* 1991 SLT 136. *Per contra* in *Keir Ltd v East of Scotland Water Board* 1976 SLT (Notes) 72 in a claim for payment *quantum meruit*, no contract price having been agreed, interest was awarded from the date of citation.

<sup>109</sup> *Hunter v Livingston Development Corporation* 1984 SLT 10.

<sup>110</sup> *Shetland Islands Council v BP Petroleum Development Ltd* 1990 SLT 82; *Trans Barwil Agencies (UK) Ltd v John S Braid & Co Ltd (No 2)* 1990 SLT 182, in which the matter was treated by the Lord Ordinary (McCluskey) as one to be decided on equitable principles.

<sup>111</sup> 1983 SLT 533, at 535 followed with some reluctance by an Extra Division in *Elliott v Combustion Engineering Ltd* 1997 SC 126, in which the context of the expression "wrongfully withheld" in *Carmichael v Caledonian Railway Co supra* is analysed.

<sup>112</sup> See the cases referred to at para 2.13, fn 53.

<sup>113</sup> (1871) 9M 1011, Lord President Inglis at 1014. In an earlier case, *Lenaghan and Callaghan v Monkland Iron and Steel Co* (1858) 20D 848, Lord Justice Clerk Hope had expressed regret that interest could not be awarded from the date of the accident.

In this case, however, the application of the verdict was delayed by the defender's dilatory tactics and interest was allowed from the date when the verdict ought to have been applied.<sup>114</sup> By 1955, the general rule could be stated as being that interest did not run on a jury award until the verdict was applied unless the delay was attributable to improper proceedings on the part of the defender.<sup>115</sup> It was not improper merely to seek a new trial, or, where damages were awarded by a judge sitting without a jury, to reclaim. So where an interlocutor applying a jury award was reclaimed unsuccessfully, interest would not run until the verdict was applied following refusal of the reclaiming motion.<sup>116</sup> There were occasional dicta to the effect that the general rule was not absolute and inflexible.<sup>117</sup> Indeed, the courts sometimes seem to have exercised ingenuity in order to avoid the rule.<sup>118</sup> There was a specific exception in admiralty practice that interest ran from the date of a collision until the date when a limitation fund was paid into court.<sup>119</sup>

2.25 Eventually the language of "wrongful withholding" began to find its way into decisions on claims for interest on damages. In *A S Kolbin & Sons v Kinnear & Co*,<sup>120</sup> a firm of shipping agents had handed over a cargo of flax and tow to a third party without obtaining a bill of lading or a guarantee in favour of the owner of the goods. The flax and tow was requisitioned by the War Office and the price paid to the third party who afterwards became bankrupt. The owner successfully sued the shipping agents for loss caused by their negligence in handing over the goods without security. In the Court of Session interest was awarded from the date when the third party received the balance of the price from the War Office in exchange for a delivery order for the goods. This was reversed by the House of Lords because the shipping agents had neither received the money nor become entitled to receive it. Lord Atkin stated:<sup>121</sup>

"It seems to be established that, by Scots law, a pursuer may recover interest by way of damages where he is deprived of an interest-bearing security or a profit-producing chattel, but otherwise, speaking generally, he will only recover interest, apart from contract, by virtue of a principal sum having been wrongfully withheld and not paid on the day when it ought to be paid – *Carmichael v Caledonian Railway Co*."

It is difficult to find support in previous authorities for any part of this statement in so far as interest on damages is concerned. There is none in the authorities to which reference was made in argument before the House of Lords.<sup>122</sup> As noted above, the circumstances in which interest on damages would be awarded at any time prior to the date of decree were exceptional. In a later case,<sup>123</sup> Lord Atkin dealt with an argument regarding interest on

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<sup>114</sup> For an earlier decision to similar effect, see *Blacks v Cadell* 9 July 1812, FC, 749. In *Hurlet & Campsie Alum Co v Earl of Glasgow* (1850) 13D 370, the court regarded itself as entitled, in exercise of a discretion, to award interest from the date of affirmation by the House of Lords of the court's decision.

<sup>115</sup> *Clancy v Dixon's Ironworks* 1955 SC 17, Lord Carmont at 18; also *McCormack v National Coal Board* 1957 SC 277, Lord Wheatley at 281.

<sup>116</sup> *Roger v J & P Cochrane & Co* 1910 SC 1; *McGovern v James Nimmo* 1938 SC (HL) 18; *McCormack v National Coal Board* 1957 SC 277.

<sup>117</sup> *Hurlet and Campsie Alum Co v Earl of Glasgow* (1850) 13D 370; *Denholm v London & Edinburgh Shipping Co* (1865) 3M 815, Lord Cowan, dissenting; *Martin & Sons v Robertson, Ferguson & Co* (1872) 10M 949, Lords Deas and Kinloch; *Vitruvia Steamship Co v Ropner Shipping Co* 1923 SC 574, Lord Skerrington at 587.

<sup>118</sup> *Eg Dunn & Co v Anderston Foundry Co Ltd* (1894) 21R 880; *Vitruvia Steamship Co v Ropner Shipping Co supra*.

<sup>119</sup> See para 2.38.

<sup>120</sup> 1931 SC (HL) 128.

<sup>121</sup> At 137.

<sup>122</sup> Listed at p 130 of the report. One of the cases cited, *Vitruvia Steamship Co v Ropner Shipping Co supra* is directly contrary to Lord Atkin's statement as regards profit-producing chattels.

<sup>123</sup> *McGovern v James Nimmo & Co Ltd* 1938 SC (HL) 18.

damages without any reference to wrongful withholding. However, the test of wrongful withholding was applied in an action for damages for breach of contract by the House of Lords in *FW Green & Co Ltd v Brown & Gracie Ltd*.<sup>124</sup> Lord Keith of Avonholm considered that quantification of damages would generally fix the earliest date from which interest could reasonably be taken to run and that that would usually coincide with the date of decree. Where, however, there was a frivolous defence or an unjustified appeal or other obstructive procedure designed to hold up payment, that might constitute wrongful withholding. Interest from the date of citation was refused.

### *Statutory interventions*

2.26 By the time of the decision in *F W Green & Co Ltd v Brown & Gracie Ltd*, the law regarding interest on damages had been amended by statute. Section 1 of the Interest on Damages (Scotland) Act 1958 (following a recommendation of the Law Reform Committee for Scotland<sup>125</sup>) gave the court a discretion, in any action for damages, to award interest from a date not earlier than the date of citation "if the circumstances warrant such a course". Existing rules of law permitting the running of interest were unaffected and the Act was not to be interpreted as authorising "the granting of interest upon interest".<sup>126</sup>

2.27 Judicial reaction to the 1958 Act was conservative. In *Macrae v Reed and Mallik Ltd*,<sup>127</sup> the first reported decision in which the Act was given detailed consideration, it was observed that section 1 of the Act required to be applied to each head of damage in a selective manner. The majority of the court held that the purpose of the Act was limited to allowing interest to be awarded on readily quantifiable elements of the pursuer's claim, such as past wage loss, for the period during which he was being deprived of it by the progress of the litigation. Perhaps influenced by the views of the Law Reform Committee, Lord Strachan considered<sup>128</sup> that the Act was primarily passed to deal with the wrongful withholding of money by a frivolous defence or unjustifiable appeal, as described by Lord Keith of Avonholm in *F W Green & Co Ltd v Brown & Gracie Ltd*. Only Lord Justice Clerk Thomson was prepared to interpret the Act as permitting interest to be awarded also on illiquid claims, notably solatium, for a period prior to the date of decree. The continuing influence of *Carmichael v Caledonian Railway Co* is plain from the terms of the opinions delivered. *Macrae v Reed and Mallik* set the ground rules for the cases which followed. Provided the quantum of a head of loss was capable of ascertainment prior to the raising of the action,

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<sup>124</sup> 1960 SLT (Notes) 43 (HL). The action was raised before the passing of the Interest on Damages (Scotland) Act 1958.

<sup>125</sup> Third Report of the Law Reform Committee for Scotland on "The rules governing the date from which interest on an award of damages is, or may be, ordered by the Court to run" (April 1957, Cmnd 141). The Committee's enquiries had indicated that the discretionary power contained in the English legislation was "seldom used". They observed (para 5): "We are aware that a few members of the legal profession think that some actions would be settled sooner if defenders knew that interest on damages might be awarded from a date earlier than the award, but we have not found any evidence that an opinion to that effect is strongly or widely held. In the event of a discretionary power such as is suggested being given to the Courts, we assume that the normal practice of awarding interest only from the date of final decree would continue except where the defender has caused unreasonable delay. We do not anticipate that the Court would award interest from the date of citation to a claimant who himself had caused delay after that date."

<sup>126</sup> S 1(2).

<sup>127</sup> 1961 SC 68.

<sup>128</sup> *Ibid* at 85.

interest would be awarded from the date of citation,<sup>129</sup> but no interest was awarded on solatium prior to the date of decree.<sup>130</sup>

2.28 In 1971 Parliament intervened again. Section 1 of the 1958 Act was repealed by the Interest on Damages (Scotland) Act 1971, and replaced by:

- a new subsection 1(1) which granted a discretion to the court to award interest on damages, or any part thereof, for any period from "the date when the right of action arose"; and
- a new subsection 1(1A) which, as regards damages and solatium for personal injury, directed the court to exercise the discretion in subsection 1(1) by awarding interest on the damages or solatium unless there were reasons special to the case why no interest should be awarded;
- a new subsection 1(1B) which declared for the avoidance of doubt that a tender was to be taken to be in full satisfaction of interest awarded under the Act unless it stated otherwise.<sup>131</sup>

2.29 The reaction of the court to the amended provisions in personal injury actions was, to say the least, unfavourable.<sup>132</sup> A particular problem identified was the application of the Act to a jury award which, according to the practice at that time, was in the form of a lump sum. One Lord Ordinary went so far as to refuse to send any personal injury cases for jury trial on the ground that the court could not carry out the duties imposed upon it by the Act when applying the verdict of a jury.<sup>133</sup> With the benefit of hindsight this problem does not appear quite so intractable. In *Macdonald v Glasgow Corporation*<sup>134</sup> the court approved an amended form of issue<sup>135</sup> in which the various heads of damages claimed would be itemised so that interest could be added to them, or not, as the Act required. This practice continues today. Another difficulty which was addressed was the starting date for the running of interest on solatium for personal injury or damages in fatal cases. A practice emerged of awarding interest on past loss of earnings and, subsequently, past solatium for the whole period since the date of the accident or death but at a reduced rate to take account of the fact that not all of the loss had accrued immediately following the occurrence of the injury.<sup>136</sup>

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<sup>129</sup> *Eg Fraser v J Morton Wilson Ltd* 1966 SLT 22; *Bell's Sports Centre (Perth) Ltd v William Briggs & Sons Ltd* 1971 SLT (Notes) 48.

<sup>130</sup> *Eg Killah v Aberdeen & District Milk Marketing Board* 1961 SLT 232.

<sup>131</sup> The 1958 Act, as amended in 1971, is reproduced in Appendix A.

<sup>132</sup> "As the debate before me disclosed, the problems created by the language of s 1 of the Interest on Damages (Scotland) Act 1971 are considerable...": *Smith v Middleton* 1972 SLT (Notes) 3, Lord Emslie at 5.

"...The Act ...gives every sign of being botched legislation. It is quite unnecessarily complicated and obscure and appears to have been framed with little if any regard to its practical consequences.": *Ross v British Railways Board* 1972 SLT (Notes) 10, Lord Stott at 10.

"This is just another of the many problems which have been created by this Act which has already been the subject of much judicial criticism, all, in my opinion, fully deserved.": *Orr v Metcalfe* 1973 SC 57, Lord President Emslie at 59.

"It would be difficult to find a section of any Act of Parliament of recent years which presents, from the obscurity of its language, so many problems of construction or operation.": *ibid*, Lord Cameron at 61.

<sup>133</sup> *McFadyen v Crudens Ltd* 1972 SLT (Notes) 11, Lord Avonside; reversed 1972 SLT 62.

<sup>134</sup> 1973 SC 52.

<sup>135</sup> An "issue" is the question put to the jury for answer in a civil jury trial.

<sup>136</sup> *Smith v Middleton* 1972 SLT (Notes) 3 (following the Court of Appeal's approach in *Jefford v Gee* [1970] 2 QB 130); *McCuaig v Redpath Dorman Long* 1972 SLT (Notes) 42; *Prentice v Chalmers* 1985 SLT 168. Cf *Ross v British Railways Board* 1972 SC 154, in which in order to do "rough justice" interest was awarded at the full judicial rate from the date of citation.

Thus the "selective and discriminating approach"<sup>137</sup> advocated in *Macrae v Reed and Mallik Ltd* continued.

2.30 Interest on damages for breach of contract or negligence resulting in loss other than personal injury has been considered in two post-1971 cases.<sup>138</sup> In both cases it was held that the pre-1958 criteria, and in particular that of wrongful withholding, continued to apply. In *James Buchanan & Co v Stewart Cameron (Drymen) Ltd*, the pursuers engaged the defenders to carry a load of whisky and advertising material by road. The lorry was stolen and the goods lost. In terms of the contract, the defenders were liable for any loss of goods occasioned during transit. The pursuers sued for the value of the goods with interest from a date agreed to represent the latest date when the "right of action arose" (in order to avoid an argument as to whether the right arose on the date of the theft or on the due delivery date in terms of the contract). The defenders did not dispute liability for the principal sum sued for but contended that interest ran only from the date of citation. Lord Maxwell did not regard it as self-evident that it was just to award interest from the date when the right of action arose and sought guidance from the pre-1958 case law dealing with interest on principal sums other than damages. Applying the dicta in *Carmichael v Caledonian Railway Co* and *FW Green & Co v Brown & Gracie Ltd* discussed above,<sup>139</sup> he held that where, as here, there was no suggestion that the defenders were enjoying an advantage from the pursuers' loss, the principal sum could not be said to be wrongfully withheld from any date prior to the date of citation. He noted also that he had no grounds for assuming that the whisky and advertising material would, if not destroyed, have earned profit for the pursuers from any particular date.

2.31 Before 1958, damages had been in a less favourable position than debt with regard to the awarding of interest. After 1971 they had appeared to be in a more favourable position. It is ironic that the first post-1971 decision on breach of contract should nevertheless be to the effect that interest on damages should run from the same date as that which was generally applicable to interest on debt. The position changed again, however, with the decision of the Second Division in *Boots the Chemist Ltd v GA Estates Ltd*.<sup>140</sup> The pursuers were tenants of shop premises who suffered loss when their premises were flooded as a consequence of a blocked culvert. An action raised against the landlord of the premises was settled but a dispute remained as to the pursuers' entitlement to interest on various heads of loss. Seven of the eight heads claimed consisted of out-of-pocket expenses, such as shopfitting costs, which had been incurred during the two months following the flooding incident. The eighth was a claim for loss of stock. The defenders contended that the pursuers had delayed in intimating claims to them and in producing adequate vouching of the losses claimed. It was argued that interest should begin to run only on the dates when the defenders were provided with proper intimation and vouching of the claims or, in any event, not earlier than the date of citation. The court held that interest on the seven heads of out-of-pocket expenses ran from the dates when these expenses were respectively incurred. As regards the loss of stock, there was no evidence before the court as to when that stock could have been turned to profit and, accordingly, following *James Buchanan & Co v Stewart Cameron (Drymen) Ltd*, interest was allowed only from the

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<sup>137</sup> *Smith v Middleton supra* per Lord Emslie at 5. See further para 2.35 below.

<sup>138</sup> *James Buchanan & Co v Stewart Cameron (Drymen) Ltd* 1973 SC 285 and *Boots the Chemist Ltd v GA Estates Ltd* 1992 SC 485.

<sup>139</sup> See para 2.25.

<sup>140</sup> 1992 SC 485.

date of citation. This seems straightforward enough, but analysis of the case is complicated by the statement by the court<sup>141</sup> of the applicable principle as being that

"...even if damages have not been quantified, interest may reasonably be held to run from a date when the damages may reasonably be regarded as quantifiable or capable of ascertainment."

In the *Boots* case, the date when the damages were quantifiable was regarded as being the date when the expenditure was incurred. From that date, the pursuers were standing out the money and it followed that the defenders were wrongfully withholding payment. Nor was this principle affected by any delay by the pursuers in intimating the claim and vouching it to the defenders' satisfaction.

2.32 The *Boots* case was important in establishing, 21 years after the passing of the 1971 Act, that interest might run prior to the date of citation in a claim for damages for breach of contract. Nevertheless, it raises questions of its own. It will not always be the case that the date when a loss is reasonably capable of quantification is the same as the date when an item of expenditure is incurred. There is also an awkwardness about the notion that payment is wrongfully withheld at a time when the wrongdoer has no notice of the amount claimed. The decision on the facts of the case seems reasonable but the court's justification of it against Lord Westbury's test appears somewhat contrived. It illustrates a continuing tension between the 19<sup>th</sup> century principles for the award of interest and more recent statutory interventions.

2.33 The 1971 Act also inserted a new subsection<sup>142</sup> dealing with tenders into section 1 of the 1958 Act. Unless otherwise stated, a tender is treated as inclusive of interest due to the claimant to whom the tender is made. In considering whether a tender has been beaten the court must take account of interest awarded under the Act, or such part thereof as the court considers appropriate.<sup>143</sup>

### Summary of the present law

2.34 **Damages other than for personal injury.** Where a court grants decree for payment of damages other than for personal injury, the interlocutor may include decree for payment of interest, at such rate or rates as may be specified, on the whole or any part of the sum awarded for the whole or any part of the period since the date when the right of action arose.<sup>144</sup> The terms of the section thus give the court a wide discretion in relation to all aspects of the award. However, the court has declined to treat the discretion as unqualified, preferring instead to apply the principles of the pre-1958 case law, and notably seeking to establish the date from which the sum in respect of which damages are being awarded may

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<sup>141</sup> Lord Justice Clerk Ross at 496, the other members of the court concurring.

<sup>142</sup> S 1(1B).

<sup>143</sup> The effect of the latter part of this provision was considered in *Manson v Skinner* 2002 SLT 448, an action for damages for personal injuries in which the defender had lodged a tender of £3,000. The sum awarded by the sheriff together with interest to the date of decree amounted to £3,047. As at the date of the tender however the principal sum plus interest amounted to £2,992. The court held that the general rule that a pursuer who beats a tender is entitled to the whole expenses of process was abridged by s 1(1B), and that the concluding words of the subsection were directed to cases such as the present one. Since the action was unnecessarily prolonged by failure to accept the tender, the defender was found entitled to expenses from the date of the tender.

<sup>144</sup> Interest on Damages (Scotland) Act 1958, s1(1), as substituted by Interest on Damages (Scotland) Act 1971, s 1.

be said to have been wrongfully withheld.<sup>145</sup> In practice, this means that interest may be held to run on out-of-pocket expenses from the date when these were incurred, or perhaps from the date (if different) when they were capable of being quantified.<sup>146</sup> Similarly, readily quantifiable pecuniary losses, such as loss of past profits, will attract interest from the date when they would have been earned but for the event giving rise to the claim. Other losses, which do not involve out-of-pocket expenditure, may attract interest only from the date of judicial demand. The rate of interest will normally be the full judicial rate from time to time specified by the relevant rules of court.<sup>147</sup>

**2.35 Damages for personal injury.** Where a court grants decree for payment of damages or solatium for personal injury, it is required to include an award of interest in terms of section 1(1) unless the court is satisfied that there are reasons special to the case why no interest should be given.<sup>148</sup> This provision applies to claims for loss of support and loss of society in fatal cases as well as to claims by the person who has sustained the injury.<sup>149</sup> In practice, the court distinguishes between awards in respect of past and future solatium and lost earnings. Only those elements of the award intended to compensate past losses carry entitlement to interest.<sup>150</sup> Account is also taken of the fact that past awards are for a cumulative loss over the period of time since the injury occurred so that it would afford excessive compensation to the pursuer if interest on the whole sum were to be awarded from the date when the right of action arose. Thus, for example, it is common practice for interest to be awarded on the whole past sum at half the judicial rate or rates for the time being in force.<sup>151</sup> Judicial practice has not been entirely consistent, but as a general rule where the loss is continuing at the date of decree, interest at half rate will be awarded on past solatium for the whole period since the date of the injury. On the other hand, where the effects of the injury have ceased at some date prior to the date of decree, interest at the full judicial rate may be awarded (as regards solatium) from the date when the effects of the injury ceased or (as regards loss of earnings) from the date of the pursuer's return to work.<sup>152</sup> Adjustments to the amount of interest awarded are made where the pursuer has received an interim payment or an award of interim damages.<sup>153</sup> Where the sum sued for in a personal injury action includes damages for something other than personal injury (such as the cost of repairs to a vehicle), this element of the claim is not subject to the special rule in section 1(1A).<sup>154</sup>

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<sup>145</sup> *Macrae v Reed & Mallik Ltd* 1961 SC 68; *James Buchanan & Co v Stewart Cameron (Drymen) Ltd* 1973 SC 285; *Boots the Chemist Ltd v GA Estates Ltd* 1992 SC 485.

<sup>146</sup> See the discussion of *Boots the Chemist Ltd v GA Estates Ltd* at para 2.31 above.

<sup>147</sup> Rules of the Court of Session, rule 7.7; Sheriff Courts (Scotland) Extracts Act 1892, s 9.

<sup>148</sup> Interest on Damages (Scotland) Act 1958, s 1(1A), as inserted by Interest on Damages (Scotland) Act 1971, s 1.

<sup>149</sup> *Plaxton v Aaron Construction (Dundee) Ltd* 1980 SLT (Notes) 6; *Prentice v Chalmers* 1985 SLT 168.

<sup>150</sup> *Smith v Middleton* 1972 SC 30.

<sup>151</sup> *Smith v Middleton* above, in which Lord Emslie awarded interest on past wage loss at half the judicial rate, following the approach of the Court of Appeal in *Jefford v Gee* [1970] 2 QB 130. However Lord Emslie awarded interest at the full rate on past solatium and this approach was initially followed in *McCuaig v Redpath Dorman Long Ltd* 1972 SLT (Notes) 42. Subsequently, however, it became the practice to award interest on past solatium at a lesser rate.

<sup>152</sup> Eg *McCabe v British Domestic Appliances Ltd* 1978 SLT (Notes) 31. Cf the approach taken in eg *McGeachie v James Buchanan & Co Ltd* 1979 SLT (Notes) 9 and *Glen v Cork* 1979 SLT (Notes) 43, where interest was awarded at less than the full rate but for the whole period since the date of the accident.

<sup>153</sup> Eg *Jarvie v Sharp* 1992 SLT 350.

<sup>154</sup> Words in parenthesis in s 1(1A). See *Orr v Metcalfe* 1973 SC 57 per Lord President Emslie at 60.

## Interest on sums other than debts or damages

2.36 Certain sums which cannot be categorised either as contract debts or damages have also been held to bear interest. These include sums due by way of repetition or recompense<sup>155</sup> and sums payable to a salvor for salvage services.<sup>156</sup>

2.37 **Interest on sums due in order to reverse unjustified enrichment.** Such authorities as there are on the running of interest on sums due in order to reverse unjustified enrichment suggest that interest will be due from the date when the event giving rise to the claim occurred and not merely from the date of citation. In *Parkhill v Batchelor*,<sup>157</sup> a claim for repetition, the court observed:

"In the question whether annualrent be due, there is a material difference, whether the money be due as a debt, or if it be due as the pursuer's property in the hands of the defender. Where it is due as a debt, then regularly no annualrent is due upon it *sine pacto*. But where one has got into his hands another person's money, then annualrent, as the profits of the money, is no less due than the money itself."

In *Glasgow Gas-Light Co v Barony Parish of Glasgow*,<sup>158</sup> money was paid under protest pending resolution of the dispute by litigation. Interest was held to be due on sums overpaid from the respective dates of payment. In another case,<sup>159</sup> teinds were paid for many years to the Crown in error. When the mistake was discovered, an action was brought by both the payer and the rightful recipient for repetition, with interest. The Crown consented to decree for repayment but disputed the liability to pay interest. The majority of the court held that no interest was due to the rightful recipient because she had been negligent in failing for many years to demand payment nor to the payer because he would thereby be enriched. The opinions of the majority suggest that the result might have been otherwise in the absence of negligence.<sup>160</sup> In *Duncan, Galloway & Co Ltd v Duncan, Falconer & Co*,<sup>161</sup> the pursuers sought repetition of part of the purchase price of a quarry business when it was discovered that some of the buildings included in the valuation of the business belonged to the landlord without any right of allowance to the tenant for their value at the termination of the lease. The Lord Ordinary's award of interest from the date when the price was paid in error was upheld on appeal.<sup>162</sup>

2.38 **Ship collisions and salvage.** Special rules regarding entitlement to interest have been applied in admiralty actions concerning both ship collisions and salvage. In both circumstances, English case law has been applied with a view to ensuring a uniform practice as between Scotland and England. So far as ship collisions are concerned, interest has

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<sup>155</sup> See para 2.37.

<sup>156</sup> See para 2.38.

<sup>157</sup> (1748) M 550.

<sup>158</sup> (1868) 6M 406. No express mention is made of repetition but this does appear to have been the basis of the claim for repayment. For two early decisions which might also now be characterised as claims for repetition, see *Gray v Cuthbert* (1677) M 552 and *Blair v Gilmour* (1678) M 552: in each interest was refused but "*pro damno et interesse*" the principal sum was doubled.

<sup>159</sup> *Countess of Cromertie and Mackenzie v Lord Advocate* (1871) 9M 988.

<sup>160</sup> The case was distinguished on this basis in *Gwydyr v Lord Advocate* (1894) 2 SLT 280, another case concerning teinds paid in error. The short report of this case discloses that interest was awarded at the rate of 3 per cent but unfortunately does not expressly confirm the date from which interest was held to run.

<sup>161</sup> 1913 SC 265.

<sup>162</sup> See also *Tibbert v McColl*, 1994 SC 178, a case concerning breach of trust, in which the court left open the possibility that the claim was correctly characterised as one for recompense. Interest was awarded from the date of citation but the court accepted a submission that it had a discretion to award interest from an earlier date.

been held to run on the amount of the limitation fund from the date when the collision occurred until the date when the fund is paid into court.<sup>163</sup> Hence a tender of the amount of the limitation fund was held to have been beaten when the court granted decree for the amount of the fund plus interest.<sup>164</sup> The rule regarding salvage has evolved more recently, and is to the effect that interest runs from the date of termination of the salvage services.<sup>165</sup>

**2.39 Legal rights in a deceased's estate.** Entitlement to interest on legal rights is subject to principles similar to those applicable to entitlement to interest in other circumstances in which funds capable of earning profit are held by one person but are ultimately due to be paid over to another. The general rule under Scots law has been that legal rights carry interest from the date of death. However, the question of entitlement to interest must be distinguished from the question of the appropriate rate of interest. Where there has been delay in payment which is not attributable to any fault on the part of the executors, it has been held that interest should not run at a rate higher than that which the funds have in fact earned.<sup>166</sup> On the other hand, where a claim has been made, or where there is no doubt that legal rights will be claimed because the claimant has been disinherited, the courts have awarded interest at the "legal rate" (ie 5 per cent), apparently on the basis of wrongful withholding.

**2.40 Aliment and financial provision on divorce.** Under the Family Law (Scotland) Act 1985,<sup>167</sup> obligations of aliment are owed by certain persons to others. This provision does not of itself create a debt due by one person to another<sup>168</sup> because the obligation is defined as being one to provide such support as is reasonable in the circumstances, having regard to the matters to which a court is required to have regard in determining what to award in an action for aliment. Thus a decree of the court is required in order to determine whether any sum is in fact due by one person to another by way of aliment. Once a decree has been granted it can be enforced by a variety of means, including a current maintenance arrestment.<sup>169</sup> The court has power to backdate an award of aliment to the date of the bringing of the action, or to such later date as the court sees fit, or, on special cause shown, to a date prior to the bringing of the action.<sup>170</sup> There is no power to award interest on the sum (consisting of the aggregate of past instalments) which falls due by reason of the backdating of the award.

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<sup>163</sup> *The "Olga" v The "Anglia"* (1905) 7F 739, following *The "Crathie"* [1897] Prob Div 178.

<sup>164</sup> *The "Devotion II"* 1979 SC 80.

<sup>165</sup> *The "Ben Gairn"* 1979 SC 98, following *The "Aldora"* [1975] QB 748.

<sup>166</sup> *Ross v Ross* (1896) 23R 802.

<sup>167</sup> S 1.

<sup>168</sup> Some obligations are owed mutually: by a husband to his wife and by a wife to her husband.

<sup>169</sup> Under the Debtors (Scotland) Act 1987, s 53.

<sup>170</sup> Family Law (Scotland) Act 1985, s 3(1)(c). The power to backdate has been used sparingly; for an example see *Walker v Walker* 1991 SLT 649.

2.41 Apart from aliment payable as a result of the backdating of an award, arrears of aliment are not generally recoverable unless the aliment was due under a court decree.<sup>171</sup> A creditor in an alimentary obligation suing to recover arrears of aliment due under a decree was found to be entitled to interest on the arrears.<sup>172</sup>

2.42 In an action for divorce either party may apply to the court for an order for the payment of a capital sum by the other party, and may also apply for an incidental order.<sup>173</sup> Among the incidental orders which may be made is an order as to the date from which interest (at the judicial rate) shall run on any amount awarded.<sup>174</sup> If interest is to be awarded for a period prior to the date of decree this must be justified by reference to the principles set out in section 9 of the 1985 Act (fair sharing of the net value of matrimonial property etc), and must be reasonable having regard to the resources of the parties. These provisions have been interpreted as permitting the court to award interest on a share of the value of matrimonial property from the date of separation, thereby, for example, compensating a spouse who has been excluded from use of the matrimonial home during the period prior to the date of decree.<sup>175</sup>

### **Awards by tribunals**

2.43 The commencement of proceedings before a tribunal does not constitute a judicial demand equivalent to the raising of court proceedings. Express statutory provision is necessary before interest will be payable on a sum awarded by a tribunal. Such provision has been made, for example, in respect of awards by Employment Tribunals,<sup>176</sup> the Lands Tribunal for Scotland,<sup>177</sup> the Competition Appeals Tribunal<sup>178</sup> and the Copyright Tribunal.<sup>179</sup>

### **Arbitration and adjudication**

2.44 Scots law has no special statutory provisions to regulate the power of an arbiter or adjudicator to award interest and the early case law afforded no guidance. The matter is normally dealt with in the deed of submission and an arbiter may be granted power to award interest from such date as he thinks fit. In the absence of such a discretion, the arbiter has power only to award interest if the claimant would be entitled to it under the general law: in other words, the principles discussed above in relation to interest on debt and interest on damages would apply.<sup>180</sup> A demand for submission to arbitration is not a "judicial demand".

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<sup>171</sup> Clive, *Husband & Wife* (4<sup>th</sup> edn, 1997), para 12.022 and authorities cited.

<sup>172</sup> *Fletcher v Young* 1936 SLT 572 (Outer House). The date from which interest was agreed to run is not clear from the report.

<sup>173</sup> Family Law (Scotland) Act 1985, s 8(1).

<sup>174</sup> *Ibid* s 14(2)(j).

<sup>175</sup> *Geddes v Geddes* 1993 SLT 494. Lord President Hope at 500 drew an analogy with the entitlement to interest of an unpaid seller of heritable property where the purchaser has been granted possession of the subjects. See also *Tahir v Tahir (No 2)* 1995 SLT 451, Lord Clyde at 453, and *Welsh v Welsh* 1994 SLT 828, Lord Osborne at 835-6.

<sup>176</sup> Employment Tribunals (Interest) Order 1990 (SI 1990/479); Employment Tribunals (Interest on Awards in Discrimination Cases) Regulations 1996 (SI 1996/2803).

<sup>177</sup> Law Reform (Miscellaneous Provisions) (Scotland) Act 1980, s 18.

<sup>178</sup> Competition Appeal Tribunal Rules 2003 (SI 2003/1372), rule 56(1).

<sup>179</sup> Copyright, Designs and Patents Act 1988, s 151A.

<sup>180</sup> See *Farrans (Construction) Ltd v Dunfermline District Council* 1988 SLT 466, and *Elliott v Combustion Engineering Ltd* 1997 SC 126, in which it was held that an arbiter, who had been appointed following the raising of an action for payment, had no power to award interest on sums due for a period prior to the date of citation in the action.

Where no express power to award interest is conferred, an arbiter has an implied power to award interest only from the date of final decree.<sup>181</sup>

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<sup>181</sup> *John G McGregor (Contractors) Ltd v Grampian Regional Council* 1991 SLT 136.

## Part 3            The Case for Reform

### The purpose of an award of interest: our guiding principles

3.1     The primary purpose of an award of interest is to acknowledge the fact that by being deprived of the use of money, a creditor has either lost an opportunity to benefit from the use of the money or, alternatively, has suffered a further loss as a consequence of not having it to hand.

"... the essence of interest is that it is a payment which becomes due because the creditor has not had his money at the due date. It may be regarded either as representing the profit he might have had if he had had the use of the money, or conversely the loss he suffered because he had not that use. The general idea is that he is entitled to compensation for the deprivation."<sup>1</sup>

Similar considerations apply to a sum claimed by way of damages: so long as the damages remain unpaid the claimant is deprived of that sum of money. If the claim is for losses incurred in the past, the claimant is in a position analogous to that of the creditor of an unpaid contractual debt. The effect of an award of interest is to compensate the creditor by redressing the balance and, in theory, leaving both parties in the same position as if the debt had been paid when it fell due or, in the case of damages, as if reparation had been made as soon as the loss was sustained. Neither the claimant nor the debtor benefits from delaying settlement or judicial determination of the dispute.

3.2     An award of interest can also, however, be used to encourage early settlement of claims by penalising late payment. This occurs when the rate of interest awarded by the courts exceeds commercial rates so that the debtor ends up worse off by delaying payment than he would have been if he had paid immediately. An example of the use of interest for this purpose is the Late Payment of Commercial Debts (Interest) Act 1998<sup>2</sup> under which the rate of interest is deliberately set well above bank minimum lending rates<sup>3</sup> in order to penalise affected businesses who fail to pay their debts timeously. In recent years, the same effect has, in practice, occurred in Scotland in relation to awards of interest at the judicial rate<sup>4</sup> which has from time to time exceeded commercial rates of interest by several percentage points.

3.3     Prompt payment of debts and other financial claims is to be encouraged and we recognise that the imposition of a punitive rate of interest is one way in which this can be done. However, the terms of our reference do not merely cover situations in which the debtor is acting wrongfully in failing to make payment; they also cover situations in which the

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<sup>1</sup> *Riches v Westminster Bank Ltd* [1947] AC 390, Lord Wright at 400.

<sup>2</sup> See para 2.18.

<sup>3</sup> The rate specified for the 1998 Act is 8 per cent per annum over the official dealing rate of the Bank of England (the official dealing rate being the rate at which the Bank is willing to enter into transactions for providing short term liquidity in the money markets): Late Payment of Commercial Debts (Rate of Interest) (Scotland) Order 2002 (SSI 2002/336), arts 3 and 4.

<sup>4</sup> Rules of the Court of Session, rule 7.7 as amended; Sheriff Courts (Scotland) Extracts Act 1892, s 9 as amended.

debtor may have good reason for not making immediate payment but where payment is subsequently agreed or found by a court to be due. There may have been a legitimate dispute as to whether any sum is due or, if so, how much. The defender in a court action may, for example, be justified in demanding further proof of the incurring of a loss before admitting the claim. In such circumstances, the claimant still deserves to be compensated for loss of use of the money during the period of dispute but the debtor does not deserve to be penalised for refusing to make earlier payment.

3.4 There are therefore two approaches to interest which could be taken as a matter of principle. On the one hand, interest could be set at a punitive rate to encourage early payment subject to a court discretion to mitigate the penal element in appropriate cases by means such as reducing the rate or reducing the period during which interest runs. On the other hand, interest could be set at a compensatory rate subject to any specific exceptions in which it is regarded as proper to use interest as a "weapon" to penalise late payment. We favour the latter approach as being more appropriate to a comprehensive reform of the law of interest on debt and damages. In our view, the general rule should be that entitlement to interest should be neutral as between the parties so that neither benefits from delayed payment. We discuss in this paper whether different considerations apply to interest awarded for a period following the grant of a decree for payment by the court.

3.5 Nor, in our view, should it matter whether the claim takes the form of an action for payment of a debt or an action for damages. The common characteristic is that the claimant is being deprived of the use of money to which he is entitled. The form which his claim must take makes no practical difference to him. Whether the principal claim is for payment of a debt or payment of damages, the claim for interest could be regarded as a claim for damages for late implement of the principal obligation: it seems to us that there is no difference in principle which would warrant a different commencement date for the running of interest or a different rate of interest.

3.6 We would welcome views as to the appropriateness of the following principles as guidance for reform of the law of Scotland relating to interest on contractual and non-contractual debt and on damages:

1. **(a) So far as practicable, interest should run on pecuniary claims during the same period and at the same rate regardless of whether the claim takes the form of a claim for payment of a contractual debt, a non-contractual debt or damages.**
  - (b) The primary goal of an award of interest should be the realistic compensation, in commercial terms, of the creditor for loss of the use of money or property. Interest should not as a general rule be payable at a punitive rate.**
  - (c) An award of interest should compensate the creditor for loss of the use of money or property throughout the period during which that loss has subsisted.**

## Criticisms of the present law

3.7 We have concluded that the present law does not conform to the guiding principles set out above. In the remainder of this part of the paper we set out the reasons why we consider that it fails to conform to the first and third of these principles. Matters concerning the rate of interest are discussed in Parts 7 and 8 below.

### *Inconsistent treatment of debt and damages*

3.8 One of the least satisfactory features of the present law is that there is a significant difference between the treatment of interest on contractual debts and interest on damages. The effect of the Interest on Damages (Scotland) Acts of 1958 and 1971 has been to place injured parties suing for damages in a better position than creditors suing for debt, who will rarely be awarded interest from a date prior to the date of judicial demand. It is anomalous that a pursuer claiming damages for breach of contract may claim interest from the date when the right of action arose whereas a pursuer seeking payment in implement of contract may claim interest only from the date of citation. There seems to us to be no good reason in principle why these two pursuers should have such differing entitlements. It is true that, unlike a claimant for damages, a person who enters into a contract does so voluntarily and may therefore make entitlement to interest a term of the bargain. However, where a debtor defaults on payment, the prejudice to the creditor is the same as that which arises where a claim for damages remains outstanding; it seems undesirable for the legal entitlement to interest to be less generous.

3.9 Differing treatment of different types of claim is not restricted to a distinction between interest on debt and interest on damages. Because of the piecemeal development of the law, the date of commencement of a creditor's entitlement to interest will depend upon the nature of the claim. An example of this is afforded by *Winestone v Wolfson*,<sup>5</sup> a case concerning an IOU. If the debt acknowledged by the IOU had been a loan, then interest would have run *ex lege* from the date of the IOU even in absence of express contractual stipulation. In this case, however, the IOU had been given by one of the former members of a joint trading venture to the other pending a settlement of accounts between them. It was held that in the absence of agreement interest did not run before the date of citation on such an IOU. The point may be made that in the case of a loan the debtor may not be in default merely because the loan remains outstanding: the date for repayment might not yet have arrived. If, however, the purpose of interest is to compensate the creditor for the loss of the use of the sum due, there seems, in principle, to be no good reason to give differential entitlement according to how the debt is characterised as a matter of law. Still less does it seem appropriate to confer an entitlement *ex lege* to a creditor in circumstances where the debtor is not in default and to decline such an entitlement where a default has occurred.

### *The wrongful withholding concept*

3.10 The concept of wrongful withholding which emerged in the 19<sup>th</sup> century as the guiding principle for an award of interest has resulted in anomalies and uncertainties as the law has subsequently developed. Erskine's observation<sup>6</sup> that "interest is the profit due by the debtor

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<sup>5</sup> 1954 SC 77. For criticism of this decision, see Professor J Murray, "Interest on Debt" 1991 SLT (News) 305, at 308.

<sup>6</sup> Institute III.iii.75.

of a sum of money to the creditor for the use of it" has not been followed because in applying the concept of wrongful withholding, the courts have been reluctant to award interest in circumstances where they have been sympathetic to the debtor's reasons for not paying earlier. This was most apparent in the approach to interest on damages prior to legislative intervention, when interest could not be awarded until the claim had been liquidated by a court decree. The problem with the use of the concept in relation to interest on debt seems to us to arise from the fact that it has become inextricably linked with the requirement of a *judicial* demand so that, in the absence of contractual stipulation, interest will normally run only from the date of the raising of an action and not from the date of any prior formal demand for payment. The consequence<sup>7</sup> is that during the period prior to the raising of a court action the debtor has the use of the creditor's money without the latter having any right to compensation for that use. It follows, firstly, that the debtor has no inducement (other than avoiding the expense of defending a court action) to pay promptly or, indeed, to pay at all unless and until an action for payment is imminent; and secondly, that even if such an action is raised and prosecuted to a conclusion, the recovery by the creditor will be less than full because he obtains no compensation for loss of the use of the money prior to the date when the action was raised. In this respect Scots law is out of step with most other legal systems which we have examined.<sup>8</sup>

3.11 Another criticism of the wrongful withholding concept in the particular context of interest on debt, is that it is difficult to predict how it will be applied on a case by case basis. As noted in paragraph 2.23 above, there have been inconsistencies among the decisions in recent case law. To some extent these have resulted from judges attempting to reconcile the concept of *wrongful* withholding with a more general feeling that a creditor who is being deprived of funds which are eventually held to be due ought to receive redress for such deprivation. As noted above, wrongful withholding is not an equitable principle which permits the court to do justice in the case before it but is a rule of law in terms of which money is deemed to be wrongfully withheld after it has been judicially demanded.<sup>9</sup> Particular difficulties have arisen in cases where the issue remaining between the parties has been one of quantification. The view has sometimes been taken that until the sum due has been quantified by agreement, certification or otherwise, it cannot be said to be *wrongfully* withheld.<sup>10</sup> But even this is not consistent with an entitlement to interest from date of citation: an action for debt might be defended only as regards quantum and this would not prevent the creditor from becoming entitled to interest from the date when the action was raised. It therefore seems artificial to regard the "period of non-payment" as beginning only when the action has been raised.<sup>11</sup>

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<sup>7</sup> Except in circumstances where the creditor is entitled to, and does, demand interest under the Late Payment of Commercial Debts (Interest) Act 1998.

<sup>8</sup> See para 4.11 below.

<sup>9</sup> *Dean Warwick Ltd v Borthwick* 1983 SLT 533, Lord Cameron at 535: see para 2.23 above.

<sup>10</sup> *British Railways Board v Ross & Cromarty County Council* 1974 SC 27; *Farrans (Construction) Ltd v Dunfermline District Council* 1988 SC 120; *Robertson Construction Co (Denny) Ltd v Taylor* 1990 SLT 698; *John G McGregor (Contractors) Ltd v Grampian Regional Council* 1991 SLT 136.

<sup>11</sup> *Dean Warwick Ltd v Borthwick* above. The term "wrongful withholding" has also been used in English case law but is not there equated with the raising of court proceedings. Instead, it is seen as an element in the statutory discretion afforded to the court by what is now the Supreme Court Act 1981, s 35A. See eg *Arnott v Redfern* (1826) 3 Bing 353, Best CJ at 359; *London, Chatham & Dover Railway Co v South Eastern Railway Co* [1893] AC 429, Lord Herschell LC at 437; *Chadwick v Parsons* [1971] 2 Lloyds Rep 49, Mars-Jones J at 62-3 (affd [1971] 2 Lloyds Rep 322).

3.12 If it were a general principle that money is wrongfully withheld from and after the time when it has fallen due for payment, much could be said in favour of the concept. It would correspond closely to the guiding principles which we set out at paragraph 3.6. Indeed, it may be that this was what those judges had in mind whose *obiter dicta* introduced the concept into Scots law in the 19<sup>th</sup> century.<sup>12</sup> Read in this way the concept could afford a useful means of distinguishing between situations where a person is in default in failing to make a payment to another and situations where he is not. With the passage of time, however, this is not how the phrase has been interpreted. Its connection with judicial demand by the raising of an action has become so firmly established that the issue seems to be beyond further judicial development.

3.13 As the court appears to have thought in *Elliott v Combustion Engineering Ltd*,<sup>13</sup> we take the view that the law in relation to interest on debt is unsatisfactory and requires reform. Reliance upon the concept of wrongful withholding has distorted the true underlying principle that a person who has been deprived of the fruits of his money while another has had the use of it should receive compensation in the form of interest during the period of deprivation. This has led to uncertainty in the development of the law. More importantly, the effect of the application of the concept to debts other than loans has been to delay unduly the commencement of a creditor's entitlement of interest. Except in so far as it has a residual application in English law, it does not feature in any of the legal systems which we have examined.<sup>14</sup> We think that it has outlived its usefulness and should no longer be the basis of entitlement to interest in relation to any type of claim for payment. A consequence of this proposal would be that the date of judicial demand would lose its significance as the likely commencement date for the running of interest against a debtor.

3.14 In the case of business to business debt, we are mindful of the existence of a remedy for late payment in the Late Payment of Commercial Debts (Interest) Act 1998 and of the fact that that Act, as amended, gives effect to obligations incumbent upon the United Kingdom in terms of a European Council Directive. The interaction of our proposals with the 1998 Act is discussed at paragraph 4.30 below. The interaction of our proposals with other existing statutory provisions which confer an express entitlement to interest is discussed at paragraph 4.32 below.

#### *Interest on damages*

3.15 The law regarding interest on damages is also in need of clarification. Although the difficulties which were originally identified in the terms of the amendments made in 1971 to the Interest on Damages (Scotland) Act 1958 have been resolved by a pragmatic approach in the courts, some of the criticisms of the wording of the statute which were made at the time remain justified. For example, section 1(1A) makes reference to an interlocutor decerning for payment of a sum which consists of or includes damages or solatium for personal injuries and then directs the court to exercise the power in section 1(1) to award interest "so as to include in that sum interest on those damages". As Lord Emslie observed,<sup>15</sup> it is not possible to follow this direction literally. The intendment of the

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<sup>12</sup> *Carmichael v Caledonian Railway Co* (1870) 8M (HL) 119 and *Blair's Trs v Payne* (1884) 12R 104.

<sup>13</sup> 1997 SC 126; see para 1.2 above.

<sup>14</sup> See paras 4.11-4.12 below.

<sup>15</sup> *Smith v Middleton* 1972 SC 30 at 39.

subsection may be reasonably clear but it is not satisfactory that the statutory language has required to be made intelligible by judicial interpretation.

3.16 The post-1958 law in relation to interest on damages has also been coloured by the courts' persistence in applying it against a common law background of identifying a time from which the damages may be said to be wrongfully withheld. This persistence is perhaps understandable given the lack of guidance afforded by the statute beyond the creation of a power to award interest on the whole or any part of the damages for the whole or any part of the period after the date when the right of action arose. Unfortunately, this has led to continuing uncertainty as to the starting date for particular heads of claim. For example, the decision of the Second Division in *Boots the Chemist Ltd v GA Estates Ltd*<sup>16</sup> leaves open questions as to when interest will begin to run on out-of-pocket expenses which were quantified or readily ascertainable at a date earlier than the date when the claimant actually incurred them. There has also been a tendency in non-personal injury claims to continue to use the date of citation as a "default" commencement date for heads of claim other than out-of-pocket expenses.

3.17 We consider that these difficulties could be resolved by replacing the existing statutory provisions allowing interest on damages with new provisions which are, so far as possible, aligned with provisions dealing with interest on contractual and other debt. In each case interest would begin to run at an early date to reflect the loss of use of money by the creditor. This would facilitate the future development of the law in relation to interest on debt and on damages along a uniform path. We also consider it desirable to make clear that the concept of wrongful withholding should also cease to influence the courts when awarding interest on damages.

#### *Interest in other circumstances*

3.18 So far as interest on claims of a pecuniary nature other than for debt or damages is concerned,<sup>17</sup> there has in Scotland been a dearth of case law on the basis of which it could be asserted that the law is clear. We suggest that if there is to be a comprehensive reform of the law relating to interest on contractual debt and a re-formulation of the law relating to interest on damages, it would be desirable also to place the law regarding entitlement to interest in certain other circumstances on a statutory basis which conforms with the guiding principles which we have adopted in relation to interest on debt and on damages.

#### *Rate of interest*

3.19 There is presently no statutory mechanism for awarding interest at a rate which equates to the loss of use of money suffered by the creditor. As we have seen,<sup>18</sup> the old "legal rate" began life as a maximum rate and was not generally regarded as equivalent to the loss actually sustained due to late payment. The "judicial rate" at which interest is awarded post-decree is altered only at infrequent intervals and has often been significantly above (or, at times, below) the rate which would compensate the creditor without penalising the debtor. In the absence of any other candidates, it has also been used in recent times as

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<sup>16</sup> 1992 SC 485.

<sup>17</sup> Eg claims for repetition, recompense, salvage etc. Certain other types of claim are already dealt with by express statutory provision: see para 4.32 and Appendix B.

<sup>18</sup> See para 2.1.

the rate to be awarded in respect of periods prior to the date of decree. If an award of interest is to be truly compensatory, a new system for determining and changing the rate of interest payable to claimants is needed.

## Part 4 Interest on Contractual Debt

### Introduction

4.1 Most debts have their origin in a contract between two or more parties. The contract may be for the supply of goods or services (including the sale or letting of heritable property), for the lending of money, for the provision of caution or insurance and so on. In each case the consideration given by one party consists of a sum of money payable to the other party. The parties may or may not expressly agree a date upon which the sum is payable or, alternatively, it may be that the due date for payment can be implied as a term of the contract.

4.2 The contracting parties may also expressly agree that interest will be payable on the sum due under the contract with effect from a specified date. If, however, the contract is silent on the question of entitlement to interest and no such entitlement arises by necessary implication, interest will not run unless and until provided for by the common law rules summarised in Part 2 of this Discussion Paper. In this Part of the paper we discuss the basis upon which an entitlement to interest on a contractual debt could be conferred by statute in circumstances where entitlement (or absence of entitlement) to interest is not determined by an express or implied contractual term.

### A statutory entitlement to interest?

4.3 There are two different conceptual bases upon which an entitlement to interest on contractual debt could be based:

- (i) interest falls due as soon as the specified date for payment has passed without payment having been made (we refer to this as an "immediate entitlement"); and
- (ii) interest for the whole period since the date for payment becomes due as a consequence of an action having been raised for payment of the debt (we refer to this as a "deferred entitlement").

The distinction might at first sight seem to be of more theoretical than practical significance. Once proceedings have begun for recovery of a debt, it makes no difference whether the right to interest was (in theory) previously in existence or whether it only came into existence when the action began. What matters is the commencement date for the running of interest which the law specifies and the rate at which interest runs. Even before proceedings have been raised, the fact that a debtor knows that if found liable he may also have to pay interest from an early date may make it more likely that a settlement prior to the commencement of a court action will include some compensation to the creditor for interest accrued during the period since the debt became due. This, however, is debatable: some debtors will take the view that so long as they pay before proceedings are begun, they will be able to resist any demand for interest because the creditor will prefer to receive the principal sum, albeit late, rather than to prolong the delay by insisting upon interest in addition.

4.4 There is no Scottish case in which this distinction has been analysed. It may, however, be said that Scots law has implicitly adopted the "immediate entitlement" approach although, to some extent, this has been masked in recent years by the fact that interest has usually been awarded only for the period since the date of citation. The authorities prior to *Blair's Trs v Payne*<sup>1</sup> contain no indication that entitlement to interest was regarded only as an aspect of the giving of judgment in proceedings for recovery of debt. In any event, since 1884 interest has run from the date of citation not because the matter has been brought before a court for judgment but because a demand has been made in what was regarded as the appropriate form. As noted earlier,<sup>2</sup> there are circumstances in which interest has been held to run from the date of an intimation by the creditor that interest will be charged if the account remains unpaid. It is not suggested in these cases that the effect of such intimation is deferred until such time, if any, as an action for payment is raised.

4.5 The approach under English law has been different. At common law a contractual debt carried no entitlement to interest unless the parties agreed that it should. Statutory provisions introducing or extending entitlement to interest have taken the form of conferring power, or imposing a duty, on the court to include an award of interest in the sum for which judgment is given.<sup>3</sup> The present law is contained in the Supreme Court Act 1981,<sup>4</sup> in terms of which the High Court has power to include interest in any sum for which judgment is given for all or any part of the period since the date when the cause of action arose. Where payment is made after proceedings are raised but before judgment, or otherwise than in pursuance of judgment, the court has power to order interest to be paid up to the date of payment. Additional (non-statutory) powers to award interest exist with regard to equitable remedies.<sup>5</sup> This deferred entitlement approach was adopted, and continues to be used,<sup>6</sup> in most Commonwealth jurisdictions which began by adopting the 19<sup>th</sup> century English legislation. It has also obviously influenced the Scottish statutory provisions regarding interest on damages.<sup>7</sup>

4.6 The opposite approach is taken in most other European systems. Interest runs as a matter of statutory entitlement during the period of default, which may or may not require a formal demand to set interest running.<sup>8</sup> In their 1978 Report on *Interest*,<sup>9</sup> the Law Commission recommended the creation of an entitlement to what was called "statutory interest" but their recommendation was not implemented. This approach has, however, now

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<sup>1</sup> (1884) 12R 104: see Part 2 above.

<sup>2</sup> See the cases discussed at para 2.13, fn 53.

<sup>3</sup> Originally the Civil Procedure Act 1833 ("Lord Tenterden's Act"), s 28, allowing the court to award interest where interest was stipulated for in a written instrument or demanded in writing, and the Judgments Act 1838, s 17, providing for interest on judgment debts; subsequently the Law Reform (Miscellaneous Provisions) Act 1934, s 3, which gave "courts of record" a discretion to award interest on the whole or any part of the debt for any part of the period since the date when the cause of action arose; latterly the Supreme Court Act 1981, s 35A.

<sup>4</sup> S 35A, inserted by the Administration of Justice Act 1982, s 15(1); Sch 1, Part I. For county courts there are parallel provisions in the County Courts Act 1984, s 69.

<sup>5</sup> See Law Commission Consultation Paper No 167 *Compound Interest* (2002), para 2.19, referring to the speech of Lord Brandon of Oakbrook in *President of India v La Pintada Compania Navigacion SA* [1985] 1 AC 104 at 116.

<sup>6</sup> Eg New Zealand (Judicature Act 1908, s 87); British Columbia (Court Order Interest Act 1996); Ontario (Courts of Justice Act 1990, s 128); New South Wales (Supreme Court (Interest) Amendment Act 1983). The same applies in most other Australian states and Canadian provinces.

<sup>7</sup> See para 2.28.

<sup>8</sup> Eg France (Code Civil, art 1153); Belgium (Code Civil, art 1153); Germany (Bürgerliches Gesetzbuch, art 288(1)); Italy (Codice Civile, art 1224); Netherlands (Burgerlijk Wetboek, art 6:119); also Quebec (Civil Code, art 1617).

<sup>9</sup> Law Com No 88 (Cmnd 7229).

been taken in the United Kingdom in the Late Payment of Commercial Debts (Interest) Act 1998, which created an entitlement to "statutory interest" from a specified date, by way of implied contractual provision.

4.7 In their 1994 Report *Aspects of Damages: The Award of Interest on Money Claims*,<sup>10</sup> the Law Commission of New Zealand considered replacing the existing deferred entitlement to interest with an immediate entitlement. They concluded that this would have an undesirable effect on the legal relations between creditor and debtor before proceedings are issued, while making no difference to the ultimate enforcement of the debtor's liability for interest after proceedings have commenced. In particular, if prior to commencement of proceedings the debtor tendered the amount of the principal and the creditor took the money without referring to a claim for interest, this would not extinguish the debt because the interest would remain outstanding. The apparent consensus at the time of payment would not be sufficient to bar the creditor's claim for interest. We agree with this analysis but for our part we do not regard it as creating a problem. If a statutory entitlement to interest on overdue payments is in force, both parties know (or are at least presumed to know) that payment of the principal alone does not extinguish the debt due to the creditor. If the creditor chooses to accept only the principal in full satisfaction of the debt, that is a matter for him. If he does not, then there seems to us to be no difference in principle from a situation in which a debtor tenders only part payment of the principal: the balance remains due and is recoverable by court action if necessary. The fact that entitlement to interest is not dependent upon the raising of proceedings would, it seems to us, operate as an increased incentive to the debtor to pay in time.

4.8 In our view, the creation of a statutory entitlement to interest, as opposed to the creation of an enlarged remedy applying only where proceedings have been raised, is more consistent with the rights-based approach traditionally adopted by Scots law. It seems unprincipled to assert that on the day before proceedings are raised no entitlement to interest exists and yet to empower or even oblige the court to award interest for the pre-commencement period as soon as the action begins. In *President of India v La Pintada Compania Navigacion SA*,<sup>11</sup> Lord Brandon of Oakbrook identified three cases in which the absence of a common law remedy for loss caused by late payment of a debt may arise: case 1, where a debt is paid late before any proceedings for its recovery have been begun; case 2, where it is paid late after proceedings have begun; and case 3, where it remains unpaid until the proceedings have been concluded and a judgment given in which the original debt becomes merged. Lord Brandon expressed the view (at page 129) that:

"An ideal system of justice would ensure that a creditor should be able to recover interest both on unpaid debts in case 1, and also in respect of debts paid late or remaining unpaid in cases 2 and 3."

We agree. In our opinion, this can best be achieved by creating a statutory entitlement to interest on contractual debt from a specified date regardless of whether the creditor requires to raise proceedings in order to recover the debt. Such an entitlement already exists in relation to debts falling within the Late Payment of Commercial Debts (Interest) Act 1998. This entitlement should, in our view, be extended to all other contractual debts except where an entitlement to interest is conferred or expressly excluded by either (a) the terms of the

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<sup>10</sup> Report No 28.

<sup>11</sup> [1985] 1 AC 104 at 122

contract itself or (b) any other statutory provision. We therefore propose that, as a general rule:

- 2. There should be created a general statutory entitlement to interest on contractual debts except where an entitlement to interest is conferred or expressly excluded either (a) by the terms of the contract itself or (b) by any other statutory provision.**

4.9 We address below the exceptions which may be required to this general rule and, in particular, whether (as the rule implies) the parties to a contract should be permitted to contract out of it. However, we emphasise the point that our proposal would confer on the creditor a right, not a duty, to demand interest on a debt which is unpaid at the due date. The creditor could, if he wished, choose to settle for the principal sum only.

### **Date from which interest runs**

4.10 The central issue in relation to contractual debt is the identification of the appropriate date from which the creditor in the obligation should become entitled to interest if payment is not made by the debtor. We are concerned with payments due under various types of contract, notably:

- contracts for supply of goods and services;
- contracts for sale or lease of heritable property;
- contracts of employment;
- cautionary obligations;
- claims under contracts of insurance.

In each of these cases, it is presumed that payment by the debtor has fallen due, either because the creditor has performed his obligation under the contract, or because of some other express or implied term of the agreement. In other words, the debtor is in default in failing to have made payment. Our approach has been to attempt to identify the time at which the creditor may be regarded as being deprived of the use of the money which is – or is after court proceedings held to be – due by the debtor. The amount of the debt will usually, but not necessarily, be quantifiable by then. Different considerations apply where the debtor has the use of the creditor's money in circumstances where there is no such default: for example:

- where repayment of a loan has not yet fallen due;
- where the creditor has yet to perform some or all of his obligations under the contract and would not be in a position to sue for payment; or
- where the "debtor" is holding money belonging to the "creditor" with the latter's consent in circumstances in which he will in due course be required to account for it: eg money held by an agent or factor.

We consider separately below the circumstances, if any, in which statutory interest should run in such circumstances.

4.11 Our examination of other legal systems has disclosed no universally accepted criterion for selecting the date from which interest runs. English law and the Commonwealth systems which have adopted its approach provide for interest to be awarded, at the discretion of the court for the whole or any part of the period from "the date when the cause of action arose".<sup>12</sup> This is usually stated to be subject to any entitlement to interest already existing by virtue of agreement, statutory provision or otherwise. There are, however, variants. In Saskatchewan the court awards interest "from the day on which loss or damage is first sustained".<sup>13</sup> In Quebec the creditor is entitled to interest from "the date of default".<sup>14</sup> The Law Commission of New Zealand has recommended<sup>15</sup> that interest should run from the date on which the cause of action arose unless the amount of the principal was not quantified at that date in which case interest does not run until such later date as the court specifies as the date at which the amount is to be quantified. Within the United States there are a number of different formulations including the date when the cause of action accrues,<sup>16</sup> the date of breach of contract<sup>17</sup> and the date of notice of claim.<sup>18</sup> The most popular choice is the date when payment was due.<sup>19</sup> In France and Belgium interest begins to run on the date of demand for payment.<sup>20</sup> In Germany and the Netherlands interest runs during the period of default,<sup>21</sup> and in Italy from the date of default.<sup>22</sup>

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<sup>12</sup> See eg Supreme Court Act 1981, s 35A(1) (England and Wales); Court of Queen's Bench Act 1988, s 80(1) (Manitoba); Court of Justice Act 1990, s 128(1) (Ontario); Judicature Act 1973, s 45(1) (New Brunswick); Common Law Practice Act Amendment Act 1972, s 4(1) (Queensland); Supreme Court Act 1935, s 32(1) (inserted by Supreme Court Amendment Act 1982, s 3) (Western Australia); Supreme Court Act 1933, s 53A(1) (Australian Capital Territory); Supreme Court Act 1970, s 94 (New South Wales); Supreme Court Act 1935, s 30C (South Australia); Supreme Court Act 1986, s 60 (Victoria).

<sup>13</sup> Pre-judgment Interest Act, s 6(1), which in terms of s 5(1) applies to judgments for recovery of debt as well as judgments for damages. Amounts due are cumulated at three-monthly intervals from the date when the loss was first sustained and interest is calculated from the last day of each three-month period.

<sup>14</sup> Civil Code, art 1617.

<sup>15</sup> Report No 28 on *Aspects of Damages: The Award of Interest on Money Claims* (1994). To date there has been no statutory implementation of the recommendation.

<sup>16</sup> Eg Alaska, New Mexico, Rhode Island, South Carolina, Vermont, Washington, West Virginia. Similarly, in New York interest is awarded from the date when damage was incurred.

<sup>17</sup> Eg Alabama, Florida, Georgia, Massachusetts, Mississippi, North Carolina, Wisconsin.

<sup>18</sup> Maine, Michigan, Nevada, New Hampshire.

<sup>19</sup> Eg California, Colorado, Delaware, District of Columbia, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maryland, Minnesota, Missouri, Montana, Nebraska, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania.

<sup>20</sup> Code Civil (France), art 1153; Code Civil (Belgium), art 1153.

<sup>21</sup> Bürgerliches Gesetzbuch (Germany), art 288(1); Burgerlijk Wetboek (Netherlands), art 6:119.1. The Dutch Civil Code contains the following detailed provisions to determine when default commences:

"6.81 Except to the extent that the delay cannot be imputed to him or performance is already permanently impossible, the debtor is in default during the period that the prestation is not rendered, once it has become exigible and the requirements of Art 82 and 83 have been met.

6.82 (1) Default commences when the debtor is put into default by a written warning granting him a reasonable period for the performance and when there is no performance within this period.

(2) If the debtor is in a temporary impossibility to perform or if it is evident from his attitude that a warning would serve no purpose, he may be put into default by a written declaration to the effect that he is held liable for his non-performance.

6.83 Default commences without the formality of putting into default:

(a) Where a term which has been set for payment lapses without the obligation having been performed, unless it appears that the term has another purpose;

(b) Where the obligation results from an unlawful act or relates to reparation of damage as referred to in Art 74 paragraph 1 and the obligation is not immediately performed;

(c) Where the creditor must conclude from a communication by the debtor that the latter will fail in the performance of the obligation."

<sup>22</sup> Codice Civile, art 1224.

4.12 Although these formulations vary and may not always lead to use of precisely the same starting date, they have in common the feature that a dispute over the principal sum due does not prevent interest running. It will also be noted that in none of the systems examined (other than four US states<sup>23</sup>) does entitlement to interest, even after the raising of proceedings, run only from the date when an action has been commenced.<sup>24</sup> Scots law is therefore out of step with modern European and Commonwealth systems, and most US states, in restricting interest to the period following the date of citation.

4.13 The principles elaborated by the Commission on European Contract Law (the "Lando Commission") provide for interest to run at a prescribed rate "from the time when payment is due".<sup>25</sup> This formulation seems to us to express in a succinct manner the general rule which we propose for a statutory entitlement under Scots law. It identifies the date after which the debtor may be regarded as being in default in failing to make payment but carries no implication that entitlement to interest is postponed until an action is raised or until the amount of the debt has been independently quantified.

4.14 For certain types of debts, it will be desirable to particularise in the legislation the date at which "payment is due". We discuss a variety of different types of contractual debt below. We would, however, welcome comment on the following proposal:

- 3. As a general rule, interest on a debt arising under a contract should run from the date when payment is due by the debtor.**

#### *Supply of goods and services*

4.15 The most common type of pecuniary obligation is the obligation to pay for goods and services received by the debtor. For such obligations there already exists a model: the Late Payment of Commercial Debts (Interest) Act 1998, section 4, which applies throughout the United Kingdom to business-to-business contracts for the supply of goods and services. This provision may be summarised as follows:

Where the parties agree a date for payment of the debt (whether fixed or dependent upon the happening or non-happening of an event), interest begins to run on that date;

In any other case, interest begins to run 30 days after the later of:

- the day on which the supplier's obligation is performed; and
- the day on which the purchaser has notice from the supplier of the amount of the debt or of the amount claimed by the supplier.

We regard this as a clear and helpful means of applying the general principle that interest should run from the date when payment is due to contracts (whether or not between businesses) for the supply of goods and services.

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<sup>23</sup> Maine, Michigan, Nevada, New Hampshire.

<sup>24</sup> Paradoxically, in England and Wales interest is awarded from the date of service of a writ on *damages* for non-pecuniary loss in personal injury actions (*Jefford v Gee* [1970] 2 QB 130, Lord Denning MR at 147), but this rule has not been adopted in relation to contractual debt.

<sup>25</sup> Principles of European Contract Law (revd 1998), art 9:508. As noted in para 4.11, fn 19 above, a similar formulation is used by many US states.

4.16 So far as the "period of grace" before interest begins to run is concerned, it is clearly attractive to have consistency between the general entitlement to statutory interest which we are proposing and a creditor's entitlement under the 1998 Act. In our view, the period of 30 days specified in the Act represents a fair and reasonable time for which to delay commencement of the period during which the creditor of a contractual debt may be said to be deprived of the use of money due by the debtor.<sup>26</sup> It allows the debtor an appropriate period of time to pay after performance of the creditor's obligation and quantification of the sum demanded. At the same time the creditor is not disadvantaged by the continuation of any dispute over the amount properly due. The issue of an invoice by the creditor would constitute "notice" for this purpose.

4.17 We therefore invite comment on the following proposal:

**4. Statutory interest should run on a debt due for the supply of goods or services from the following date:**

**Where the parties agree a date for payment of the debt (whether fixed or dependent upon the happening or non-happening of an event), that date;**

**In any other case, 30 days after the later of:**

- **the day on which the supplier's obligation is performed; and**
- **the day on which the purchaser has notice of the amount of the debt or of the amount claimed by the supplier.**

*Sale or lease of heritable property*

4.18 In practice, sale of heritable property is the situation in which entitlement to interest is most likely to be the subject of express contractual stipulation and a statutory provision applying in the absence of agreement to the contrary may seldom be required. The Late Payment of Commercial Debts (Interest) Act 1998 does not apply to heritable property,<sup>27</sup> but our view is that, in the interests of consistency, no distinction should be drawn in respect of the more general entitlement which we propose. The formulation in the 1998 Act which we propose to adopt in relation to supplies of goods and services generally could apply, with little adaptation, to sales of heritable property.

4.19 A situation which requires further consideration is where a purchaser obtains possession of heritable - or, indeed, moveable - property without having paid the purchase price. It was established at an early date that the unpaid seller was entitled to some form of compensation for relinquishing possession without having received payment. In some cases this compensation took the form of interest; in others a share of the profit of the lands.<sup>28</sup> It is possible to see this either as compensation for loss of use of the subjects of sale or of loss of use of the purchase price. If it were the former, then the compensation might be regarded

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<sup>26</sup> In 2003/2004, 1,007 of the 2,706 public limited companies in the United Kingdom had an average payment period of 30 days or less. (Source: Federation of Small Businesses: Private Sector Payment Performance League Tables 2003/4.)

<sup>27</sup> The term "goods" is defined as in the Sale of Goods Act 1979, s 61(1).

<sup>28</sup> See para 2.3.

as analogous to rent payable by the purchaser in possession. In all the modern cases, however, any compensation found payable has taken the form of interest on the purchase price rather than attempting to quantify the benefits accruing to the purchaser from possession of the subjects of sale.<sup>29</sup>

4.20 Our general rule is intended to apply in circumstances where the debtor is in default by failing to make payment. In the case of a purchaser of property who is in possession without paying the price, non-payment may or may not constitute default, depending on whether the seller is in a position to implement all of his obligations under the contract. The present law as regards heritable property is clear: interest starts to run when possession is taken unless the purchase price is consigned.<sup>30</sup> This is so even where the purchaser has a good reason for non-payment and would have a good defence to an action for payment.<sup>31</sup> If a seller were to be entitled to statutory interest in circumstances in which the purchaser is not in default in failing to make payment, this would require an extension of our proposed general rule. There would also, presumably, require to be an exception to the extension where the purchase price has been consigned. Our provisional view is that entitlement to interest (whether as a rent substitute or as compensation for loss of the use of purchase price) where the purchaser is *not* in default in failing to make payment should not be included within the statutory scheme but should be left to the common law to determine.<sup>32</sup> However, we invite views on the following question:

**5. Should the entitlement to statutory interest extend to all circumstances in which the purchaser of property (whether heritable or moveable) has been granted possession without payment of the price to the seller, except during any period when the price has been consigned at an appropriate rate of interest?**

4.21 We propose that the general rule set out above would apply to arrears of rent. Once again the landlord's entitlement to interest is likely to be the subject of express provision in the lease<sup>33</sup> but we see merit in having the same statutory "default" provision for arrears of rent as applies to other sums payment of which is overdue. In their 1978 Report on *Interest*,<sup>34</sup> the Law Commission excluded rent and other sums payable by a tenant to his landlord from the scope of their scheme for two reasons. Firstly, the scheme for statutory interest which the Law Commission proposed was restricted to contract debts and it was noted that not all rent was contractual; for example, where a statutory tenancy had replaced a contractual tenancy protected by statute. Secondly, it was observed that there were special social policies involved in the rules as to payment and recovery of rent in relation to residential tenancies, one of the objects of which was to strike a balance between the economic strengths of the parties. The introduction of a statutory entitlement to interest

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<sup>29</sup> Eg *Cadzow v Wilson* (1830) 5 Mur 98; *West Highland Railway Co v Place* (1894) 21R 576; *Grandison's Trs v Jardine* (1895) 22R 925.

<sup>30</sup> *Prestwick Cinema Co v Gardiner* 1949 SC 645 (affd 1951 SC 98).

<sup>31</sup> Eg *Grandison's Trs v Jardine* (1895) 22R 925, in which the purchaser was unable to pay the price because his lender would not lend until the seller could deliver a clear title. This decision has been criticised as being contrary to the doctrine of mutuality.

<sup>32</sup> This might involve a reconsideration of *Grandison's Trs v Jardine supra*.

<sup>33</sup> At least in tenancies granted by private landlords; we understand that public sector landlords do not presently provide in leases for the charging of interest on unpaid rent. There is no provision for payment of interest in the Model Scottish Secure Tenancy Agreement produced by the Scottish Executive (for the text of which see [www.scotland.gov.uk/library3/housing/msst.pdf](http://www.scotland.gov.uk/library3/housing/msst.pdf)). Interest could, of course, be demanded from the date of citation.

<sup>34</sup> Law Com No 88.

might, it was thought, upset this balance. The first of these reasons is not strictly applicable to our scheme if, as we propose, it will not be restricted to contractual debt. In any event, even if it were so restricted, it would seem to us to be more consistent with principle to make special provision to include rent payable under statutory tenancies than to exclude rent altogether. The second of the Law Commission's reasons for exclusion seems to us to have less force in relation to a scheme, such as we propose, where the rate of interest is designed to be compensatory and not penal. We recognise that the conferment of a statutory entitlement to interest prior to judicial demand may, in the short term at least, result in an unforeseen benefit to landlords who have set rent levels a little higher than they would otherwise have done to take into account an assumption that interest would not run on rent arrears. This marginal benefit does not seem to us to warrant an exception from the general rule in relation to all rent.

4.22 Perhaps of greater concern is the potential effect of extending a statutory entitlement to interest to public sector landlords who, we understand, do not presently charge interest. It might be thought undesirable for individuals who may already be financially vulnerable to be exposed to a further liability in the form of interest on unpaid rent. We would emphasise, however, that we do not envisage that the charging of interest will be compulsory. As discussed below,<sup>35</sup> we consider that parties to a contract should have the right to contract out of the statutory entitlement to interest which would otherwise apply. It would therefore be open to a public sector landlord, should it wish, to include a provision in its tenancy agreements that interest would not run on arrears of rent. In any event, as we have already observed, the proposed new legislation would confer a right and not impose a duty to demand interest. Where, for example, a tenancy agreement which had been entered into prior to the new legislation taking effect did not provide for arrears of rent to be interest-free, there would be no obligation on the landlord to enforce any entitlement which the legislation created. On balance, we consider that there is insufficient risk of creation or exacerbation of hardship to justify excepting tenants' pecuniary obligations from our proposed general rule. We therefore invite comment on the following proposal:

**6. Interest should run on arrears of rent and other sums payable by a tenant to a landlord as it runs on other sums which have fallen due for payment.**

*Contractual debt where entitlement or quantification requires determination by a third party*

4.23 Entitlement to payment under a contract may be dependent upon a determination or certification made by a third party. A common example is a provision, such as those which appear in the commonly-used standard-form building contracts, that the contractor's right to payment does not accrue until the sum payable has been certified by the architect. Cases such as *British Railways Board v Ross & Cromarty County Council*<sup>36</sup> and *Farrans (Construction) Ltd v Dunfermline District Council*<sup>37</sup> have raised the issue of when interest begins to run where the creditor's entitlement to receive payment is dependent upon a determination by a third party such as an arbiter. In both cases, it was held that interest did not begin to run until the arbiter had determined the principal sum due. Under the new test proposed, if the claim was not covered by a contractual provision regarding payment

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<sup>35</sup> See para 4.34.

<sup>36</sup> 1974 SC 27.

<sup>37</sup> 1988 SC 120.

following certification, interest would begin to run 30 days after the creditor made his claim for payment. This is a situation in which it may well be that no criticism can be made of the debtor for waiting for the arbiter's determination before making payment. Nevertheless, our view is that no exception to the general rule is required. The creditor is deprived of the use of money even though the amount due has not been ascertained by the method agreed by the parties. We invite comment on the following proposal:

- 7. Statutory interest should run on a contractual debt even where the amount of the debt, if found to be due, remains unascertained pending determination by a third party.**

#### *Contracts of employment*

4.24 We are aware of no modern Scots cases in which the question of entitlement to interest on remuneration from employment prior to date of citation has been raised as an issue, although it will have been normal practice to seek interest from the date of citation in actions raised to recover arrears of pay. We propose that debts falling due under contracts of employment should fall within the scope of statutory interest.<sup>38</sup> The Late Payment of Commercial Debts (Interest) Act 1998 contains an express exclusion,<sup>39</sup> for the avoidance of doubt, of contracts of service, ie employment, and apprenticeship. This reflects the restriction of the scope of that Act to business-to-business transactions and we see no need to reproduce the exclusion in the more general scheme which we propose.

4.25 The rule which we propose in relation to supplies of goods and services requires some adaptation to make it work for earnings. In the first place, performance of an employee's duties takes place on a day to day basis and it seems undesirable to create a situation where interest falls to be calculated on each day's earnings separately. It would also seem unnecessarily complicated, where wages are paid on a weekly basis, to calculate interest separately on each weekly instalment. We suggest that a pragmatic solution would be to provide for interest to run from the last day of the month following the month in which the service under the contract was performed. This would require only one calculation of interest per month and would recognise that earnings from employment are normally paid in arrears. Secondly, it will seldom occur that an employee would give notice of the amount which he claims is due to him and so this branch of the rule regarding goods and services is likely to be inapplicable. Thirdly, where, unusually, the remuneration of the employee has not been expressly agreed so that payment *quantum meruit* has to be demanded, we do not regard it as appropriate that the running of interest should be deferred until a rate has been proposed or agreed. We therefore invite comment on the following proposal:

- 8. (a) Statutory interest should run on sums due under a contract of employment or apprenticeship.**

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<sup>38</sup> One consequence of this would be that awards by the Employment Tribunal under the Employment Rights Act 1996, s 13 (unauthorised deductions from wages) would include statutory interest. At present the entitlement to interest of a claimant in the Employment Tribunal in such cases is conferred by the Employment Tribunals (Interest) Order 1990 (SI 1990/479), in terms of which interest does not begin to run until 42 days after the date of the Tribunal's determination. This entitlement would be superseded by our proposals.

<sup>39</sup> S 2(4).

**(b) Unless the contract contains a contrary provision, interest should run from the last day of the month following the month in which the service under the contract was performed.**

**(c) Entitlement to interest should not be deferred by virtue of there having been no agreement as to the amount due under the contract.**

*Cautionary obligations: cautioner's right of relief*

4.26 We are not aware of any modern case law which addresses the issue of a cautioner's right to interest prior to date of citation on sums sued for by way of relief from the principal debtor. Three old Acts of Sederunt (of 1590, 1610 and 1613 respectively) made provision for interest to run from the date when the cautioner made payment and these Acts were applied in a number of 17<sup>th</sup> and 18<sup>th</sup> century cases.<sup>40</sup> This is consonant with the current law as regards payments under dishonoured bills of exchange.<sup>41</sup> In terms of our proposed general rule, it seems to us that the date when payment is made by the cautioner should be regarded as the date when payment is due to him by the principal debtor. It may be that no specific statutory provision is needed for cautionary obligations but we invite comment on the following proposal in principle:

- 9. Statutory interest should run on a sum paid by a cautioner in satisfaction of a debt due by the principal debtor from the date when payment by the cautioner was made.**

*Insurance and other claims for indemnity*

4.27 Contracts of insurance are likely to contain provisions regulating the policyholder's entitlement to interest on the proceeds of the policy. As with other forms of contractual debt, it seems desirable to have a statutory provision which will apply where a contract is silent. The obligation of an indemnity insurer is characterised by Scots law as a contractual obligation to pay a sum of money equivalent to the loss sustained by the insured.<sup>42</sup> In principle there seems to be no reason why late payment by an insurer, or by a party liable under any other contract of indemnity, should not result in entitlement to statutory interest. However, the model which we have borrowed for contractual debt from the 1998 Act may require some adaptation to render it suitable for fixing a commencement date for the running of interest on a sum due by an insurer under a policy of insurance. The insurer's liability arises as a consequence of the occurrence of an event, such as the insured having sustained a loss, and not as a result of the insured having performed an obligation. In some cases, such as third party and public liability insurance, the insured's loss may not actually occur until some time after the event giving rise to the claim. Non-indemnity insurance, such as life assurance, is in a different position in respect that it does not necessarily involve the

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<sup>40</sup> See para 2.2.

<sup>41</sup> Bills of Exchange Act 1882, s 57.

<sup>42</sup> *Scott Lithgow Ltd v Secretary of State for Defence* 1989 SC (HL) 9, Lord Keith of Kinkel at 20. Scots law has not adopted the English analysis of treating the occurrence of the event as a breach of contract by the insurer (see eg *Firma C-Trade SA v Newcastle P&I Association* [1991] 2 AC 1 and "*The Italia Express*" (No 2) [1992] 2 Lloyds Rep 281).

insured sustaining a loss. On the other hand, the date when the insurer's liability is triggered is not in doubt. In all cases the insurer may require time to investigate the claim.<sup>43</sup>

4.28 In England, the running of interest on insurance policy proceeds has been treated as a matter for the discretion of the court. In exercise of that discretion, interest has been awarded from the date of the loss,<sup>44</sup> from the date of the claim,<sup>45</sup> from the date of repudiation,<sup>46</sup> from the date when the policy proceeds were held to have been "wrongfully detained"<sup>47</sup> and from the date of commencement of proceedings.<sup>48</sup>

4.29 The question of when payment is due under a contract of insurance or other contract of indemnity is a matter for the underlying law (including the terms of the parties' contract) to determine. There are at least three conditions which must be satisfied before it may be said that payment is due by an insurer:

- (i) the event insured against has occurred;
- (ii) as regards indemnity insurance, the insured has sustained a loss as a consequence of the occurrence. In cases such as third party liability claims this will not occur until the insured has had to make payment to the third party, whether as a result of a court decree or not;<sup>49</sup> and
- (iii) the claim has been intimated to the insurer.

It might also be argued that payment is not due until the insurer has had a reasonable opportunity to investigate the claim. We understand that it is normal for contracts of insurance to contain a term entitling the insurer to a period of investigation before deciding whether or not to make payment. In cases where no express contractual provision is made, the question is whether interest should begin to run before such a period has ended. It seems to us that there is a reasonable case for allowing a period for investigation before interest begins to run. This is not a situation in which non-payment immediately indicates default. We have provisionally selected a period of 30 days as appropriate for investigation, although we would welcome views on whether a period of 30 days is regarded as too short. We invite comment on the following proposal which is intended to take into account all of the conditions mentioned:

**10. Where a contract of insurance or indemnity contains no express provision with regard to the running of interest, it should begin to run from whichever is the later of:**

- (a) the date 30 days after the date when a claim in respect of the occurrence of the event insured against is intimated to the insurer; and**

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<sup>43</sup> In *The Rosarino* [1973] 1 Lloyds Rep 21, a sum was held by an arbitrator to be payable by the guarantor of a charterer's liability under a charterparty. Exercising the discretion conferred on the court by the Law Reform (Miscellaneous Provisions) Act 1934, s 3, Mocatta J awarded interest from a date some 39 days after the arbitrator's award, to allow the guarantor some time "to think about it".

<sup>44</sup> *Sillem v Thornton* (1854) 3 E & B 868.

<sup>45</sup> *Burts and Harvey Ltd and Alchemy Ltd v Vulcan Boiler and General Insurance Co Ltd (No 2)* [1966] 1 Lloyds Rep 354; see also *Macbeth & Co Ltd v Maritime Insurance Co Ltd* (1908) 24 TLR 559.

<sup>46</sup> *Mackie v European Assurance Society* (1869) 21 LT 102.

<sup>47</sup> *Webster v British Empire Mutual Life Assurance Co* (1880) 15 Ch D 169.

<sup>48</sup> *J Gliksten & Son v State Assurance Co* (1922) 10 Lloyd LR 604.

<sup>49</sup> The amount of such a payment might of course include interest payable to the third party.

**(b) where the insured has sustained a loss as a consequence of the occurrence of the event insured against, the date when the loss was sustained.**

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

4.30 The provisions of the Late Payment of Commercial Debts (Interest) Act 1998 cannot be amended in such a way that the amended Act would cease to implement Directive 2000/35/EC. It is therefore necessary to preserve entitlements under the 1998 Act and consequently to exclude any entitlement to interest under our proposals where interest is running under that Act. This does not mean that our proposals could never apply to business-to-business debts. There is no obligation upon a creditor to demand interest at the rates to which he is entitled by virtue of the 1998 Act. If a creditor were to choose instead to demand interest under an Act giving effect to our proposals, then we consider that he should be free to do so. Given that the 1998 Act is intended to impose a penal rate of interest for late payment and that our proposals are intended merely to compensate the creditor for loss of the use of money, it will normally be to the advantage of the creditor to exercise his rights under the existing Act. There may, however, be sound practical reasons why he would decide not to do so. He may, for example, have a continuing business relationship with the debtor which he would not wish to jeopardise by demanding interest at a punitive rate. There may even be circumstances in which it is to his advantage to claim interest under our proposals. For example, if an Act implementing our proposals were to provide for compound interest to be charged, it might be to the creditor's advantage, with regard to a debt which remained outstanding for a very long time, to charge compound interest at a low rate instead of simple interest at a higher rate.

4.31 Our view is that conflict between the two regimes can be avoided, and the United Kingdom's obligations under European law respected, by providing that a debt does not carry interest under the proposed new scheme if or to the extent that it consists of a sum in respect of which a creditor's remedy for late payment under the 1998 Act is *enforced*, as opposed merely to being enforceable. It will then remain open to a creditor to choose to pursue his entitlement to demand interest at the punitive rate specified in the 1998 Act, or, alternatively, to seek statutory interest under the proposed new scheme. We invite comment on the following proposal:

- 11. A debt shall not carry interest under the proposed new scheme if or to the extent that it consists of a sum in respect of which a creditor has elected to claim interest under the Late Payment of Commercial Debts (Interest) Act 1998.**

### **Exception for interest due under other statutory provisions**

4.32 As noted in our discussion of the present law,<sup>50</sup> there exist a large number of statutory provisions other than the Late Payment of Commercial Debts (Interest) Act 1998 which confer an entitlement to interest. Some of the circumstances in which they apply will arise out of a contractual relationship. We do not propose any amendment to these provisions in so far as they specify the dates between which interest runs or the extent to which the court has a discretion as to whether or not to award interest. Legislation giving

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<sup>50</sup> See para 2.17.

effect to the scheme which we propose would exclude from its scope any debt on which interest is due under any other statutory provision. Nevertheless, our proposals could affect the *rate* of interest payable under certain statutory provisions. We discuss this at paragraph 7.55.

4.33 Certain taxes and duties payable to local or central government do not presently bear interest. An example is the council tax: no interest is charged on arrears but when the sheriff grants a summary warrant authorising recovery a 10% surcharge is added to the arrears.<sup>51</sup> Such debts do not fall within the scope of our reference and we do not propose that a new liability to interest shall be created in such circumstances.

### **Contracting out of the new scheme**

4.34 Section 8(1) of the Late Payment of Commercial Debts (Interest) Act 1998<sup>52</sup> provides as follows:

"Any contract terms are void to the extent that they purport to exclude the right to statutory interest in relation to the debt, unless there is a substantial contractual remedy for late payment of the debt."

Section 9 defines "substantial remedy" by providing that a remedy shall be regarded as a substantial remedy unless (a) it is insufficient for the purpose of compensating the supplier for late payment or for deterring late payment, and (b) it would not be fair or reasonable to allow the remedy to be relied on to oust or vary the right to statutory interest which would otherwise apply in relation to the debt. Apart from the prospective obligation to implement the 2000 Directive which was at that time in draft, the inclusion of these provisions was regarded as essential to protect the intended beneficiaries of the legislation. In the Consultation Paper<sup>53</sup> which preceded the 1998 Act, the DTI had stated:<sup>54</sup>

"To permit contracting-out would negate the purpose of the legislation by enabling large businesses to put pressure on small businesses to forego their right to statutory interest. It will still remain for any business to decide whether it wishes to exercise the right or not, but this decision will be voluntary not coerced."

4.35 Our provisional view is that the same considerations do not apply to the running of interest generally on contractual debt. We reach this view for the following reasons. In the first place there is less of an incentive for a party to contract out of payment of interest at a compensatory rather than a punitive rate. It is, after all, open to parties under the present law to agree that interest shall not run after date of citation on an overdue debt but we have not come across any instance of this being done. Secondly, it would seem to be wrong to prohibit parties from agreeing that one shall have interest-free use of the other's money. We noted above<sup>55</sup> the current position regarding public sector tenancies and it seems right that the parties to a tenancy should remain able to agree that no interest is to be payable on arrears of rent. It should also remain possible for parties to agree that loans shall be interest-free even after the date for repayment has arrived. Some Muslims, for example, would

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<sup>51</sup> Local Government Finance Act 1992, Sch 8, para 2(2).

<sup>52</sup> Implementing Art 3(3) of Directive 2000/35/EC.

<sup>53</sup> *Improving the Payment Culture: A Statutory Right to Claim Interest on Late Payment of Commercial Debt* (July 1997).

<sup>54</sup> Para 6.2.1.

<sup>55</sup> Para 4.22.

regard the charging of interest as forbidden by Islamic law and this should be recognised by some means in a new statutory scheme. Thirdly, any statutory provision will inevitably be in general terms which are unlikely to work equally well in all circumstances. In our view, it should remain open to parties to devise their own rules where they regard this as appropriate. Fourthly, the situation envisaged in the DTI Consultation Paper of a large business putting pressure on a small business does not seem likely to arise in the case of debts to which the 1998 Act is not applicable. There are few circumstances in which a large business is likely to incur debt under a contract with a person who is not acting in the course of a business. (One of these circumstances is a contract of employment.) Conversely, it seems unlikely in a contract where the creditor is the business and the debtor is the person *not* acting in the course of a business that the former would allow the latter to contract out of liability for interest on debts paid late. But there seems to be no obvious reason to prohibit this if it is what the parties want. An example might be debts to utility companies, one of the few remaining situations in which consumers might contract with large businesses on interest-free credit. The utility company should, we think, be free to agree with its clients that late payment of bills will be enforced by methods other than the charging of interest.<sup>56</sup> Finally, in business to business transactions there will be no incentive to contract out of liability for interest under the new provisions because the punitive liability under the 1998 Act would remain unless some other "substantial remedy" was provided.

4.36 A distinction could be drawn between, on the one hand, contracting out of an entitlement to interest altogether and, on the other hand, contracting for payment of interest at a different rate, or during a different period, or on a different principal sum from that which would be recoverable under the proposed legislation. In our view there is no need to draw such a distinction for present purposes. If, as we consider, parties should be free to contract out of entitlement to statutory interest, they should be free to agree an entitlement which is less than that which would be afforded by statute. They should also, in our opinion, be free to agree an entitlement which is greater than that afforded by statute, subject to the existing legislation regulating unfair contract terms, extortionate credit bargains and so on.

4.37 We invite comment on the following proposal:

**12. There is no need for statutory provision to prohibit parties from contracting out of the creditor's entitlement to interest under the proposed new legislation.**

4.38 If, contrary to our provisional view, it were felt that there was a need for a general prohibition on contracting out of the creditor's entitlement to statutory interest, it would be necessary to consider whether contracting out might be permitted in some circumstances, as is the case under the 1998 Act, and, if so, what those circumstances might be. We think that it would create undesirable complexity to introduce a new test to sit alongside the test contained in the 1998 Act and that if it is regarded as appropriate to include a prohibition on contracting out, the same test as that used in the 1998 Act should apply.

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<sup>56</sup> We believe that in practice it is common for electricity and gas supply contracts to confer an option on the supplier to demand interest on outstanding charges, typically at a rate 4% above the Bank of England base rate. However we understand that for public relations reasons it is uncommon for the supplier to enforce its entitlement to interest unless court proceedings are raised. It would remain open to suppliers to adopt this approach under our proposals whether the interest was due by contractual provision or by statutory entitlement.

## Judicial discretion to remit interest

4.39 Section 5 of the Late Payment of Commercial Debts (Interest) Act 1998 provides for remission of interest due under that Act for the whole or part of the period for which it would otherwise run, and for interest to be allowed for any period at a lower rate than that at which it would otherwise run, if this is required in the interests of justice, "by reason of any conduct of the supplier" at any time.<sup>57</sup> Having borrowed from the 1998 Act the principle that interest should begin to run from an early date, we invite comment as to whether this principle should be accompanied by a judicial discretion to withdraw entitlement to interest if it is in the interests of justice to do so.

4.40 There are persuasive arguments both for and against the inclusion of a judicial discretion to remit interest. Other law reform bodies who have considered this matter have reached differing conclusions. Most Commonwealth jurisdictions follow England and Wales<sup>58</sup> in conferring a wide discretion on the court to award interest at such rate, for such period and on such part of the principal sum as the court thinks fit.<sup>59</sup> This discretion was regarded by the Law Reform Commission of Western Australia<sup>60</sup> as justified by the many variables relevant to awards of interest, including:

- interest rates varying over time;
- whether there was delay on the part of the claimant in pursuing the claim;
- whether there was a legitimate reason for not paying the sum claimed earlier;
- any agreement between the parties that interest should not be recoverable.

4.41 In some other jurisdictions the court is given a discretion regarding the award of interest but the discretion is not unlimited. For example, in Ontario<sup>61</sup> the court may disallow interest, or award it at a higher or lower rate or for a longer or shorter period than that specified in the statute, taking into account various factors including the circumstances of the case, the amount claimed and the amount recovered, the conduct of any party tending to shorten or to lengthen unnecessarily the duration of the proceedings, and "any other relevant consideration". In an unimplemented report,<sup>62</sup> the Law Reform Commission of Hong Kong recommended that "where payment is withheld due to genuine doubts or dispute as to the terms of the agreement or the amount of the principal the courts should be able to intervene".<sup>63</sup>

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<sup>57</sup> Directive 2000/35/EC requires Member States to ensure that interest is payable "unless the debtor is not responsible for the delay" (art 3(1)(c)(ii)).

<sup>58</sup> Supreme Court Act 1981, s 35A(1).

<sup>59</sup> Eg New South Wales (Supreme Court Act 1970, s 94(1)); Western Australia (Supreme Court Act 1935, s 32(1), as inserted by the Supreme Court Amendment Act 1982, s 3); New Brunswick (Judicature Act, RSNB 1973 cJ-2, s 45(1)); Saskatchewan (Pre-Judgment Interest Act, cP-22.2, s 5(3)).

<sup>60</sup> Report on *Pre-Judgment Interest* (Project No 70(1)), 1981.

<sup>61</sup> Court of Justice Act, RSO 1999 c 43, s 130.

<sup>62</sup> Report on *Interest on Debt and Damages* (Topic 19), 1990.

<sup>63</sup> Other examples include Nova Scotia (Judicature Act, RSNS 1989 c 240, s 41(k)): the court has discretion to refuse interest if the claimant has not been deprived of the use of the money during the whole pre-judgment period, or if the claimant has been responsible for undue delay in the litigation; and Manitoba (Court of Queen's Bench Act, CCSM 1988 c 280, s 81(2)): court must have regard to changes in the quarterly interest rate, the circumstances of the case, and the conduct of the proceedings.

4.42 By way of contrast, in British Columbia judicial discretion has been excluded by statute. The court is obliged to add pre-judgment interest at a rate the court considers appropriate from the date when the cause of action arose until the date of the order.<sup>64</sup> The Law Reform Commission of British Columbia considered and rejected the arguments for judicial discretion.<sup>65</sup> Delay by the claimant in prosecuting his action was not regarded as causing prejudice to the debtor because he has had the use of the money during the period of such delay. Good faith on the part of the debtor in withholding payment was regarded as entirely irrelevant: if the debtor is liable to pay money, either he had the use of the money which ought to have been paid to the creditor forthwith or else he has been saved the expense of borrowing it. To introduce a discretion was considered to result in uncertainty and confusion and to complicate the legislation. A similar view was taken by the New Zealand Law Commission<sup>66</sup> who did, however, recommend that there be a limited discretion to vary the rate of interest in judgments given in a foreign currency and that a discretion was also needed as regards awards by the Employment Tribunal. No discretion exists in the systems of continental Europe or in the Civil Code of Quebec.

4.43 The arguments in favour of a discretion may be categorised as either economic or non-economic. Economic arguments support the retention of a discretion to ensure that the creditor is neither over- nor under-compensated. It may be, though, that this can be ensured by means other than a judicial discretion; for example, by maintaining rates of interest in line with current market rates and by appropriate definition of the starting date for the running of interest. Non-economic arguments support the retention of a discretion to cover cases where it might be regarded, for whatever reason, as unfair to the debtor to have to pay interest on the whole sum due for the whole period to the date of payment or decree. One of these is that the debtor has been in good faith in refusing to pay. For example, assume that A carries out work for B and submits an excessive bill which B refuses to pay. After several months' negotiation, a settlement is reached whereby B agrees to pay a lesser amount. B could not have paid earlier because A would not have accepted a cheque for a lesser sum than that initially demanded. Our provisional view is that this is not a good reason to refuse to award interest on the sum ultimately agreed to be payable. Under our proposals the award is compensatory and not penal. A has gained nothing by the tactic of submitting an excessive bill. B has lost nothing because he has had the use of the money for a longer period. Were a discretion to be retained to remit interest in such circumstances, it would re-introduce the concept of "wrongful withholding" which has created the present uncertainties and anomalies in the law.

4.44 As noted above, the 1998 Act contains a discretion to remit interest, but only by reason of any conduct of the supplier. For example, A carries out work for B and submits a bill which B refuses to pay on the ground that the work was not properly executed. A does nothing about this for more than four years but eventually raises an action for payment within the prescriptive period. On one view, this too is irrelevant to entitlement to interest on any sum found due at a rate which is compensatory and not penal. Whilst it may be unfair to require a debtor to pay interest at a rate which is set intentionally high to penalise late payment when the delay is wholly or mainly due to the conduct of the creditor, it is not so obviously unfair to require the debtor to pay interest at a rate which merely compensates the

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<sup>64</sup> Court Order Interest Act, RSBC 1996 c 79, s 1(1), implementing the recommendations of the Law Reform Commission of British Columbia in their Report on *The Court Order Interest Act* (LRC 90), 1987.

<sup>65</sup> Report, pp 15-22.

<sup>66</sup> Report No 28 on *Aspects of Damages: The Award of Interest on Money Claims* (1994), as yet unimplemented.

creditor for not having had the use of the money during the period since the debt fell due. It may be argued therefore that no judicial discretion to remit interest is required.

4.45 There is one further argument against the inclusion of a judicial discretion to remit interest. With the exception of the limited discretion in the 1998 Act, the systems in which a discretion is conferred are all "deferred entitlement" systems, ie systems where entitlement to interest arises only if proceedings have been raised. We have proposed an "immediate entitlement" system in which statutory interest runs irrespective of the raising of proceedings. It might be thought that the inclusion of a judicial discretion is inconsistent with a statutory entitlement to interest. In any event, it may be that it would lead to uncertainty as to the parties' rights in the absence of court action and would therefore discourage the resolution of claims for interest on debts paid late without recourse to the court.

4.46 We invite comment on the following alternative approaches to remission of interest by judicial discretion:

13. (a) **there should be no judicial discretion to remit interest;**
- (b) **there should be a judicial discretion to remit interest where the interests of justice so require, but only by reason of any conduct of the creditor (as in the 1998 Act); or**
- (c) **there should be a wide judicial discretion to remit interest in any circumstances where the interests of justice so require.**

#### **Interaction with claims for interest as a head of damages**

4.47 Interest payable to a third party may sometimes be claimed as a head of damages: for example, where a purchaser repudiates a contract to purchase a house and the seller incurs bridging loan interest during the period prior to concluding missives for a re-sale. As we noted earlier,<sup>67</sup> we have not regarded such claims as falling within the scope of our reference. However, there can be circumstances in which a claimant will seek to recover both statutory interest for late payment and also interest paid to a third party as a head of damages.

4.48 These circumstances are well illustrated by the facts of *Tiffney v Bachurzewski*.<sup>68</sup> Missives were concluded for the sale of a house but on the date of entry (31 December 1977) the purchaser failed to pay the purchase price. The missives contained no express provision entitling the seller to interest in this eventuality. The seller, who had been in a position to give entry and a good title, raised an action seeking implement of the contract of sale. Eventually the sale settled on 26 February 1980 and the seller amended his claim to one for damages. Among the sums claimed by the seller were (i) interest on part of the purchase price during the period between the date of citation and 26 February 1980, and (ii) the cost of a bridging loan arranged to purchase his new house. Proof before answer was allowed of the first of these claims, but the second was held irrelevant on the ground that it had not been explained why the cost of a bridging loan should have been within the reasonable contemplation of the purchaser.

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<sup>67</sup> See para 1.4.

<sup>68</sup> 1984 SC 108.

4.49 One may take issue with the court's view that it was not within the reasonable contemplation of a purchaser of domestic property that the seller might require a bridging loan if the price were not paid on time,<sup>69</sup> and it may be that a different decision would be reached today on similar facts. For present purposes, the point is that there was no overlap between the seller's two claims. The bridging loan interest was an amount in respect of which he was actually out of pocket: in other words, he ended up receiving the purchase price of the house *less* what he had had to pay to his bank. Moreover, he received the purchase price late and lost the use of that money during the period of default. For that loss he would, under our proposals, receive statutory interest from the date when the purchase price fell due (the original date of entry) until the date when it was eventually paid to him. He would also be entitled to seek statutory interest on that part of the sum sued for consisting of the bridging loan interest, assuming that this were to be held to be a relevant head of claim. Thus he would be fully compensated, but not over-compensated, for the purchaser's breach of contract.

### **Money held with the consent of the person entitled to it**

4.50 The common feature of all the circumstances so far discussed is that money has not been received by the creditor after the date when it ought to have been paid: put another way, the debtor is holding the funds to which another person is entitled without the consent of the latter. On the other hand, there are circumstances, some of which arise under contract and some of which do not, in which one person will have the use of another's money but where no question of default arises or, at least, where no question of default has yet arisen. The most obvious example is an express loan of money. Another is where a person acting in a capacity such as that of agent holds money for which he will at some future date be bound to account to his principal. Subject to what is said below in relation to the rate of interest on loans, we do not propose to include such circumstances in our proposed reform. So long as payment has not fallen due, we consider that the obligation, if any, of the holder to pay interest should be left to the existing law to determine. But it is necessary to consider situations in which a person who has been holding funds with the consent of the creditor continues to hold them after payment has fallen due.

### *Loans*

4.51 Under the present law there is a presumption that loans of money carry interest from the date when the loan is made. This presumption may be displaced by circumstances or by agreement to the contrary.<sup>70</sup> We see no reason to interfere with the common law presumption. The anomalies which have occurred, for example in relation to interest running on IOUs,<sup>71</sup> have not arisen because there is something wrong with the current law regarding interest on loans but because the law did not permit interest to be demanded prior to the date of citation on debts other than loans.<sup>72</sup> The common law presumption does not go so far as to specify the rate at which loans are presumed to carry interest. It may be that it would be helpful for it to be provided by statute that where the legal presumption operates, there shall be a rebuttable presumption that interest runs at the rate which we propose in

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<sup>69</sup> Lord Hunter at 113 described the submission as "a somewhat extravagant proposition".

<sup>70</sup> *Neilson v Stewart* 1991 SC (HL) 22, Lord President Hope in the Inner House at 34-5, citing Bell, *Commentaries* 1.693; Gloag, *Contract* (2<sup>nd</sup> edn), p 681; *Smellie's Executrix v Smellie* 1933 SC 725, Lord Justice Clerk Alness at 727.

<sup>71</sup> See the discussion at para 2.20.

<sup>72</sup> Eg *Winestone v Wolfson* 1954 SC 77.

Part 7 of this Discussion Paper. As yet we have reached no view on this but would welcome responses to the following question:

**14. Where a loan carries interest as a matter of common law presumption, should there be a rebuttable presumption that interest runs at the rate prescribed for statutory interest?**

4.52 There remains the situation where a loan has fallen due for repayment but has not been repaid. Under the present law, if a rate of interest was agreed then this contractual rate will continue after default, after an action for payment has been raised and even after decree.<sup>73</sup> We do not propose any change to this rule. We consider that where no contractual rate was agreed, the general rule stated at paragraph 4.14 above should apply to loans where repayment of the principal sum has become due. Accordingly, statutory interest would run at the prescribed rate from the time when the debtor is in default in failing to make repayment. This would apply in various circumstances, for example:

- where, at the time when the loan was made, the parties agreed a date for repayment but did not agree a rate of interest;
- in the case of a loan repayable on demand, the creditor has demanded repayment but the debtor has failed to pay and no rate of interest was agreed;
- where, by agreement or by implication, the loan was interest-free but the creditor has now demanded repayment and the debtor has failed to pay.

In the case of supplies of goods and services, we have adopted a "period of grace" of 30 days before interest starts to run. This approach could be adapted for loans by providing for interest to run from the date agreed by the parties for repayment of the principal or, failing such agreement, the date 30 days after the day when repayment is demanded by the creditor. We seek views on the following proposal:

**15. In the absence of agreement to the contrary, statutory interest should run on a loan of money from the date agreed by the parties for repayment of the loan or, failing such agreement, from the date 30 days after the day when the creditor demands repayment of the loan.**

*Obligations to account for money belonging to another*

4.53 In a variety of circumstances, a person may have possession of funds to which another is entitled in respect of which he will in due course be required to account for his intromissions. Some arise out of a contractual relationship, others do not. The most obvious example of a situation arising out of contract is where funds are held on behalf of a principal by an agent or factor. In England, an agent has a duty to account for interest which he has received on the principal's funds<sup>74</sup> and it is thought that the same rule applies in Scotland. The attitude of the court has been coloured by whether or not the holder of the funds has acted improperly. In *Wellwood's Trs v Hill*,<sup>75</sup> trustees to whom a landed estate had been conveyed appointed one of their number to be agent and factor. In the course of his

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<sup>73</sup> *Bank of Scotland v Davis* 1982 SLT 20.

<sup>74</sup> Bowstead and Reynolds, *Agency* (16<sup>th</sup> edn), para 6-101.

<sup>75</sup> (1856) 19D 187.

management, the agent placed funds held on behalf of the trust in his own bank account. The court found him liable to account for interest not merely at the rate earned but at "the highest legal rate" in view of the risk to which the funds had been put. Similarly, an agent who has failed properly to invest funds under his management may be found liable for interest which would have been received had the funds been invested properly. These appear to us to be rules of the substantive law of agency which we do not propose to disturb.

4.54 Our provisional view is that the statutory interest scheme which we propose should be restricted to circumstances in which the debtor is in default in failing to pay the principal sum to the creditor. This would include situations where the agent was initially in possession of the principal's funds with the latter's consent but is overdue in accounting for them. Interest under the statutory scheme would run from the date when payment fell due in accordance with the general proposal in paragraph 4.14 above. Entitlement of the principal to interest prior to that date would be left to the common law applicable to the particular circumstances in which the funds come to be so held. We would welcome views on the following proposal:

- 16. Statutory interest should run on funds held by one person on behalf of another from the date when the holder is in default in failing to make them over to the person entitled to them.**

## Part 5 Interest on Damages

### Introduction

5.1 In relation to interest on damages, it is less obvious than in the case of interest on contractual debt that any fundamental change to the existing law is required with regard to the commencement date for the running of interest. Statutory intervention has taken place twice and, despite the criticisms which were made of them shortly after their enactment, the operation of these provisions seems to be broadly satisfactory. The effect of the 1971 amendments to the Interest on Damages (Scotland) Act 1958 was to bring forward the date from which interest may be awarded on damages and, in the case of solatium for personal injury, to bring it forward to the date of the injury. We are not aware of any glaring injustice to be remedied with regard to the running of interest on damages. There is a persuasive argument that if the present legislation works in practice, it ought to be left alone. (As a separate issue, questions have arisen regarding the *rate* of interest payable on damages; these are addressed in Parts 7 and 8 below.)

5.2 Nevertheless, we have considered whether the law relating to interest on damages should be subject to a statutory re-statement in somewhat amended form. In our view, such re-statement may be justified for the following reasons:

- (i) The current statutory provisions depend heavily on the exercise of judicial discretion. They do no more than empower the court to award interest during any period since the date when the right of action arose. It is clearly not always appropriate for every head of claim to bear interest from the date when the right of action arose but the law gives no further guidance as to how the discretion ought to be exercised.
- (ii) There are uncertainties which remain unresolved, such as the date when interest runs on out-of-pocket expenses which are capable of quantification at a date earlier than the date when they are actually incurred by the person claiming them as a head of loss (such as where a pursuer sues for reimbursement of an expense which has been quantified but not yet actually incurred). Nor is there any clear authority on the commencement date for interest on damages for the destruction of property which is not replaced.
- (iii) The current statutory provisions have been judicially interpreted as requiring the court to continue to have regard to the criterion of "wrongful withholding". If, as we are proposing, this is to be abolished as the test for interest to run on sums other than damages, it seems appropriate also to remove it as a requirement for interest to run on damages. The most appropriate way to do so would be to re-cast the statutory provisions in such a way as to leave no room for the application of that test.
- (iv) The drafting of the existing legislation, in particular the subsections which were substituted in 1971, has been subject to criticism. Interpretation has

required a degree of judicial elucidation and we consider that even as regards aspects of the present law to which we propose no significant change of substance, the law could be more clearly stated than it was in 1958 and 1971.

For these reasons, it seems appropriate to us to consult on the question whether the law relating to interest on damages is in need of statutory re-statement. We seek views on the following question:

**17. Is it desirable for the law relating to interest on damages to be re-formulated by statute?**

The remainder of this part of the Discussion Paper proceeds upon the assumption that such a re-formulation ought to be attempted.

**Date for commencement of running of interest**

5.3 As with interest on contractual debt, our guiding principle is that a claimant should be compensated for loss in the whole of the period during which that loss has subsisted. The corollary of this is that interest should not be awarded on any sum for any period prior to the time when the head of loss in question was sustained. By way of example, consider earnings lost as a consequence of an accident at work. The loss accrues over a period which may continue after the date of the award. In principle, the instalments of past earnings lost should carry interest from the respective dates when they would have been received were it not for the accident. On the other hand, instalments of future earnings should not carry interest. They are not being received late: in fact, they are being received early and should be subject to a discount.<sup>1</sup>

5.4 Damages are also awarded as a surrogatum for loss which is not patrimonial: the most common example is solatium for pain and suffering due to personal injury. In other cases, money damages are awarded for patrimonial losses other than loss of the use of money, for example, destruction or loss of property. In these cases too, the loss which is being compensated may have arisen at any time, or at various times, since the date when the event giving rise to the claim occurred and may also continue into the future. Again, therefore, it is in principle appropriate to divide up the award into its component parts, awarding interest on past losses but not on compensation for losses which will arise or continue to arise in future. A method also has to be found for ensuring that past losses bear interest from an appropriate date or dates.

5.5 The Interest on Damages (Scotland) Act 1958, as amended in 1971, addresses these requirements by *permitting* the award of interest for any period beginning on or after "the date when the right of action arose". The use of the benchmark "when the right of action arose" appears to have been borrowed from English law. Many of the Commonwealth legal systems have also adopted this benchmark.<sup>2</sup> It had not previously been used in Scots law in the context of commencement of an entitlement to interest. Whilst it has the merit of affording the court the possibility of awarding interest from the earliest possible date, it requires some kind of modification to take account of the fact that not all

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<sup>1</sup> In current practice tables of multipliers (notably the "Ogden tables") are used to achieve an appropriate discount for early receipt of damages attributable to future loss.

<sup>2</sup> The phrase usually used is "cause of action" rather than "right of action".

loss accrues on the date when the harmful event occurs. Most systems, including Scots law, have resolved this by giving the court a wide discretion to award interest from any date or dates after the date when the cause or right of action arose, enabling the court to achieve a just result in individual cases. We have considered alternative formulations which would give greater certainty as to the date of commencement without depending to a large extent on the exercise of judicial discretion.

5.6 An example of a system which operates without judicial discretion is afforded by British Columbia. The Court Order Interest Act 1996<sup>3</sup> utilises the benchmark of the date on which the cause of action arose, but requires the court to add interest from that date at a rate which the court considers appropriate. There are, however, two notable exceptions. Firstly, if the sum awarded consists in whole or in part of "special damages",<sup>4</sup> interest runs from the end of each six-month period in which the special damages were incurred. Secondly, the court must not award interest on non-pecuniary damages arising from personal injury or death. The first of these exceptions acknowledges that not all items of actual pecuniary loss are incurred on the date of the event giving rise to the claim. We agree that whatever statutory formulation is adopted must be such as to secure that interest is awarded on items of actual pecuniary loss only from the time when it was in fact incurred. The second appears to have been the consequence of a reluctance on the part of the Canadian courts to apportion non-pecuniary loss into past and future components.<sup>5</sup> This reluctance has not been shared by the courts in Scotland where solatium is routinely (albeit on a broad-brush basis) divided into pre-judgment and post-judgment loss. We would not wish to except non-pecuniary loss from the scope of our proposed scheme.

5.7 The solution which we propose is to provide, with as little further elaboration as possible, for interest to run on a particular head of loss from the date upon which that loss was sustained. This would be a principled approach and would moreover have the attraction of simplicity. It makes clear that the court must continue to take the "selective and discriminating" approach to assessment of damages which the case law presently requires and provides a test for the starting date for interest on each head of claim which does not depend upon applying the criterion of "wrongful withholding". It seems to us that such a benchmark would provide significantly greater guidance to the court than does the present law. We invite comment on the following proposal:

**18. In an action for damages, interest should run on each head of loss from the date on which the loss in question was sustained.**

5.8 We are attracted to the idea of a principle which can be shortly stated and which can be applied by the court in such a way as to achieve a just result on the facts of each particular case. Our provisional view is that a statutory provision which confers an entitlement to interest on each head of damage awarded from the date when the loss was sustained is sufficiently clear without need of further elaboration for specific types of loss although, as noted below, the meaning of the test in relation to solatium may require express

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<sup>3</sup> RSBC 1996 c 79, implementing in part the recommendations of the Law Reform Commission of British Columbia in their Report on *The Court Order Interest Act* (LRC 90, 1987).

<sup>4</sup> The term is not defined in the British Columbian Act. It has been used in England as synonymous with "actual pecuniary loss suffered by a plaintiff": *Jefford v Gee* [1970] 2 QB 130, Lord Denning MR at 146.

<sup>5</sup> There has been a similar reluctance on the part of the English courts: see eg *Jefford v Gee* above; *Wright v British Railways Board* [1983] 2 AC 773; McGregor, *Damages* (16<sup>th</sup> edn) paras 645-652.

statutory explanation. We see the principle applying to different types of loss in the following way.

### **Application of the general rule to particular types of loss**

#### *Pecuniary losses (including out-of-pocket expenses)*

5.9 In the case of out-of-pocket expenses, the application of the principle would be straightforward. The loss is sustained on the date when the expense is incurred. It does not matter that the amount of the expense was quantifiable, or, indeed, quantified, at an earlier date: to award interest prior to the incurring of the expense would be to over-compensate the claimant. For example, assume that A causes a road accident in which B's car is damaged beyond economic repair. B sues for (i) the value of the car, and (ii) the cost of hiring a car during the period prior to purchase of a replacement car. The dates on which B's losses are sustained are (i) in the case of the car itself, the date on which B incurs the expense of purchase of the replacement car, and (ii) in the case of the hire charges, the date or dates upon which these are incurred. Although B has been deprived of the use of his damaged car from the date of the accident, he would be over-compensated by allowing interest to run from that date: his deprivation of the use of the car prior to the purchase of the replacement is in this case compensated by reimbursement of the expense of a temporary replacement; in other cases a different loss (such as increased public transport expenses) might be incurred instead.

5.10 The principle would apply in the same way where the loss consists not of an out-of-pocket expense but rather of the loss of money which would have been received but for the event giving rise to the claim, such as wage loss. The main obstacle to the straightforward application of this principle in such cases seems to us to be practicality: actual pecuniary losses may consist of a large number of individual items the loss of which was sustained at different times. For example, each instalment of past wage loss will have been sustained on the date when that instalment would have been received. This is a difficulty which must be addressed by any system in which interest is awarded on past losses. Precise calculation of interest due on each instalment is tedious but entirely feasible. To what extent is the system prepared to sacrifice accuracy for ease of calculation? Existing legislation in Scotland gives no guidance on this. The practice, encouraged by court decisions during the period following the legislative amendments in 1971, is for a broad measure of accuracy to be achieved by calculating the total wage loss over the whole period of past loss and then awarding interest on that total at half the judicial rate. In some Canadian jurisdictions<sup>6</sup> interest runs only from the end of the six-month period in which the loss was sustained thereby reducing the number of interest calculations required.

5.11 Our provisional view is that the fact that strict accuracy could only be achieved by a detailed process of calculation is not a sufficient reason to depart from the principle that interest should run on a particular item of loss from the time when that item of loss was sustained. It would be to the disadvantage of pursuers if the commencement of running of interest on pecuniary losses were to be delayed until the end of the six-month period in which the loss accrued. We do not regard this disadvantage as a fair price to pay for a speedy calculation. In any event the availability of the on-line and other computational aids

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<sup>6</sup> Eg British Columbia (see above), Ontario and Manitoba.

which we suggest elsewhere in this Discussion Paper<sup>7</sup> should mean that speedy calculation remains entirely feasible. There is, of course, no reason why parties should not continue to settle claims on the basis of a more approximate calculation; nor, indeed, why they should not invite the court to employ a degree of approximation where this will not cause material prejudice to either party. The claimant's statutory entitlement should, in our view, be clear.

We invite comment on the following proposal:

- 19. (a) Interest on pecuniary losses consisting of out-of-pocket expenses should run from the date when the expense in question was incurred.**
- (b) No special provision is required in relation to losses accruing periodically during the time since the date of the event giving rise to the claim.**

### *Solatium*

5.12 There has been no consensus among judges in different jurisdictions as to the proper interpretation of an award for non-pecuniary loss. Some courts have taken the view that the valuation of financial compensation for non-pecuniary damage such as personal injury or death is such an approximate process that it would introduce a spurious accuracy to divide the sum into past and future elements or to award interest on a past element. Legislation sometimes prohibits the award of interest on solatium. This is not presently the case in Scotland. Section 1(1A) of the 1958 Act requires interest to be "included" in the damages awarded in respect of solatium for personal injury.<sup>8</sup> Clarification might be required with regard to the application to awards of solatium of the simply-expressed test which we have tentatively proposed. On the one hand, it could be argued that the loss which is compensated by an award of solatium is sustained on the day of the accident. On the other hand, it might be said that the loss is sustained on every day following the accident unless and until the claimant makes a full recovery. The latter interpretation is the one which seems to us to represent the reality. We would intend that the legislation be drafted in such a way, if necessary by a specific provision, as to achieve this result. It would thus remain possible for interest on solatium allocated to the past to be calculated at a rate which is one-half of that specified by law in order to compensate the effects of the injury over a period of time. We would welcome views on the following question:

- 20. If the principle which we have proposed were to be adopted, is there a need to specify by statute that the loss which is compensated by an award of solatium is sustained throughout the period during which the effect of the event giving rise to the claim endures, and is not sustained wholly on the date when the event occurs?**

**If so, how might this best be done?**

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<sup>7</sup> See para 8.43.

<sup>8</sup> For criticism of this formulation see *Smith v Middleton* 1972 SC 30, Lord Ordinary (Emslie) at 39. See para 2.29.

### *Property lost or destroyed*

5.13 Another situation which requires to be separately addressed is that of property which is destroyed or lost and not replaced. An example is provided by *James Buchanan & Co v Stewart Cameron (Drymen) Ltd.*<sup>9</sup> The pursuers engaged the defenders to carry a load of whisky and advertising material by road. The lorry was stolen and the goods lost. It was held by Lord Maxwell that where, as here, there was no suggestion that the defenders were enjoying an advantage from the pursuers' loss, the principal sum could not be said to be wrongfully withheld from any date prior to the date of citation. He noted also that he had no grounds for assuming that the whisky and advertising material, if not lost, would have earned profit for the pursuers from any particular date. Applying the principle which we have proposed to the facts of this case, it becomes necessary to determine when the owner's loss was sustained: was it the date of the theft or was the loss sustained only at the date when the stolen goods would have been used for profit? We consider the latter alternative to be a more accurate reflection of reality: if interest were to be awarded from the date of the theft, the claimant could be better off than if the goods had not been stolen. It may be more accurate still to regard the loss of the *cost* of the goods (which will usually constitute the greater part of the loss) as occurring on the date of the theft but to regard the loss of profit on their re-sale as occurring on the date when they would have been used for profit.

5.14 Different dates might be appropriate for the different types of goods lost: it would in each case be for the pursuer to prove when a financial loss actually occurred. In the circumstances of the *James Buchanan* case, interest might not run from the same date in respect of the whisky as in respect of the advertising material. So far as the whisky is concerned, the appropriate date for commencement of the running of interest seems to be the date when it would have been sold in the course of the pursuers' business. The advertising material is perhaps more difficult. If, for example, the pursuers proved that they required to incur expense on ordering replacement material then interest would run from the date when that expense was incurred on the normal principle for out-of-pocket expenses.<sup>10</sup> If, on the other hand, the material was not replaced then, as discussed in paragraph 5.16 below, the only possible date for the calculation of interest on whatever loss was claimed would appear to be the date of the theft.

5.15 The principle may be further tested by applying it to the facts of *Boots the Chemist Ltd v GA Estates Ltd.*<sup>11</sup> The pursuers were tenants of shop premises who suffered loss when their premises were flooded as a consequence of a blocked culvert. Seven of the eight heads of loss claimed from the landlord consisted of out-of-pocket expenses, such as shopfitting costs, which had been incurred during the two months following the flooding incident. The eighth was a claim for loss of stock. The court held that interest on the seven heads of out-of-pocket expenses ran from the dates when these expenses were respectively incurred. As regards the loss of stock, there was no evidence before the court as to when that stock could have been turned to profit, and accordingly, following *James Buchanan & Co v Stewart Cameron (Drymen) Ltd*, interest was allowed only from the date of citation. Applying the new principle which we have proposed, the situation as regards the out-of-

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<sup>9</sup> 1973 SC 285; see para 2.30.

<sup>10</sup> If in addition the pursuers had sustained consequential loss as a consequence of being deprived for a period of the use of the advertising material (for example, because they were unable to run an intended sales promotion event), then that would constitute a separate head of claim whose admissibility would depend upon application of normal *Hadley v Baxendale* rules. Interest would also run on this head of claim.

<sup>11</sup> 1992 SC 485; see paras 2.31-2.32.

pocket expenses would be no different. The position as regards the lost stock would depend (a) upon whether or not the stock was replaced, and, if not, (b) upon proof of the date when the stock would have been likely to have been turned to profit. A difference from the existing law would be that there would be no "safety net" of date of citation for a pursuer who failed to prove when the loss was sustained.

5.16 The examples in the two previous paragraphs concern property whose loss can be compensated by reference to its commercial value. This will not always be possible. Assume that in the example in paragraph 5.9 above, B does not purchase a replacement car and simply sues for the value of the car which was damaged beyond repair, with no intention of expending the sum recovered on a car. There would seem to be only one possible date upon which B's loss could be said to be sustained, namely the date of the accident. It might be thought anomalous that interest runs from different dates depending upon B's decision whether or not to replace his car. However this is because a different type of loss is being compensated. In the first case, it is a permanent financial loss which does not occur immediately, accompanied by the temporary loss of use of an asset; in the second, it is a permanent loss of an asset which occurs immediately. On reflection, we do not regard it as anomalous that the commencement dates for the running of interest should be different,<sup>12</sup> and it seems to us that our proposed test is capable of applying in all of the foregoing circumstances in a fair and reasonable way.

5.17 Another example is afforded by the English case of *Metal Box Co Ltd v Curry's Ltd*.<sup>13</sup> Goods belonging to the plaintiffs which were stored in the defendants' warehouse were destroyed by a fire caused by the negligence of the defendants' employees. It appears that the goods were stock intended for sale. The plaintiffs were compensated for the value of the goods destroyed and the question was whether interest was due on the compensation and, if so, in respect of what period. The defendants contended that no interest at all was due because payment had not been wrongfully withheld. Alternatively, since the plaintiffs were insured, it was due only from the date when the insurers made payment to the plaintiffs. It was argued that unless the plaintiffs had intended to sell the goods on the day of the fire, they were not entitled to interest. The plaintiffs contended that interest should run from the date when their loss adjusters wrote to the defendants' insurers to intimate a claim. There were further arguments as to whether the plaintiffs had delayed unduly in prosecuting their claim and McNeill J, in exercise of the statutory discretion,<sup>14</sup> awarded interest from a date midway between the date of the fire and the date when the action was raised. It seems clear that the judge was correct to reject the submission that no interest was due. On the test which we propose, however, interest would be awarded on the compensation for the destruction of the stock from the date when the stock would have been used for profit. The question whether delay on the part of a pursuer in raising proceedings should affect the running of interest is discussed below.<sup>15</sup> Leaving that matter aside, however, it seems to us that our proposal would have been reasonable in the circumstances of the *Metal Box* case. In the course of argument in that case, counsel for the defendants invited the court to consider the situation where a work of art or a Ming vase was destroyed. He argued that

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<sup>12</sup> A parallel may be found in English admiralty cases. Where a ship is destroyed, in a collision or otherwise, interest is awarded from the date of destruction: *Straker v Hartland* (1864) 34 LJ Ch 122. Where on the other hand a ship is damaged, interest is awarded from the date when the plaintiff incurred the cost of the repairs: *The Hebe* (1847) 2 W Rob 530; *The Norseman* [1957] P 224.

<sup>13</sup> [1988] 1 WLR 175.

<sup>14</sup> Supreme Court Act 1981, s 35A.

<sup>15</sup> Para 5.23.

profit-earning capacity was irrelevant to the question whether or not interest should be paid on the damages awarded for its destruction. Whilst we agree that interest should be awarded whether the item destroyed has a profit-earning capacity or not, it does not seem to us to follow that the commencement date should be the same in all cases.

5.18 We invite comment on the following proposals and question:

**21. (a) Where loss is sustained as a consequence of the loss or destruction of an item of property which is replaced, the loss should be taken to occur on the date when expense is incurred on replacement.**

**(b) Where loss is sustained as a consequence of the loss or destruction of an item of property which is not replaced and which consists of a loss of proceeds of realisation of the item, the loss should be taken to occur at the time of loss or destruction but any lost profit on realisation should not be taken to have occurred until the date when the proceeds would have been received.**

**(c) Where loss is sustained as a consequence of the loss or destruction of an item of property which is not replaced and which was not intended for realisation, the loss should be taken to occur at the time of loss or destruction.**

**(d) If these proposals are adopted, is there a need for express statutory provision setting them out, or could they be regarded as following naturally from the principle that interest runs from the time when loss is sustained?**

#### **Date for termination of running of interest**

5.19 Under the current legislation,<sup>16</sup> interest runs for the whole or any part of the period until the date of the interlocutor granting decree for payment of damages "including" interest. After decree, interest continues to run at the judicial rate in terms of Rule of Court 7.7 or the sheriff court equivalent.<sup>17</sup> We discuss below:

- whether interest before and after decree should be calculated by reference to the same rate;<sup>18</sup> and
- whether interest accrued to the date of decree should be compounded with the principal for the purpose of calculating interest post-decree.<sup>19</sup>

5.20 Where the defender makes an interim payment of damages, interest ceases to run on the sum paid.<sup>20</sup> At present, this obviously sensible result is achieved by operation of the

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<sup>16</sup> Interest on Damages (Scotland) Act 1958, s 1(1) (as substituted by the Interest on Damages (Scotland) Act 1971).

<sup>17</sup> Sheriff Courts (Scotland) Extracts Act 1982, as most recently amended by the Act of Sederunt (Interest in Sheriff Court Decrees and Extracts) 1993 (SI 1993/769).

<sup>18</sup> See paras 7.43-7.52.

<sup>19</sup> See paras 7.46-7.51. (For a recent example see *Ryan v Fairfield Rowan Ltd*, 29 July 2004 (unreported).)

<sup>20</sup> *Redman v McRae* 1991 SLT 785; *Jarvie v Sharp* 1992 SLT 350.

judicial discretion in s1(1) of the 1958 Act. It could also be achieved by express provision in legislation. In any event, we suggest that:

- 22. Where a defender makes a payment to the pursuer in part satisfaction of his liability, the amount on which interest is calculated after the date of such payment should be reduced by the amount of the payment.**

### **Judicial discretion to remit interest**

5.21 The current statutory provisions afford a wide discretion to the court to restrict the period during which interest runs. This is necessary because the 1958 Act simply permits the awarding of interest from any date after the right of action arose. There are in fact four separate discretions in section 1(1) as amended:

- whether to award interest at all;
- the rate or rates of interest;
- the amount of the sum carrying interest; and
- the period during which interest runs.

As regards damages or solatium for personal injury, the first of these discretions is restricted by section 1(1B): the court must award interest unless there are reasons special to the case why no interest should be given. The other three discretions remain.

5.22 Despite the width of the statutory wording, the courts have been reluctant to treat this as an unfettered discretion, preferring to apply the provisions of the 1958 Act against the common law background of "wrongful withholding". As with contractual debt, we propose that the criterion of wrongful withholding should cease to apply to interest on damages and be replaced by the new principle that interest should run on each head of loss from the date when it was sustained. It is for consideration, therefore, whether there is a need to retain any accompanying judicial discretion.

5.23 At one time the courts were inclined to exercise the discretion in the current law to restrict entitlement to interest where there was unreasonable delay on the part of the pursuer in prosecuting a claim.<sup>21</sup> However, this approach was disapproved by the Second Division in *Boots the Chemist Ltd v GA Estates Ltd*<sup>22</sup> and, since then, the discretion has not been exercised to penalise delay by the pursuer. So far as the rate of interest is concerned, the discretion has been exercised largely to achieve a broadly fair application to periods prior to decree of the judicial rate prescribed by Rule of Court 7.7 in respect of interest payable under a decree. As noted above, the discretion has also been used to restrict entitlement to interest where an interim payment has been made by the defender.

5.24 Arguments in favour of retaining a discretion in any new scheme applicable to interest on damages include the following:

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<sup>21</sup> *Nacap Ltd v Moffat Plant Ltd* 1986 SLT 326; *Buchan v J Marr (Aberdeen) Ltd* 1987 SLT 521; *M & I Instrument Engineers Ltd v Varsada* 1991 SLT 106.

<sup>22</sup> 1992 SC 485, Lord Justice Clerk Ross at 497.

- The court may wish in certain circumstances to penalise the pursuer for his conduct of the litigation;
- There may be circumstances in which the court would wish to award interest at a higher or lower rate than that prescribed by legislation, as discussed in Part 7 below, for example, where the defender has used the money to earn interest at a higher rate than that prescribed;
- The discretion can be used to ensure that interest entitlement is restricted when an interim payment has been made;
- There may be other circumstances in which it would be unfair to require the defender to pay interest for the whole period since a particular loss was sustained.

5.25 Against these arguments it may be said:

- If conduct of litigation is to be penalised then this should be done by some means other than interest, such as awards of expenses;
- The rate of interest actually earned by the defender may be regarded as irrelevant to the loss to the pursuer as a consequence of delayed payment;
- The effect of interim payments can be dealt with expressly by statute.

We think that it would also be desirable that the same degree of discretion, if any, should apply to interest on damages as applies to interest on contractual and other pecuniary claims.

5.26 A separate issue arises as to whether there should be judicial discretion to vary the *rate* of interest or to apply simple or compound interest. These issues are discussed at paragraphs 7.29 to 7.32 and 8.32 to 8.35.

5.27 We have not reached a conclusion as to whether to retain a discretion with regard to the award of interest on damages. We invite comment on the following alternatives:

- 23. (a) There should be no judicial discretion to remit interest on damages;**
- (b) There should be a judicial discretion to remit interest on damages where the interests of justice so require, but only by reason of any conduct of the pursuer;**
- (c) There should be a judicial discretion to remit interest in any other particular circumstances (which would be specified in the legislation);**  
or
- (d) There should be a wide judicial discretion to award or disallow interest as the interests of justice require.**

## Part 6 Interest in Other Circumstances

### Introduction

6.1 Not all claims for payment of money fall conveniently into the categories of contractual debt and damages. There are a variety of other circumstances in which a pecuniary claim may be made which, if refused, could result in a court action. Inevitably in such cases the question of entitlement to interest on the sum sued for arises. Examples are: certain forms of claim based on unjustified enrichment, notably claims for repetition of money paid in error or for recompense; claims for salvage; and claims on a fund paid into court following a ship collision. In addition, there are circumstances in which a person may hold funds on behalf of another, otherwise than as a consequence of a contractual relationship or following the expiry of a contractual relationship, in circumstances in which the holder may be regarded as being in default by having failed to hand over the funds. For example, an executor or a trustee may have delayed unduly in winding up an estate or trust and making over the capital to the beneficiaries; or one of the partners of a dissolved partnership may be holding funds properly due to one of his ex-partners. A further example is delay in satisfying a claim for legal rights in a deceased's person's estate. A sum claimed by way of alimony or financial provision on divorce is neither of the nature of debt nor damages.<sup>1</sup>

6.2 Each of these examples is currently governed by common law or statutory rules.<sup>2</sup> It would be possible to effect a statutory reform of entitlement to interest on contractual debt and interest on damages without altering the existing law in relation to these non-contractual claims for payment. That this is feasible is demonstrated by the Late Payment of Commercial Debts (Interest) Act 1998 which is expressly restricted in its scope. Equally, however, it would be possible to bring some or all of these types of claim within the scope of the reform. Legislation in some other jurisdictions applies to "pecuniary judgments" or "orders for the payment of money" without attempting to distinguish between contractual and non-contractual claims.<sup>3</sup> We see advantages of certainty and consistency in bringing non-contractual pecuniary claims within the scope of our proposed reforms:

- The present law is lacking in certainty in view of the relatively small number of decided cases in which entitlement to interest on non-contractual debts has been a matter in dispute;
- Some of the examples described above bear a close similarity to contractual debts. For example, there are both contractual and non-contractual situations in which a person may come to hold funds on behalf of another and incur a liability to interest by failing to make them over at the due date. There seems to be no good reason to have differing rules regarding entitlement to interest as a consequence of late payment.

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<sup>1</sup> *Geddes v Geddes* 1993 SLT 494, Lord President Hope at 500.

<sup>2</sup> See paras 2.36 to 2.42.

<sup>3</sup> Eg British Columbia Court Order Interest Act 1996, s 1(1); Ontario Courts of Justice Act RSO 1990 c 43, s 128(1).

In this Part we discuss the application of the general rule which we have proposed in relation to contractual claims, namely that interest should run from the date when payment is due, to various types of non-contractual pecuniary claim.

6.3 As with contractual debts, there are circumstances in which existing statutory provisions create an entitlement to interest on non-contractual claims. Examples are to be found in section 29 of the Trusts (Scotland) Act 1921 and in section 81 of the Adults with Incapacity (Scotland) Act 2000.<sup>4</sup> We do not propose any amendment to these provisions in so far as they specify the dates between which interest runs or the extent to which the court has a discretion as to whether or not to award interest. Legislation giving effect to the scheme which we propose would exclude from its scope any debt on which interest is due under another statutory provision. Again, however, our proposals could affect the *rate* of interest payable under certain statutory provisions. We discuss this at paragraphs 7.55 to 7.62.

### Unjustified enrichment

6.4 A claim founded on the principle of unjustified enrichment may take the form of a demand for money: for example, repetition of money paid in error or in contemplation of an event which did not take place, or recompense for the value of a benefit unjustly received by the defender and by which he has been enriched.<sup>5</sup> It is appropriate to consider each of these possible bases for a claim for payment separately.<sup>6</sup>

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<sup>4</sup> See paras 7.57 and 7.59.

<sup>5</sup> Useful examples of both are found in *Shilliday v Smith* 1998 SC 725, a case in which the pursuer had incurred expense and made payments to the defender in contemplation of a marriage which did not take place. The claims were described by Lord President Rodger at 728-9 as follows:

"The larger part of the pursuer's claim is based on the fact that, in contemplation of the parties' marriage, she paid for repairs and for materials used in repairs to the defender's house and that she installed various items in the house and garden. The defender has benefited from these materials, repairs and items... In this aspect of her case the pursuer is therefore seeking payment of a sum of money which will reverse the defender's enrichment by transferring from him to her a sum which represents the value of the benefit enjoyed by him as a result of the outlay which she incurred.

The remainder of the pursuer's claim is different. It is based on the fact that in contemplation of the parties' marriage she paid £1,880 to the defender, which he used to pay for materials and for work on his house. The pursuer is asking the court to reverse the defender's enrichment by ordering him to repay that sum to her. This part of her claim is therefore one for repetition of the money which she paid to the defender.

Although the two aspects of the pursuer's claim can be distinguished in this way, none the less for each of them she relies on the same ground of action, which falls under the rubric of the *condictio causa data*. On the one hand the pursuer says that she paid money to the defender in contemplation of marriage, on the other she says that she expended money on his house in various ways in contemplation of marriage. Although the usual situations discussed in connection with the *condictio causa data* are where money is paid or property transferred on a particular basis, in my view there is no relevant difference between the two aspects of the pursuer's claim. If she is entitled to recover money paid to the defender in contemplation of a marriage which never took place, in principle she must equally be entitled to recompense for the materials and work she paid for on the same basis."

<sup>6</sup> We do not consider it necessary to address the third remedy for unjustified enrichment, namely restitution, because it is a claim for return of a specific item of property and not for payment of money. A claim for restitution might, of course, be accompanied by a claim for recompense for the defender's use of the property which would be a claim for money upon which interest should in principle run.

6.5 **Repetition.** In the simplest situation in which a claim for repetition may be made, namely of money paid by one party to another in error, it will normally be the case that the appropriate date for the commencement of the running of interest is the date of payment. From that date the creditor has been deprived of the use of the money and the debtor has had the benefit of its use. This accords with what is probably the current position under Scots law.<sup>7</sup> It seems likely to be regarded as the date when payment fell due to the creditor. There are, however, other circumstances in which a claim to reverse unjustified enrichment takes the procedural form of a claim for repetition and where the date when payment fell due will not coincide with the date when the creditor was deprived of use of the money. Our provisional view is that it would be sufficient to provide, as with other pecuniary claims, for statutory interest to run from the date when payment is due by the defender/debtor to the pursuer/creditor, leaving it to the court to apply that general rule to the circumstances of a particular case.

6.6 **Recompense.** As regards claims for recompense, the measure of the claim is the value of the benefit to the defender<sup>8</sup> rather than (if different) the extent of the loss or expense sustained by the pursuer. Recompense is an equitable remedy and it is not possible to foresee all of the circumstances in which it might be invoked in order to reverse an unjustified enrichment. Again, our provisional view is that it should be left to the court to apply the general rule which we have proposed to the circumstances of a particular case.

6.7 Assume, for example, as in *Shilliday v Smith*, that A, in contemplation of marriage to B, pays B the cost of various works to be carried out to B's house and also pays a contractor directly to carry out further works. The marriage does not take place and A sues for repetition and recompense. A has been out of pocket since the date or dates when she paid over money to B and to the contractor but these will not necessarily be the dates when payment should be regarded as having fallen due by B to A. So long as marriage was still in contemplation, A was not seeking payment from B; there was not yet any unjustified enrichment of B by A. Under our proposed rule, A would be entitled to statutory interest from the date when payment fell due: that is, from the date when marriage was no longer contemplated. We consider that this is a reasonable outcome, suggesting that the rule which we are proposing is capable of applying in a flexible manner to the variety of claims falling within the scope of the law of unjustified enrichment.

6.8 An alternative approach to that outlined above would be to leave the awarding of interest in unjustified enrichment claims to be determined by the exercise of judicial discretion. The argument in favour of such an approach is that the outcome of the action in relation to the principal sum will be heavily influenced by considerations of equity. As Professor Evans-Jones concludes:<sup>9</sup>

"In *Morgan Guaranty Trust Co of New York v Lothian Regional Council*,<sup>10</sup> the fact that the *condictio* is an equitable claim was underlined. There is authority to the effect that considerations of 'equity' rightly influence the question whether, at what level, and from what point in time interest is payable. There is a whole range of circumstances that may properly be taken into consideration in determining the equity of the matter of payment of interest: whether the pursuer was negligent in

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<sup>7</sup> See para 2.37.

<sup>8</sup> See Evans-Jones, *Unjustified Enrichment*, Vol 1, chapter 9.

<sup>9</sup> *Unjustified Enrichment*, Vol 1, para 9.54.

<sup>10</sup> 1995 SC 151.

making an undue payment; whether the defender had been earning interest on the undue sum and even perhaps whether, as in *Woolwich*,<sup>11</sup> the Revenue had made an *ultra vires* demand the validity of which the building society had disputed from the very beginning."

On this basis, Professor Evans-Jones suggests that interest should be claimed by the pursuer from the moment of receipt of money by the defender, with the onus resting upon the defender to demonstrate that equity requires a different result. He also expresses the view<sup>12</sup> that there are in any event no grounds to exclude a claim for interest from the moment when the defender has formal notice that what he holds is being reclaimed.<sup>13</sup>

6.9 One of the cases in which the influence of equitable considerations may be observed is *Countess of Cromertie v Lord Advocate*.<sup>14</sup> Teinds were paid for many years to the Crown in error. When the mistake was discovered, an action was brought for repetition, with interest, by both the payer and the rightful recipient. The Crown consented to decree for repayment but disputed the liability to pay interest. The majority of the court held that no interest was due to the rightful recipient because she had been negligent in failing for many years to demand payment nor to the payer because he would thereby be enriched. Under our proposal interest would, if equitable considerations were disregarded, have been payable by the Crown to the payer.

6.10 The argument against the inclusion of a discretion is the same as that for excluding it in relation to claims for payment of contractual debt and/or damages: the function of an award of interest is simply to recognise that the pursuer has been deprived of the use of money. Whilst it is appropriate for equitable principles to determine whether any sum is payable to the pursuer and, if so, how much, there is (according to this argument) no reason to deprive him of the full financial compensation which an award of interest ensures. Thus, for example, in the *Countess of Cromertie* case described above, it is not easy to see why the Crown should have obtained the benefit of interest-free use of the teinds paid in error. The court was influenced by a reluctance to see the rightful recipient put in a better position than the creditor of an ordinary debt who would not, as the law stood (and still stands), have a right to interest from the date when the debt fell due. If our proposals in relation to contractual debt were to be accepted, this argument would disappear. But should the rightful recipient's negligence in failing to demand payment over a period of time be regarded as sufficient reason, as a matter of equity, to deprive her of interest when payment is eventually made?

6.11 We invite views on the following questions:

**24. (a) Should the new statutory scheme extend to claims for payment based upon the law of unjustified enrichment?**

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<sup>11</sup> *Woolwich Building Society v Inland Revenue Commrs* [1993] AC 70.

<sup>12</sup> *Op cit* para 9.55.

<sup>13</sup> As in *Sprot's Trs v Lord Advocate* (1903) 10 SLT 452. This would, however, re-introduce an element of wrongful withholding into the criteria for the running of interest.

<sup>14</sup> (1871) 9M 988. See also *Bank of Scotland v Grimm-Foxen* 1992 GWD 37-2171, in which interest was awarded only from date of citation because the claim for repetition arose as a consequence of an error by the pursuer.

**(b) If so, should the date when interest begins to run be the date when payment fell due by the debtor to the creditor, or should some other criterion be used instead?**

**(c) Is there a need for a judicial discretion which would operate either**

**(i) instead of the general rule proposed in Question 24(a);**

**(ii) alongside the general rule proposed in Question 24(a), but without restriction on the scope of the discretion;**

**(iii) alongside the general rule proposed in Question 24(a), and restricted to taking account of the conduct of the pursuer; or**

**(iv) in some other way?**

## **Salvage**

6.12 In *The "Ben Gairn"*,<sup>15</sup> which appears to have been the first case in which the question of interest on salvage awards came before a Scottish court for decision, the Lord Ordinary (Allanbridge) doubted whether salvage could be characterised as a debt and described it instead as a unique maritime right in a class of its own, based on a right to recompense by the common law of Scotland. He awarded interest on the salvage award from the date when the salvage services ceased, partly because he considered that a salvor was at least as entitled to interest as a person claiming damages and partly to ensure comity with the admiralty law of England and Wales.

6.13 Both the reasons given by Lord Allanbridge for awarding interest on salvage services seem persuasive. Selecting the date of cessation of the service as the date when interest begins to run is consistent with our proposals in relation to other pecuniary claims and we propose no change in the law in this regard. We see advantage, however, in there being a statutory statement of this rule alongside the others. We invite views on the following questions:

**25. (a) Should the new statutory scheme extend to claims for payment for salvage services?**

**(b) If so, should the date when interest begins to run be the date when the salvage services are completed or some other date?**

## **Limitation funds**

6.14 In actions arising out of ship collisions, oil pollution and other events causing loss, the party alleged to be at fault may be entitled under various enactments, including the Merchant Shipping Act 1995, to limit his liability by paying into court a limitation fund of an amount determined by factors which include the tonnage of the vessel. It is settled by case law in

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<sup>15</sup> 1979 SC 98.

both England and Scotland<sup>16</sup> that a claimant on the fund is entitled to interest on his claim from the date of the event until the date when the fund was paid into court. We do not wish to disturb this rule. It could be retained either by express provision in new legislation or by exception from the scope of such legislation. We provisionally favour the latter course and invite comment on the following proposal:

- 26. There should be an express exclusion from the new statutory scheme in respect of interest on claims on limitation funds established under the Merchant Shipping Acts or similar legislation.**

### **Obligations to account for money to which another person is entitled**

6.15 In Part 4 of this Discussion Paper we considered circumstances arising out of a contractual relationship in which a person may have possession of funds to which another person is entitled and in respect of which the holder will in due course be required to account for his intromissions. Such a situation may also arise where there is no contractual relationship or, alternatively, no continuing contractual relationship. Examples include:

- funds held by executors administering an estate;
- funds held by trustees under express trusts;
- funds held on constructive trust;
- funds of a child administered by a parent or guardian as the child's legal representative in terms of the Children (Scotland) Act 1995, section 10.

Holders of funds in such circumstances are subject to statutory and common law duties to invest them appropriately.<sup>17</sup> If they fail to do so, they may be found personally liable for a sum representing the interest which the capital would have earned if properly invested. If on the other hand they have acted reasonably, then they will not be obliged to account for interest at a rate different from that actually earned on the capital.

6.16 It might be regarded as inconsistent to include in the proposed statutory scheme obligations to account which arise out of contract but to exclude other circumstances such as those instanced above which are closely analogous. The provisional view which we have expressed in relation to obligations arising out of contract is that if a statutory interest scheme is to be introduced, it should be restricted to circumstances in which the debtor is in default in failing to pay the principal sum to the creditor.<sup>18</sup> We consider that it would be possible to include non-contractual obligations to account in the statutory scheme, subject to the same restriction. The date when payment by the holder of funds falls due will be determined by the underlying substantive law. Entitlement of the owner to interest in respect of any period prior to the date when payment became due would be left to be regulated by the substantive law applicable to the parties' relationship: the law of trusts or otherwise as the case may be.

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<sup>16</sup> *The "Olga" v The "Anglia"* (1905) 7F 739, following *The "Crathie"* [1897] P 178.

<sup>17</sup> See eg Wilson & Duncan, *Trusts, Trustees and Executors* (2<sup>nd</sup> edn), ch 25.

<sup>18</sup> See para 4.54.

6.17 An example of a situation giving rise to an obligation to account is the right of an outgoing partner to be paid the value of his share in the partnership. Although the obligation to account arises as a consequence of a pre-existing contractual relationship, it is not a contractual debt; rather it arises from the fact that following the resignation of the outgoing partner the other partners are left holding funds due to him. The recommendation in our Report on *Partnership Law*<sup>19</sup> is that in such circumstances the outgoing partner should be entitled to interest on the value of his share at a commercial rate from the date of his withdrawal from the partnership. Our proposals in relation to a statutory right to interest are consistent with that recommendation.

6.18 Applying the principle of our proposal to situations in which money is held by one person in trust for others is less straightforward. There are a variety of circumstances in which a beneficiary may have a claim which includes a demand for interest. Not all of these involve issues of late payment. Our view is that a beneficiary's entitlement to interest in circumstances other than late payment should be left to the common law to determine. Examples would include the following:

- (i) Where a beneficiary claims that trustees have, during the trust period, failed to invest the trust fund so as to produce a reasonable rate of return;
- (ii) Where a trustee is called upon to account for trust funds which he has misappropriated for his own benefit;<sup>20</sup>
- (iii) Where a child who has attained age 16 claims that his legal representative has failed to administer his property to the standard required by section 10(1) of the Children (Scotland) Act 1995 (ie has failed "to act as a reasonable and prudent person would act on his own behalf").

6.19 The next complication which requires to be addressed is that, depending on the circumstances, a beneficiary's demand for interest may take the form either of a claim against the trust estate or of a claim against the trustee personally. For example, the claim of a legatee for interest on a pecuniary legacy is a claim against the executry estate, thus ensuring that the benefit of interest earned by the legacy during the period between the date of death and the date of payment accrues to the legatee and not to the person entitled to residue. On the other hand, where a trust has come to an end and the capital falls to be made over to one or more beneficiaries, any demand for interest arising out of delayed payment would be made against the trustee personally. We are concerned here only with situations in which there is default by a trustee or executor in failing to make payment when it has fallen due. If an executor were to delay unreasonably in distributing the estate, it would not be appropriate to penalise the residuary beneficiary by awarding the legatee interest, payable out of the estate, at a rate higher than that which had actually been earned. A claim for such excess over the rate actually earned ought to be a claim against the executor personally.

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<sup>19</sup> Report of the Law Commission and the Scottish Law Commission on *Partnership Law* (Scot Law Com No 192) at para 8.75.

<sup>20</sup> In such cases the courts have been inclined to award compound interest at a high rate: see paras 8.7-8.8.

6.20 We recognise that the position of a trust beneficiary is not on all fours with that of a party to a contract. Nevertheless, it seems to us, as a matter of principle, that a beneficiary who has been deprived of the use of funds which ought to have been paid over by a trustee or executor should have the same entitlement to interest as persons in other circumstances where payment is overdue. Although we are proposing that statutory interest should be payable at a compensatory rather than a punitive rate, this may still exceed the rate of interest actually earned by the money in the trustee's hands. If so, the difference should be payable by the trustee personally rather than out of another beneficiary's share of the fund.

6.21 The question whether there should be an element of judicial discretion arises once again, even if no such discretion were to be considered necessary in cases of contractual debt. If, as we suggest above, the statutory scheme is to apply only where the holder is in breach of his obligation to account, this requires a judgment to be made as to when the breach occurred. It might be regarded as harsh for persons such as trustees and executors to be told, with the benefit of hindsight, that they were in default in failing to make payment by a particular date and are personally liable for interest as a result. Such cases of potential unfairness could be dealt with if the rule which we propose could be varied by the exercise of judicial discretion.

6.22 Against inclusion of a discretion, it may be said that it is liable to lead to uncertainty as to the parties' respective rights. It might also be argued that if the matter is looked at primarily from the point of view of the pursuer/creditor, it should make no difference what kind of claim is being made: the entitlement to interest should be uniform. This is not the only situation in which a person who has a reasonable excuse for delaying payment may be found liable to pay interest; the same would occur where the defender in a damages action is justifiably dissatisfied with the quality of the evidence supporting the pursuer's claim which eventually turns out to be well founded. We invite views in response to the following proposals and questions:

27. (a) **Should the new statutory scheme extend to claims for payment based upon an obligation to account for funds in circumstances where the obligation is non-contractual?**
- (b) **If so, should interest run only from the date when the holder is in default in failing to make over the funds to the person entitled to them?**
- (c) **Should the new scheme extend to beneficiaries' claims arising out of late payment by trustees or executors, imposing personal liability on the trustee or executor for the difference between statutory interest and the interest actually earned?**
- (d) **Is there a need for a judicial discretion and, if so, at what rate and during which period?**

#### **Legal rights in a deceased's estate**

6.23 As noted in Part 2 of this paper, the general rule under Scots law has been that legal rights carry interest from the date of death. Where there has been delay in payment which is not attributable to any fault on the part of the executors, it has been held that interest should

not run at a rate higher than that which the funds have in fact earned.<sup>21</sup> On the other hand, where it has been considered that payment ought to have been made, for example where a claim has been made or where there is no doubt that legal rights will be claimed because the claimant has been disinherited, the courts have awarded interest at the "legal rate".

6.24 The peculiarity of legal rights is that payment may be delayed for many years through the fault of no-one, for example during the period when a potential claimant lacks the capacity to make an election. However, the funds which are potentially subject to the claim will normally be capable of earning interest during the period of uncertainty and it seems reasonable that whoever eventually becomes entitled to those funds should also receive the interest which has accrued on them regardless of the period during which the uncertainty has subsisted. Consistently with our other proposals, our provisional view is that we should not amend the substantive law rules which determine a legal rights claimant's entitlement to interest in circumstances where there has been no default on the part of the executors in making timeous payment. Where, however, there has been delay on the part of the executors in making payment, we propose that statutory interest should run at the prescribed rate. The discussion above of the desirability of a judicial discretion, instead of or in addition to, such an entitlement to interest<sup>22</sup> applies *mutatis mutandis* to interest on sums due by way of legal rights whose payment has been delayed. We therefore invite views in response to the following questions:

- 28. (a) Should the new statutory scheme extend to claims for sums due by way of legal rights in a deceased person's estate, from the date when the executor is in default in failing to make payment to the person claiming legal rights?**
- (b) Is there a need for a judicial discretion as to whether to award interest and, if so, at what rate and during which period?**

### **Aliment and financial provision on divorce**

6.25 Entitlement to a sum by way of aliment<sup>23</sup> or by way of a capital sum awarded as financial provision on divorce arises by virtue of a decree having been pronounced by the court. In so far as interest will run post-decree, the law in this area will be affected only by our proposals in relation to the *rate* of post-decree interest.<sup>24</sup> In relation to aliment, however, the court has power in certain circumstances to backdate the award<sup>25</sup> and the question arises whether instalments referable to periods prior to the date of the award should carry interest from the time at which they ought to have been paid or from some other date. We understand that it is not current practice to claim interest in these circumstances. In principle it seems to us that interest should run: by backdating the award the court is recognising that the debtor ought to have been paying aliment throughout the period of backdating and, correspondingly, that the creditor has been deprived of the use of the money during the same period. We therefore invite views in response to the following question:

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<sup>21</sup> *Ross v Ross* (1896) 23R 802.

<sup>22</sup> Paras 6.21-6.22.

<sup>23</sup> A lump sum could be payable where, for example, the court has backdated an award of aliment or where the claim is for arrears of aliment payable under a previous decree.

<sup>24</sup> See paras 7.48-7.52.

<sup>25</sup> Family Law (Scotland) Act 1985, s 3(1)(c): see para 2.40.

**29. (a) Should an award of aliment which has been backdated carry interest from the date or dates when the instalments ought to have been paid?**

**(b) If so, is there a need for a judicial discretion as to whether to award interest and, if so, during which period?**

6.26 It appears that as the law stands arrears of aliment which are recoverable by court action carry interest although the authority for this is not particularly strong.<sup>26</sup> Given the range of remedies available to enforce an award of aliment, it seems likely that actions to recover arrears of aliment awarded under a previous court order will be rare. However, in principle we suggest that such arrears should carry interest from the date or dates when they ought to have been paid and not merely from the date of the decree permitting recovery.

**30. (a) Should arrears of aliment carry interest from the date or dates when they ought to have been paid?**

**(b) If so, is there a need for a judicial discretion as to whether to award interest and, if so, during which period?**

6.27 In relation to financial provision on divorce, the existing legislation<sup>27</sup> affords the court a discretion as to the date from which interest shall run on any amount awarded which must be exercised under reference to the principles set out in the Act and with regard to the resources of the parties. This seems to us to be an appropriate means of giving effect to the objectives of the legislation and we do not propose any change to it. In particular, we do not propose to disturb the current interpretation of section 14(2)(j) as permitting the court, where circumstances require, to award interest on a capital sum from the date of separation as a means of compensating a party *inter alia* for loss of use of an item of property such as the former matrimonial home.

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<sup>26</sup> See para 2.41.

<sup>27</sup> Family Law (Scotland) Act 1985, s 14(2)(j): see para 2.42.

# Part 7      Rate of Interest

## Introduction

7.1      Erskine wrote that interest is "the profit due by the debtor of a sum of money to the creditor for the use of it."<sup>1</sup> The principle underlying our proposals is that interest should compensate the creditor rather than penalise the debtor. Interest should be applied at a rate which best expresses the creditor's loss. This principle is expressed by Lord Denning MR in *Jefford v Gee*<sup>2</sup> as follows:

"Interest should not be awarded as compensation for the damage done. It should only be awarded to a plaintiff for being kept out of money which ought to have been paid to him."

Lord Denning MR had previously expressed this view in a slightly different form in *Harbutt's Plasticene Limited v Wayne Tank and Pump Co Limited*.<sup>3</sup>

"It seems to me that the basis of an award of interest is that the defendant has kept the plaintiff out of his money; and the defendant has had the use of it himself. So he ought to compensate the plaintiff accordingly."

7.2      This principle can be applied quite clearly to a case of debt where a liquid sum has been in the possession of one party when it should have been in the possession of another. It can also be applied to damages where at a point (or points) in time a sum of money would have compensated the pursuer and from that point the pursuer has been kept out of his or her money.

7.3      Applying this principle, the rate of interest should reflect either:

- (a)      the interest which the creditor would have been likely to earn on the money;  
          or
- (b)      the cost to the creditor of borrowing money to make up any shortfall.

7.4      Of course, these two measures of interest are not the same. It costs more to borrow money than can be gained by lending it, especially where the borrower is an individual or small business. Any rate, or formula for producing a rate, is likely to be a compromise between these two measures. The rate should reflect the "cost of money" during the period when interest runs. This could be achieved by making statutory provision specifying a formula for a rate of interest which would vary according to the cost of money during the relevant period. However, as explained below, the cost of money is not the same for all parties and any formula chosen would involve a compromise between the utility of a

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<sup>1</sup> Institute III.iii.75.

<sup>2</sup> [1970] 2 QB 130, at 146A. Approved by Lord Emslie in *Smith v Middleton* 1972 SC 30.

<sup>3</sup> [1970] 1 QB 447, at 468.

common rate for all parties and the theoretical desirability of a rate which truly reflects the loss of each pursuer.

### The judicial rate of interest

7.5 At present, if no rate of interest has been specified by the parties and if there is no other statutory provision to set a rate of interest, the courts usually apply the "judicial rate" set for post-decree interest. The "judicial rate" is set by rule 7.7 of the Rules of the Court of Session 1994.<sup>4</sup> It is the same rate as that applying in England and Wales which is set by section 17 of the Judgments Act 1838.<sup>5</sup> RCS 7.7 states:

"Where interest is included in, or payable under, a decree, it shall be at the rate of 8 per cent a year unless otherwise stated."

The rate was changed to its current level in 1993.<sup>6</sup> When the Rules of the Court of Session were consolidated in 1965,<sup>7</sup> the rate was set at 5%.<sup>8</sup> It was amended to 7% in 1970, 11% in 1975, 12% in 1983, and 15% in 1985. The current rate of 8% applies to any decree pronounced after 1 April 1993 regardless of when the action commenced.

7.6 The position in the sheriff courts is similar to that in the Court of Session. The judicial rate is prescribed by section 9 of the Sheriff Courts (Scotland) Extracts Act 1892. The rate may be amended by Act of Sederunt and was changed to 8% by the Act of Sederunt (Interest in Sheriff Court Decrees and Extracts) 1993.<sup>9</sup> A rate of 8% also applies to awards by Employment Tribunals sitting in Scotland.<sup>10</sup>

7.7 On the face of it, the rule applies only to interest payable on late payment of a sum due under decree but the rate set is used on other occasions in the absence of any other rate. On a loan, for example, if no interest is stipulated, the court will award interest at the judicial rate. In *Neilson v Stewart*,<sup>11</sup> Lord President Hope said that "the court will normally award interest on a debt of any period for which interest is due at the judicial rate for the time being, unless there is a contractual rate to which it can give effect."

7.8 It is not clear why the judicial rate came to be the rate used when no other rate is available. Reported opinions which touch on the issue suggest that it was the only rate available to the court and it seemed to be fair and just. Where the principle of interest is at issue the rate to be applied tends to be the last matter to be decided and very little explanation is given as to why a particular rate is chosen. In *Smith v Middleton*,<sup>12</sup> for example, Lord Emslie said:

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<sup>4</sup> SI 1994/1443, as amended (although no amendments have been made to RCS 7.7).

<sup>5</sup> The interest rate in section 17 can be amended by Order using the power in the Administration of Justice Act 1970 (c 31), s 44. The current rate of 8% in England and Wales was set by SI 1993/564.

<sup>6</sup> SI 1993/770.

<sup>7</sup> SI 1965/321. There were earlier consolidations in 1948 (SRO 1948/1691) and 1913 (SRO 1913/638). There was no provision for interest in the 1948 consolidation.

<sup>8</sup> Rule 66.

<sup>9</sup> SI 1993/769.

<sup>10</sup> Art 4 of the Employment Tribunals (Interest) Order 1990 (SI 1990/479). A different statutory instrument sets the rate for discrimination cases heard by Employment Tribunals: The Employment Tribunals (Interest on Awards in Discrimination Cases) Regulations 1996 (SI 1996/2803) applies (in Scotland) the rate specified in Act of Sederunt (Interest on Sheriff Court Decrees and Extracts) 1993 (SI 1993/769). That rate is also 8%.

<sup>11</sup> 1991 SC (HL) 22, 35.

<sup>12</sup> 1972 SC 30, 38.

"As to the rate of interest the only feasible yardstick is provided by the rate prescribed from time to time by the court for interest on awards of damages. This rate since January 1969 has been seven per cent and was formerly five per cent. Since the period in question in this case begins on 28<sup>th</sup> November 1968, an appropriate guiding rate would be the average of the two rates, viz six per cent."

It is assumed that by "the rate prescribed from time to time by the court for interest on awards of damages" Lord Emslie was referring to the rate prescribed in the Rules of the Court of Session. (It is hard to see why that rate is the *only* "feasible yardstick" – it appears to be simply the most convenient).

7.9 In the annotated edition<sup>13</sup> of the Rules of the Court of Session<sup>14</sup> the note to rule 7.7 states:

"It is now sought to maintain a rate of interest which is about 1 per cent above the minimum lending rate of the clearing banks. This is the principle applied by the Lord Chancellor, with the concurrence of the Treasury, for interest on judgment debts (in England and Wales) under the Judgments Act 1838, s 17."<sup>15</sup>

If this is the principle underlying the rate of 8 per cent, then it has rarely been adhered to in practice. Over the last five years, the judicial rate has been on average 3.33% above the Bank of England rate<sup>16</sup> despite the fact that the judicial rate can be amended by a relatively short statutory instrument.<sup>17</sup> Further, if the intention had been to link the judicial rate to the Bank of England rate, RCS 7.7 could have been drafted accordingly rather than by simply specifying a fixed rate.

7.10 There may also be some hangover from the concept of a "legal rate" – a rate of 5% fixed by statute which applied for some centuries. Indeed, the rate prescribed by RCS 7.7 is still occasionally referred to as "the legal rate", perhaps to encourage or justify its use beyond post-decree interest.<sup>18</sup> However, the concept of a fixed "legal rate" has been firmly laid to rest by Lord President Cooper in *Kearon v Thomson's Trustees*.<sup>19</sup> It had been held in the Outer House that interest applied on legitim from the date of death until payment and the rate should be 5%; this was described by Lord Sorn as "legal interest at the standard rate." Replacing this with a rate of 3%, Lord President Cooper said that the term "legal rate" was "...originally applicable to the maximum rate of 5 per cent fixed by a statute of 12 Anne, long since repealed...", adding that "...it is 250 years since Parliament last intervened to prescribe interest rates, and over 80 years since the Act then passed was repealed." He quoted Lord McLaren in *Ross v Ross*:<sup>20</sup>

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<sup>13</sup> Published in *The Parliament House Book* (W Green & Son).

<sup>14</sup> Act of Sederunt (Rules of the Court of Session 1994) 1994 (SI 1994/1443), as amended.

<sup>15</sup> Note 7.7.1.

<sup>16</sup> The average Bank of England base rate between September 1999 and August 2004 was 4.67%, calculated from figures available on the Bank of England website ([www.bankofengland.co.uk](http://www.bankofengland.co.uk)).

<sup>17</sup> An Act of Sederunt, which is a statutory instrument made by the Lords of Council and Session and not subject to parliamentary scrutiny.

<sup>18</sup> See for example Lord Cullen in *Quinn v Bowie (No 1)* 1987 SLT 575 or Lord Morison in *Starkey v NCB* 1987 SLT 103.

<sup>19</sup> 1949 SC 287.

<sup>20</sup> (1896) 23R 802, 806.

"... there is at present no standard rate of legal interest; five per cent was only a maximum rate, and there is no statutory rule obliging the Court to award five per cent in perpetuity. It may not be beyond the powers of the Court to reduce the rate usually awarded in case of a permanent fall in the rate of interest obtainable in this country."

Lord President Cooper goes on to question why 5% (having been set as a maximum) should ever have been the "ordinary rule" and to assert that there is no reason why the rate should not fluctuate:

"It was further suggested that interest rates fluctuate, and that, if we were to fix a rate normally appropriate under the circumstances of to-day, we might have to fix a different rate a few years hence and thereafter at brief intervals. The short answer to this objection is – why not? Our function is to dispense justice to those who appeal to us, and not to offer as a substitute arbitrary stereotyped rules which may have done justice in the days of Queen Anne, and may yet do justice at some unknown future date, but which do not do justice now."<sup>21</sup>

7.11 We are not seeking to revive the concept of a legal rate. But, as the judicial rate appears to be used for pre-decree interest only in the absence of anything more suitable, it is proposed to replace this with a fluctuating rate prescribed by legislation.

#### **What does "interest" represent?**

7.12 In general terms, outside the context of litigation, interest is income received as a result of a contractual obligation to pay for the use of property. The need for the payment of interest arises because in an advanced society capital is rarely owned by people who are in the best position to utilise it (for example, elderly people in receipt of a private pension) and interest is, in effect, the price paid by another party to enable that party to control the capital and benefit from its use.<sup>22</sup> In legal terms, when "interest" is referred to, it is a shorthand expression referring to the interest which would be payable if the sum of money at issue were capital which was subject to a contractual obligation to pay interest.

7.13 Commercial rates of interest vary according to the nature of the contractual obligation to which they apply. Rates differ according to the rate of inflation, the anticipated rates of inflation during the period of the obligation, the relative strengths of the parties to a transaction and the risk of non-payment. A relatively safe investment, for example, may carry a rate of interest which is low and mainly reflects the anticipated rate of inflation. On the other hand, an unsecured loan with a high risk that it will not be repaid, is likely to include a high rate of interest. This is because interest can be divided into a number of elements:

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<sup>21</sup> 1949 SC 287, 295.

<sup>22</sup> "The principal justification for interest and interest-bearing securities is that they provide an easy and convenient way for skilled administrators to control capital that they do not own, and for the owners of capital to relinquish its control. The price society pays for this arrangement is interest." *Encyclopaedia Britannica* (15<sup>th</sup> edn) Vol 3, p 802.

- (i) an element to account for the time value of money, or inflation.
- (ii) an element for reward for not having the use of the money: "a reward for foregoing the use of the capital sum for the time being."<sup>23</sup> In many circumstances, this element can be conflated with the concept of commercial profit and is affected by supply and demand factors which mean that the commercial "going rate" may vary.
- (iii) an element to account for the risk of non-payment: "a reward for taking a risk of loss or reduction of capital."<sup>24</sup>

An interest charge may also include an element to allow for the expense of the transaction or a penal element to encourage prompt payment. The appropriate rate of interest in any case will vary according to what proportion of each of these elements is applicable. In theory, it would be possible for the courts to apply a rate of interest which is tailored to the circumstances of each case to be decided. For example, where a pursuer had borrowed money to make good a loss, the court might decide to award interest at the actual rate applied to the pursuer's borrowings. However, this approach would create a degree of uncertainty for litigants, and it is also likely that the courts would simply fall back upon use of the current judicial rate. Although different rates are applied in courts throughout the world, it appears almost universal that a prescribed rate is available to the court. The problem which arises is: which rate will do justice in most cases? Whatever rate is chosen will inevitably have a "one size fits all" quality: it may seem generous in some cases, or fail to compensate fully in others. But whether or not a degree of judicial discretion is necessary to ensure fairness in all cases, we have taken the view that it would assist both courts and litigants if a rate of interest were prescribed by statute.

### **Fluctuation and base rate**

7.14 If a rate of interest is to be prescribed by legislation, the problem is how to set a rate which can be applied universally but which also truly reflects the cost of money. One solution is to have a fixed rate of interest which is set at a suitable level above a base rate such as the Bank of England base rate.<sup>25</sup> This can be prescribed by statutory instrument so that it may be changed promptly if fluctuations in the base rate make this necessary. That is the system which currently applies to post-judgment interest. However, it is not particularly sensitive to fluctuations in interest rates which are available in the market. An interest rate which remains the same throughout a legal dispute, which may last for some years, will not reflect the decline or rise in the real value of money during that period. The cost of money fluctuates and it would seem fairer that the rate to be applied by the courts should fluctuate with it.

7.15 An alternative approach is to specify a fixed rate by statutory instrument which changes with sufficient frequency to reflect fluctuations in the market. The rate could be set according to a prescribed formula but the instrument would set out only the result of the formula. For example, legislation could prescribe that the interest rate should be set according to a formula (for example, base rate plus one per cent) every year on a specified

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<sup>23</sup> Lord Diplock in *Wright v British Railways Board* [1983] 2 AC 773, 781.

<sup>24</sup> *Ibid* p 781.

<sup>25</sup> See paras 7.18-7.21.

date. Alternatively, the rate could be set every six months or even every month. The advantage would be that the rate for a given period would be known to all parties without further calculation. The disadvantage would be that it would not be as sensitive to changes in the cost of money as a rate which fluctuated automatically and was calculated by the parties themselves in each case.

7.16 A further approach is for the legislation to specify only the basis upon which the rate will fluctuate. An example of legislation prescribing a fluctuating interest rate can be found in the Late Payment of Commercial Debts (Interest) Act 1998. That Act empowers the Secretary of State by Order (statutory instrument) to set the applicable rate of interest and the instrument currently in force is the Late Payment of Commercial Debts (Rate of Interest) (Scotland) Order 2002.<sup>26</sup> Article 4 of that Order provides:

"The rate of interest for the purposes of the Late Payment of Commercial Debts (Interest) Act 1998 shall be 8 percent per annum over the official dealing rate in force on the 30th June (in respect of interest which starts to run between 1st July and 31st December) or the 31st December (in respect of interest which starts to run between 1st January and 30th June) immediately before the day on which statutory interest starts to run."

7.17 The effect of the above device for setting the interest rate is to fix the relationship between the rate to be used and the "official dealing rate" (defined as the Bank of England rate). The dealing rate will fluctuate and so the rate applying to the 1998 Act will also fluctuate but the extent to which the rate is punitive or compensatory is fixed by the Order. In that example, the rate is intended to penalise late payment of debt. A possible criticism of a fluctuating rate is that it would make the calculation of interest more complicated and time consuming for pursuers. In personal injury actions separate calculations would be required each time there was a change in the interest rate during the period between the date of the accident and eventual settlement or decree.<sup>27</sup> The effect could be greater expense with, arguably, an adverse effect on access to the courts. There might also be concern that the rate would be difficult to ascertain at any given time. On the other hand, a fluctuating rate would produce a fairer and more accurate calculation of the pursuer's loss. If the fluctuating rate is compounded, this is likely to lead to higher payments in long running cases.<sup>28</sup> Concerns of complexity and accessibility are addressed by the availability, discussed below, of an on-line calculator together with printed tables.<sup>29</sup>

### **Selection of base rate**

7.18 The "Bank of England rate" is not the only rate which can be used as a base. Commercial contracts often use other forms of base rate in an interest clause. The "Bank of England rate", "the official dealing rate" or the "repo rate"<sup>30</sup> is the rate set by the Monetary Policy Committee<sup>31</sup> of the Bank of England as the rate at which the Bank is willing to enter into transactions for providing short term liquidity in the money markets. The Bank has

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<sup>26</sup> SSI 2002/336.

<sup>27</sup> In these actions a valuation of each head of claim, including the calculation of interest, must be lodged in court.

<sup>28</sup> See para 8.31 and Appendix E.

<sup>29</sup> See paras 7.39 and 8.43.

<sup>30</sup> In this Discussion Paper we refer to the Bank of England base rate to encompass the rate set by the bank since its foundation. The current base rate has been referred to officially, since 1996, as the "repo rate", a contraction of "repurchase option".

<sup>31</sup> The Monetary Policy Committee is a statutory body by virtue of s 13 of the Bank of England Act 1998.

enjoyed the power to set rates independently of the government since 1997. Although it is not, strictly speaking, a market rate, its attraction is its influence on the market. The market bases its transactions and decisions on what the Bank of England rate is and also on what it anticipates that rate will be in future. It is perhaps the best known interest rate and any changes to it are widely publicised. However, other rates are available and are considered below:

1. The inflation rate: if we assume that interest is paid as compensation due to the loss of value of money caused by inflation then the inflation rate as measured by, for example, the Retail Price Index might be an appropriate base rate.<sup>32</sup> However, the true cost of the pursuer's loss is not measured by inflation but by the cost of money which the pursuer, in theory at least, had to borrow or, on another view, lost the opportunity to invest.
2. LIBOR: the LIBOR (London Inter Bank Offer Rate) is the rate at which banks offer to lend money to each other. The five major London banks set daily LIBOR rates at 11 am on every working day but the rate usually referred to as the LIBOR is the three-month LIBOR. Because it is a rate which is determined by the market, the LIBOR may be a better reflection of available commercial rates than the Bank of England base rate. This rate is sometimes used in legislation, for example:

"12. - (1) Where the Scottish Ministers intend to recover on demand payment by way of grant in whole or in part in accordance with paragraph 11, they may, in addition, recover interest on that amount at a rate of 1% above LIBOR calculated on a daily basis for the period from the date of payment until the date of recovery."<sup>33</sup>

3. An average of the lending rates of six UK clearing banks.<sup>34</sup> This is used as a base for the formula setting the interest rate under section 178 of the Finance Act 1989.<sup>35</sup> The Bank of England publishes a similar statistic on its website.<sup>36</sup>
4. The weighted<sup>37</sup> standard variable mortgage rate (the "SVR rate"): Since 1998, this rate has averaged 6.8%. Details can be found readily on the Bank of England website.<sup>38</sup> However, it does not directly reflect the cost of money at a given time, being an indicator of the market in mortgages and loans secured

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<sup>32</sup> There are alternative measures of inflation such as the CPI (Consumer Prices Index), the RPIX or the GDP deflator. The CPI is targeted by the Monetary Policy Committee of the Bank of England, but it does not include housing costs. The RPIX is similar to the Retail Price Index, but excludes mortgage interest payments. The GDP deflator is measured quarterly and is subject to backward revision as the GDP data is revised. By contrast, the RPI is measured monthly and tends to change from month to month.

<sup>33</sup> Sea Fishing (Transitional Support) (Scotland) (No 2) Scheme 2003 (SSI 2003/116).

<sup>34</sup> Halifax Bank of Scotland; Barclays Bank; Lloyds Bank; Midland Bank; National Westminster Bank; and The Royal Bank of Scotland.

<sup>35</sup> The rate is set by SI under a power in s 178. The current rate is set by the Taxes (Interest Rate) Regulations 1989 (SI 1989/1297), as amended. The banks are listed in regulation 2(2).

<sup>36</sup> [www.bankofengland.co.uk](http://www.bankofengland.co.uk).

<sup>37</sup> The SVR rate is "weighted" because it is compiled by the Bank of England by taking the interest rates offered by a range of financial institutions and the figures for each institution are "weighted" according to market share.

<sup>38</sup> [www.bankofengland.co.uk](http://www.bankofengland.co.uk).

by a standard security. On the other hand, it is reasonably close to the average interest rate charged on bank loans to the corporate sector.<sup>39</sup>

5. The European Central Bank ("ECB") rate: the ECB is the central bank for the euro, the currency of the European Union's third stage of economic and monetary union. The Governing Council of the ECB meets once a month to set an interest rate in a similar way to national central banks such as the Bank of England. This rate is not used to set the rates of interest used in the UK and is not at present relevant to the UK market.<sup>40</sup>

7.19 Having considered the various rates, we are of the view that the Bank of England rate is the best available base rate. The bank lending rates and the SVR rate are good measures of the cost of money because they reflect interest rates which are available in the market, but the reason they appear to be similar<sup>41</sup> is that both are related to the Bank of England rate. The rate of inflation, however measured, reflects only one element of the pursuer's loss. The ECB rate would not reflect the pursuer's loss unless the euro were to become the UK's currency in which case it would replace the Bank of England rate. The three-month LIBOR is generally very close to the Bank of England rate<sup>42</sup> but can change on a minute-by-minute basis as market purchasing and selling activity affect the rate. Although monthly averages and end-month figures for the three-month LIBOR can be found on the Bank of England's website, the Bank's own rate is publicised more widely and is easily accessible by businesses and by households. The Bank of England rate is more stable than LIBOR, being agreed once a month at a pre-arranged meeting of the Monetary Policy Committee.

7.20 On top of this base rate is to be added a figure so that the total reflects the cost of prudent borrowing. A rate of 1.5% above the Bank of England base rate reflects the rate at which larger businesses are able to borrow money.<sup>43</sup> It has been suggested that the rate at which smaller businesses can borrow money is closer to 3% above base.<sup>44</sup> However, individuals are more likely to borrow money by means of a loan secured by standard security and 1% above base would represent a good rate (from the borrower's point of view) in the secured loan market. The rate which an average company is paying on its borrowing is usually similar to the rate which a prudent individual might be able to obtain on a secured loan.<sup>45</sup> There is a close relationship between the SVR rate and the rate at which banks will lend to their corporate customers, because both rates are influenced by the Bank of England rate.

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<sup>39</sup> See graph E in Appendix D.

<sup>40</sup> This position would change if the UK were to join the euro, ie participate in the third stage of economic and monetary union. At that point, consideration could be given to using the ECB rate as a base rate for calculating interest rather than the Bank of England rate.

<sup>41</sup> See graph E in Appendix D which compares the SVR rate with the bank corporate lending rate.

<sup>42</sup> See graph A in Appendix D which compares LIBOR and the Bank of England rate from September 1998 to June 2004. These rates rarely deviate more than 0.25%.

<sup>43</sup> See graph F in Appendix D: between January 1999 and June 2004 the average corporate bank loan rate was 6.6%. During this same period base rate plus 1% averaged 5.8% and base rate plus 2% averaged 6.8%.

<sup>44</sup> *Jaura v Ahmed* 2002 EWCA Civ 210. See also the high level of the corporate overdraft rate on graph F in Appendix D.

<sup>45</sup> See graph E in Appendix D.

7.21 Graph D in Appendix D compares, for a period between September 1998 and June 2004, various interest rates which an ordinary household might pay on loans or receive on deposits. The graph shows that interest on loans secured by a standard security and mortgages ("the SVR mortgage rate") is charged at a rate about half way between the Bank of England base rate plus 1% and the same rate plus 2%. These rates are all higher than can be obtained on an instant access deposit account or a timed deposit account,<sup>46</sup> but considerably less than the rates paid on credit cards or unsecured personal loans.<sup>47</sup> On balance, it is suggested that 1% or 1.5% above base would be a fair rate of interest to be set in the proposed legislation. We therefore invite comment on the following proposal and question:

- 31. There should be a prescribed rate of interest which would fluctuate according to the Bank of England base rate. We propose that the rate of interest prescribed by statute should be a specified percentage, such as 1% or 1.5%, above the official dealing rate of the Bank of England.**
- 32. Is there another rate which would be better than the Bank of England base rate as the basis of the prescribed rate?**

7.22 We also invite comment on the alternative approach set out in paragraph 7.15 above:

- 33. (a) A fixed interest rate would be prescribed by statutory instrument at pre-set periods. The rate prescribed would be calculated according to a formula set out in primary legislation but the statutory instrument would specify only the rate produced by this calculation on a given date.**  
**(b) Views are also sought on whether the rate should be fixed annually, every six months, every month, or such other periods as consultees may wish to suggest.**

### **Prescribed rate in other legal systems**

7.23 Although not in force in any jurisdiction, *Principles of European Contract Law* produced by the Lando Commission<sup>48</sup> provides<sup>49</sup> for interest to be paid on money where payment has been delayed. Such interest would be payable at "the average commercial bank short-term lending rate to prime borrowers prevailing for the contractual currency of payment at the place where payment is due."

7.24 A simple fixed rate of interest is used in many civil law jurisdictions.<sup>50</sup> For example, the Italian Civil Code provides for a rate of 5%.<sup>51</sup> In Greece, Luxembourg, the Netherlands, Portugal and Spain the interest rate is set annually by the government.

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<sup>46</sup> ie an account with a minimum notice period for withdrawal, such as three months.

<sup>47</sup> See graph D in Appendix D, which compares these rates. The rates paid on credit cards and unsecured personal loans reflect a large element of risk.

<sup>48</sup> See para 4.13.

<sup>49</sup> Art 9:508.

<sup>50</sup> According to the notes to Art 9:508 of "Principles of European Contract Law".

<sup>51</sup> Art 1224(1); 1284.

7.25 The interest provisions in the German Civil Code were amended by the Act to Modernise the Law of Obligations in January 2002.<sup>52</sup> The rate of interest on a debt payable by virtue of a statute is fixed at 4%. Interest is deemed payable on a money debt during any period of default at 5% per annum above a basic interest rate which is changed twice yearly.<sup>53</sup> The reference rate used for changes to the basic rate is based on a European Central Bank rate.<sup>54</sup> The German Commercial Code provides for a default rate of 5% per annum.<sup>55</sup>

7.26 Flexible rates have been introduced in some European jurisdictions. In Denmark a percentage, fixed every two years by the Minister of Justice, is added to the official discount rate.<sup>56</sup> In Finland, different rates are applied in various circumstances. If there is an agreed rate of interest on a debt, then the interest on any delay is 4% above that agreed rate. In other cases, interest on delay is 7% above an official reference rate set by the Bank of Finland. In Sweden, 8% is added to the official discount rate. In France, the rate is calculated by taking the average of the last twelve monthly figures of the official discount rate.<sup>57</sup>

7.27 In Canada, rates of interest applied by the courts differ from province to province. The most detailed examination of the appropriate rate was carried out in British Columbia<sup>58</sup> by the Law Reform Commission of British Columbia in their *Report on The Court Order Interest Act*<sup>59</sup> in 1987. They recommended that the basis of pre-judgment interest should be the "prime rate", which was the rate charged by the Canadian Chartered banks to their most creditworthy customers. It was responsive to the market and fluctuated with inflation. They considered, and rejected, several other rates including the "bank rate": a rate announced by the Bank of Canada every Thursday which was the rate payable by the Bank of Canada to the Chartered banks for short-term advances. They considered that the "bank rate" did not reflect the market or correspond to any rate paid by or to litigants. They also recommended that a rate based on the prime rate should be published monthly.<sup>60</sup> However, the subsequent Court Order Interest Act 1996 left the rate of pre-judgment interest to the discretion of the court and adopted the prime rate for post-judgment interest.

7.28 By contrast, in Ontario the prime rate was used until 1984<sup>61</sup> when it was substituted by the bank rate which was considered to be more readily ascertainable and it remains the basis of pre- and post-judgment interest.<sup>62</sup> Manitoba has a similar provision to Ontario but with a different rounding provision. In other Canadian provinces, there is no particular pattern to the rate applied. In Saskatchewan, the interest rate is published in the Gazette at

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<sup>52</sup> Schuldrechtmodernisierungsgesetz Art 246.

<sup>53</sup> Bürgerliches Gesetzbuch Art 288.

<sup>54</sup> Artikel 497 provides for an exception for default on a consumer loan secured by a security over land ("*ein Grundpfandrechtlich gesicherten Verbraucherdarlehensvertrag*") where interest is held to be at a rate of 2.5% above the basic interest rate. In individual default cases, the lender may prove that the loss was greater or the borrower may prove that the loss was less.

<sup>55</sup> Handelsgesetzbuch Art 352.

<sup>56</sup> Lov 583 Renteloven 1 September 1986, § 5.

<sup>57</sup> Loi n° 75-619 du 11 juillet 1975 relative au taux de l'intérêt légal, modifiée par la loi n° 89-421 du 23 juin 1989, art 1.

<sup>58</sup> See paras 8.20-8.21 below.

<sup>59</sup> LRC 90 1987.

<sup>60</sup> See para 8.20 below.

<sup>61</sup> Courts of Justice Act 1984 (SO 1984 c 11).

<sup>62</sup> Courts of Justice Act 1990 (RSO 1990 c 43). Slightly different formulae are used for pre- and post-judgment interest but the basis of the rate in either case is the bank rate (Courts of Justice Act 1990, s 127).

a frequency to be determined by the Government.<sup>63</sup> In Nova Scotia, the applicable rate is at the discretion of the court.<sup>64</sup> In New Brunswick, the rate is fixed by Rules of Court.<sup>65</sup> In the Civil Code of Quebec, interest is at "the legal rate"<sup>66</sup> which is fixed at 5% per annum.

### **Judicial discretion**

7.29 If a rate of interest is prescribed by legislation, it may be perceived that there are occasions when it would be unfair to apply the prescribed rate. On the other hand, the strength of a prescribed rate, either fixed or fluctuating, would be that it would provide an element of certainty. Questions may arise as to whether interest is to apply or not but there is some merit in having a rate of interest which will apply to all parties in any circumstances.

7.30 At present, in those situations where pre-judgment interest is available, there is a broad judicial discretion, albeit seldom exercised, to apply a rate higher or lower than 8%. If pre-judgment interest is to be more widely applied, a question arises whether there should be a greater or a lesser degree of judicial discretion as to the rate to be applied in the particular circumstances of an individual case. The defender may, through no fault of his own, have obtained only a lower rate of interest on the sums at issue. There will be cases where someone comes into possession of another person's money without any fault or intention. The defender may have a good explanation as to why it was not possible to place the funds in an account with a higher rate of interest or may have no experience in financial matters. In such cases, judicial discretion could be exercised to apply a rate of interest which is comparable with the rate which the defender was able to obtain. It is less clear whether this principle can also be applied in circumstances where the person holding the funds has obtained a rate of interest *higher* than the prescribed rate. It is also difficult to envisage other circumstances where a higher rate could be applied by the court without a penal element or without re-introducing the concept of "wrongful withholding".

7.31 On another view, if a rate is to be prescribed by legislation and that rate is sensitive to the current cost of money, there is arguably no need for judicial discretion. In the absence of such a discretion, parties to a dispute would be secure in the knowledge that at the end of the day, where interest is to apply, it will apply at a known rate which generally reflects the rates available in the market.

7.32 We invite comment on the following questions:

- 34. (a) If a rate of interest is prescribed by legislation, should there be judicial discretion to apply a rate other than the prescribed rate?**
- (b) If there is to be judicial discretion to apply a rate other than the prescribed rate, comments are sought on whether discretion should be limited to applying a lower rate than the one prescribed and should not extend to applying a higher rate.**

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<sup>63</sup> Pre-Judgment Interest Act (SS 1984-85-86 c P-22.2), s 2.

<sup>64</sup> Judicature Act 1989 (RSNS 1989 c 240), s 41. Interest is payable pre- and post-judgment.

<sup>65</sup> Judicature Act 1973 (RSNB 1973, c J-2), s 46. The prescribed rate applies to pre- and post-judgment interest.

<sup>66</sup> CcQ Art 1565 (in respect of debts) and Art 1617 (in respect of damages). The legal rate also applies post-judgment.

## Foreign currency awards

7.33 So far in our discussion we have assumed that the sums of money to be paid, and on which interest is to be awarded, are in sterling. However, it is competent for Scottish courts to award decree for a sum of money in a currency other than sterling.<sup>67</sup> Difficulties would follow if the recommendation at 31 above were to apply to sums to be paid in a foreign currency. The debt (or damages) which the pursuer is seeking to recover is not bearing interest at a rate referable to the Bank of England base rate but rather at a rate referable to the currency concerned. One way of addressing this problem would be to require interest to be awarded at a rate referable to the base rate set by the central bank or other authority responsible for monitoring the currency in question. So, for example, where a pursuer sued for payment in euros, the court would award interest at, say, the European Central Bank rate plus 1% instead of a rate based on the Bank of England rate plus 1%.

7.34 Alternatively, the appropriate rate of interest in any case in which decree is granted in a foreign currency could be left to judicial discretion. There may occasionally arise circumstances where an appropriate base rate has not existed in relation to the foreign currency throughout the period in respect of which interest is sought: for example, because the currency has gone through a temporary period of hyper-inflation. In such circumstances, it may be desirable to leave it to the court to fix a rate of interest which is fair to both parties.

7.35 We invite comment on the following questions:

- 35. (a) Where a party seeks an award in a currency other than sterling, and the award includes an element of interest, should the party be entitled to interest at a rate referable to the currency of the principal sum?**
- (b) Where an award is made in a currency other than sterling, should the court have a broad discretion to award interest at a rate other than the prescribed rate?**

## Changes to the prescribed rate

7.36 In actions for damages, where there has been a change in the applicable interest rate (hitherto, the judicial rate) in the period between the cause of action and the date of the award, the court has to decide how to take the different rates into account. There is no settled view on how this should be achieved and three approaches have been adopted:

- (i) Take an average of the different rates;<sup>68</sup>
- (ii) Apply different rates to portions of the relevant period;<sup>69</sup> or

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<sup>67</sup> *Commerzbank AG v Large* 1977 SC 375. See also *Miliangos v George Frank Textiles Ltd* [1976] AC 443.

<sup>68</sup> *Smith v Middleton* 1972 SC 30; *Wilson v Norman J Stewart & Co (1970) Ltd* 1986 SLT 469; *Quinn v Bowie (No 1)* 1987 SLT 575; *Starkey v NCB* 1987 SLT 103.

<sup>69</sup> *Preston v Grampian Health Board* 1988 SLT 435; *Keicher v NCB* 1988 SLT 318.

(iii) Adjust the date from which interest runs to take account of changes in the rates.<sup>70</sup>

7.37 If legislation applying the principles set out in this paper is enacted, it is likely that the interest rate will change more frequently than at present. If the legislation is based on the principle that the rate of interest applied should compensate the creditor or claimant no more or less than their loss, then it may be desirable to recommend a preferred method of calculating awards to deal with fluctuations. The logical position appears to be (ii) above, as this would most accurately compensate the creditor and would certainly be the appropriate way to calculate interest on a debt. In actions for damages, however, the circumstances may vary considerably and where (ii) is simply too complex to be of use, there is a case for allowing judicial discretion to apply method (i). Method (iii) seems somewhat arbitrary and while it may have provided a just solution in the circumstances of the case in which it was used, it does not appear to disclose any general principle which could achieve a just result in other cases.

7.38 We invite comment on the following proposal and question:

**36. (a) There should be a preferred method for dealing with changes to the rate of interest. The most accurate method would be to apply the fluctuating prescribed rate to the appropriate period of the debt or sum due in damages.**

**(b) Should there continue to be judicial discretion to apply different methods to different circumstances?**

### **Method of calculation**

7.39 As well as recommending a prescribed rate, we also propose that compound interest should be applied rather than simple interest (see Part 8 below). If interest is compounded, then the sum calculated will vary according to the method of calculation used. For example, if the interest is compounded monthly, the result will be a larger sum than if it is compounded every six months. For this reason it is recommended, at paragraphs 8.40-8.43 below, that there should be a prescribed method of calculating compound interest. It is also proposed that a means of calculating compound interest by the prescribed method is made available on a website and also that tables setting out the calculations are made available in court buildings.

### **Interest at half the prescribed rate**

7.40 Under the Interest on Damages (Scotland) Act 1958, the court retains a wide discretion as to whether to award interest in damages actions and as to the rate at which it should be awarded. A "selective and discriminating approach" is taken in respect of rates of interest and the periods to which particular rates apply.<sup>71</sup> Interest is applied only to the past elements of the claim, not to future loss. However, past loss, whether for solatium or pecuniary loss, might not all be suffered on one day. It is more likely to be suffered on a

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<sup>70</sup> *McNeil v Roche Products Ltd* 1989 SLT 498.

<sup>71</sup> *Smith v Middleton* 1972 SC 30.

day-to-day basis over a period. The applicable rate of interest is usually reduced to take account of this.<sup>72</sup>

7.41 In respect of pre-decree pecuniary loss, the court's practice is to award interest at half the judicial rate from the date the loss began to either the date the loss ceased or the date of decree.<sup>73</sup> Where the court attributes a portion of solatium to the past, interest is usually set at half the judicial rate from the date of the accident to the date of decree, but it has been awarded at higher than half rate depending on what view is taken of the proportion of suffering relating to the past.<sup>74</sup> We see no reason why this practice should not continue but we envisage that the prescribed rate of interest would be used as the base rate to be halved where the court considered it appropriate to do so.

7.42 As discussed above,<sup>75</sup> interest may be composed of a number of elements of which one is inflation. It can be argued that the award of interest at a rate – even a half rate – which is based upon the Bank of England base rate over-compensates the pursuer because it includes such an element of inflation. The sum awarded by the court by way of solatium reflects the value of money at the date when the award is made. If a rate of interest which includes an element of inflation is then applied to that award, the consequence is that inflation is compensated twice. However, the degree of over-compensation is minimal<sup>76</sup> and, given that an award of solatium is in any event a conventional figure intended to compensate non-pecuniary loss, we do not suggest that the existing practice of awarding interest on past solatium at a half rate should be disturbed.

### Post-decree interest

7.43 As its name implies, the "judicial rate" is set by the judges of the Court of Session who make the relevant subordinate legislation<sup>77</sup> as "the Lords of Council and Session". At 3.25%<sup>78</sup> above base, the current rate is mildly penal. On one view, a rate which encourages early payment after decree is right and proper since it acts as a means of enforcement of the will of the court. On the other hand, there is a system of diligence available to a pursuer to enforce the will of the court and it can be argued that there is no need to reward a successful pursuer who does not make use of the remedies provided by diligence.

7.44 The statutes setting the judicial rate<sup>79</sup> provide for simple interest only. Over shorter periods (up to about a year) and relatively small amounts of money (up to about £10,000), it makes little difference whether simple or compound interest is applied. On larger sums over long periods, simple interest can lead to under-compensation of the pursuer.<sup>80</sup> A judicial rate which is slightly high redresses the imbalance created by applying simple interest, albeit without great precision. If post-judgment interest were compounded, a judicial rate could be set which was more closely linked to prevailing market rates.

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<sup>72</sup> For a full discussion of this point, see para 5.12.

<sup>73</sup> *Smith v Middleton* 1972 SC 30; *McCuaig v Redpath Dorman Long* 1972 SLT (Notes) 42.

<sup>74</sup> See *Skakle v Downie* 1975 SLT (Notes) 23; *Banner's Tutor v Kennedy's Trs* 1978 SLT (Notes) 83.

<sup>75</sup> See para 7.13; also *Wright v British Railways Board* [1983] 2 AC 773, Lord Diplock at 783-4, approving *Birkett v Hayes* [1982] 1 WLR 816 (CA).

<sup>76</sup> If, for example, base rate plus 1% is 5.75%, the rate of interest on past solatium is only 2.875%.

<sup>77</sup> See para 7.5.

<sup>78</sup> The Bank of England base rate at 12 November 2004 was 4.75%.

<sup>79</sup> See paras 7.5-7.6.

<sup>80</sup> For a more detailed comparison between simple and compound interest, see Pt 8 and Appendix E.

7.45 If the rate applied post-judgment is intended only to be compensatory and not penal, the question arises whether interest should be treated any differently post- or pre- an award by the court. If there is a change in the law to the effect that pre-decree interest is available from the date when the right of action arose or from when the pursuer was kept out of his or her money, interest would run from the appropriate date regardless of the date of judgment.

7.46 If decree is awarded for a sum which includes an element of interest already, (for example, on damages where interest under the Interest on Damages (Scotland) Act 1958 has been awarded), any interest charged post-decree at the judicial rate will be, in effect, a form of "interest upon interest". Despite the long-standing strictures against "interest upon interest", and despite the fact that the 1958 Act explicitly states that nothing in section 1 "...shall...authorise the granting of interest upon interest,...", the courts have accepted that interest from the date of decree until payment is charged on the whole sum awarded in the decree including any element of pre-decree interest. When considering, in *Smith v Middleton*,<sup>81</sup> how to apply interest under the 1958 Act, as amended in 1971, Lord Emslie took the view that once the interest on damages had been calculated and added to the sum of damages, interest would run on the resulting sum:

"What, in my opinion should be done, bearing in mind that any interest elements in an award may be subject to tax is to discern for payment of a sum of damages, assessed in accordance with accepted principles, together with an additional sum derived from interest at specified rates, for specified periods ending with the date of the interlocutor on those parts of the total sum of damages which should bear interest. Damages would therefore consist of the addition of two sums and on the resulting sum interest would no doubt run from the date of decree until payment."

7.47 Although not stated explicitly, this appears to be the practice followed by the courts<sup>82</sup> after the flurry of cases following the 1971 amendments. In *Moulard v Ferguson*,<sup>83</sup> for example, Lord Stewart approved that dictum of Lord Emslie and added:

"If past interest were not included in the amount upon which interest runs from the date of decree, it would be to the advantage of any defender to delay payment of damages containing a substantial past interest element for as long as possible. I do not consider that subs (2)(a) of s 1 [of the 1958 Act] has the effect for which counsel for the defender contended. It is intended to give a warning against the compounding of interest. When decree is granted for a sum which includes an element of interest which has accrued prior to its date, that decree is, at the date it is pronounced, a decree for a principal sum upon which post-decree simple interest then begins to run at whatever rate is appropriate."

7.48 If post-decree interest and pre-decree interest are set at the same rate, then it could be said that interest should run from the appropriate pre-decree date until payment and decree would not affect the running of interest one way or the other. The question of compounding at the date of decree would not arise. However, a question arises as to whether pre-decree interest should be compounded<sup>84</sup> and if compounding of interest is acceptable pre-decree, there would not be any reason why it should not be acceptable from

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<sup>81</sup> 1972 SC 30, 39.

<sup>82</sup> See for example *McKeown v Sir William Arrol* 1974 SC 97.

<sup>83</sup> 1979 SLT(Notes) 85, 86.

<sup>84</sup> See Pt 8 below.

decree onwards. If the current general rule against compounding were removed, then there would be no need to compound at the date of decree: interest would be compounded at monthly intervals (or at whatever other period was provided) both before and after decree.

7.49 Where there is an applicable contractual rate, the present law is that it continues to apply after decree instead of the judicial rate.<sup>85</sup> No change to this rule is proposed. If parties have agreed a contractual rate or the court has held that the parties have so agreed, it seems logical that that is the rate which should be applied. If the judicial rate were applied post-judgment and it was significantly different from the contractual rate, one of the parties would pay more or receive less than would have been the case if the contract had not been subject to litigation.

7.50 If it is considered necessary to apply a high rate of post-decree interest, then this can be achieved by Act of Sederunt, as at present. However, if a formula for pre-decree interest is prescribed in legislation, it would not necessarily follow that the post-decree rate would always be higher. To ensure a higher post-decree rate, it would be necessary to specify that the pre-decree formula is varied post-decree so that the rate is higher. This would retain the advantages of an interest rate which fluctuated with the applicable bank rate and, because the rate would change automatically, there would be less need for judicial involvement. It would also include an element which encouraged early payment according to the will of the court. For example, if the formula for pre-decree interest is "1% above base rate", then the formula for post-decree interest could be "2% above base rate" or even higher. It might be considered harsh to apply the higher rate immediately on decree and it would be logical to allow only compensatory interest for a period of grace after decree: but there would come a point at which the defender would be expected to obtemper the order of the court or face a penal rate of interest. The courts could set a period of fourteen days, or perhaps thirty days, after which the higher rate of interest would apply.

7.51 We invite comment on the following treatments of post-decree interest:

**37. Interest:**

**(a) on sums due post-decree should continue to run at a rate to be prescribed in rules of court independently of the rate applicable to pre-decree interest.**

**(b) on sums due post-decree should run on the same basis as sums due pre-decree and the applicable rate post- and pre- decree should be standardised and calculated by the same method. The amount of pre-decree interest would be fixed at the date of the award and post-decree interest would then run on that sum until payment.**

**(c) should run from the appropriate date until payment regardless of whether it is pre- or post- decree and the same rate and method of calculation should apply throughout this period.**

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<sup>85</sup> *Bank of Scotland v Davis* 1982 SLT 20.

7.52 We also invite responses to the following questions:

**38. (a) Should post-decree interest run at a higher rate than pre-decree interest in order to penalise late payment?**

**(b) If post-decree interest should run at a higher rate, should the higher rate be linked to the formula for determining pre-decree interest (ie if pre-decree interest is 1% above base, post-decree interest could be 2% above base)?**

**(c) If post-decree interest is to run at a higher rate, should there be a period allowed before the higher rate is applied (for example, 14 days after decree)?**

**(d) If pre-decree interest is compounded, should post-decree interest also be compounded?**

### **Interest under the Late Payment of Commercial Debts (Interest) Act 1998**

7.53 Where a claimant is entitled to claim interest under the 1998 Act<sup>86</sup> the rate is calculated by reference to the Bank of England base rate plus 8%. Section 6 of the 1998 Act provides:

"(1) The Secretary of State shall by order made with the consent of the Treasury set the rate of statutory interest by prescribing—

- (a) a formula for calculating the rate of statutory interest; or
- (b) the rate of statutory interest.

(2) Before making such an order the Secretary of State shall, among other things, consider the extent to which it may be desirable to set the rate so as to—

- (a) protect suppliers whose financial position makes them particularly vulnerable if their qualifying debts are paid late; and
- (b) deter generally the late payment of qualifying debts."

7.54 The Department of Trade and Industry (and, in Scotland, the Scottish Ministers) have chosen to set the current rate according to section 6(1)(a).<sup>87</sup> It should be noted that the interest rate applied under the 1998 Act is based on a reference rate (the Bank of England rate) which is fixed for a six-month period. This is required by article 3(1)(d) of the Directive which provides that "...the reference rate in force on the first calendar day of the half-year in question shall apply for the following six months". The effect is that the Bank of England

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<sup>86</sup> See paras 7.16-7.17.

<sup>87</sup> In Scotland the rate is set at 8% over base by art 4 of the Late Payment of Commercial Debts (Rate of Interest) (Scotland) Order 2002 (SSI 2002/336) which provides: "The rate of interest for the purposes of the Late Payment of Commercial Debts (Interest) Act 1998 shall be 8 percent per annum over the official dealing rate in force on the 30<sup>th</sup> June (in respect of interest which starts to run between 1<sup>st</sup> July and 31<sup>st</sup> December) or on the 31<sup>st</sup> December (in respect of interest which starts to run between 1<sup>st</sup> January and 30<sup>th</sup> June) immediately before the day on which statutory interest starts to run."

base rate on 31 December 2002 was used to calculate the late payment interest rate from 1 January 2003 to 30 June 2003. The Bank of England base rate for that period was 4%, and consequently the late payment rate was 12%. For the following two half-yearly periods (1 July 2003 to 31 December 2003 and 1 January 2004 to 30 June 2004) the Bank of England base rate at the relevant days was 3.75% and consequently the late payment rate from 1 July 2003 to 30 June 2004 was 11.75%. This device is imposed on the regime set up by the 1998 Act by its governing directive but there does not seem to be any advantage in reproducing it for the purposes of setting a formula for interest on debt and damages.

### **Rates of interest under other existing statutory provisions**

7.55 We noted in our summary of the present law that there are a large number of existing statutory provisions which create an entitlement to interest. In this Discussion Paper we are concerned primarily with circumstances in which interest is payable as a matter of private law by one person to another rather than where it is payable to or by a central or local government body. So far as rates of interest are concerned, the statutory provisions applicable to private law relationships which we have identified fall into three broad categories:

- (i) The rate of interest is set by reference to the judicial rate, for example, by reference to the rate payable on sheriff court decrees or a rate is specified which is derived from the judicial rate;
- (ii) No rate of interest is specified;
- (iii) A rate of interest is specified which is peculiar to the provision in question.

We address each of these in turn.

7.56 **Judicial rate specified.** Examples of legislation in which there is a reference to the judicial rate<sup>88</sup> include the Debtors (Scotland) Act 1987, sections 50(5) and 55(7),<sup>89</sup> and the Adults with Incapacity (Scotland) Act 2000, section 81.<sup>90</sup> A similar rate is found in the Bankruptcy (Scotland) Act 1985. In section 51 of the 1985 Act, the "prescribed rate"<sup>91</sup> is set by the Bankruptcy (Scotland) Regulations 1985.<sup>92</sup> That rate is not set by reference to the judicial rate but it is set at 8% which was changed from 15% in the same year as the judicial rate was also amended.<sup>93</sup>

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<sup>88</sup> The reference is made to s 9 of the Sheriff Courts (Scotland) Extracts Act 1892, as amended from time to time by Act of Sederunt. See para 7.6 above.

<sup>89</sup> Interest on sums paid or repaid under earnings arrestments and current maintenance arrestments; the reference to the sheriff court decree rate is in s 73(1).

<sup>90</sup> Misuse of funds. See also sch 2, para 8(7) which provides for interest at the same rate where there is a deficiency in the accounts of a guardian.

<sup>91</sup> S 51 lists the order of priority in a distribution of the debtor's estate by the permanent trustee. At s 51(1)(g) the order of priority is interest on (i) the preferred debts and (ii) the ordinary debts. The interest rate is the higher of (i) the "prescribed rate" or (ii) the rate which applies to that particular debt (s 51(7)).

<sup>92</sup> SI 1985/1925, as amended. Relevant amendments were made by the Bankruptcy (Scotland) Amendment Regulations 1993 (SI 1993/439), reg 4.

<sup>93</sup> Reg 4 of the Bankruptcy (Scotland) Amendment Regulations 1993 (SI 1993/439) changed the rate in the Bankruptcy (Scotland) Regulations 1985 (SI 1985/1925) from 15% to 8%.

7.57 Section 81 of the Adults with Incapacity (Scotland) Act 2000<sup>94</sup> provides that where funds have been misused in breach of fiduciary duty by certain specified classes of person, they shall be liable to repay the funds misused with interest at the same rate as that applicable to a sheriff court decree. There is a similar provision<sup>95</sup> for a deficiency in the accounts of a guardian, whereby the guardian is liable, under certain circumstances relating to a deficiency in the estate, to pay interest to the estate at the rate applicable to a decree of the sheriff court in respect of the period for which it appears that the deficiency has existed. Although no specific reason for this interest rate is set out in the Explanatory Notes to the 2000 Act, these provisions appear to be intended to apply the common law fiduciary duties and duties of care to appointees under that Act.

7.58 These provisions would be indirectly affected by our proposals in relation to the rate of interest applicable post-decree in sheriff court actions.<sup>96</sup> If the post-decree rate of interest were to be aligned with the "compensatory" rate of statutory interest which we have proposed, then this would apply wherever there is existing legislation which provides for interest to run at sheriff court decree rates. In principle, this seems to us to be acceptable: there seems to be no good reason for expressly preserving a special, higher rate in any of the circumstances which we have considered. Only formal amendment would be needed to existing statutory provisions to achieve this result.

7.59 **No rate specified.** Examples of legislation in which there is reference to interest being due but with no rate specified include the Bills of Exchange Act 1882, section 57<sup>97</sup> and the Trusts (Scotland) Act 1921, section 29.<sup>98</sup> In the absence of other candidates, at present it seems that the most likely rate of interest to be awarded would be the judicial rate.<sup>99</sup> We think it is appropriate for the rate of interest due under these provisions to be the new statutory rate which we are proposing and express provision should be made in new legislation to this effect. No amendment would be required to the existing provisions themselves.<sup>100</sup>

7.60 **Rate other than the judicial rate specified.** Examples of legislation with its own rate specified include the Partnership Act 1890, sections 24(3)<sup>101</sup> and 42(1),<sup>102</sup> the standard conditions in Schedule 3 to the Conveyancing and Feudal Reform (Scotland) Act 1970<sup>103</sup>

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<sup>94</sup> 2000 asp 4.

<sup>95</sup> Para 8 of sch 2.

<sup>96</sup> Paras 7.43-7.52.

<sup>97</sup> Interest recoverable "as damages" on bills dishonoured by non-acceptance or non-payment which may, however, be withheld "if justice requires it" (s 57(3)).

<sup>98</sup> Sums improperly advanced by a trustee on inadequate security.

<sup>99</sup> Byles on *Bills of Exchange and Cheques* (27<sup>th</sup> edn, 2002), para 28-10 states the practice in England with regard to bills of exchange as follows: "There is no prescribed rate of interest. It is common for interest to be claimed and awarded at a rate equivalent to that under the Judgments Act 1838, but in a commercial case it may be more appropriate to seek a reasonable rate at or just above base rate. If a high rate is asked there may be difficulty in entering a default judgment." The assumption underlying these observations appears to be that the judicial rate will exceed a rate at or just above base rate.

<sup>100</sup> If the pre- and post-judgment rates of interest are not aligned then further consideration would have to be given to which of these rates applied.

<sup>101</sup> On advances by a partner beyond the capital which he has agreed to subscribe: rate of 5% specified.

<sup>102</sup> Option of outgoing partner to demand interest on his share of assets until paid: rate of 5% specified.

<sup>103</sup> Creditor performing debtor's obligations entitled to recover expenses and charges (including interest) reasonably incurred: interest runs at rate at which advances are secured under the standard security or, if no rate is specified, at the "bank rate".

and the Insolvency (Scotland) Rules 1986, rule 4.66.<sup>104</sup> We have already made recommendations in our Report on *Partnership Law* in relation to interest on partners' advances<sup>105</sup> and on the value of the share of an outgoing partner<sup>106</sup> which would see the present 5% rate replaced by a commercial rate of interest. We see advantages in bringing other such statutes in line with our proposals regarding a statutory rate of interest which reflects commercial rates. We suggest that legislation specifying a rate other than the judicial rate should be reviewed to assess whether it would be appropriate to substitute the statutory rate which we are proposing to be prescribed.

7.61 We invite views on the following questions:

**39. (a) Where a statute currently provides for interest to run at the post-decree rate, should interest run at the statutory rate which we have proposed or (if different) should it continue to run at the rate applicable after decree?**

**(b) Where a statute currently provides for interest to run without specifying the rate, should interest run at the statutory rate which we have proposed or (if different) should it run at the rate applicable after decree?**

**(c) Are there any statutes which currently provide for interest to run at a rate other than the post-decree rate which should be amended to provide for interest to run at the statutory rate which we have proposed or alternatively (if different) at the rate applicable after decree?**

7.62 Thus far we have considered only statutory provisions which regulate entitlement to interest in private law relationships. Most of the existing statutory provisions which provide for interest to be paid to or by a public body (such as interest on taxes and financial penalties) lie outside the scope of our reference.<sup>107</sup> It is worth noting that the existing statutory provisions contain a very wide variety of specified rates for interest to run.<sup>108</sup> Sometimes compounding is specified and sometimes it is not. We appreciate that there will be factors peculiar to individual circumstances which may make it appropriate for interest to run at different rates on different sums of money. Nevertheless, we take the opportunity to invite views on the following question:

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<sup>104</sup> SI 1986/1915, as amended. Creditors' entitlement in the order of priority on distribution: interest is at "the official rate", specified by the Insolvency Act 1986, ss 189(4) and (5), read with rule 4.66(2), as being whichever is the greater of the rate applicable to the debt apart from the winding up and 15%.

<sup>105</sup> Law Commission and Scottish Law Commission Report on *Partnership Law* (November 2003), para 10.30(2) the recommendation is that partners should be entitled to interest at a commercial rate on advances to the partnership.

<sup>106</sup> *Ibid* para 8.75(2): the recommendation is that the outgoing partner should have a right to be paid interest at a commercial rate on the value of his share from the date of withdrawal. The prescribed rate would initially be 3% above the Bank of England base rate, alterable by statutory instrument to allow for changes in economic conditions.

<sup>107</sup> See for example the Taxes (Interest Rate) Regulations 1989 (SI 1989/1297), as amended. These regulations set out formulae for the purposes of section 178 of the Finance Act 1989 which provides an interest rate for various (mainly tax) statutory provisions. The formulae are complex and frequently amended.

<sup>108</sup> For example, for a large number of statutory provisions relating to compulsory purchase and other lesser interferences with property rights, the rate is set at 0.5% below the base rate quoted by the reference banks: Acquisition of Land (Rate of Interest after Entry) (Scotland) Regulations 1995 (SI 1995/2791), prescribing a rate for the purposes of the Land Compensation (Scotland) Act 1963, s 40. By way of contrast, various statutory instruments dealing with grants and subsidies provide for interest to be chargeable on grants which fall to be repaid at a rate set at 1% above LIBOR in force during the period in question on a day to day basis.

40. **Are there any other rates of interest specified in statutory provisions which ought to be brought into line with the statutory rate which we are proposing in this Discussion Paper for contractual and non-contractual debts and damages?**

## Part 8            Compounding of Interest

### Compound interest in Scots law

8.1     "Interest upon interest" or "compound interest" has not generally been regarded as the appropriate method of calculating interest on awards by courts in Scotland. The Institutional writers state the principle that there should be no interest upon interest although scant reasoning is given. Its origin lies in the Canon Law and in Roman Law.

8.2     Bell wrote:<sup>1</sup>

"Interest does not, in the general case, ipso jure bear interest: Therefore, however long arrears of interest may have continued unpaid, they cannot, without some voluntary or judicial operation, be converted into a principal bearing interest."

This principle, once stated, serves only as an introduction to a discussion of the exceptions to the general rule.

8.3     Erskine took a similar approach:<sup>2</sup>

"It is unlawful to accumulate interest by any previous conditional stipulation. Thus it is criminal to stipulate in a bond, that the interest, if not paid precisely as it falls due, shall be accumulated into a principal sum bearing interest...Neither is it lawful, where the interest has run on unpaid for several years together, to state interest against the debtor upon that arrear of interest, from the day or term at which it fell due, except in the cases of distressed cautioner, or of a denunciation."

As with Bell, this principle is stated in an introductory paragraph to a more detailed exposition of the various exceptions.

8.4     Judicial opinions on this issue have followed a similar pattern. The basic rule – no interest upon interest – is assumed in judgments to be so well established as not to require further explanation. *Macleay v Campbell*<sup>3</sup> was an appeal to the Inner House about a disputed executry. The pursuer had been kept out of his money and was entitled to interest but he contended for compound interest from the date of citation "...accumulated, and interest allowed on the accumulated sum, with biennial rests from the date of the summons." All four judges expressed the view that "rests" should not be allowed, ie that there should be no compounding at specified, in this case biennial, periods. No reasoning is given except that rests are seen to be of a "penal nature" and in the circumstances of the case it was not appropriate to penalise the defender.

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<sup>1</sup> Bell, Commentaries, Vol I, 5<sup>th</sup> edn, 651.

<sup>2</sup> Institute III.iii.81.

<sup>3</sup> (1856) 18D 609.

8.5 Another statement of the law on this issue is found in *Douglas v Douglas's Trs*<sup>4</sup> in a dictum of Lord Justice Clerk Patton, with stress again on the exceptions:

"A claim for compound interest, with annual rests, is a demand which can only be maintained, either in the case of a fixed usage in commercial dealings, or where there has been an abuse in a party trusted with funds, and violating his trust."<sup>5</sup>

He offers no further explanation other than that the decision of the House of Lords in *Jolly v McNeill*<sup>6</sup> has been followed and adhered to. However, as has been observed in subsequent case law, the report in *Jolly v McNeill* is inadequate. The Court of Session had allowed accumulated interest with biennial rests and the House of Lords reversed that decision. But the reasoning of the Lords is not set out. The implication in the report is that their Lordships accepted the appellant's argument that

"Accumulation of compound interest upon a loan of money is contrary to the established rules of the law of Scotland. To this there are no doubt exceptions, but none of them apply to the present case, and they fortify the general rule."

8.6 Lord Patton's dictum in *Douglas* was applied in 1992 by the Second Division in *Roxburgh Dinardo's JF v Dinardo*,<sup>7</sup> a case which the court held was "special and exceptional" so as to warrant an award of compound interest. A judicial factor had been appointed to a partnership in which one of the partners had possession of the firm's assets and the other of its liabilities. The factor petitioned the Court of Session to have the accounts and a scheme of division approved and the Accountant of Court reported to the court. With the approval of the Accountant of Court, the factor had applied compound interest at 3% above base rate on the assets held by the partner who had possession of them. Observing that there was no rule that the "legal rate" (*sic*) had to be applied in all cases, the Inner House confirmed that the judicial factor and the Accountant had discretion to apply a commercial rate of interest if they thought that was appropriate in the exceptional circumstances. It was held that such circumstances were present in this case because (1) the partner who was left with the liabilities had financed them by overdraft to which compound interest was applied and (2) there was a fiduciary relationship between the partners and the assets were therefore subject to a constructive trust.<sup>8</sup>

8.7 On the basis of the reported cases it may therefore be stated that there are three exceptions to the general rule:

(i) Where there is express agreement that compound interest should apply. In *Bank of Scotland v Davis*,<sup>9</sup> Lord Justice Clerk Wheatley explained that where interest is to be paid in terms of a contractual agreement, it should be paid according to the contractual obligation (in that case, an obligation in respect of a loan). Also, where for example accounts have been rendered year by year by the creditor and the

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<sup>4</sup> (1867) 5M 827.

<sup>5</sup> P 836.

<sup>6</sup> (1830) 4 W & S 458.

<sup>7</sup> 1992 SC 188.

<sup>8</sup> Applying *Douglas v Douglas's Trs* (1867) 5M 827.

<sup>9</sup> 1982 SLT 20.

balance accumulated, acquiescence in this practice by the debtor can raise an implied contract in favour of compounding.<sup>10</sup>

(ii) In cases of breach of trust or failure in an obligation to invest and accumulate.<sup>11</sup> This is related to the rule that a person in a position of trust is obliged to collect interest on capital and accumulate further interest on that sum.

(iii) Where there is an established commercial usage allowing interest on interest such as in the case of bank accounts or bank loans.<sup>12</sup> In *Reddie v Williamson*<sup>13</sup> Lord Justice Clerk Inglis stated: "The privilege of a banker to balance the account at the end of the year, and accumulate the interest with the principal is founded on this plain ground of equity, that the interest ought then to be paid, and, because it is not paid, the debtor becomes thenceforth debtor in the amount, as a principal sum itself bearing interest."

8.8 Each of these exceptions can be supported on the basis of principle as well as on authority. If a contract specifies compound interest then it is only fair that the person who fails to carry out a contractual obligation should be no better off because of that failure. The court is simply giving effect to an agreement freely entered into. In the case of breach of trust, the law implicitly recognises that interest on investments or debts would be compounded so that gain or loss in a fiduciary relationship could be expressed in terms of compounded interest. A trustee is obliged to invest, to collect interest on capital and accumulate further interest on that sum, although not necessarily compound interest. Where an element of *culpa* enters into the reasoning of the courts in cases where there has been a breach of trust or failure to carry out the duties of a trustee, it has been regarded as appropriate to hold the trustee to the most strict form of accounting.<sup>14</sup>

8.9 In the case of "established commercial usage" such as banking, it is recognised that any loss or gain will have been subject to compounding and it is therefore regarded as just that compensation should be compounded. In the Victorian period when most of the relevant cases were reported, banks prepared their accounts annually and added interest at the end of the year. In the case of an overdrawn account, the creditor could pay the interest at that point and it was known or assumed to be known that, if unpaid, the interest would be added to the debt. The logic of this exception must be related to that of the first (ie contractual) exception: the debtor has entered into a contract or an implied contract or has acquiesced in a practice where interest is accumulated annually.

8.10 A further exception to the rule against compounding occurs when post-decree interest is added to an award which already includes an element of interest. Where, for example, interest under the Interest on Damages (Scotland) Act 1958 is added to the award,

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<sup>10</sup> *Graham's Exrs v Fletcher's Exrs* (1870) 9M 298, per Lord Kinloch, 304. See also *Munro's Trs v Murray and Ferrier* (1871) 9 SLR 174.

<sup>11</sup> *Cranston & Hay v Scott* (1826) 5S 62; *Douglas v Douglas's Trs* (1867) 5M 827; *Roxburgh Dinardo's JF v Dinardo* 1992 SC 188.

<sup>12</sup> *Douglas v Douglas's Trs* (1867) 5M 827; *Munro's Trs v Murray and Ferrier* (1871) 9 SLR 174; *Bank of Scotland v Davis* 1982 SLT 20.

<sup>13</sup> (1863) 1M 228, 237.

<sup>14</sup> For example, *Douglas v Douglas's Trs* (1867) 5M 827. Lord Justice Clerk Patton explained (836) that "... where there is a fiduciary relation constituted between two parties, so that a party who is trustee is bound either to recover or to account for sums of money, and fails in his duty, and, it may be, uses the property held by him in trust for his own purposes, he shall be held to account upon the very strictest system of accounting."

any further post-decree interest is subsequently added to the interest which has accumulated at the date of the award.<sup>15</sup> This practice has been adopted by the courts and arguments that it contravenes the rule on compounding have been rejected.<sup>16</sup>

8.11 The principle of "no interest upon interest" applies to claims for damages as well as debt. As discussed elsewhere,<sup>17</sup> prior to 1958, no interest was allowed on damages at all except from the date of decree. The Interest on Damages (Scotland) Act 1958 gave the courts power to include interest on a claim for damages from the date of citation, but expressly retained the stricture against "interest upon interest".<sup>18</sup>

### Law Commission proposals

8.12 In England and Wales there are similar restrictions on interest upon interest. Last year, however, the Law Commission recommended<sup>19</sup> that the courts should have a power to award compound interest. In payments of £15,000 or more there should be a rebuttable presumption in favour of compound interest. Where less than £15,000 is due, there should be a rebuttable presumption in favour of simple interest.<sup>20</sup> In order to address the problem, as it was perceived, of complexity of calculation, the Law Commission recommended that the Court Service should make a computer program freely available on its website to calculate compound interest. The Law Commission had previously set out the basis for its recommendations in a Consultation Paper:<sup>21</sup>

"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, or had to borrow to cover, in either case at compound interest."

8.13 Although concerns about complexity remain, it is now considered far easier to carry out complex arithmetical calculations: hence the Law Commission's proposal to have a calculator made available on the internet (backed up by printed tables in court buildings).

8.14 The Law Commission observed that compound interest can be calculated in several different ways and that this could lead to dispute. It is proposed that this problem should be addressed by having a prescribed system for calculating compound interest. The Law Commission recommends that the compounding interval be set by rules of court. All interest under the new statutory regime would then be calculated in accordance with the prescribed interval. The Commission also recommends that the calculations should be presented to the court by the claimant rather than calculated by a judge or court official.

8.15 In general terms, we are provisionally in agreement with the Law Commission's view of the advantages of compound interest. However, the Law Commission is proposing to make compound interest available by giving a power to the courts to award it. We would be inclined to the view that, if compounding is the fairest way of calculating interest, then it should be available as a statutory right. Also, in a Scottish context, it would be more

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<sup>15</sup> See para 7.46.

<sup>16</sup> *Smith v Middleton* 1972 SC 30; *Mouland v Ferguson* 1979 SLT(N) 85. The case law is discussed at paras 7.46-7.47.

<sup>17</sup> Paras 2.24-2.33.

<sup>18</sup> S 1(2)(a), which was not amended by the Interest on Damages (Scotland) Act 1971.

<sup>19</sup> Report on *Pre-judgment Interest on Debts and Damages* (Law Com No 287).

<sup>20</sup> *Ibid* para 1.18.

<sup>21</sup> *Compound Interest* (Consultation Paper No 167), para 4.1.

appropriate to set the method of calculation and the compounding period in primary or secondary legislation rather than in procedural rules of court.

8.16 The Law Commission's proposals involve a system of rebuttable presumptions<sup>22</sup> with different presumptions applying above and below claims of £15,000. This introduces an element of uncertainty and also a degree of judicial discretion. We welcome views on whether or not there should be an element of judicial discretion as to how (or whether) compound interest is applied<sup>23</sup> but it seems logical to us that compound interest is either fair and correct, or it is not. The Law Commission presents evidence that compound interest is not significantly different in effect from simple interest where the debt is small and the period over which interest is due is short, but that does not in itself afford sufficient reason to disapply compounding in debts of less than £15,000. By way of comparison, a credit card or bank account still charges or pays compound interest if the debit or credit is less than £15,000. If there is no advantage to compounding on small sums of money, it seems odd that all major financial institutions are content to charge compound interest on any sum, however small.

8.17 The Law Commission argued<sup>24</sup> that a fixed rule on compounding could import excessive complications into small cases. The Commission did not set out explicitly what these complications are, but any difficulties in calculating compound interest, whatever the sum of money involved, would be addressed by providing an online calculator backed up by printed tables.<sup>25</sup> Where the amount claimed is small and the benefits of compounding are negligible, a pursuer may take the view that is not worth the expense of calculating compound interest. In these circumstances, the pursuer would retain a right to claim simple interest at the prescribed statutory rate.

8.18 In their response to the Law Commission's Consultation Paper, the Law Society of England and Wales stated that "simple interest never provides a full indemnity for the loss to the litigant".<sup>26</sup> Although there are cases where a high rate of simple interest may, crudely, indemnify the litigant, we would endorse that view and, if it is true, it follows that compound interest should be the norm.

### **Other jurisdictions**

8.19 Practice and law in respect of compounding varies across both common law and continental jurisdictions. Despite some proposals for reform,<sup>27</sup> few jurisdictions yet allow interest to be awarded on a compound basis.

8.20 In British Columbia, the Court Order Interest Act<sup>28</sup> 1974 provided for interest to be added to an award for pecuniary loss (a "pecuniary judgment"),<sup>29</sup> but limited this power so

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<sup>22</sup> Para 8.12 above.

<sup>23</sup> See para 8.39.

<sup>24</sup> Para 4.29 of Consultation Paper No 167 and para 5.24 of Law Com No 287.

<sup>25</sup> See para 8.43.

<sup>26</sup> Quoted in Law Com No 287 at para 4.4.

<sup>27</sup> British Columbia, (*Report on the Court Order Interest Act* LRC 90 1987); Manitoba (*Report on Pre-judgment Compensation on Money Awards* (1982)); and Ontario (*Report on Compensation for Personal Injuries and Death* (1987)).

<sup>28</sup> SBC 1974 c 65.

<sup>29</sup> S 1.

that compound interest was excluded.<sup>30</sup> In their report of January 1987,<sup>31</sup> the Law Reform Commission of British Columbia recommended that this prohibition should not be carried forward into a new Act and, specifically, that pre-judgment interest should be compounded.<sup>32</sup> They argued that compounding was a more accurate reflection of the market place and measured more accurately the cost of delay to the successful plaintiff. The difficulties perceived in other jurisdictions related to calculation but they advocated the official publication of tables of multipliers. The printed tables would show the value of a sum of money at a specific date adjusted to include compound interest. This would be possible because the rate of interest and the method of calculation would be prescribed by statute. A sum of money could, at a given date, be converted into an equivalent sum, including compound interest, at a later date.<sup>33</sup>

8.21 The British Columbia recommendations were welcomed by some scholars<sup>34</sup> who thought that compounding would bring the law closer to the principle of *restitutio in integrum*. However, that part of the Commission's recommendations was not implemented. The current Court Order Interest Act<sup>35</sup> provides for mandatory payment of interest from the date on which the cause of action arose<sup>36</sup> but retains the prohibition against compounding.<sup>37</sup>

### **Should Scottish courts have the power to award compound interest?**

8.22 In principle, compound interest best expresses the pursuer's loss. Nevertheless, consideration has to be given to the questions of whether this underlying principle should apply in all cases and whether there should be judicial discretion to award simple or compound interest.

8.23 When interest is paid in compensation it means that the sum at issue is being treated as if it were capital which was subject to a contractual obligation to pay interest. The court imagines a hypothetical sum of money on which the pursuer could have claimed interest or which the pursuer had to borrow to make good the loss. It is an estimate of the pursuer's loss and even if some precise arithmetical calculations are carried out, the figure is still an estimate. Only if we could visualise a world in which the pursuer never suffered a loss would we know how much that money would have cost (if borrowed) or earned (if invested). The question being asked is "what is it *likely* that this money would have cost or earned?" That can only be answered in terms of present-day financial practice: if this money were invested or borrowed would simple or compound interest apply? The fact is that compound interest is the accepted method of charging or paying interest in the financial services market. Our contractual debts, such as credit cards and bank overdrafts, are calculated using interest which is compounded monthly. If we open a savings account, we expect interest to be compounded monthly or even daily. If the model for interest as compensation is the cost of money, then compound interest ought to feature in that model.

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<sup>30</sup> S 2(c).

<sup>31</sup> *Report on the Court Order Interest Act* LRC 90 1987.

<sup>32</sup> *Ibid*, p 21.

<sup>33</sup> As suggested below (para 8.43) this process can be carried out even more easily using a web-based computer program.

<sup>34</sup> Bowles and Whelan, "Compound Interest: Could Multipliers be the Way Forward?" (1986) 136 New LJ 876; and "The Law of Interest: Dawn of a New Era?" (1986) 64 Canadian Bar Review 142.

<sup>35</sup> RSCB 1996 c 79.

<sup>36</sup> S 1.

<sup>37</sup> S 2.

8.24 And yet a borrower or lender in Victorian times would have had the same expectation. Why has compound interest not been accepted by the courts (or the legislature) before now? The courts have recognised exceptions to the rule but have not queried its basis. In the case of a failure to invest trust funds, it is accepted that compensation should include compound interest because this is what would have been paid on the trust's investments. Why, then, have the courts not accepted that compound interest would best compensate losses in other cases?

*The case against compound interest*

8.25 It may be that there remains a distrust of a practice which is seen as essentially usurious, a fear which still lurks in the background long after the repeal of the usury laws. Or there may be an underlying concern for its effect on disadvantaged sections of society. Although the application of simple and compound interest produce similar results over short periods, for large debts over a longer period compounding causes the total debt to rise exponentially. The effect can be dramatic and less predictable to those unskilled in financial matters. Compounding may more readily lead the debtor into a position where not only can the principal not be repaid but the debt cannot be serviced.<sup>38</sup>

8.26 Moreover, there is a public policy argument underlying the historic distrust of compounding viz that it could lead to a higher level of awards in actions for damages.<sup>39</sup> The result might be higher insurance premiums. It could also place a greater burden on the taxpayer due to increased cost to the NHS of settling claims. This is clearly not an argument based on principle because it is, in effect, an argument against full compensation. Nevertheless, it does express a concern which may lead to opposition to the introduction of compound interest. However, it would be possible to balance the extra cost to the public purse by introducing an interest rate which was a more realistic reflection of the current cost of money. At present, the judicial rate is set a level which can lead to over-compensation.<sup>40</sup>

8.27 Another perception is that interest is a charge for delay and that the pursuer or creditor must share some of the responsibility for any delay. By compounding interest, the creditor may be seen as being rewarded for sitting for too long on the claim. Even if the courts have power to stop interest running where delay is the fault of the pursuer, it may still be difficult to identify culpability and creditors might be able to "bank" their debts with debtors by showing prolonged forbearance.

8.28 As the Law Commission concluded in 1978, the virtue of simple interest is its simplicity. It is easier to calculate and consequently its effect is more predictable. Compound interest is usually calculated with periodic rests which cause sudden jumps in the total sum outstanding. Compound interest is more complex and more difficult for the parties to calculate. Compound interest can be calculated in different ways leading to conflicting results between parties. This added complexity could cause problems for parties at crucial

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<sup>38</sup> This effect is especially marked when the risk element of interest is compounded: see para 8.36 below.

<sup>39</sup> See table G and graph H in Appendix E. Simple and compound methods are used to calculate interest on a sum of £10,000. After about 12 months, compounding produces a significantly higher figure than simple interest at the same rate.

<sup>40</sup> Table G and graph H in Appendix E also compare the effect of applying 8% simple interest to £10,000 with base rate plus 1% simple and base rate plus 1% compound. See also graphs B and C in Appendix D: 8% is a higher rate than could be obtained on a timed-deposit account (ie an account with a notice period for withdrawal).

times in litigation such as the day of a proof when the parties are outside the court and are amenable to settlement.

### *The case for compound interest*

8.29 In the case of a debt which is a liquidated sum, the case for compound interest is quite clear. The debt ought to have been paid at an agreed date and if it is not paid then periodic interest is due. If interest is not paid it should be added to the principal debt and interest should then be due on the aggregate figure. With damages, the difficulty is that quantum may be disputed and it may be quite proper for a defender to wait for the decision of the court before making payment. Once the court's decision is made, however, it is retrospective in respect of both liability and quantum. The intention is that the award should place the pursuer in the same position as if the wrong had never taken place and any sum due from that date becomes, in effect, the same as an ordinary debt and the same argument for compounding is applicable.

8.30 Compound interest also encourages early payment of claims. The sooner payment is made, the sooner interest stops running. If simple interest applies, the sum of money due can be invested by the defender and earn compound interest, yet only simple interest will be paid to the pursuer when the case is resolved. If a claim or debt is settled at an early stage the difference between simple and compound interest is not significant. It is only after a year that compound interest yields any advantage to the creditor.<sup>41</sup>

8.31 In terms of social policy, there may be a concern that for debtors who cannot repay their debt, as opposed to those who will not repay, compound interest is harsh and raises the fear of debts spiralling out of control. However, social issues arise mainly in respect of consumer debt, which is nearly always contractual and typically provides for compound interest.<sup>42</sup> If compound interest were available to the courts, it would to some extent redress the social balance in that it would become available to weaker parties in disputes rather than only to those in a strong contractual position. The effect of compounding is also more significant in long running cases,<sup>43</sup> such as claims based on health and medical issues, which are commonly brought to court by economically weak members of society. Compounding can be said to provide a higher and arguably more just level of compensation to those raising actions against former employers for long-term health problems.

### **Judicial discretion**

8.32 A possible approach would be for legislation which allows compound interest to be applied or disapplied at the discretion of the court. This would enable the courts to tailor the kind of interest to the particular circumstances of the case. If it appeared inequitable to allow a particular sum of money to be compounded then a judge could specify that only simple interest would be awarded.

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<sup>41</sup> See table G and graph H in Appendix E.

<sup>42</sup> The rate of interest for a consumer debt under a contract (eg a credit card debt) is likely to include a large risk element to reflect the possibility of non-payment. The risk element of the rate can be far greater than other elements (eg in an APR of 20%, the risk element might account for 14%) and the effect of compounding that element would be dramatic. See para 8.36.

<sup>43</sup> See table G and graph H in Appendix E. For the first 12 months there is little difference between compound and simple interest but after five years the difference between the two rates is more pronounced (£427 on £10,000).

8.33 The disadvantage of such an approach is that it introduces a measure of uncertainty into the system. Most cases will settle before reaching court but parties will not be able to predict with complete accuracy how a court would have awarded interest. This may result in settlements which are unsatisfactory for the weaker party in any negotiations or it may discourage parties from settling, at least until a body of case law develops. If the method of calculating interest on debt is clear, many disputes could be resolved even without recourse to legal advice. In damages actions, at the point where settlement becomes likely, parties should be able to obtain clear legal advice as to how interest will be applied to the claim.

8.34 A consequence of retaining a degree of judicial discretion would be the likely survival of some elements of the existing case law including the concept of "wrongful withholding". In applying their discretion, the courts would be entitled to consider past case law on interest. In cases where a defender has had use of the pursuer's money through no fault of the defender and no profit to the defender, courts may think it unfair to award compound interest and may use their discretion to mitigate the effect of the award on the blameless defender. On one view, this would be a reasonable and equitable approach; but on another view it would undermine one of the principles underlying the reforms proposed in this paper *viz* that an award of interest should be made simply for the realistic compensation of the creditor for loss of the use of money or property.

8.35 The same advantages and difficulties apply if compounding is mandatory but judicial discretion is allowed as to the frequency of compounding. If monthly compounding is specified in legislation, there may be cases where the court believes that annual, or even daily, compounding, best reflects the pursuer's loss in a particular case and in those circumstances it would be fairer for the court to be able to use its discretion and vary the period of compounding. On the other hand, it is hard to see how litigants can reach a fair extra-judicial settlement if they do not have a clear understanding of how the court would have awarded interest.

### **Compounding of risk**

8.36 Interest, as explained above,<sup>44</sup> consists of three elements of which one is the risk that the creditor will not be paid. In a contract of loan, for example, the creditor seeks a rate of interest which will reflect the likelihood of that sum being repaid. If the loan is unsecured and the debtor has a poor credit record, the risk of non-payment is high and a high rate of interest will be charged. It is the compounding of this risk element which can lead to concerns about debt becoming unmanageable. Arguably, the risk element in a rate of interest ought not to be compounded because it is not subject to inflationary pressures and does not necessarily increase over time: in the case of a contractual debt, for example, risk is a one-off element which should be priced over the anticipated term of the contract. The rate of interest proposed in this paper<sup>45</sup> is similar to the rates applied to loans secured by a standard security, and also to the rates at which banks will lend to their corporate customers. These are rates with a relatively low risk element and the effect of compounding should not therefore be significant.

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<sup>44</sup> Para 7.13.

<sup>45</sup> Para 7.21.

## Claiming simple interest

8.37 If a right to claim interest is enshrined in legislation, it would still be possible to pursue a claim for a debt or for damages without claiming interest. The right would simply not be exercised. But if the right to claim interest is a right to claim interest calculated in a specified way, it is unlikely that a pursuer could claim any other form of interest. In our view a pursuer should remain entitled to elect to claim simple interest only (at the prescribed statutory rate). It may seem odd that some creditors may wish to claim less than that to which they are entitled, but it is envisaged that some businesses may have accounting systems which make it difficult for them to issue invoices and reminders with compound interest applied. We have included a question on this issue at 42(c) below.

## Proposals

8.38 As outlined above, there are arguments against the compounding of interest and these have found favour both historically and in other jurisdictions. Nevertheless, we have inclined to the view that the case against compounding is essentially a case against interest itself. In principle, we are provisionally in agreement with the Law Commission's proposals in respect of compound interest.<sup>46</sup> The pursuer's loss is more accurately compensated by the application of compound interest. If it is acceptable to charge interest, it becomes a debt like any other when it is charged. Interest should therefore attract interest like any other debt. We would welcome views on the following proposal:

- 41. If legislation is enacted specifying a rate of interest, it should allow for that interest to be compounded at specified intervals.**

8.39 Views are also welcomed on:

- 42. (a) Whether there should remain a judicial discretion to refuse compound interest where it would be just to do so.**
- (b) If judicial discretion is retained, should it be restricted to allowing simple rather than compound interest or should there be judicial discretion to allow compounding at a different frequency from the recommended period?**
- (c) Whether the pursuer should retain a right to claim simple interest provided that the sum claimed is less than would be claimed if compound interest were applied.**

## How should compound interest be calculated and what should be the frequency of compounding?

8.40 As stated above, compound interest can be calculated in different ways creating potential for dispute even where the principle of compounding is accepted. The answer to this problem is to prescribe a formula for calculating compound interest which would be used by all parties. The formula would be something like:  $Total\ Sum = P \times (1 + i)^n$ , where  $P$  = the principal sum,  $i$  = the periodic interest rate, and  $n$  = the number of time periods.  $i$  would

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<sup>46</sup> See paras 8.12-8.18.

either be the prescribed rate or a contractual rate and  $n$  would depend on the frequency of compounding. In order that  $n$  could be calculated consistently by all parties, it would be necessary to prescribe the frequency at which interest should be compounded.

8.41 The prescribed frequency could be annual, half-yearly, quarterly or monthly. The Law Commission's Consultation Paper *Compound Interest*<sup>47</sup> suggested that annual rests would be appropriate because it would simplify the calculation in long-running cases, ie in those cases in which compounding would have the greatest significance. Annual rests would also reflect the approach taken by the Lando Commission in *Principles of European Contract Law* which provides that interest be "added to the outstanding capital every 12 months".<sup>48</sup>

8.42 However, in the Report which followed the Consultation Paper, *Pre-judgment Interest on Debts and Damages*,<sup>49</sup> the Law Commission accepted the views of consultees that monthly compounding should be prescribed. Monthly compounding reflects current commercial practice and would be the frequency used by most lenders and investors. It also avoids the sudden jump in the amount of the debt which results from annual compounding.

8.43 We are provisionally of the view that monthly rests would be the best form of compounding. Whether a successful pursuer has had to borrow money to make up a shortfall or has lost an opportunity to invest in an interest bearing account, it is likely that that loss would have included monthly compounding. For ease of calculation, a computer program for calculation of interest could be made available on a public site on the internet for use not only by parties to litigation but to creditors calculating interest on debts in respect of which litigation is not, or not yet, in contemplation. An example of a program which, given the appropriate variables, calculates compound interest may be accessed on the website of the Scottish Law Commission.<sup>50</sup> Parties would not therefore have to calculate interest themselves although they would remain responsible for presenting figures to the court. The program would carry out the calculations using the prescribed formula thus reducing the potential for disputes. A set of printed tables could be made available in areas such as public libraries and court buildings for the use of parties who did not have access to the internet.<sup>51</sup> We would welcome views on the following question and proposal:

**43. (a) Should interest be compounded at monthly or annual intervals or any other period suggested by consultees?**

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<sup>47</sup> Consultation Paper No 167.

<sup>48</sup> *Principles of European Contract Law*, Part III (revd 2002) Art 17:101.

<sup>49</sup> Law Com No 287.

<sup>50</sup> [www.scotlawcom.gov.uk/html/calculator.htm](http://www.scotlawcom.gov.uk/html/calculator.htm). Further examples of online compound interest programs may be viewed at <http://allchin.net/converter/compoundinterest.html>

[www.kbapps.com/calculators/default.html](http://www.kbapps.com/calculators/default.html)

<http://javascript.internet.com/calculators/compound-interest.html>

[www.3pumpcourt.com/compound.html](http://www.3pumpcourt.com/compound.html)

<sup>51</sup> It should be noted that even if printed tables are updated frequently they would include a degree of approximation. For example, the tables might be updated every month with interest rates calculated as at the end of the previous month.

**(b) A computer program for calculating interest according to the prescribed formula should be made available free of charge on a website which can be accessed by the general public. Printed tables for the calculation of interest should be made available in appropriate places such as court buildings and public libraries.**

## Part 9           Tenders

9.1     As a general rule, a pursuer who obtains decree for payment of a sum greater than an amount tendered by the defender is entitled to an award of the whole expenses of process. Conversely, if the pursuer fails to beat the tender, an award of expenses from the date of the tender will normally be made in favour of the defender on the ground that the pursuer, by failing to accept the tender has unnecessarily prolonged the litigation. The Interest on Damages (Scotland) Act 1958, section 1(1B)<sup>1</sup> provides as follows:

"For the avoidance of doubt, it is hereby declared that where, in any action in which it is competent for the court to award interest under this Act, a tender is made in the course of the action, the tender shall, unless otherwise stated therein, be in full satisfaction of any claim to interest thereunder by any person in whose favour the tender is made; and in considering in any such action whether an award is equal to or greater than an amount tendered in the action, the court shall take account of the amount of any interest awarded under this Act, or such part of that interest as the court considers appropriate."

So far as we are aware the principle underlying this provision has not led to any difficulties. In practice, tenders are invariably calculated to take account of interest accrued to the date of the tender.

9.2     Section 1(1B) of the 1958 Act, quoted above, applies only to awards of interest "under this Act", ie to awards of interest on damages. We see no reason why its scope should not be extended to cover awards of interest on sums other than damages. We invite comment on the following proposal:

**44.     The principle to which section 1(1B) of the Interest on Damages (Scotland) Act 1958 gives effect should be retained and extended to awards of interest on sums other than damages.**

9.3     An important point of construction of section 1(1B) arose in the case of *Manson v Skinner*.<sup>2</sup> The pursuer was awarded damages of £2,800 for personal injuries. A tender of £3,000 had been lodged along with the defences. At that time the value of the award, with interest to date, would have been £2,992. By the date of decree the principal award together with interest amounted to £3,047. In the Second Division, section 1(1B) was described as "abridging" the general rule that a pursuer who obtains an award greater than the amount of the tender is entitled to the whole expenses of process. Delivering the opinion of the court, Lord Justice Clerk Gill observed:<sup>3</sup>

"The concluding words of [section 1(1B)] are clearly directed to a case such as this where the value of the award ultimately made exceeds the amount of the tender by reason only of the accrual of interest. If the pursuer had accepted the tender when it was made, she would have been at least as well off as she ultimately was. In our

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<sup>1</sup> As substituted by the Interest on Damages (Scotland) Act 1971.

<sup>2</sup> 2002 SLT 448.

<sup>3</sup> At 450.

view it is right to say in such a case that the refusal of the tender unnecessarily prolonged the proceedings to no purpose. These are the circumstances that Parliament seems to have envisaged in enacting s 1(1B)."

The defender was accordingly held entitled to expenses from the date of the tender.

9.4 The decision in *Manson v Skinner* provides an authoritative interpretation of section 1(1B) which seems to us to provide a fair and reasonable result. It is noteworthy that it has taken until 2002 for this construction to emerge. A contrary interpretation by Lord Morison in *Hodge v British Coal Corporation (No 3)*<sup>4</sup> was disapproved by the Inner House in *Manson v Skinner*. The sheriff principal in *Manson v Skinner* had decided the point in the pursuer's favour. In these circumstances we wonder whether the wording of section 1(1B) requires to be amended in order to make it more transparent in the light of the construction adopted in *Manson v Skinner*. We invite views on the following question:

- 45. Should section 1(1B) be re-enacted with amended wording in order to make clear that the statutory intention is in accordance with the interpretation given to the existing section by the Inner House in *Manson v Skinner*?**

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<sup>4</sup> 1992 SLT 1005.

## Part 10 Tribunals

10.1 The Annual Report of the Scottish Committee of the Council on Tribunals for 2003 listed 47 types of tribunals either operating in Scotland or which could, in theory at least, sit in Scotland. This number is growing as new legislation is passed.<sup>1</sup> The jurisdiction of most tribunals is administrative<sup>2</sup> and their decisions are rarely expressed as awards of sums of money. It is unusual for their procedural rules to make any provision for interest and at common law, even tribunals whose jurisdiction includes making awards of compensation or directing other forms of payment, have no power to award interest. The commencement of tribunal proceedings does not constitute a "judicial demand" and accordingly interest does not run from the date of such commencement.

10.2 There are some tribunals which are exceptional in that they make monetary awards and have statutory powers to award interest. Tribunals which sit in Scotland<sup>3</sup> and make monetary awards can be divided into two categories: those which have a specific power to award or refuse interest and those which simply apply legislation which includes an element of interest.

(a) *Tribunals with interest-awarding powers:*

- Employment Tribunals: an award carries interest at a prescribed rate if it remains unpaid 42 days after the date of sending the decision to the parties.<sup>4</sup> The prescribed rate is currently set at 8%, in line with the judicial rate.<sup>5</sup>
- The Lands Tribunal for Scotland: the Tribunal has power to determine that an award of compensation shall carry interest from the date of the award.<sup>6</sup> The Lands Tribunal is also empowered to award interest on payments for the loss of a farm from the date of displacement from the farm.<sup>7</sup>

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<sup>1</sup> For example, the Mental Health (Care and Treatment) (Scotland) Act 2003 establishes a Mental Health Tribunal for Scotland which has not yet been brought into operation.

<sup>2</sup> Except the Employment Tribunals, which hear disputes between parties and do not have an administrative jurisdiction.

<sup>3</sup> Some tribunals with interest-awarding powers may in theory sit in Scotland but in fact rarely or never do. The Copyright Tribunal has power when making certain orders and directions under its parent Act to award simple interest at such rate and for such periods as it thinks fit (s 151A Copyright, Designs and Patents Act 1988). The Competition Appeal Tribunal has the power to impose, confirm or vary any penalty imposed under the Competition Act 1998. It may order interest to be paid from such date as it considers appropriate although not from a date earlier than the date the application to the Tribunal was made. (The Competition Appeal Tribunal Rules 2003 (SI 2003/1372), rule 56(1)). If the Tribunal makes an award of damages it may include interest from the date when the cause of action arose (*ibid*, rule 56(2)).

<sup>4</sup> The Employment Tribunals (Interest) Order 1990 (SI 1990/479), art 2. See para 10.4 below regarding awards for discrimination cases.

<sup>5</sup> *Ibid* art 4. This provision applies the rate specified in s 17(1) of the Judgments Act 1838.

<sup>6</sup> Law Reform (Miscellaneous Provisions) (Scotland) Act 1980, s 18. Interest is awarded at the judicial rate.

<sup>7</sup> The Land Compensation Act 1973, ss 34, 36, which applies the rate specified in the Land Compensation Act 1961, s 32.

(b) *Tribunals applying legislation where interest is specified:*

- **Social Security Tribunals:** the Unified Appeals Tribunal<sup>8</sup> is a body established to hear appeals of any decision, or review of a decision, made by the Secretary of State regarding any "relevant benefit".<sup>9</sup> Further appeal lies to a Social Security Commissioner on the ground that the tribunal decision was erroneous on a point of law.<sup>10</sup> The Social Security Tribunals have no general power to award interest in situations of over or underpayment of benefits. However, interest is awarded where the legislation applicable to a particular benefit specifies that interest should be added.<sup>11</sup>
- **Tax Tribunals:** such as the VAT and Duties Tribunals for Scotland, the General Commissioners of Income Tax and the Special Commissioners for Income Tax, have no general procedural power to award interest. Awards made by these tribunals only include interest as specified under various tax statutes, according to rates set under section 178 of the Finance Act 1989.<sup>12</sup>

10.3 With one exception it is proposed that the statutory powers of tribunals to award interest should be excluded from the scope of the reforms proposed in this paper. In many cases the existing regulation has been tailored to suit the particular type of claim and the variety of claims suggests that a "one size fits all" approach is not appropriate. Some of the tribunals have a UK-wide jurisdiction and it would generally be difficult to justify the existence of different rules as between Scotland on the one hand and England and Wales or Northern Ireland on the other.

10.4 The exception is where the existing legislation specifies a rate of interest which is related to the current judicial rate for periods prior to the date of the award. An example can be found within the jurisdiction of the Employment Tribunals. The Employment Tribunals (Interest on Awards in Discrimination Cases) Regulations 1996<sup>13</sup> confer power on an Employment Tribunal to award simple interest on compensation for discrimination on the grounds of sex, race, disability, sexual orientation, religion or belief,<sup>14</sup> from certain specified

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<sup>8</sup> Created by Part I s 4 Social Security Act 1998, consolidating Part II Social Security Administration Act 1992; s 21 Child Support Act 1991 and s 4 Vaccine Damage Payments Act 1979.

<sup>9</sup> Social Security Act 1998 s 8 defines a "relevant benefit" as those benefits named in Parts II to V of the Contributions and Benefits Act 1992; jobseeker's allowance; income support; family credit; disability working allowance; a social fund payment mentioned in s 138(1)(a) or (2) of the Contributions and Benefits Act 1992; child benefit or such other benefit as may be prescribed. See also s 12 of the Social Security Act 1998 which includes statutory sick pay or statutory maternity pay as relevant benefits.

<sup>10</sup> S 14 Social Security Act 1998. See also Social Security Commissioners (Procedure) Regulations (SI 1999/1495) and the Social Security Commissioners (Procedure) (Amendment) Regulations (SI 2001/1095) for further details of the procedure.

<sup>11</sup> See for example s 57(7B)(2) of the Social Security Act 1998 which amends Sch 1 of the Contributions and Benefits Act 1992 to provide for interest to be paid to the Secretary of State on employee pension contributions which have not been paid by the due date. Interest is chargeable at the rate prescribed in s 178 of the Finance Act 1989 from the "reckonable date" until payment. See also s 37 of the Tax Credit Act 2002 which provides for interest to be applied in situations where a tax credit has been overpaid to an individual, which is attributable to fraud or neglect of behalf of the claimant. The Tax Credit (Interest Rate) Regulations 2003 (SI 2003/123), regulation 2, provides that the established rate is 6.5% per annum.

<sup>12</sup> The rates are specified in the Taxes (Interest Rate) Regulations 1989 (SI 1989/1297).

<sup>13</sup> SI 1996/2803.

<sup>14</sup> The awards made under the Equal Pay Act 1970, the Sex Discrimination Act 1975, the Race Relations Act 1976 and the Disability Discrimination Act 1995. The regulations apply to discrimination on the grounds of sexual orientation by virtue of the Employment Equality (Sexual Orientation) Regulations 2003 (SI 2003/1661) and to discrimination on the grounds of religion or belief by virtue of the Employment Equality (Religion or Belief) Regulations 2003 (SI 2003/1660).

dates prior to the date of the award. The rate of interest specified (subject to an overriding discretion which may be exercised in exceptional circumstances) is the rate fixed for the time being for sheriff court decrees: in other words, the judicial rate. It seems to us that if the judicial rate is no longer to be used prior to decree in court actions or if the judicial rate is amended according to the principles in this paper, it would be anomalous to continue to use it prior to award in discrimination claims to an Employment Tribunal.

10.5 In non-discrimination cases within the jurisdiction of the Employment Tribunal, interest runs on a pecuniary award from a date 42 days after the date of the Tribunal's determination.<sup>15</sup> The rate of interest stipulated (for Scotland as well as for England and Wales) is the rate specified in section 17 of the Judgments Act 1838.<sup>16</sup> This entitlement would be superseded to some extent by our proposal that arrears of income from employment should carry statutory interest.<sup>17</sup> However it will remain applicable to other claims, such as claims for damages consisting of wages lost as a result of unfair dismissal. It may be regarded as anomalous that Tribunal claimants must wait until 42 days after determination of their claim for interest to begin to run whereas pursuers in court actions are, under the present law, entitled to interest from the date when the right of action arose and, under our proposals, would be entitled to interest from the date when the loss is sustained. The anomaly is perhaps less apparent in practice as a consequence of the comparative speed with which claims to the Employment Tribunal are made and disposed of. We make no proposal in this regard but invite comment as to whether Tribunal claimants should be entitled to interest on awards of damages from a date earlier than that presently specified by the 1990 Order.

10.6 We would welcome views on the following proposals and question:

- 46. (a) Where a tribunal presently has power to award interest at the judicial rate, this should be replaced by a power to award interest at the rate prescribed by statute.**
- (b) Should interest run on awards made by the Employment Tribunal from an earlier date than 42 days after the date of the Tribunal's determination?**
- (c) In all other respects, the powers of particular tribunals to award interest should remain unaffected by our proposals.**

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<sup>15</sup> Employment Tribunals (Interest) Order 1990 (SI 1990/479).

<sup>16</sup> *Ibid* art 4. The rate under s 17 is presently the same as the judicial rate in Scotland.

<sup>17</sup> See para 4.24.

# Part 11 Arbitration, Adjudication and other forms of Dispute Resolution

## Introduction

11.1 The terms of our reference include "claims... submitted for decision to arbitration, adjudication or some other form of dispute resolution". Except in cases where a statutory provision requires a dispute to be submitted to arbitration<sup>1</sup> or adjudication,<sup>2</sup> the resolution of disputes by a means other than litigation depends upon the parties to the dispute having agreed that it should be resolved in this manner. It is therefore open to the parties to agree what powers, if any, the person to whom the dispute has been submitted should have with regard to the award of interest. The principal questions which we have sought to address in this Discussion Paper are, firstly, whether extra-judicial decision-makers should have power to award interest in the absence of express agreement; and, secondly, if so, whether those powers should be broadly equivalent to those available to the courts or, alternatively, whether extra-judicial decision-makers should be afforded a wider discretion.

## Arbitration

11.2 It is common practice for deeds of appointment of arbiters to make express provision with regard to their power to award interest, for example a power to award interest from such date and at such rates as the arbiter may see fit. We are not aware of there being any difficulties in relation to arbitration awards where such a power is expressly conferred.

11.3 Another possibility is that the claimant's entitlement to interest is itself referred to arbitration as occurred (by implication) in *Farrans (Construction) Ltd v Dunfermline District Council*<sup>3</sup> and (by express provision) in *Elliott v Combustion Engineering Ltd*.<sup>4</sup> In these cases the court held that the arbiter's duty was to apply the general law on entitlement to interest and, in particular, to determine the date from which it could be said that sums successfully claimed had been wrongfully withheld according to the current law. Again, we see no need to make express provision for such referrals. If the law on interest were to be amended in the manner we propose, the arbiter's duty would be to award interest in accordance with the law as amended. The concerns expressed by the Extra Division in *Elliott v Combustion Engineering Ltd*<sup>5</sup> would be met.

11.4 It remains to consider the situation where an arbiter or adjudicator is appointed to resolve a dispute regarding a principal sum claimed and there is no express power conferred to award interest. In *John G McGregor (Contractors) Ltd v Grampian Regional Council*,<sup>6</sup> the Second Division held that an arbiter has no implied power to award interest for any period

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<sup>1</sup> See paras 11.8-11.9.

<sup>2</sup> See para 11.10.

<sup>3</sup> 1988 SC 120.

<sup>4</sup> 1997 SC 126.

<sup>5</sup> See para 1.2.

<sup>6</sup> 1991 SLT 136.

prior to the date of his final decree. In so holding, the court disapproved a statement to the contrary in *Irons & Melville*.<sup>7</sup> This decision has been criticised by Professor John Murray<sup>8</sup> as being contrary to what had been the understanding of Scottish practitioners as well as the law in England, Australia and New Zealand. Professor Murray points out that if the claimant had first raised a court action for payment and then sisted it for arbitration, he would have been able to obtain interest on the arbitration award from the date of citation in the court action. We agree that this is an unsatisfactory situation.

11.5 Scots law lacks a comprehensive statutory code for arbitration which would apply in the absence of agreement to the contrary. It may be that if such a code existed, it would include express provision in relation to the award of interest. The question arises whether, in the absence of a comprehensive code, we should consider whether or not an arbiter should have a power to award interest.

11.6 It is notable that no express provision regarding interest is contained in the UNCITRAL Model Law (which has the force of law in Scotland with regard to international commercial arbitrations) or in the Rules of Arbitration of the International Chamber of Commerce or in the Arbitration Rules of the Law Society of Scotland. On the other hand, express provisions granting wide powers to award interest are included in the Scottish Arbitration Code 1999<sup>9</sup> and in the London Court of International Arbitration Rules.<sup>10</sup> In 1996, the Scottish Advisory Committee on Arbitration Law produced a draft Arbitration (Scotland) Bill which, if enacted, would have applied to proceedings where the seat of the arbitration is in Scotland. A revised version of the draft Bill was published in 2003. Clause 22(1) of the revised draft provides:

"In addition to the powers conferred generally or specifically on the tribunal elsewhere in this Act, the tribunal has the following powers (unless the parties otherwise agree):

...

(d) Power to order that simple or compound interest shall be paid by any party on any sum awarded at such rate or rates and with such rests as the tribunal determines to be appropriate without being bound by legal rates of interest imposed by any State, court or any agreement between the parties in respect of any period which the tribunal determines to be appropriate including a date prior to the appointment of the tribunal and ending not later than the date upon which the award was complied with."

It will be noted that the power which the clause would have granted to arbiters differs from the statutory scheme which we are proposing in that the clause confers a wide *discretion* upon an arbiter to award interest or not as he sees fit.

11.7 Standing the decision in *John G McGregor (Contractors) Ltd v Grampian Regional Council*,<sup>11</sup> it appears that the conferring of a "default" power on arbiters to award interest prior to the date of decree would require legislative intervention. However, it might be regarded as unsatisfactory to make specific statutory provision for one aspect of an arbiter's

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<sup>7</sup> *Irons & Melville, Treatise on the Law of Arbitration in Scotland* (1903), p 219.

<sup>8</sup> "Interest on Debt" 1991 SLT (News) 305, 310-11.

<sup>9</sup> Article 16(5). The Code was prepared by the Scottish Council for International Arbitration, the Chartered Institute of Arbitrators (Scottish Branch) and the Scottish Building Contract Committee.

<sup>10</sup> Article 26(6).

<sup>11</sup> 1991 SLT 136.

powers while everything else remains regulated in the absence of agreement by the common law. It might also be regarded as anomalous for an arbiter to be granted a wide statutory discretion to award interest from such dates, at such rates and with such rests as he thinks fit, if the scope of judicial discretion in relation to the award of interest in court actions is restricted. If arbiters were given statutory powers which simply mirrored those available to the courts, it would remain open to the parties to agree to confer a wider discretion. On the other hand, it might be regarded as in keeping with the flexibility of the arbitration process that the "default" statutory power to award interest should be a matter of broad discretion. We invite views on the following questions:

- 47. Should the proposed legislative reform of the law on interest on debt and damages include a provision conferring, in the absence of contrary agreement, a power on the arbiter or adjudicator to award interest for a period prior to the date of the award or should this be left to await the enactment of a comprehensive statutory arbitration code?**
- 48. If arbitration is included in the proposed legislative reform,**
- (a) should the arbiter's power to award interest be co-extensive with the powers which the court would have in relation to interest (on the various categories of pecuniary claims) under the proposed new legislation; or, alternatively,**
- (b) should the arbiter's power be exercisable on the basis of a wide discretion such as that contained in Clause 22 of the Scottish Advisory Committee's draft Bill?**

11.8 In addition to arbitration agreements at common law, there are a number of statutory regimes which provide that disputes must be referred to arbitration. These are discussed by Professor Fraser Davidson in his work on *Arbitration*.<sup>12</sup> They include the following in which the dispute may lead to the making of a pecuniary award:

- Questions arising between the landlord and tenant of an agricultural holding.<sup>13</sup>
- Apportionments of milk quota under the Dairy Produce Quotas Regulations 1997.<sup>14</sup>
- A dispute relating to a compensation order under Part II of the Industry Act 1975 (which empowers the Secretary of State to acquire the capital or assets of an "important manufacturing undertaking" which would otherwise pass to a person resident outside the United Kingdom).<sup>15</sup>
- Various disputes arising under legislation relating to the acquisition of companies by British Shipbuilders.<sup>16</sup>

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<sup>12</sup> F Davidson, *Arbitration* (1<sup>st</sup> edn, 2000).

<sup>13</sup> Agricultural Holdings (Scotland) Act 1991, s 60 and Sch 8.

<sup>14</sup> SI 1997/733, Sch 3.

<sup>15</sup> Industry Act 1975, s 20 and Sch 3.

<sup>16</sup> Aircraft and Shipbuilding Industries Act 1977, s 42 and Sch 7.

- Questions arising with regard to coal mining subsidence.<sup>17</sup>
- Disputes regarding compensation for unnecessary seizure of goods under legislation such as the Food Safety Act 1991,<sup>18</sup> or for other unjustified official action.<sup>19</sup>
- Disputes regarding compensation for losses arising out of transfers of property to public bodies<sup>20</sup> or arising out of the exercise of official functions by public bodies.<sup>21</sup>

11.9 Most of these provisions are in a standard format requiring the dispute to be submitted to an arbiter selected by a specified individual such as the Lord President of the Court of Session. None contains any express power to award interest on any sum which the arbiter finds to be payable. It seems to us to be appropriate that an arbiter appointed under one of these provisions should, in the absence of agreement to the contrary, have the same power in relation to the awarding of interest as an arbiter appointed under an arbitration agreement which is silent as to power to award interest. We therefore propose:

- 49. An arbiter appointed under a statutory provision requiring a dispute to be referred to arbitration should have the same "default" power in relation to the award of interest as an arbiter appointed under an arbitration agreement.**

## Adjudication

11.10 The Housing Grants, Construction and Regeneration Act 1996 established a regime known as adjudication for the resolution of disputes arising under construction contracts. In contrast to the position in Scots law regarding arbitration, the Schedule to the Scheme for Construction Contracts (Scotland) Regulations 1998<sup>22</sup> contains detailed rules for the conduct of adjudication. So far as interest is concerned, paragraph 20(2) of the Scheme provides:

"(2) The adjudicator may take into account any other matters which the parties to the dispute agree should be within the scope of the adjudication or which are matters under the contract which he considers are necessarily connected with the dispute and, in particular, he may -

... (c) having regard to any term of the contract relating to the payment of interest, decide the circumstances in which, the rates at which, and the periods for which simple or compound rates of interest shall be paid."

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<sup>17</sup> Under the Coal Mining Subsidence (Arbitration Schemes) Regulations 1994 (SI 1994/2566).

<sup>18</sup> Fair Trading Act 1973, s 32(2); Energy Conservation Act 1981, s 24(2); Consumer Protection Act 1987, ss 14(8), 34(2); Food Safety Act 1990, ss 9(8), 12(10).

<sup>19</sup> See eg Health Services and Public Health Act 1968, s 71(2), (compensation for stopping work to prevent the spread of disease); Road Traffic Act 1988, s 78(6), (compensation for the cost of taking a vehicle to a weighbridge); Environmental Protection Act 1990, s 43(7) (compensation for immediate suspension of a waste management licence).

<sup>20</sup> Eg National Parks and Access to the Countryside Act 1949, s 18(3); Transport Act 1968, Sch 4, para 13(3); Ordnance Factories and Military Services Act 1984, Sch 1, para 2(5); Further and Higher Education (Scotland) Act 1992, Sch 3, para 6(4); Coal Industry Act 1994, Sch 2, para 8(6); Atomic Energy Authority Act 1995, Sch 1, para 10(6); Broadcasting Act 1996, Sch 5, para 8(6).

<sup>21</sup> Eg Civil Aviation Act 1982, s 47(9); New Roads and Street Works Act 1991, ss 133(2), 158; Environment Act 1995, Sch 18, para 6; Water Industry (Scotland) Act 2002, Sch 2, para 6.

<sup>22</sup> SI 1998/687.

This provision confers a wide power on adjudicators in relation to the award of interest which is applicable whether or not the parties' contract contains any term relating to the payment of interest. We are not aware of any practical difficulty arising out of it. In the absence of such difficulty, there seems to be no reason to propose any legislative amendment. We invite views on the following question:

**50. Is any amendment required to the existing statutory provisions regarding the power of an adjudicator to award interest?**

**Other forms of dispute resolution**

11.11 Not all modes of dispute resolution culminate in the making of a pecuniary award in favour of one of the parties. A power to award interest is necessary only in proceedings which are quasi-judicial in nature, ie where a person is appointed by the parties for the primary purpose of making a decision which will be binding upon them. It seems unlikely, therefore, that questions regarding awards of interest would arise in proceedings such as mediation and conciliation where the function of the person appointed is to promote a consensual resolution of the dispute. There exist hybrid procedures containing features of both arbitration and mediation. If the outcome of a procedure of this type were to be the making of an arbitration award, it seems appropriate for any new legislative provision regarding arbiters to apply. On the other hand, if the outcome is a consensual resolution, there is no need for any legislative intervention as regards interest.

11.12 It would be difficult to anticipate in a statutory provision all the forms which dispute resolution might take. Our provisional view is that it would be unwise to extend the proposed statutory entitlement to interest beyond the methods of dispute resolution presently available which lead to a judicial or quasi-judicial determination of the parties' respective rights and obligations, namely litigation, arbitration and adjudication. However, we would welcome comments in response to the following question:

**51. In addition to litigation, arbitration and adjudication, is there any form of dispute resolution in respect of which statutory provision would be desirable with regard to entitlement to interest on a sum found to be payable by one party to another?**

# Part 12      Transition

## Introduction

12.1 Transition to the proposed new regime requires the balancing of competing policies. On the one hand, legitimate expectations acquired under the existing regime should not readily be disturbed. On the other hand, it would be inconvenient to maintain two parallel regimes of entitlement to interest in existence during an extended period of time. It might also be argued that if, as we believe, the proposed new system would represent a significant improvement upon the existing law, that benefit should be generally available as soon as possible. One method of minimising retrospective application of the new law would be to delay its commencement for a period after the date of Royal Assent.

## Contractual debts

12.2 The following options exist for the application of a new entitlement to statutory interest to contractual debts:

- (i) all obligations to pay which are created on or after the commencement date;
- (ii) all debts which become due on or after the commencement date;
- (iii) all actions for payment<sup>1</sup> raised on or after the commencement date;
- (iv) all decrees for payment granted on or after the commencement date.

12.3 Of these options, the first is the only one which avoids entirely any element of retrospective application. In all the others, an entitlement to interest is created which did not exist at the time when the parties entered into their contract. The Late Payment of Commercial Debts (Interest) Act 1998<sup>2</sup> "does not affect contracts of any description made before this Act comes into force for contracts of that description", thus effectively adopting option (i). The principal disadvantage of option (i) is that the period of transition for the new regime would be prolonged, perhaps for many years, during which contracts in existence prior to the commencement date continue to run.<sup>3</sup>

12.4 It seems to us to be arguable that no real issue of retrospection arises under option (ii). Parties do not (or at least should not) enter into a contract with a view to the benefit, if any, which they may obtain by failing to implement it. Accordingly, the choice of option (ii) ought not to affect decisions taken or courses of conduct entered into in reliance upon the existing law. It may be regarded as sufficient to avoid retrospection if the consequences of a breach of contract are determined according to the law as it stands at the time when the breach occurs rather than when the parties entered into the contract. The advantage of

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<sup>1</sup> Including claims to tribunals and claims in arbitration.

<sup>2</sup> S 17(4).

<sup>3</sup> There is also an argument against option (i) based on a desire for consistency, since, as noted in para 12.7 below, option (i) could not apply to non-contractual debt.

adopting this option would be that it would bring within the scope of the new scheme existing contracts of long duration which might otherwise remain outside it for many years.

12.5 Option (iii) has a real element of retrospection: it would mean that a debtor who was in default would be worse off on the commencement day than he had been on the day before. The principal advantage of option (iii) (in addition to those of option (ii)) would be one of consistency: prior to the commencement date, interest would run in most actions (in absence of contrary stipulation) from the date of citation; after the commencement date, interest would run from the date when payment was due. It might be thought that this degree of retrospectivity is an acceptable price to pay for a clean and speedy transition. It must be borne in mind, however, that we are proposing to create a statutory entitlement to interest which does not depend upon the raising of proceedings.<sup>4</sup> If, therefore, option (iii) were to be preferred, it would require to be expressed negatively: in other words, the new scheme would not apply to debts in respect of which an action had been raised prior to the commencement date.

12.6 Option (iv) has found favour in law reform elsewhere.<sup>5</sup> It has the advantage of simplicity where the underlying legislative scheme is one of "deferred entitlement",<sup>6</sup> but is less easily adapted to the system of "immediate entitlement" which we propose. The alternative of negative expression which could be used for option (iii) could not be used with option (iv). More importantly, it would affect the rights of parties to existing litigation and in particular could cause tenders which had been lodged on the basis of the existing law to become unprotective. Our provisional view is that this option should be rejected.

### **Non-contractual debts**

12.7 The options for commencement in relation to non-contractual debts are the same as for contractual debts with the exception of option (i) which has no counterpart. The arguments set out above for and against the other options apply *mutatis mutandis* to non-contractual debts.

### **Damages**

12.8 The options for commencement in relation to claims for damages are:

- (i) all rights of action arising on or after the commencement day;
- (ii) all actions raised on or after the commencement day;
- (iii) all decrees granted on or after the commencement day.

12.9 As with interest on debt and damages, retrospective effect can be avoided entirely only by option (i). Its disadvantage would be that two regimes would exist side by side for many years until all actions arising out of events occurring before the commencement date had been completed. Option (ii) would also result in parallel regimes existing for a period. But the degree of retrospectivity arising out of the application of the new legislation to rights

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<sup>4</sup> I.e. a system of "immediate entitlement": see paras 4.3-4.8.

<sup>5</sup> Eg British Columbia: Court Order Interest Act 1996, s 6; New Brunswick: Judicature Act (RSNB 1973, cJ-2), s 46(3).

<sup>6</sup> I.e. where entitlement to interest is based upon an action for payment having been raised: see paras 4.3-4.8.

of action accruing prior to its commencement may be regarded as acceptable: the substantive reform which we are proposing in relation to damages is not radical and, unlike interest on debt, interest on damages already runs prior to the date of commencement of the action under the present law. This option was adopted in the Interest on Damages (Scotland) Act 1958.<sup>7</sup> Option (iii) seems to us to be more attractive in relation to damages than in relation to debt because it could be expressed negatively (as in the 1958 Act). It would, however, affect the rights of parties to pending court proceedings. As with actions for payment, it could cause tenders to become unprotective although, given the current rate of judicial interest, this seems unlikely.

## **Conclusion**

12.10 There would be advantages of consistency in having the same commencement date in relation to all types of pecuniary claim, whether for debt or for damages. The two options which could achieve such consistency are (i) to provide for the Act to apply to all debts falling due or, as the case may be, rights of action arising, on or after the commencement date; or (ii) to provide for the Act to apply immediately to all claims except those in respect of which an action has been raised prior to the commencement date. If consistency as between debt and damages were not regarded as crucial, one or other of these two options could be used for debts but the new Act could apply immediately to all claims for damages, regardless of whether proceedings had been raised. A further possibility would be to amend the law with regard to *rates* of interest with immediate effect for all pecuniary claims<sup>8</sup> but to apply one of the other options to the substantive changes in the law which we have proposed. We would welcome responses to the following question:

**52. Should the new provisions apply:**

- (a) to all debts falling due and all rights of action arising on or after the commencement date; or**
- (b) to all pecuniary claims except those in respect of which an action has been raised prior to the commencement date; or**
- (c) on some other basis?**

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<sup>7</sup> S 3(3): "This Act ...shall not apply to any action commenced against any person before the passing of this Act".

<sup>8</sup> As presently occurs when the judicial rate of interest is changed.

## Part 13 List of Proposals and Questions

1. (a) So far as practicable, interest should run on pecuniary claims during the same period and at the same rate regardless of whether the claim takes the form of a claim for payment of a contractual debt, a non-contractual debt or damages.  
  
(b) The primary goal of an award of interest should be the realistic compensation, in commercial terms, of the creditor for loss of the use of money or property. Interest should not as a general rule be payable at a punitive rate.  
  
(c) An award of interest should compensate the creditor for loss of the use of money or property throughout the period during which that loss has subsisted.

(Paragraph 3.6)

2. There should be created a general statutory entitlement to interest on contractual debts except where an entitlement to interest is conferred or expressly excluded either (a) by the terms of the contract itself or (b) by any other statutory provision.

(Paragraph 4.8)

3. As a general rule, interest on a debt arising under a contract should run from the date when payment is due by the debtor.

(Paragraph 4.14)

4. Statutory interest should run on a debt due for the supply of goods or services from the following date:

Where the parties agree a date for payment of the debt (whether fixed or dependent upon the happening or non-happening of an event), that date;

In any other case, 30 days after the later of:

- the day on which the supplier's obligation is performed; and
- the day on which the purchaser has notice of the amount of the debt or of the amount claimed by the supplier.

(Paragraph 4.17)

5. Should the entitlement to statutory interest extend to all circumstances in which the purchaser of property (whether heritable or moveable) has been granted possession without payment of the price to the seller, except during any period when the price has been consigned at an appropriate rate of interest?

(Paragraph 4.20)

6. Interest should run on arrears of rent and other sums payable by a tenant to a landlord as it runs on other sums which have fallen due for payment.

(Paragraph 4.22)

7. Statutory interest should run on a contractual debt even where the amount of the debt, if found to be due, remains unascertained pending determination by a third party.

(Paragraph 4.23)

8. (a) Statutory interest should run on sums due under a contract of employment or apprenticeship.

(b) Unless the contract contains a contrary provision, interest should run from the last day of the month following the month in which the service under the contract was performed.

(c) Entitlement to interest should not be deferred by virtue of there having been no agreement as to the amount due under the contract.

(Paragraph 4.25)

9. Statutory interest should run on a sum paid by a cautioner in satisfaction of a debt due by the principal debtor from the date when payment by the cautioner was made.

(Paragraph 4.26)

10. Where a contract of insurance or indemnity contains no express provision with regard to the running of interest, it should begin to run from whichever is the later of:

(a) the date 30 days after the date when a claim in respect of the occurrence of the event insured against is intimated to the insurer; and

(b) where the insured has sustained a loss as a consequence of the occurrence of the event insured against, the date when the loss was sustained.

(Paragraph 4.29)

11. A debt shall not carry interest under the proposed new scheme if or to the extent that it consists of a sum in respect of which a creditor has elected to claim interest under the Late Payment of Commercial Debts (Interest) Act 1998.

(Paragraph 4.31)

12. There is no need for statutory provision to prohibit parties from contracting out of the creditor's entitlement to interest under the proposed new legislation.

(Paragraph 4.37)

13. (a) There should be no judicial discretion to remit interest;

(b) There should be a judicial discretion to remit interest where the interests of justice so require, but only by reason of any conduct of the creditor (as in the 1998 Act); or

(c) There should be a wide judicial discretion to remit interest in any circumstances where the interests of justice so require.

(Paragraph 4.46)

14. Where a loan carries interest as a matter of common law presumption, should there be a rebuttable presumption that interest runs at the rate prescribed for statutory interest?

(Paragraph 4.51)

15. In the absence of agreement to the contrary, statutory interest should run on a loan of money from the date agreed by the parties for repayment of the loan or, failing such agreement, from the date 30 days after the day when the creditor demands repayment of the loan.

(Paragraph 4.52)

16. Statutory interest should run on funds held by one person on behalf of another from the date when the holder is in default in failing to make them over to the person entitled to them.

(Paragraph 4.54)

17. Is it desirable for the law relating to interest on damages to be re-formulated by statute?

(Paragraph 5.2)

18. In an action for damages, interest should run on each head of loss from the date on which the loss in question was sustained.

(Paragraph 5.7)

19. (a) Interest on pecuniary losses consisting of out-of-pocket expenses should run from the date when the expense in question was incurred.

(b) No special provision is required in relation to losses accruing periodically during the time since the date of the event giving rise to the claim.

(Paragraph 5.11)

20. If the principle which we have proposed were to be adopted, is there a need to specify by statute that the loss which is compensated by an award of solatium is sustained throughout the period during which the effect of the event giving rise to the claim endures, and is not sustained wholly on the date when the event occurs?

If so, how might this best be done?

(Paragraph 5.12)

21. (a) Where loss is sustained as a consequence of the loss or destruction of an item of property which is replaced, the loss should be taken to occur on the date when expense is incurred on replacement.

(b) Where loss is sustained as a consequence of the loss or destruction of an item of property which is not replaced and which consists of a loss of proceeds of realisation of the item, the loss should be taken to occur at the time of loss or destruction but any lost profit on realisation should not be taken to have occurred until the date when the proceeds would have been received.

(c) Where loss is sustained as a consequence of the loss or destruction of an item of property which is not replaced and which was not intended for realisation, the loss should be taken to occur at the time of loss or destruction.

(d) If these proposals are adopted, is there a need for express statutory provision setting them out, or could they be regarded as following naturally from the principle that interest runs from the time when loss is sustained?

(Paragraph 5.18)

22. Where a defender makes a payment to the pursuer in part satisfaction of his liability, the amount on which interest is calculated after the date of such payment should be reduced by the amount of the payment.

(Paragraph 5.20)

23. (a) There should be no judicial discretion to remit interest on damages;
- (b) There should be a judicial discretion to remit interest on damages where the interests of justice so require, but only by reason of any conduct of the pursuer;
- (c) There should be a judicial discretion to remit interest in any other particular circumstances (which would be specified in the legislation); or
- (d) There should be a wide judicial discretion to award or disallow interest as the interests of justice require.

(Paragraph 5.27)

24. (a) Should the new statutory scheme extend to claims for payment based upon the law of unjustified enrichment?

(b) If so, should the date when interest begins to run be the date when payment fell due by the debtor to the creditor, or should some other criterion be used instead?

(c) Is there a need for a judicial discretion which would operate either

(i) instead of the general rule proposed in Question 24(a);

(ii) alongside the general rule proposed in Question 24(a), but without restriction on the scope of the discretion;

(iii) alongside the general rule proposed in Question 24(a), and restricted to taking account of the conduct of the pursuer; or

(iv) in some other way?

(Paragraph 6.11)

25. (a) Should the new statutory scheme extend to claims for payment for salvage services?

(b) If so, should the date when interest begins to run be the date when the salvage services are completed or some other date?

(Paragraph 6.13)

26. There should be an express exclusion from the new statutory scheme in respect of interest on claims on limitation funds established under the Merchant Shipping Acts or similar legislation.

(Paragraph 6.14)

27. (a) Should the new statutory scheme extend to claims for payment based upon an obligation to account for funds in circumstances where the obligation is non-contractual?

(b) If so, should interest run only from the date when the holder is in default in failing to make over the funds to the person entitled to them?

(c) Should the new scheme extend to beneficiaries' claims arising out of late payment by trustees or executors, imposing personal liability on the trustee or executor for the difference between statutory interest and the interest actually earned?

(d) Is there a need for a judicial discretion and, if so, at what rate and during which period?

(Paragraph 6.22)

28. (a) Should the new statutory scheme extend to claims for sums due by way of legal rights in a deceased person's estate, from the date when the executor is in default in failing to make payment to the person claiming legal rights?

(b) Is there a need for a judicial discretion as to whether to award interest and, if so, at what rate and during which period?

(Paragraph 6.24)

29. (a) Should an award of aliment which has been backdated carry interest from the date or dates when the instalments ought to have been paid?

(b) If so, is there a need for a judicial discretion as to whether to award interest and, if so, during which period?

(Paragraph 6.25)

30. (a) Should arrears of aliment carry interest from the date or dates when they ought to have been paid?

(b) If so, is there a need for a judicial discretion as to whether to award interest and, if so, during which period?

(Paragraph 6.26)

31. There should be a prescribed rate of interest which would fluctuate according to the Bank of England base rate. We propose that the rate of interest prescribed by statute should be a specified percentage, such as 1% or 1.5%, above the official dealing rate of the Bank of England.

(Paragraph 7.21)

32. Is there another rate which would be better than the Bank of England base rate as the basis of the prescribed rate?

(Paragraph 7.21)

33. (a) A fixed interest rate would be prescribed by statutory instrument at pre-set periods. The rate prescribed would be calculated according to a formula set out in primary legislation but the statutory instrument would specify only the rate produced by this calculation on a given date.

(b) Views are also sought on whether the rate should be fixed annually, every six months, every month, or such other periods as consultees may wish to suggest.

(Paragraph 7.22)

34. (a) If a rate of interest is prescribed by legislation, should there be judicial discretion to apply a rate other than the prescribed rate?

(b) If there is to be judicial discretion to apply a rate other than the prescribed rate, comments are sought on whether discretion should be limited to applying a lower rate than the one prescribed and should not extend to applying a higher rate.

(Paragraph 7.32)

35. (a) Where a party seeks an award in a currency other than sterling, and the award includes an element of interest, should the party be entitled to interest at a rate referable to the currency of the principal sum?

(b) Where an award is made in a currency other than sterling, should the court have a broad discretion to award interest at a rate other than the prescribed rate?

(Paragraph 7.35)

36. (a) There should be a preferred method for dealing with changes to the rate of interest. The most accurate method would be to apply the fluctuating prescribed rate to the appropriate period of the debt or sum due in damages.

(b) Should there continue to be judicial discretion to apply different methods to different circumstances?

(Paragraph 7.38)

37. Interest:

(a) on sums due post-decree should continue to run at a rate to be prescribed in rules of court independently of the rate applicable to pre-decree interest.

(b) on sums due post-decree should run on the same basis as sums due pre-decree and the applicable rate post- and pre- decree should be standardised and calculated by the same method. The amount of pre-decree interest would be fixed at the date of the award and post-decree interest would then run on that sum until payment.

(c) should run from the appropriate date until payment regardless of whether it is pre- or post- decree and the same rate and method of calculation should apply throughout this period.

(Paragraph 7.51)

38. (a) Should post-decree interest run at a higher rate than pre-decree interest in order to penalise late payment?

(b) If post-decree interest should run at a higher rate, should the higher rate be linked to the formula for determining pre-decree interest (ie if pre-decree interest is 1% above base, post-decree interest could be 2% above base)?

(c) If post-decree interest is to run at a higher rate, should there be a period allowed before the higher rate is applied (for example, 14 days after decree)?

(d) If pre-decree interest is compounded, should post-decree interest also be compounded?

(Paragraph 7.52)

39. (a) Where a statute currently provides for interest to run at the post-decree rate, should interest run at the statutory rate which we have proposed or (if different) should it continue to run at the rate applicable after decree?
- (b) Where a statute currently provides for interest to run without specifying the rate, should interest run at the statutory rate which we have proposed or (if different) should it run at the rate applicable after decree?
- (c) Are there any statutes which currently provide for interest to run at a rate other than the post-decree rate which should be amended to provide for interest to run at the statutory rate which we have proposed or alternatively (if different) at the rate applicable after decree?
- (Paragraph 7.61)
40. Are there any other rates of interest specified in statutory provisions which ought to be brought into line with the statutory rate which we are proposing in this Discussion Paper for contractual and non-contractual debts and damages?
- (Paragraph 7.62)
41. If legislation is enacted specifying a rate of interest, it should allow for that interest to be compounded at specified intervals.
- (Paragraph 8.38)
42. (a) Whether there should remain a judicial discretion to refuse compound interest where it would be just to do so.
- (b) If judicial discretion is retained, should it be restricted to allowing simple rather than compound interest or should there be judicial discretion to allow compounding at a different frequency from the recommended period?
- (c) Whether the pursuer should retain a right to claim simple interest provided that the sum claimed is less than would be claimed if compound interest were applied.
- (Paragraph 8.39)
43. (a) Should interest be compounded at monthly or annual intervals or any other period suggested by consultees?

(b) A computer program for calculating interest according to the prescribed formula should be made available free of charge on a website which can be accessed by the general public. Printed tables for the calculation of interest should be made available in appropriate places such as court buildings and public libraries.

(Paragraph 8.43)

44. The principle to which section 1(1B) of the Interest on Damages (Scotland) Act 1958 gives effect should be retained and extended to awards of interest on sums other than damages.

(Paragraph 9.2)

45. Should section 1(1B) be re-enacted with amended wording in order to make clear that the statutory intention is in accordance with the interpretation given to the existing section by the Inner House in *Manson v Skinner*?

(Paragraph 9.4)

46. (a) Where a tribunal presently has power to award interest at the judicial rate, this should be replaced by a power to award interest at the rate prescribed by statute.

(b) Should interest run on awards made by the Employment Tribunal from an earlier date than 42 days after the date of the Tribunal's determination?

(c) In all other respects, the powers of particular tribunals to award interest should remain unaffected by our proposals.

(Paragraph 10.6)

47. Should the proposed legislative reform of the law on interest on debt and damages include a provision conferring, in the absence of contrary agreement, a power on the arbiter or adjudicator to award interest for a period prior to the date of the award or should this be left to await the enactment of a comprehensive statutory arbitration code?

(Paragraph 11.7)

48. If arbitration is included in the proposed legislative reform,

(a) should the arbiter's power to award interest be co-extensive with the powers which the court would have in relation to interest (on the various categories of pecuniary claims) under the proposed new legislation; or, alternatively,

(b) should the arbiter's power be exercisable on the basis of a wide discretion such as that contained in Clause 22 of the Scottish Advisory Committee's draft Bill?

(Paragraph 11.7)

49. An arbiter appointed under a statutory provision requiring a dispute to be referred to arbitration should have the same "default" power in relation to the award of interest as an arbiter appointed under an arbitration agreement.

(Paragraph 11.9)

50. Is any amendment required to the existing statutory provisions regarding the power of an adjudicator to award interest?

(Paragraph 11.10)

51. In addition to litigation, arbitration and adjudication, is there any form of dispute resolution in respect of which statutory provision would be desirable with regard to entitlement to interest on a sum found to be payable by one party to another?

(Paragraph 11.12)

52. Should the new provisions apply:

(a) to all debts falling due and all rights of action arising on or after the commencement date; or

(b) to all pecuniary claims except those in respect of which an action has been raised prior to the commencement date; or

(c) on some other basis?

(Paragraph 12.10)

# APPENDIX A

## Current Statutory Provisions

This appendix contains the text of two statutes referred to in this Discussion Paper: the Interest on Damages (Scotland) Act 1958 and the Late Payment of Commercial Debts (Interest) Act 1998. Both texts are shown as amended.

### INTEREST ON DAMAGES (SCOTLAND) ACT 1958 (CHAPTER 61)

An Act to amend the law of Scotland relating to the power of the courts to order payment of interest on damages. [1<sup>st</sup> August 1958].

#### 1. Power of courts to grant interest on damages

(1) Where a court pronounces an interlocutor decerning for payment by any person of a sum of money as damages, the interlocutor may include decree for payment by that person of interest, at such rate or rates as may be specified in the interlocutor, on the whole or any part of that sum for the whole or any part of the period between the date when the right of action arose and the date of the interlocutor.

(1A) Where a court pronounces an interlocutor decerning for payment of a sum which consists of or includes damages or solatium in respect of personal injuries sustained by the pursuer or any other person, then (without prejudice to the exercise of the power conferred by subsection (1) of this section in relation to any part of that sum which does not represent such damages or solatium) the court shall exercise that power so as to include in that sum interest on those damages and on that solatium or on such part of each as the court considers appropriate, unless the court is satisfied that there are reasons special to the case why no interest should be given in respect thereof.

(1B) For the avoidance of doubt, it is hereby declared that where, in any action in which it is competent for the court to award interest under this Act, a tender is made in the course of the action, the tender shall, unless otherwise stated therein, be in full satisfaction of any claim to interest thereunder by any person in whose favour the tender is made; and in considering in any such action whether an award is equal to or greater than an amount tendered in the action, the court shall take account of the amount of any interest awarded under this Act, or such part of that interest as the court considers appropriate.<sup>1</sup>

*[(1) Where the court having jurisdiction in any action for damages pronounces an interlocutor decerning for payment by any person of a sum of money as damages, the interlocutor may, if the circumstances warrant such a course, include decree for payment by*

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<sup>1</sup> S 1(1), (1A) and (1B) substituted for s 1(1) by the Interest on Damages (Scotland) Act 1971, s 1(1).

*that person of interest on the sum or any part thereof at such rate as may be specified in the interlocutor, from such date as may be so specified (being a date not earlier than the date on which the action was commenced against that person) until the date of the interlocutor.]<sup>2</sup>*

(2) Nothing in this section shall—

- (a) authorise the granting of interest upon interest, or
- (b) prejudice any other power of the court as to the granting of interest, or
- (c) affect the running of any interest which apart from this section would run by virtue of any enactment or rule of law.

## **2. Amendment of s 31 of Sheriff Courts (Scotland) Act 1907**

*[2. Section thirty-one of the Sheriff Courts (Scotland) Act, 1907 (which among other things specifies the grounds on which an interlocutor of a sheriff entering judgment under that section may be appealed to the Court of Session) shall have effect as if after head (4) thereof there were inserted the following head—*

*"(5) That no grant of interest on the damages (if any) has been included in the interlocutor or that any such grant so included is inadequate or is excessive."*

*and as if there were added at the end of the section the words "and upon any such appeal so far as based on the ground specified in head (5) of this section the court may make such order as to it seems just."]<sup>3</sup>*

## **3. Citation, interpretation, extent and commencement**

(1) This Act may be cited as the Interest on Damages (Scotland) Act 1958.

(2) In this Act, "personal injuries" includes any disease and any impairment of a person's physical or mental condition.<sup>4</sup>

*[(2) In this Act references to an action include references to a counter-claim, and for the purposes of this Act an action shall be taken to commence against a person on the date of the citation of that person, or, in the case of a counter-claim, the date of the lodging of the defences or other document containing the counter-claim, or, when the counter-claim is included in the record by way of adjustment or amendment, the closing, or, as the case may be, the re-closing, of the record.]<sup>5</sup>*

(3) This Act shall extend to Scotland only, and shall not apply to any action commenced against any person before the passing of this Act.

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<sup>2</sup> Words in italics show the wording of s 1(1) before substitution by the Interest on Damages (Scotland) Act 1971, s 1(1).

<sup>3</sup> Section 2 was repealed by Law Reform (Miscellaneous Provisions) (Scotland) Act 1980, s 11(2), Sch 3.

<sup>4</sup> Section 3(2) was substituted by the Interest on Damages (Scotland) Act 1971, s 1(3).

<sup>5</sup> Words in italics show the wording of s 3(2) before substitution by the Interest on Damages (Scotland) Act 1971, s 1(3).

# **LATE PAYMENT OF COMMERCIAL DEBTS (INTEREST) ACT 1998 (CHAPTER 20)**

An Act to make provision with respect to interest on the late payment of certain debts arising under commercial contracts for the supply of goods or services; and for connected purposes.  
[June 11, 1998]

## **PART I STATUTORY INTEREST ON QUALIFYING DEBTS**

### **1 Statutory interest**

(1) It is an implied term in a contract to which this Act applies that any qualifying debt created by the contract carries simple interest subject to and in accordance with this Part.

(2) Interest carried under that implied term (in this Act referred to as "statutory interest") shall be treated, for the purposes of any rule of law or enactment (other than this Act) relating to interest on debts, in the same way as interest carried under an express contract term.

(3) This Part has effect subject to Part II (which in certain circumstances permits contract terms to oust or vary the right to statutory interest that would otherwise be conferred by virtue of the term implied by subsection (1)).

### **2 Contracts to which Act applies**

(1) This Act applies to a contract for the supply of goods or services where the purchaser and the supplier are each acting in the course of a business, other than an excepted contract.

(2) In this Act "contract for the supply of goods or services" means—

(a) a contract of sale of goods; or

(b) a contract (other than a contract of sale of goods) by which a person does any, or any combination, of the things mentioned in subsection (3) for a consideration that is (or includes) a money consideration.

(3) Those things are—

(a) transferring or agreeing to transfer to another the property in goods;

(b) bailing or agreeing to bail goods to another by way of hire or, in Scotland, hiring or agreeing to hire goods to another; and

(c) agreeing to carry out a service.

(4) For the avoidance of doubt a contract of service or apprenticeship is not a contract for the supply of goods or services.

(5) The following are excepted contracts—

- (a) a consumer credit agreement;
- (b) a contract intended to operate by way of mortgage, pledge, charge or other security [; *and*
- (c) *a contract of a description specified in an order made by the Secretary of State.*

(6) *An order under subsection (5)(c) may specify a description of contract by reference to any feature of the contract (including the parties).]*<sup>6</sup>

(7) In this section—

"business" includes a profession and the activities of any government department or local or public authority;

"consumer credit agreement" has the same meaning as in the Consumer Credit Act 1974;

"contract of sale of goods" and "goods" have the same meaning as in the Sale of Goods Act 1979;

"government department" includes any part of the Scottish Administration;

"property in goods" means the general property in them and not merely a special property.

## **2A Application of the Act to Advocates**

The provisions of this Act apply to a transaction in respect of which fees are paid for professional services to a member of the Faculty of Advocates as they apply to a contract for the supply of services for the purpose of this Act.<sup>7</sup>

## **3 Qualifying debts**

(1) A debt created by virtue of an obligation under a contract to which this Act applies to pay the whole or any part of the contract price is a "qualifying debt" for the purposes of this Act, unless (when created) the whole of the debt is prevented from carrying statutory interest by this section.

(2) A debt does not carry statutory interest if or to the extent that it consists of a sum to which a right to interest or to charge interest applies by virtue of any enactment (other than section 1 of this Act).

This subsection does not prevent a sum from carrying statutory interest by reason of the fact that a court, arbitrator or arbiter would, apart from this Act, have power to award interest on it.

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<sup>6</sup> Words in italics repealed as regards Scotland by The Late Payment of Commercial Debts (Scotland) Regulations 2002 (SSI 2002/335).

<sup>7</sup> Section 2A applies to Scotland only and was inserted by The Late Payment of Commercial Debts (Scotland) Regulations 2002 (SSI 2002/335).

(3) A debt does not carry (and shall be treated as never having carried) statutory interest if or to the extent that a right to demand interest on it, which exists by virtue of any rule of law, is exercised.

*[(4) A debt does not carry statutory interest if or to the extent that it is of a description specified in an order made by the Secretary of State.*

*(5) Such an order may specify a description of debt by reference to any feature of the debt (including the parties or any other feature of the contract by which it is created).]*<sup>8</sup>

#### **4 Period for which statutory interest runs**

(1) Statutory interest runs in relation to a qualifying debt in accordance with this section (unless section 5 applies).

(2) Statutory interest starts to run on the day after the relevant day for the debt, at the rate prevailing under section 6 at the end of the relevant day.

(3) Where the supplier and the purchaser agree a date for payment of the debt (that is, the day on which the debt is to be created by the contract), that is the relevant day unless the debt relates to an obligation to make an advance payment.

A date so agreed may be a fixed one or may depend on the happening of an event or the failure of an event to happen.

(4) Where the debt relates to an obligation to make an advance payment, the relevant day is the day on which the debt is treated by section 11 as having been created.

(5) In any other case, the relevant day is the last day of the period of 30 days beginning with—

(a) the day on which the obligation of the supplier to which the debt relates is performed; or

(b) the day on which the purchaser has notice of the amount of the debt or (where that amount is unascertained) the sum which the supplier claims is the amount of the debt,

whichever is the later.

(6) Where the debt is created by virtue of an obligation to pay a sum due in respect of a period of hire of goods, subsection (5)(a) has effect as if it referred to the last day of that period.

(7) Statutory interest ceases to run when the interest would cease to run if it were carried under an express contract term.

(8) In this section "advance payment" has the same meaning as in section 11.

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<sup>8</sup> Subss 3(3) and 3(4) were repealed as regards Scotland by The Late Payment of Commercial Debts (Scotland) Regulations 2002 (SSI 2002/335).

## **5 Remission of statutory interest.**

(1) This section applies where, by reason of any conduct of the supplier, the interests of justice require that statutory interest should be remitted in whole or part in respect of a period for which it would otherwise run in relation to a qualifying debt.

(2) If the interests of justice require that the supplier should receive no statutory interest for a period, statutory interest shall not run for that period.

(3) If the interests of justice require that the supplier should receive statutory interest at a reduced rate for a period, statutory interest shall run at such rate as meets the justice of the case for that period.

(4) Remission of statutory interest under this section may be required—

(a) by reason of conduct at any time (whether before or after the time at which the debt is created); and

(b) for the whole period for which statutory interest would otherwise run or for one or more parts of that period.

(5) In this section "conduct" includes any act or omission.

### **5A Compensation arising out of late payment**

(1) Once statutory interest begins to run in relation to a qualifying debt, the supplier shall be entitled to a fixed sum (in addition to the statutory interest on the debt).

(2) That sum shall be—

(a) for a debt less than £1,000, the sum of £40;

(b) for a debt of £1,000 or more, but less than £10,000, the sum of £70;

(c) for a debt of £10,000 or more, the sum of £100.

(3) The obligation to pay an additional fixed sum under this section in respect of a qualifying debt shall be treated as part of the term implied by section 1(1) in the contract creating the debt.<sup>9</sup>

## **6 Rate of statutory interest**

(1) The Secretary of State shall by order made with the consent of the Treasury set the rate of statutory interest by prescribing—

(a) a formula for calculating the rate of statutory interest; or

(b) the rate of statutory interest.

(2) Before making such an order the Secretary of State shall, among other things, consider the extent to which it may be desirable to set the rate so as to—

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<sup>9</sup> S 5A was added by The Late Payment of Commercial Debts (Scotland) Regulations 2002 (SSI 2002/335).

- (a) protect suppliers whose financial position makes them particularly vulnerable if their qualifying debts are paid late; and
- (b) deter generally the late payment of qualifying debts.

## **PART II CONTRACT TERMS RELATING TO LATE PAYMENT OF QUALIFYING DEBTS**

### **7 Purpose of Part II**

(1) This Part deals with the extent to which the parties to a contract to which this Act applies may by reference to contract terms oust or vary the right to statutory interest that would otherwise apply when a qualifying debt created by the contract (in this Part referred to as "the debt") is not paid.

(2) This Part applies to contract terms agreed before the debt is created; after that time the parties are free to agree terms dealing with the debt.

(3) This Part has effect without prejudice to any other ground which may affect the validity of a contract term.

### **8 Circumstances where statutory interest may be ousted or varied**

(1) Any contract terms are void to the extent that they purport to exclude the right to statutory interest in relation to the debt, unless there is a substantial contractual remedy for late payment of the debt.

(2) Where the parties agree a contractual remedy for late payment of the debt that is a substantial remedy, statutory interest is not carried by the debt (unless they agree otherwise).

(3) The parties may not agree to vary the right to statutory interest in relation to the debt unless either the right to statutory interest as varied or the overall remedy for late payment of the debt is a substantial remedy.

(4) Any contract terms are void to the extent that they purport to—

- (a) confer a contractual right to interest that is not a substantial remedy for late payment of the debt, or

- (b) vary the right to statutory interest so as to provide for a right to statutory interest that is not a substantial remedy for late payment of the debt,

unless the overall remedy for late payment of the debt is a substantial remedy.

(5) Subject to this section, the parties are free to agree contract terms which deal with the consequences of late payment of the debt.

### **9 Meaning of "substantial remedy"**

(1) A remedy for the late payment of the debt shall be regarded as a substantial remedy unless—

- (a) the remedy is insufficient either for the purpose of compensating the supplier for late payment or for deterring late payment; and
- (b) it would not be fair or reasonable to allow the remedy to be relied on to oust or (as the case may be) to vary the right to statutory interest that would otherwise apply in relation to the debt.

(2) In determining whether a remedy is not a substantial remedy, regard shall be had to all the relevant circumstances at the time the terms in question are agreed.

(3) In determining whether subsection (1)(b) applies, regard shall be had (without prejudice to the generality of subsection (2)) to the following matters—

- (a) the benefits of commercial certainty;
- (b) the strength of the bargaining positions of the parties relative to each other;
- (c) whether the term was imposed by one party to the detriment of the other (whether by the use of standard terms or otherwise); and
- (d) whether the supplier received an inducement to agree to the term.

## **10 Interpretation of Part II**

(1) In this Part—

"contract term" means a term of the contract creating the debt or any other contract term binding the parties (or either of them);

"contractual remedy" means a contractual right to interest or any contractual remedy other than interest;

"contractual right to interest" includes a reference to a contractual right to charge interest;

"overall remedy", in relation to the late payment of the debt, means any combination of a contractual right to interest, a varied right to statutory interest or a contractual remedy other than interest;

"substantial remedy" shall be construed in accordance with section 9.

(2) In this Part a reference (however worded) to contract terms which vary the right to statutory interest is a reference to terms altering in any way the effect of Part I in relation to the debt (for example by postponing the time at which interest starts to run or by imposing conditions on the right to interest).

(3) In this Part a reference to late payment of the debt is a reference to late payment of the sum due when the debt is created (excluding any part of that sum which is prevented from carrying statutory interest by section 3).

## **11 Treatment of advance payments of the contract price**

(1) A qualifying debt created by virtue of an obligation to make an advance payment shall be treated for the purposes of this Act as if it was created on the day mentioned in subsection (3), (4) or (5) (as the case may be).

(2) In this section "advance payment" means a payment falling due before the obligation of the supplier to which the whole contract price relates ("the supplier's obligation") is performed, other than a payment of a part of the contract price that is due in respect of any part performance of that obligation and payable on or after the day on which that part performance is completed.

(3) Where the advance payment is the whole contract price, the debt shall be treated as created on the day on which the supplier's obligation is performed.

(4) Where the advance payment is a part of the contract price, but the sum is not due in respect of any part performance of the supplier's obligation, the debt shall be treated as created on the day on which the supplier's obligation is performed.

(5) Where the advance payment is a part of the contract price due in respect of any part performance of the supplier's obligation, but is payable before that part performance is completed, the debt shall be treated as created on the day on which the relevant part performance is completed.

(6) Where the debt is created by virtue of an obligation to pay a sum due in respect of a period of hire of goods, this section has effect as if—

(a) references to the day on which the supplier's obligation is performed were references to the last day of that period; and

(b) references to part performance of that obligation were references to part of that period.

(7) For the purposes of this section an obligation to pay the whole outstanding balance of the contract price shall be regarded as an obligation to pay the whole contract price and not as an obligation to pay a part of the contract price.

### **PART III GENERAL AND SUPPLEMENTARY**

#### **12 Conflict of laws**

(1) This Act does not have effect in relation to a contract governed by the law of a part of the United Kingdom by choice of the parties if—

(a) there is no significant connection between the contract and that part of the United Kingdom; and

(b) but for that choice, the applicable law would be a foreign law.

(2) This Act has effect in relation to a contract governed by a foreign law by choice of the parties if—

(a) but for that choice, the applicable law would be the law of a part of the United Kingdom; and

(b) there is no significant connection between the contract and any country other than that part of the United Kingdom.

(3) In this section—

"contract" means a contract falling within section 2(1); and

"foreign law" means the law of a country outside the United Kingdom.

### **13 Assignments, etc**

(1) The operation of this Act in relation to a qualifying debt is not affected by—

- (a) any change in the identity of the parties to the contract creating the debt; or
- (b) the passing of the right to be paid the debt, or the duty to pay it (in whole or in part) to a person other than the person who is the original creditor or the original debtor when the debt is created.

(2) Any reference in this Act to the supplier or the purchaser is a reference to the person who is for the time being the supplier or the purchaser or, in relation to a time after the debt in question has been created, the person who is for the time being the creditor or the debtor, as the case may be.

(3) Where the right to be paid part of a debt passes to a person other than the person who is the original creditor when the debt is created, any reference in this Act to a debt shall be construed as (or, if the context so requires, as including) a reference to part of a debt.

(4) A reference in this section to the identity of the parties to a contract changing, or to a right or duty passing, is a reference to it changing or passing by assignment or assignation, by operation of law or otherwise.

### **14 Contract terms relating to the date for payment of the contract price**

(1) This section applies to any contract term which purports to have the effect of postponing the time at which a qualifying debt would otherwise be created by a contract to which this Act applies.

(2) Sections 3(2)(b) and 17(1)(b) of the Unfair Contract Terms Act 1977 (no reliance to be placed on certain contract terms) shall apply in cases where such a contract term is not contained in written standard terms of the purchaser as well as in cases where the term is contained in such standard terms.

(3) In this section "contract term" has the same meaning as in section 10(1).

### **15 Orders and regulations**

(1) Any power to make an order or regulations under this Act is exercisable by statutory instrument.

(2) Any statutory instrument containing an order or regulations under this Act, other than an order under section 17(2), shall be subject to annulment in pursuance of a resolution of either House of Parliament.

## **16 Interpretation**

(1) In this Act—

"contract for the supply of goods or services" has the meaning given in section 2(2);

"contract price" means the price in a contract of sale of goods or the money consideration referred to in section 2(2)(b) in any other contract for the supply of goods or services;

"purchaser" means (subject to section 13(2)) the buyer in a contract of sale or the person who contracts with the supplier in any other contract for the supply of goods or services;

"qualifying debt" means a debt falling within section 3(1);

"statutory interest" means interest carried by virtue of the term implied by section 1(1);  
and

"supplier" means (subject to section 13(2)) the seller in a contract of sale of goods or the person who does one or more of the things mentioned in section 2(3) in any other contract for the supply of goods or services.

(2) In this Act any reference (however worded) to an agreement or to contract terms includes a reference to both express and implied terms (including terms established by a course of dealing or by such usage as binds the parties).

## **17 Short title, commencement and extent**

(1) This Act may be cited as the Late Payment of Commercial Debts (Interest) Act 1998.

(2) This Act (apart from this section) shall come into force on such day as the Secretary of State may by order appoint; and different days may be appointed for different descriptions of contract or for other different purposes.

An order under this subsection may specify a description of contract by reference to any feature of the contract (including the parties).

(3) The Secretary of State may by regulations make such transitional, supplemental or incidental provision (including provision modifying any provision of this Act) as the Secretary of State may consider necessary or expedient in connection with the operation of this Act while it is not fully in force.

(4) This Act does not affect contracts of any description made before this Act comes into force for contracts of that description.

(5) This Act extends to Northern Ireland.

## APPENDIX B

# Statutory Provisions Creating Entitlement to Interest

The following is a summary of current statutory provisions which create an entitlement to interest on sums due by one person to another. It is not intended to be exhaustive, but is illustrative of the diversity of circumstances in which a statutory entitlement to interest may currently arise.

**(i) Interest payable by one private individual to another (other than on decree or tribunal decision)**

- Bills of Exchange Act 1882 s 57 - Right of recovery where a bill is dishonoured, payable with interest from the time of presentment for payment. S 57(3) - Interest may be withheld "if justice require it".
- Partnership Act 1890 s 24(3) – A partner making any advance "beyond the amount of capital which he has agreed to subscribe" is entitled to interest at 5% per annum. S 42(1) – Any outgoing partner is entitled to profits attributable to the use of their share, or interest on the share, of assets at 5% per annum.
- Trusts (Scotland) Act 1921 s 29 - Where a sum is improperly advanced on an inadequate heritable security, the trustee is liable for the sum advanced in excess of what would have been a proper investment, "with interest".
- Conveyancing and Feudal Reform (Scotland) Act 1970 Sch 3, para 7 - Where a creditor performs a debtor's obligation, the creditor is entitled to recover expenses and charges, including interest reasonably incurred, at the rate in respect of advances secured under the standard security, or if none specified, at the bank rate in force at the relevant time.
- Companies Act 1985 ss 99-105 - Various obligations to pay interest in relation to allotment of shares at "the appropriate rate" (5% or a rate otherwise prescribed by SI (s 107)). S 347F – Interest payable on any payment to the company by a director of a political donation, or expenditure incurred in breach of ss 347C-347D, at a rate to be prescribed by SI.
- Bankruptcy (Scotland) Act 1985 s 51(1)(g) - Provides for interest to be payable on debts from the date of sequestration. S 51(7) – the rate is the higher of the "prescribed rate" at date of sequestration, or the rate applicable to the debt apart from sequestration. (The "prescribed rate" is the judicial rate defined in SI 1985/1925, and amended by SI 1993/439.) Sch 1, para 1 - Debts brought forward by sequestration are subject to the deduction of interest at the rate specified in s 51(7).

- Insolvency Act 1986 s 189 – Interest is payable on any debt proved in winding up. S 212(3) - Misuse of company funds by officer, liquidator or administrative receiver renders interest to be paid at such rate as the court thinks just. S 304 - Where a trustee of a bankrupt's estate has misapplied or retained money or other property comprising the bankrupt's estate, they can be ordered to repay with interest. Sch B1, para 8, part 75 – The court may examine the conduct of a person purporting to be the administrator of a company and order that person to repay or restore money with interest for a breach of duty.
- Insolvency (Scotland) Rules 1986 (SI 1986/1915) rule 1.19 - Interest is added to advances made by "the responsible insolvency practitioner" in respect of the company payable by the supervisor in a voluntary arrangement, at the official rate. Rule 4.66 - Interest is payable at "the official rate", which in s 189(4) of the Insolvency Act 1986 is deemed to be whichever is the greater of the rate specified in s 17 of the Judgments Act 1838 or the rate applicable to that debt apart from the winding up.
- Debtors (Scotland) Act 1987 s 50(5) - Interest is chargeable on sums paid or repaid under earnings arrestments at "the specified rate", (ie the sheriff court decree rate specified in s 73(1)). S 55(7) – Interest is chargeable on sums paid or repaid under current maintenance arrestment at the same rate.
- Adults with Incapacity (Scotland) Act 2000 s 81 - Where funds held under a fiduciary duty are misused, interest is payable at the Sheriff Court decree rate. Sch 2, para 8(7) - Where there is a deficiency in the accounts of a guardian, interest is payable at the Sheriff Court decree rate.

**(ii) Interest on court decrees and tribunal awards**

- Sheriff Courts (Scotland) Extracts Act 1892 s 9, as amended by s 4 of the Administration of Justice (Scotland) Act 1972 and para 2 of the Act of Sederunt (Interest in Sheriff Court Decrees and Extracts) 1993 (SI 1993/769) - Sets the judicial interest rate at 8% per annum.
- Court of Session Act 1988 s 42 - The House of Lords may, when hearing an appeal from the Inner House, make such order with regard to interest, simple or compound, as it thinks fit. S 34 - Interest is awarded where an appeal to the House of Lords is dismissed for want of prosecution.
- Employment Tribunals (Interest) Order 1990 (SI 1990/479) Articles 3-4 – Applies the "42 day rule" and interest at rate specified in s 17 of the Judgments Act 1838.
- Act of Sederunt (Rules of the Court of Session 1994) 1994 (SI 1994/1443) Rule 7.7 - Sets the judicial interest rate at 8%.
- Employment Tribunals (Interest on Awards in Discrimination Cases) 1996 (SI 1996/2803) Article 8 - Interest applies from the day after the date of the decision at the rate specified in the Employment Tribunals (Interest) Order 1990.

**(iii) Interest payable by State to individual**

**(a) Pension schemes**

- Teachers' Superannuation (Scotland) Regulations 1992 (SI 1992/280) regulation E31A, as amended by SI 2001/3649 - Interest on late payments after one month at "the base rate for the time being quoted by the reference banks" on a day to day basis compounded with quarterly rests. Regulation 13 - Interest payable on returned contributions at 3.5%, compounded with annual rests.
- NHS Superannuation Scheme (Scotland) Regulations 1995 (SI 1995/365) regulation 3 - Cash equivalent for transfer-out arrangements and buy-outs. Interest is awarded on a daily basis from date of leaving pensionable employment at the same rate as that payable for the time being on judgment debts by virtue of the Judgments Act 1838 s 17. Regulation 9 - Interest on late payment of benefits at base rate for the time being quoted by the reference banks on a day to day basis compounded with quarterly rests.
- Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998 (SI 1998/192) - Compensation for premature retirement. Regulation 30 - Interest at 1% above base rate on a day to day basis compounded with quarterly rests.
- Local Government Pension Scheme (Scotland) Regulations 1998 (SI 1998/366), regulation 81 – Overdue payments of more than one month require interest to be paid at 1% above base rate on a day to day basis compounded with quarterly rests. Regulation 88 - Same for contributions deducted in error from pay. Regulation 91 - Same for late payment of certain benefits.
- The Scotland Act 1998 (Transitory and Transitional Provisions) (Scottish Parliamentary Pension Scheme) 1999 (SI 1999/1082) A2 - References to interest are to compound interest at 4% per annum with annual rests.
- Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 1998 (SI 1998/2888) - Administering authority must pay interest on any fund money "used by them and not repaid" at a rate not lower than the lowest rate at which they could have obtained a commercial loan of that amount at 7 days' notice.
- NHS (Superannuation Scheme, Injury Benefits and Compensation for Premature Retirement) (Scotland) Amendment Regulations 2001 (SSI 2001/437) regulation 17 – (Inserting the new regulation T9), interest on late payment of benefits set at base rate, quoted by the reference banks, compounded with quarterly rests.

**(b) Compulsory purchase**

- Land Compensation (Scotland) Act 1963 s 40 - Rate for compensation where entry is taken before payment is to be prescribed by SI, instead of the 5% prescribed by Lands Clauses Consolidation Act 1845 s 84.

- Land Compensation (Scotland) Act 1973 s 16 – Interest is due on awards of compensation for compulsory purchase. S 33(6) – Same for farm loss payments. S 34(5) – Same for disturbance payments. S 59 – Same for compensation for injurious affection where no land was taken. All rates are prescribed by the Land Compensation (Scotland) Act 1963 s 40.
- Planning & Compensation Act 1991 s 78(4) - Compensation for notice to treat ceasing to have effect carries interest at rate specified in the Land Compensation Act 1963 s 40. S 80(1) - Compensation awarded under a long list of provisions listed in Schedule 18 carries interest at the rate prescribed under s 40.
- Roads (Scotland) Act 1984 s 149 - Where the roads authority is entitled to recover expenses it shall also be entitled to recover interest at the rate prescribed under the Land Compensation Act 1963 s 40.
- Housing (Scotland) Act 1987, Sch 7, para 13 - Any sum payable by virtue of this section shall carry interest at the rate prescribed under the Land Compensation Act 1963 s 40, from the time of entry by the local authority on the land, or from vesting of the land, whichever is earlier, until payment.
- Acquisition of Land (Rate of Interest after Entry) (Scotland) Regulations 1995 (SI 1995/2791) regulation 2 - Rate of interest on compensation for compulsory acquisition of land on which entry is taken before payment is 0.5% per annum below the base rate quoted by the reference banks.
- Town & Country Planning (Scotland) Act 1997 Sch 15, para 30 - The acquiring authority is liable to pay compensation and interest on compensation as they would have been liable had they taken possession of the land under the Acquisition of Land (Authorisation Procedure) (Scotland) Act 1947 Sch 2, paragraph 3.
- Contaminated Land (Scotland) Regulations 2000 (SSI 2000/178) Sch 3 - Compensation payable to a person who has been granted rights of entry in terms of EPA 1990, s 78G which allows matters specified in a remediation notice to be carried out. Interest runs from the date of granting of the rights until payment at rate specified in Land Compensation Act 1963 s 40.
- Pollution Prevention and Control (Scotland) Regulations 2000 (SSI 2000/323) Sch 6, para 7 - Compensation is payable where a person is required to grant another rights of entry in order to fulfil an "off-site condition". Interest runs from various specified dates (date of depreciation in value of land, loss etc) until payment at the rate specified in the Land Compensation Act 1963 s 40.

(c) *Other*

- Repayment of Student Loans (Scotland) Regulations 2000 (SSI 2000/110) Regulation 9 - Over-repayment carries interest at the same rate as charged on loan accounts.
- Local Government (Scotland) Act 1975 s 9A (inserted by Local Government Finance Act 1992 s 110): interest is to be paid on the repayment of rates paid in error or repaid because of reduction in valuation.

**(iv) Interest payable by individual to the State (other than taxes and duties)**

*(a) Repayment of grants and subsidies*

- Civic Government (Scotland) Act 1982 ss 99-100 - Local authority can recover expenses from any person entitled to interest at such reasonable rate as they may require from date of demand for expenses until payment.
- Housing (Scotland) Act 1987 s 243 - Improvement grant becomes due to be repaid if it is not used. This carries interest at such reasonable rate as the local authority may determine from date paid until date repaid. S 274 – Repayment of reinstatement grants, due if qualifying work is not completed within a set time period, carries interest at such a rate as the local authority may determine from date paid until date repaid. Sch 19, para 1 – On breach of conditions of an improvement grant, it is to be repaid with interest from date of final settlement of balance by local authority until payment.
- Tax Credits Act 2002 s 37 – Where an individual has been overpaid, due to his fraud or negligence, interest is added to the repayments at 6.5% per annum.

*(b) Pension schemes*

- Teachers' Superannuation (Scotland) Regulations 1992 (SI 1992/280) regulation C2A, as amended by SI 1999/446, regulation 5 - Back contributions are payable into scheme, with interest payable at 7% per annum compounded with annual rests. Regulation 8, as amended by SSI 2001/291 - Additional contributions to purchase current added years, with interest payable at 4% per annum compounded with annual rests. Regulation G7, as amended by SSI 2003/423 - An employer is to pay interest on employers' contributions (part-time elections) at 7% per annum compounded with annual rests. Regulation G8 - Employers' contributions, interest at 8% per annum compounded with monthly rests.
- Social Security Act 1998 s 57 (7B) – Provides for interest to be paid to the Secretary of State on employee pension contributions which have not been paid by the due date.

*(c) Loans and guarantees*

Various statutory provisions enabling or obliging local authorities to make loans:

- Crofters Holdings (Scotland) Act 1886 s 32 – Loans made from the Secretary of State for purchase and equipment of fishing boats shall carry interest as the Secretary of State may determine.
- Local Government (Development and Finance) (Scotland) Act 1964 s 7 – Local authority advances for the erection of buildings shall carry interest at a rate not less than  $\frac{1}{4}$  per cent greater than the rate fixed by the Treasury.
- Fire Precautions Act 1971 s 36 – Power of local authorities to make loans to meet expenditure on certain alterations. Every loan shall bear interest at the rate determined in accordance with the National Loans Act 1968 s 5.

- Housing (Scotland) Act 1987 s 217 – Duty of local authorities to offer loans to meet expenses of improvement of houses in housing action areas.
- Public Finance and Accountability (Scotland) Act 2000 s 9 – Scottish Ministers may lend sums to the Keeper of the Registers of Scotland. The rate of interest on any loan shall not be less than the lowest rate determined by the Treasury under the National Loans Act 1968 s 5.
- Education (Student Loans) (Scotland) Regulations 2000 (SSI 2000/200) regulation 15, as amended by SSI 2001/228 - Interest on student loans at APR equal to increases in the Retail Price Index from March to March.
- Graduate Endowment (Scotland) Regulations 2001 (SSI 2001/280) - Loans to bear interest at the rate above.

(d) *Interest on financial penalties*

- Gas Act 1986 s 30D - Interest on penalties applied at the rate in the Judgments Act 1838.
- Electricity Act 1989 s 27D - Interest on penalties applied at the rate in the Judgments Act 1838.
- National Lottery etc Act 1993 s 10A – On penalties for breach of conditions in licences, interest is applied at the rate in the Judgments Act 1838.
- Railways Act 1993 s 55 – On sums payable under a contravention order interest is applied at the rate in the Judgments Act 1838.
- Postal Services Act 2000 s 35 – On financial penalties interest is applied at the rate in the Judgments Act 1838.
- Enterprise Act 2002 s 113 – In mergers interest is applied on penalties at the rate in the Judgments Act 1838.

(e) *Other*

- Civil Legal Aid (Scotland) Regulations 2002 (SSI 2002/494) regulation 41 - Sums secured over land under regulation 40 carry interest at the rate specified in the Rules of the Court of Session, at Rule 7.7.

(v) **Taxes and duties**

- Finance Act 1989 s 178(2), as amended - Lists all the enactments charging interest on unpaid taxes and duties, the rate for which is to be that specified in regulations made under that section.
- Taxes Management Act 1970 s 59C - Surcharge on unpaid income tax and capital gains tax carries interest at the rate in the Finance Act 1989 s 178. S 87 – Same provisions apply as regards overdue income tax on company payments and overdue

corporation tax. S 103A - Interest on penalties is due at the rate specified under the Finance Act 1989 s 178.

- Fossil Fuel Levy (Scotland) Regulations 1996 (SI 1996/293) regulation 24 – Interest is charged on late payments of the levy at 4% pa above the Royal Bank of Scotland base rate.

# APPENDIX C

## Research Project

C.1 The research project involved a study of summons and writs lodged in court in order to find out what kind of interest is normally claimed in practice. Research at the Court of Session was conducted in April, May and September 2004, in three exercises the details of which are set out below. All the cases indexed<sup>1</sup> in March 2004 were checked<sup>2</sup> to find out what kind of interest had been claimed and, where possible, to find out what interest had been awarded. In addition, all the ordinary actions and commercial actions which were lodged at the Court of Session in March 2004 were checked, mainly in order to see if any reference was made to the Late Payment of Commercial Debts (Interest) Act 1998. Further research was carried out at Aberdeen Sheriff Court in June 2004 where it was anticipated that there would be a representative sample of cases in which both parties were involved in a commercial transaction.

C.2 The Project Team are grateful to staff at the Court of Session and Aberdeen Sheriff Court for their assistance during the collection of data for this project.

### **Exercise 1: Court of Session cases indexed in March 2004**

C.3 The sample for exercise 1 was drawn from processes which had been indexed in March 2004. It was thought that if an earlier month were chosen there would be fewer cases to which the Late Payment of Commercial Debts (Interest) Act 1998 could apply.<sup>3</sup> February was a shorter month, and April and January had fewer business days due to the effect of holiday periods. The index numbers in the sample ranged from 830/2004 to 1302/2004 (473 numbers). Of these, seven numbers were unallocated to a process.<sup>4</sup> One number had been accidentally allocated to two processes. There was, therefore, a total of 467 cases which had been indexed that month. The processes were examined by members of the project team on 21 and 22 April, 13 and 14 May and 27 September 2004. Of the 467, 13 had been borrowed and were unavailable during each of the research visits. This left 454, of which 121 were petitions and six were family actions. Interest is not awarded in petitions and family actions, so these cases were excluded from our sample. Of the remaining 327 processes, 19 were incomplete and did not contain all the data required for our survey. The resulting sample consisted of 308 cases.

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<sup>1</sup> In the Court of Session a case is "indexed" when it is concluded, "fallen asleep" or otherwise becomes inactive. It is given an index number and put into storage.

<sup>2</sup> Family actions and petitions were not examined because interest was unlikely to be claimed in these cases.

<sup>3</sup> The Late Payment of Commercial Debts (Interest) Act 1998 came fully into force in August 2002. Only 9.74% of the cases in our March 2004 sample were signeted after the Act came into force.

<sup>4</sup> A number becomes unallocated where a case becomes live again and the process is returned to the General or Petition office. After the case has concluded and is returned to storage it is given a new index number, and the original index number is not re-allocated.

- 245 of the 308 cases (79.54%) were damages cases in which the pursuer was an individual (ie mostly personal injury cases).
  - In 110 (44.90%) of the 245 damages cases (35.71% of the whole sample) interest was claimed at 8% from the date when the right of action arose.
  - In 95 (36.73%) of the 245 damages cases (30.84% of the whole sample) interest was claimed at 8% from the date of decree.
  - In 28 (11.43%) of the 245 damages cases (9.09% of the whole sample) interest was claimed at 8% from the date of service.
  - In 11 (4.49%) of the 245 damages cases (3.57% of the whole sample) no interest was claimed.
- 43 of the 308 cases (13.96%) in exercise 1 involved parties who were both in a commercial undertaking.
  - 30 (69.77%) of those 43 (9.74% of the total sample) were signeted after the Late Payment of the Commercial Debts (Interest) Act 1998 came into force.
  - 2 (4.65%) of those 43 (0.65% of the total sample) claimed interest under the Late Payment of the Commercial Debts (Interest) Act 1998.<sup>5</sup>
  - 25 (58.14%) of those 43 (8.12% of the total sample) involved breach of contract.
    - Of the breach of contract cases, 4 (16%) out of 25 (9.30% of the 43 commercial cases) claimed interest at a rate specified in a contract.
    - 10 (40%) of the 25 contract cases (23.25% of the 43 commercial cases) sought interdict or declarator and no interest was claimed.
    - 6 (13.95%) of the 43 commercial cases (1.95% of the total sample) were for recovery of unpaid tax and a rate of interest under tax legislation was claimed.

## **Exercise 2: Court of Session cases lodged in March 2004**

C.4 Many of the actions in exercise 1 were initiated before the Late Payment of Commercial Debts (Scotland) Act 1998 came into force<sup>6</sup> or related to debts which were probably incurred before the Act came fully into force. In order to find out if reference was made to the 1998 Act in more recent cases we checked all the summons lodged in the Court of Session in March 2004 and examined those cases in which both parties were involved in a commercial undertaking. It was anticipated that by March 2004 the 1998 Act would be

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<sup>5</sup> There were no cases in the sample in which it was clear that the 1998 Act was applicable but was not used.

<sup>6</sup> 9.94% of the total sample and 69.77% of the cases in which the parties were commercial undertakings.

available to all litigants if the case involved a debt to which that Act would apply. Petitions and Personal Damages<sup>7</sup> actions were not included in the sample.

C.5 The project team collected data at the Court of Session on 14, 26 and 27 May and 27 September 2004. For each summons, the team recorded the type of case, the interest which was asked for (if any) and the authority cited for interest (if any). 87 ordinary actions were examined. Of these, 61 were cases in which both parties were involved in business. In addition, 14 commercial action summons were examined. After excluding non-business cases, the total sample was 75 cases.

- Interest was claimed in 56 (74.66%) of the 75 cases.
- In 1 (1.33%) of the 75 cases (or 1 out of 56: 1.79%) interest was claimed under the Late Payment of Commercial Debts (Interest) Act 1998.
- In 19 (25.33%) of the 76 cases no interest was claimed because no monetary award was sought.<sup>8</sup>
- In 27 (36%) out of 75 cases (or 27 out of the 56 claiming interest: 48.21%) a rate under tax legislation was claimed.<sup>9</sup>
- In 3 (4%) out of 75 cases (or 3 out of 56: 5.35%) a rate specified in a contract was claimed.
- In 2 (2.66%) out of 75 cases (or 2 out of 56: 3.57%) interest was claimed but no rate or period specified.
- In 12 (16%) out of 75 cases (or 12 out of 56: 21.43%) interest was claimed at 8% from the date of service.
- In 9 (12%) out of 75 cases (or 9 out of 56: 16.07%) interest was claimed at 8% from the date when the right of action arose.
- In 1 (1.33%) of the 75 cases (or 1 out of 56: 1.79%) interest was claimed at 8% from the date of decree.

### **Exercise 3: Summary cause and small claims in Aberdeen Sheriff Court**

C.6 The sample for exercise 3 was taken from all summary cause actions and small claims which were due to call in Aberdeen Sheriff Court on 24 June 2004. 140 cases were examined by a member of the project team at Aberdeen Sheriff Court on 16 and 17 June 2004. It was anticipated that this sample would include a large number of debt actions between businesses to which the Late Payment of Commercial Debts (Interest) Act 1998 would apply.

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<sup>7</sup> ie actions to which Chapter 43 of the Rules of the Court of Session apply ("Actions of Damages For, or Arising From Personal Injuries"), as substituted by the Act of Sederunt (Rules of the Court of Session Amendment No 2) (Personal Injuries Actions) 2002 (SSI 2002/570).

<sup>8</sup> Eg actions seeking interdict or declarator.

<sup>9</sup> ie the actions were for recovery of unpaid tax.

- 126 (90%) of the 140 cases were actions for recovery of a debt.
- 9 (6.43%) of the 140 cases were actions for damages. Interest was claimed in all 9 cases.
  - In 3 (33%) of the 9 cases interest was claimed from the date of decree.
  - In 5 (55.55%) of the 9 cases interest was claimed from the date when the right of action arose.
  - In 1 (11.11%) of the 9 cases interest was claimed from the date of citation.
- In 35 (25%) of the 140 cases both parties were involved in a commercial undertaking. 7 of those 35 cases were actions in which the Registrar of Companies sought a penalty under the Companies Acts. This left 28 commercial undertakings cases, excluding tax cases, in which interest was sought as well as the principal sum:
  - In 9 (32.14%) of the 28 interest was claimed in terms of the Late Payment of Commercial Debts (Interest) Act 1998.
  - 8 of those 9 (28.57% of the 28 cases) also sought a fixed sum under the 1998 Act.
  - In 7 (25%) of the 28 cases interest was claimed from the date of decree.
  - In 10 (35.71%) of the 28 cases interest was claimed from the date of service.
  - In 2 (7.14%) of the 28 cases interest was sought as specified in a contract.
  - In 25 (89.28%) of the 28 cases it appeared that interest under the 1998 Act could have been claimed. Only in 9 (36%) of those 25 cases was it in fact claimed.<sup>10</sup>
- 3 (2.14%) of the 140 cases were for recovery of unpaid tax and interest was sought in terms of tax legislation.
- 14 (10%) of the 140 cases were actions by SAAS<sup>11</sup> for recovery of student awards and no interest was sought in these cases.

## Conclusions

C.7 In exercise 3, interest under the Late Payment of Commercial Debts (Interest) Act 1998 was not claimed in most of the cases where it appeared that a claim would be valid. However, it is not known, in cases where such interest is not claimed, if this is due to ignorance of the creditor's rights or forbearance on the part of the creditor. In other cases, a variety of interest rates are claimed which seem to bear little relation to the nature of the claim. In exercise 1 there were 245 cases out of a sample of 308 in which it appeared that interest could have been claimed from the date when the right of action arose. In fact, interest was claimed from the date of decree or the date of citation even in some long

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<sup>10</sup> In all 16 out of the 25 cases where interest under the 1998 Act could have been claimed but was not, the pursuers were legally represented.

<sup>11</sup> Student Awards Agency for Scotland.

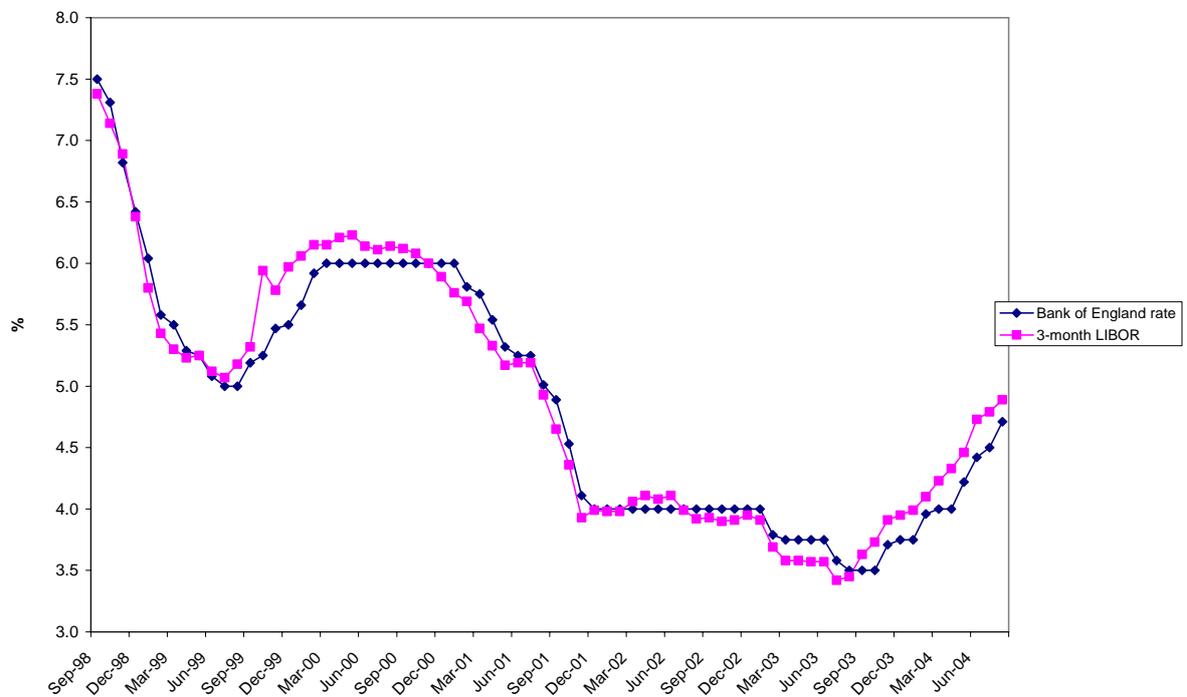
running personal injury claims. This is borne out by the damages actions examined in exercise 3, albeit from a very small sample of nine damages cases. It may be that the rate of interest and the date from when it should run are not always considered carefully by court practitioners at the point of drafting the court writs and it is not known whether a more precise calculation of interest is achieved at the point of settlement.

# APPENDIX D

## Comparison of Interest Rates

The graphs and tables in this appendix were compiled using data obtained from the Bank of England's website.<sup>1</sup>

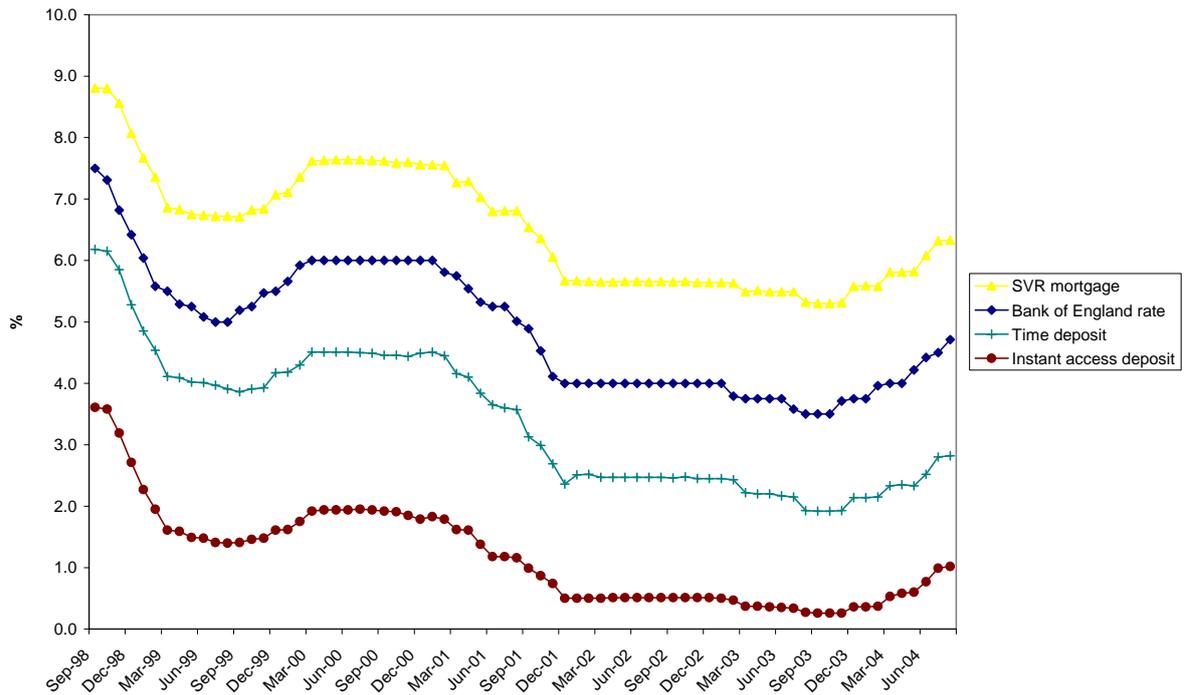
### A. Bank of England base rate<sup>2</sup> and 3-month LIBOR



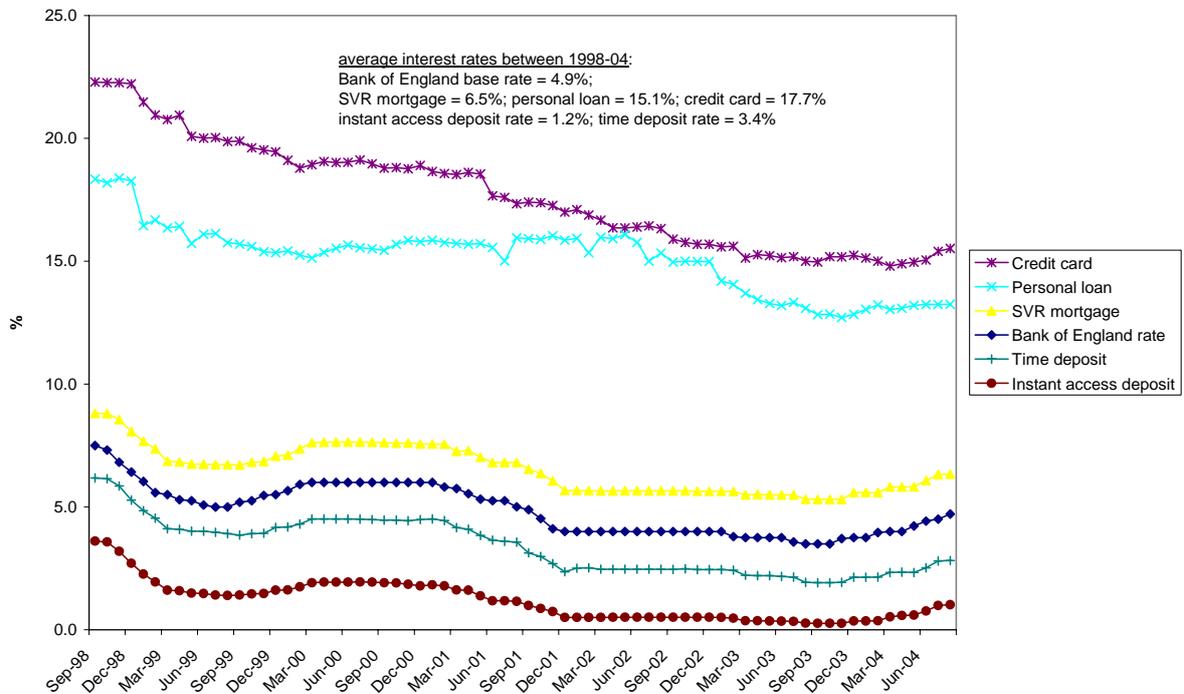
<sup>1</sup> [www.bankofengland.co.uk](http://www.bankofengland.co.uk)

<sup>2</sup> Also referred to as the "repo" rate.

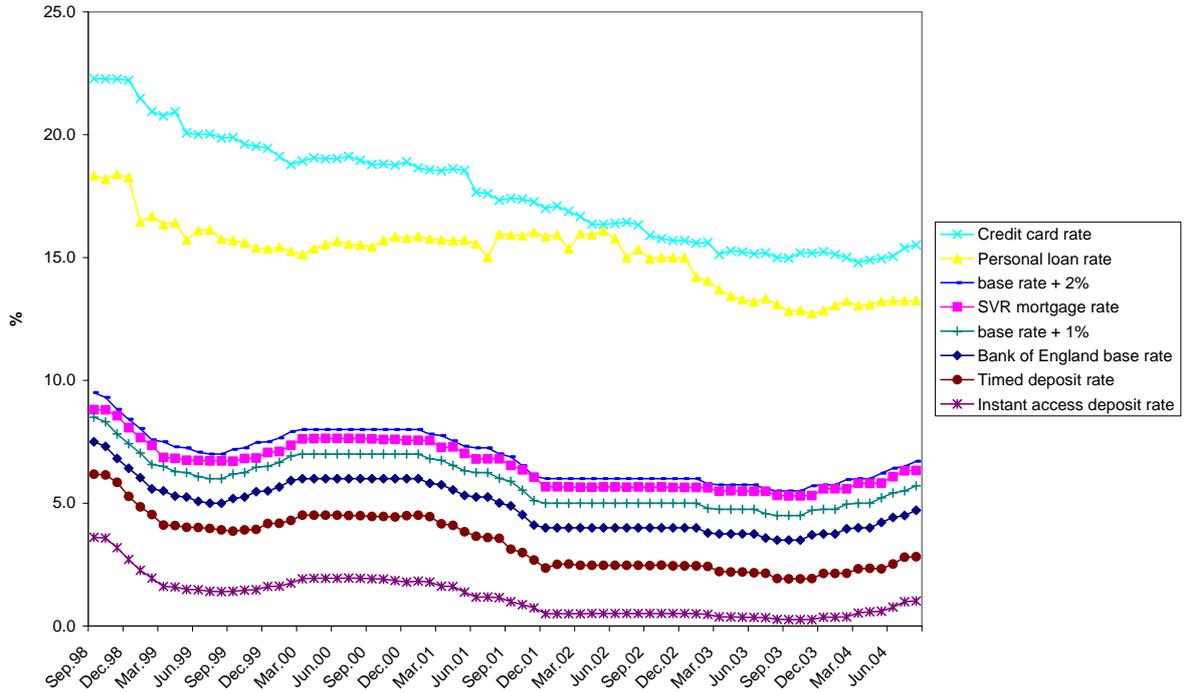
## B. Comparison of household rates, excluding loans and credit cards



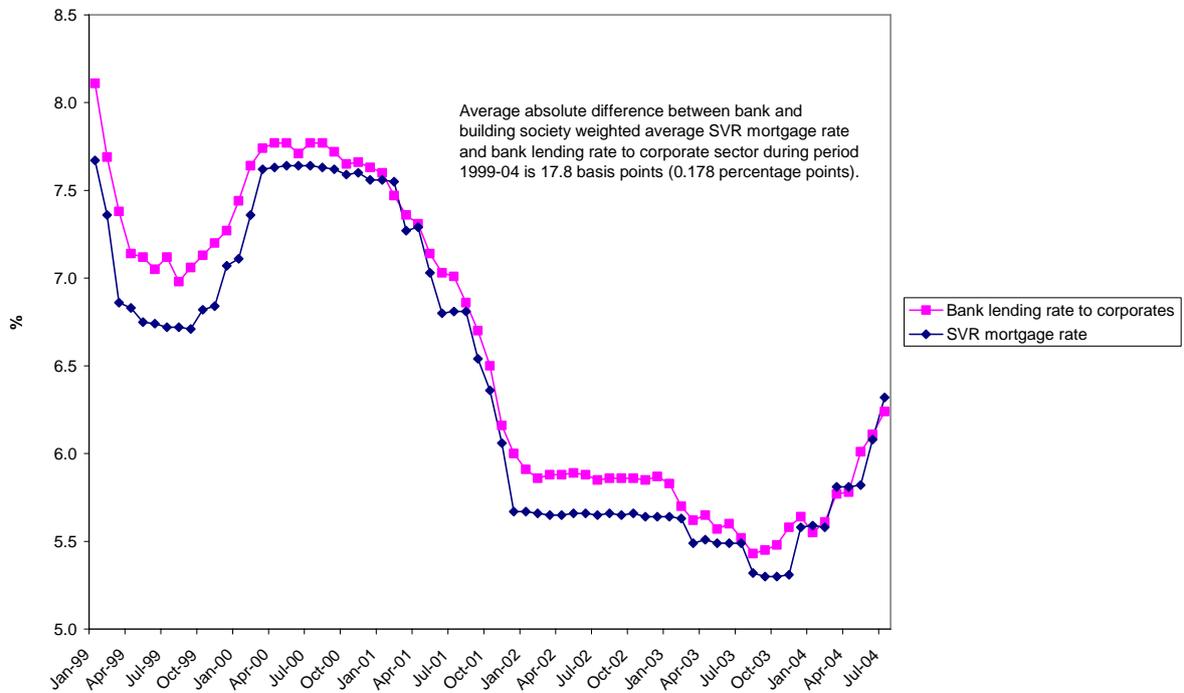
## C: Comparison of household interest rates



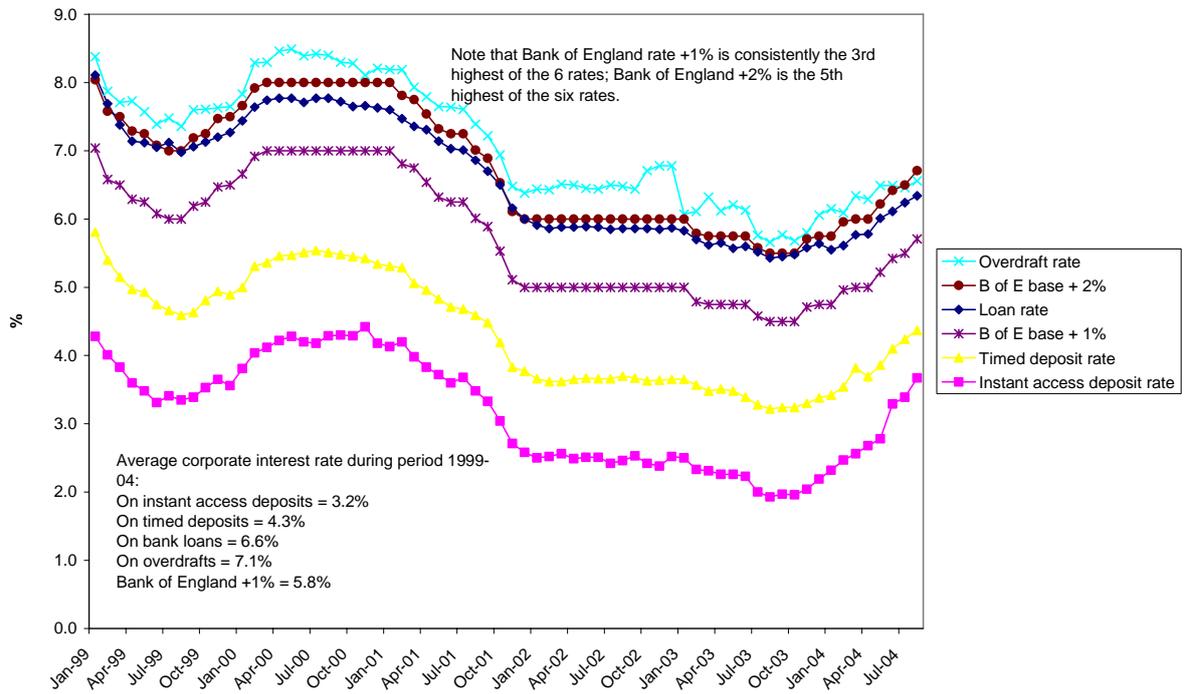
**D: Household and "Bank of England base rate-plus" rates compared.**



**E: Comparison of weighted average SVR mortgage and bank corporate lending rate**



**F: Comparison of corporate lending and deposit rates with "Bank of England base rate-plus" rates**



# APPENDIX E

## Comparison of Simple and Compound Interest

### G. Table showing comparison of compound and simple rates of interest

The table below illustrates the effect of applying interest on a sum of £10,000 by three methods:

1. Simple interest at 8% per annum.
2. Compound interest at the Bank of England base rate (as it has varied from month to month) plus 1%.
3. Simple interest at the Bank of England base rate plus 1%.

Graph G shows the same information in line graph form.

MONTH	8% Simple	Base rate +1 Compound	Base rate +1 Simple
September 99 *	10,067	10,052	10,052
October 99	10,134	10,104	10,104
November 99 *	10,201	10,159	10,158
December 99	10,268	10,214	10,212
January 00 *	10,335	10,271	10,268
February 00 *	10,402	10,331	10,326
March 00	10,469	10,391	10,384
April 00	10,536	10,452	10,442
May 00	10,603	10,513	10,500
June 00	10,670	10,574	10,558
July 00	10,737	10,636	10,616
August 00	10,804	10,698	10,674
September 00	10,871	10,760	10,732
October 00	10,938	10,823	10,790
November 00	11,005	10,886	10,848
December 00	11,072	10,950	10,906
January 01	11,139	11,014	10,964
February 01 *	11,206	11,076	11,020
March 01	11,273	11,138	11,076
April 01 *	11,340	11,198	11,130
May 01 *	11,407	11,256	11,182
June 01	11,474	11,315	11,234
July 01	11,541	11,374	11,286
August 01 *	11,608	11,431	11,336
September 01 *	11,675	11,486	11,384
October 01 *	11,742	11,539	11,430
November 01 *	11,809	11,587	11,472
December 01	11,876	11,635	11,514
January 02	11,943	11,683	11,556
February 02	12,010	11,732	11,598
March 02	12,077	11,781	11,640

April 02	12,144	11,830	11,682
May 02	12,211	11,879	11,724
June 02	12,278	11,928	11,766
July 02	12,345	11,978	11,808
August 02	12,412	12,028	11,850
September 02	12,479	12,078	11,892
October 02	12,546	12,128	11,934
November 02	12,613	12,179	11,976
December 02	12,680	12,230	12,018
January 03	12,747	12,281	12,060
February 03 *	12,814	12,330	12,100
March 03	12,881	12,379	12,140
April 03	12,948	12,428	12,180
May 03	13,015	12,477	12,220
June 03	13,082	12,526	12,260
July 03 *	13,149	12,573	12,298
August 03	13,216	12,620	12,336
September 03	13,283	12,667	12,374
October 03	13,350	12,715	12,412
November 03 *	13,417	12,765	12,452
December 03	13,484	12,816	12,492
January 04	13,551	12,867	12,532
February 04 *	13,618	12,921	12,574
March 04	13,685	12,975	12,616
April 04	13,752	13,029	12,658
May 04 *	13,819	13,086	12,702
June 04 *	13,886	13,146	12,748
July 04	13,953	13,206	12,794
August 04 *	14,020	13,269	12,842

Months in which the Bank of England rate changed are shown by an asterix. The relevant changes to the rate were:

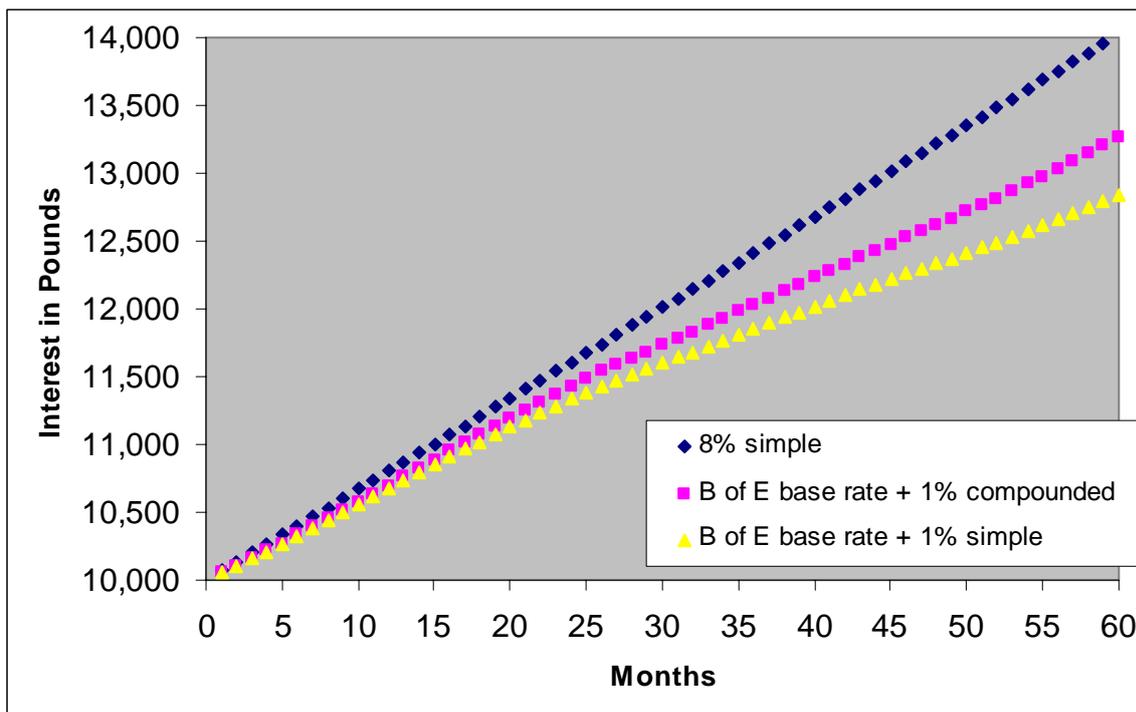
September 1999	5.25%
November 1999	5.5%
January 2000	5.75%
February 2000	6.0%
February 2001	5.75%
April 2001	5.5%
May 2001	5.25%
August 2001	5.0%
September 2001	4.75%
October 2001	4.5%
November 2001	4.0%
February 2003	3.75%
July 2003	3.5%
November 2003	3.75%
February 2004	4.0%
May 2004	4.25%
June 2004	4.5%
August 2004	4.75%

## H: Graph showing comparison of compound and simple rates of interest

The graph below shows the effect of applying interest on a sum of £10,000 by three methods:

1. Simple interest at 8% per annum.
2. Compound interest at the Bank of England base rate (as it has varied from month to month) plus 1%.
3. Simple interest at the Bank of England base rate plus 1%.

The graph demonstrates that for the first year there is little difference between the three forms of calculation. The 8% simple rate (shown by the line marked by diamonds) rises steeply and evenly, leading to a figure far in excess of the lower rates, both compounded and simple. The lines marked by squares (Bank of England base rate plus 1% compounded) and by triangles (Bank of England base rate plus 1% simple) illustrate best the difference between simple and compound methods of calculation. For the 12 months there is little difference between them, but after that they begin to diverge until after 24 months there is a significantly higher figure for the compounded sum.



# APPENDIX F

## Law Reform Projects in Other Jurisdictions

### Australia

- Queensland Law Reform Commission, *An Examination of the Law Relating to Interest on Damages* (1971)
- The Law Reform Commission of Western Australia, *Report on Pre-Judgment Interest* (1981)
- New South Wales Law Reform Commission, Community Law Reform Programme Second Report, *Interest on Certain Debts* (1983)
- The Law Reform Commission of Tasmania, *Report on Interest on Pre- and Post-Judgment Debts* (1985)

### Canada

- Manitoba Law Reform Commission, *Report on Prejudgment Compensation on Money Awards: Alternatives to Interest* (1982)
- Law Reform Commission of British Columbia, *Report on the Court Order Interest Act* (1987)
- Ontario Law Reform Commission, *Report on Compensation for Personal Injuries and Death* (1987)

### England and Wales

- The Law Commission, *Law of Contract: Report on Interest* (1978)
- The Department of Trade and Industry: A Consultation Paper, *Improving the Payment Culture, A Statutory Right to Claim Interest on Late Payment of Commercial Debt* (1997)
- The Department of Trade and Industry: A Summary of Responses to the Government's Green Paper, *Improving the Payment Culture, A Statutory Right to Claim Interest on Late Payment of Commercial Debt* (1997)
- The Law Commission, *Pre-Judgment Interest on Debts and Damages, Item 4 of the Eighth Programme of Law Reform: Compound Interest* (2003)

### **Hong Kong**

- The Law Reform Commission of Hong Kong, *Report on Interest on Debts and Damages* (1990)

### **New Zealand**

- Law Commission of New Zealand, *Aspects of Damages: The Award of Interest on Money Claims* (1994)

### **South Africa**

- South African Law Commission, *Report on Interest on Damages* (1994)

### **United States**

- New York Law Revision Commission, *Recommendation Relating to the Rate of Interest Provided by Section 5004 of the Civil Practice Law and Rules* (1989)