



NEWS FROM THE LAW COMMISSION

4 September 2002

Courts should be able to award compound interest, says Law Commission

The Law Commission today publishes a Consultation Paper that proposes a new system for interest awarded by the courts as part of money judgments.

“ **Professor Hugh Beale QC, Law Commissioner, said:**

“The courts’ power to award interest at simple rates but not at compound rates fails to provide an accurate method of compensating claimants who have been kept out of their money. The computer revolution enables compound interest to be calculated quickly and accurately. The courts should be given the discretion to award interest at compound rates that reflect the scale of the claimant’s probable loss.”

The Consultation Paper provisionally proposes:

- giving the courts power to award simple or compound interest, at such rates and with such rests as they see fit;
- laying down that, unless there is a good reason to take a different course in a particular case, the court should as a rule award compound interest at a standard rate with annual rests;
- basing that standard rate on the bank rate in force from year to year.

Reasons for change

When money is paid late, the claimant normally suffers a loss of interest. Either the claimant has had to borrow money to cover the period of delay, or he or she has lost the opportunity to invest the money and earn interest upon it. Claimants will normally have had to borrow at compound rates – or will have lost the opportunity to invest at compound rates. This is true whether the claim is for an unpaid debt or is for damages to compensate losses suffered by the claimant, for example in an accident.

Curiously, under existing law there is no general right to any interest at all on the late payment unless the money is due under a contract that provides for interest. In other cases interest is payable as of right only in very limited circumstances. But if proceedings to recover the money have been started, the courts have a discretion to award interest on the late payment. The courts' general power to award interest on debts or damages is contained in the Supreme Court Act 1981 and the County Courts Act 1984.

At present the courts can normally award only simple interest. This cannot be relied upon to reflect the actual losses suffered by claimants. It is true that simple interest is sometimes awarded at above market rates, and that this can make up for the effect of not awarding compound interest. But this does not fully compensate those who have to wait a long time for payment, especially victims of serious accidents, who may have to wait 6 years or more. At the other end of the scale, in the speediest cases the present system may over-compensate the claimant.

The restriction to simple interest does not apply to arbitrators, who can award simple or compound interest at any rate they see fit.

Now that computers make it easy to calculate compound interest, it seems right to give the courts discretion to award interest at compound rates that come nearer to reflecting the actual loss suffered by the claimant. This is what the Consultation Paper proposes.

There are some situations, such as unpaid tax, where there is already a legal right to fixed interest. Interest may also be included in certain accounts ordered by the courts, for example in trust cases. Neither of these kinds of cases is affected by the Law Commission's proposals.

NOTES

1. The Law Commission's Eighth Programme of Law Reform¹ recommended that an examination be made of the courts' power to award compound interest.
2. The Law Commission was set up by the Law Commissions Act 1965 to promote the reform of the law.

The Commissioners are:

Mr Justice Toulson, *Chairman*
Professor Hugh Beale QC
Mr Stuart Bridge
Professor Martin Partington CBE
Judge Alan Wilkie QC

¹ (2001) Law Com No 274, page 10; see also the Seventh Programme (1999) Law Com No 259, page 11.