



Law Commission

Pre-Judgment Interest on Debts and Damages

Summary

Report Law Com No 287 (Summary)
24 February 2004

REPORT ON PRE-JUDGMENT INTEREST ON DEBTS AND DAMAGES

Summary

1. The current system for awarding interest before judgment leads to widespread confusion and mistakes. Even when the rules are applied correctly, they bear little relationship to commercial reality. In short cases, debtors often pay too much – frequently paying 8% at a time when base rate is 4% or less. In long-running cases the present ban on compound interest means that claimants may be under-compensated.
2. The Law Commission's proposals are designed to provide claimants with fair compensation for delays in payment, without penalising debtors. We make three main recommendations:
 - (1) The courts should normally award interest at a **specified rate**, set each year at 1% above the Bank of England base rate. This would provide a starting point, though the courts would have discretion to depart from the rate where there was good reason to do so. In particular, where claimants could show that they had been forced to borrow at higher rates, they would be able to apply for higher interest.
 - (2) The courts should have a power to award **compound interest** in appropriate circumstances. For debts or damages of £15,000 or more, if claimants asked for compound interest there would be a presumption that they should receive it (though the presumption could be rebutted for good reason). For cases involving less than £15,000 there would be a rebuttable presumption that interest should be simple.¹
 - (3) The Court Service should make available both a **computer programme** and **tables** to make interest calculations as simple and straight-forward as possible.
3. The Civil Procedure Rule Committee should have power to provide the court with further guidance on how to exercise their discretion, both to depart from the specified rate and to grant compound interest.
4. Our recommendations would not affect cases where the contract specifies a rate of interest (as happens in most loans, credit cards or mortgages). Nor would it affect other statutory interest rates – such as those concerned with unpaid tax or compulsory purchase.

¹ In addition, all cases involving less than a year's delay would be limited to simple interest, as the amount of money involved would not be worth the costs of calculation.

5. This summary explains how the proposals would affect consumer claims, commercial claims and personal injury claims.

CONSUMER CLAIMS

6. We are concerned that at present poor and socially excluded debtors routinely pay 8% interest to commercial creditors who are able to borrow money at much lower rates. The 8% rate was set at a time when the base rate was higher (6% rather than 4%) and it now over-compensates claimants.
7. We recommend that in future debtors should pay 1% over base rate (which would currently be 5%). Claimants would be able to ask for more if they could show a good reason – such as having to borrow at a higher rate.
8. This would affect large numbers of debtors (over 100,000 a year), but in most cases the money involved would be small. Over half of claims are for less than £500, and most last for less than six months. In many cases the reduction would be less than £10. However, the move would benefit those who defend cases, which means that the case lasts longer. On a defended case of £3,000 that lasts a year, the reduction in interest would be £90.
9. The introduction of compound interest would have little effect on consumer cases. It will not affect cases where the creditor specifies interest (which with loans and mortgages is nearly always compound). With other cases, very few involve more than £15,000.

COMMERCIAL CLAIMS

10. Since August 2002, businesses recovering debts from other businesses are usually entitled to claim higher rates of interest under the Late Payment of Commercial Debts (Interest) Act 1998. This currently provides interest at 11.75%, plus a fixed sum to cover enforcement costs.
11. The main effect of our proposals will be in commercial claims for damages or restitution. The Commercial Court already often awards interest at base +1%. The main change here will be to allow claimants to receive compound interest. We are concerned that the current limitation to simple interest ignores commercial reality, which may reflect poorly on the legal system in large commercial disputes.
12. In county court claims, claimants often receive 8% interest on damages. Here our proposals will standardise practice between courts. The specified rate is likely to lead to a reduction in the interest paid. As most claims are under £15,000, compound interest will have less effect.

PERSONAL INJURY CLAIMS

13. When calculating interest, one needs to divide personal injury damages into three types: non-pecuniary loss; past pecuniary loss and future loss. Under the present law:
 - *Future loss does not carry interest.*
We recommend that this should continue.

- *Non-pecuniary damages attract simple interest at 2% from the date of the service of the claim.*

Again we recommend that this should continue. General damages represent a global sum, and it is not appropriate to apply precise compound calculations to them. Furthermore, the rate is so low, and the period so short, that compounding would make little practical difference. The money at stake is not worth the costs of calculation.

- *Past pecuniary loss carries simple interest at the rate available on money paid into court (currently 6%).*

This is known as the “special investment account rate”. We recommend that in future past pecuniary loss should carry interest at base +1%. Where the claimant can show hardship through having to borrow at higher rates, they may ask the court to award a higher rate. In larger cases, where the past pecuniary element alone amounts to £15,000 or more, the presumption should be that interest will be compound.

CALCULATING INTEREST ON PAST PECUNIARY LOSS

14. We found widespread confusion about how to calculate interest on past pecuniary loss. Below we give more details about how the current law applies in practice and how we think it should change.

(a) Assuming continuous loss

15. Past pecuniary losses tend to arise continuously over time. Typically, the claimant will have lost earnings (and incurred care costs) each year since the accident. The losses are rarely completely even: for example, care costs may be greater in the first year, while the earnings loss may be greater in the final year, because wages have increased. However, the courts have held that it is sensible to ignore minor fluctuations.² For interest purposes, one should treat roughly continuous losses as if they arose at an even rate since the accident.
16. Of course, in some cases the losses do not arise evenly at all. Some large losses (such a home adaptation costs) may have happened all at once, or the loss of earnings may all be in the first year. Here practitioners already use computer programmes to work out the full interest on each discrete item of expenditure.
17. Practitioners currently have to make a choice whether to treat past pecuniary losses as roughly even, or whether to calculate interest more precisely on each discrete item. We recommend that this should continue. We accept that in practice it is often sensible to treat losses as continuous, even at the cost of some loss of accuracy.

(b) The half-rate rule of thumb

18. Where losses are treated as continuous, Lord Denning recommended that they should receive interest at half the normal rate for the full period (or, which

² *Jefford v Gee* [1970] 2 QB 130.

amounts to the same thing, the full rate for half the period).³ This quick rule of thumb works well provided that interest rates do not fluctuate. If the interest rate has remained at 6% for three years, then one can produce a quick, easy interest calculation by assuming 3% interest on the whole sum for three years.

19. The trouble comes when interest rates fluctuate. In long cases, the appropriate interest rate will have fluctuated from 14.25% in 1991 to 6% in 2002. If one takes each interest rate and applies it at half the rate on the whole sum, one gives too much prominence to the earlier rates and too little prominence to the later rates. As interest rates were much higher in the early 1990s than they are now, the effect is to over-calculate interest.⁴
20. Another problem with the half rate rule of thumb is that it does not work for compound interest.

(c) Bringing greater clarity to the calculation

21. We found that in practice, solicitors took a variety of approaches to calculating interest on past pecuniary loss. From 1993 to 1999, the special investment account rate was 8%, and the half rate approach became known as “the 4% rule”. Some practitioners continued to use 4%, ignoring changes since 1999. Some used 3.5% or 3% (though not always correctly). Others attempted to track rates over time – but because this is difficult to do without special tools, the results were not always accurate.
22. Interest on past pecuniary loss can be significant, and the current confusions and inaccuracies do not show the English legal system in a good light. We recommend that the Court Service should provide parties with easy-to-use tools that would allow the accurate calculation of interest on continuous loss. We would like to see the Court Service make a computer programme available on its website to deal with a wide variety of calculations. We also recommend that the Court Service

³ *Ibid.*

⁴ To illustrate this with an example. Suppose losses occur at £10,000 a year for ten years. The simple interest rate for the first three years is 15%; for the next three years it is 10%; and for the final four years it is 6%.

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

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

consult practitioners on whether there is a demand for tables to track the specified rate so as to calculate both simple and compound interest on continuous loss.

THE COST OF OUR PROPOSALS IN PERSONAL INJURY CLAIMS

23. Our proposals will reduce interest in smaller, shorter personal injury cases – partly by substituting a 5% rate for 6%, and partly by improving the accuracy of the calculations. In some longer cases, however, the introduction of compound interest will increase interest payments.
24. Where payments are mostly made in claims of 10 years or less, the overall cost effect will be broadly neutral.⁵ Any small increase in interest payments in the 10-year cases will be offset by interest reductions in the five year ones.
25. The main cost increase will be in clinical negligence claims, where a high proportion of money is spent on claims where the gap between loss and payment is 15 years or more. We calculate that if our proposals were applied in full to clinical negligence claims they would cost the taxpayer between £20 and £25 million a year. As a matter of principle, we think it right that compound interest should be available to those victims who have suffered compound losses. However, we recognise that this is a matter for the Government to decide how far the introduction of compound interest in clinical negligence claims represents a political priority. It would be possible to make special rules for clinical negligence claims, so that (for example) compound interest only applied to new causes of action.

THE FULL REPORT

26. The full Report, Pre-Judgment Interest on Debts and Damages (Law Commission No 287), was published on 24 February 2004. It is available free from our website (<http://www.lawcom.gov.uk>) or from TSO (The Stationery Office) for £17.50 (Tel: 0870 600 5522).

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⁵ The important time period is between loss and payment (rather than between cause of action and payment). In industrial disease cases, for example, where losses do not show for many years, interest only starts to run once the loss starts to show. Where insurers have a caseload of very short claims (3 years or less) they may pay slightly less in interest.