Enough Interest? Equitable Compensation and Interest

Snell on Equity (33rd edition) covers today's topic succinctly:

"Interest may be awarded on an equitable compensation order and may be awarded on a compound basis."

That is indeed the whole of paragraph 7-061, and the whole of the text on the subject, supported by two cases mentioned in the footnote, *Wallersteiner v. Moir (no. 2)*[1] and *Alenco (Holdings) Ltd v. Bates*[2], though one should be aware that the latter is a first instance case in which the defendant was unrepresented. *Wallersteiner* has often been cited, and was applied, among other instances, by the Privy Council in *Rama v. Millar*[3]. It is well to remember that it was not based on the approach of considering what it would have cost the plaintiff or claimant to borrow the money out of which it has been kept for the duration of the case: it was based on a presumption against a party obliged by equity to compensate that the wrongdoer will have made use of the money and earned profits.[4]

In many books, though *McGregor on Damages* and *Goff and Jones* are outstanding exceptions, interest receives little attention. I intend no disrespect to two books whose great standing we know when I remark that in neither Meagher, Gummow and Lehane's *Equity: Doctrine and Remedies* (5th edition) nor Spry's *Equitable Remedies* (9th edition) could I find interest mentioned in the index. Of the books to which I have turned[5], the Australian work *Remedies in Equity*, by Wright and Hepburn (2010), has a section which appeals to me, three paragraphs on the subject at section 15.9.310 which show what I suggest is an appealingly flexible, straightforward and modern approach. It was so easy to introduce such an approach by legislation, in the Arbitration Act 1996 in England and the Arbitration (Scotland) Act

[1][1975] Q.B. 373 (C.A.)

[2][2005] EWHC 1540 [2005] All ER (D) 211 at paragraph 50

[3][1996] 1 N.Z.L.R. 257. The award upheld was in fact one of simple interest.

[4][1975] Q.B. 373 at pp. 388, 397-8, 406

[5]One that I could not obtain defeated libraries and Amazon. The latter's offering in response to my search included "Life is Sweet: A Chocolate Box Short Story Collection".

2010, but outside the cases to which legislation of that type applies interest is not a topic which shows Judge-made law to best advantage.

As Lord Nicholls said of the English law attitude to compound interest, in the *Sempra Metals* case[6]:

"... legal rules which are not soundly based resemble proverbial bad pennies: they turn up again and again."[7]

Interest certainly does. Dare I suggest that practitioners can do more to bring awards into line with commercial reality?

The problems about interest are widespread in the common law world.

In England judge-made law was for a very long time limited in its development as a result of statutory intervention. The view was essentially that because Parliament had intervened to tackle problems in judge-made law the judiciary should not go further than had Parliament.

A recent example of that difficulty is that the Privy Council was driven to conclude in *The National Housing Trust v. Y.P. Seaton & Associates Co Ltd*[8] that Jamaica needs fresh legislation if its arbitration law is to have the simplicity of the up-to-date English arbitration law on the subject. The arbitrator had therefore been wrong to hold that, in the absence of express provision in the arbitration agreement, he had jurisdiction to award compound interest.

More remarkably, I was startled to learn a couple of years ago that interest had been the subject of difficulty even in New York. The situation was such that as recently as 1989 it was considered necessary to legislate to make clear that agreements to pay compound interest are enforceable there: General Obligations Law paragraph 5-527(1). A case which I came across, which had New York law but London jurisdiction, and was in the event settled, would have alerted anyone whose attention wandered at school when the maths class progressed from simple to compound interest to the practical significance of the choice. The claimant

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[6]*Sempra Metals Ltd v. Inland Revenue Commissioners* [2007] UKHL 34 [2008] 1 A.C. 561

[7]paragraph 51

[8][2015] UKPC 43; [2016] B.L.R. 215

was suing on a large promissory note which in certain circumstances would carry interest at 18% per annum, compounded monthly. You will not be surprised to know that one of the major issues in the case was limitation, which is a challenging subject when you run into compound interest.

Importantly, it is very easy to work out the compound interest nowadays, at least within acceptable limits. You can find free programs on the Internet. These will tell you that if the promissory note had been for $10,000 and had been outstanding at that rate of interest for 10 years, the amount owed would have risen to just under $60,000. (At simple interest the figure would have been only $28,000). In the Jamaican case already mentioned, Lord Toulson, who, unusually for the Privy Council dissented, was prepared to uphold an award of interest which was almost nine times the principal sum on which the arbitrator awarded it. (Lord Toulson was Chairman of the Law Commission when, in 2004, it made its very important report on pre-judgment interest[9].)

These figures no doubt had a lot to do with the aversion, two centuries earlier, to compound interest. But interest rates like that are a fact of life. Corporations which are less than prime sometimes pay a lot for money. For individuals rates can be very high: even when Bank of England base rate is at 0.25% credit card interest rates of 16-18% compounded monthly are very far from uncommon in England. I have a case in which a private individual needed credit card borrowing to stave off bankruptcy. If the Court will not award her interest on a basis consistent with interest at that sort of level compounded monthly then it will not be providing full compensation for her having been kept out of money. We shall see whether she gets it. Yet should there really be a difficulty about it?

In the equitable compensation cases, no, in the sense that there is flexibility. Equity is willing in appropriate cases to strip the defendant of profits. In cases where there is uncertainty, the underlying thought has been that the defendant will have been using the claimant's money and that investment returns are compounded. But there may be a question to be considered further. It was said in *Libertarian Investments Ltd v Hall*[10] that double-counting or punishment is to be avoided. On that basis only simple interest was

[9]LC no. 287. It is a tremendous resort. But its recommendations have not been implemented by Government. The Law Commission website still says, gloomily, that "This project reviews the system for awarding interest before judgment, which leads to widespread confusion and mistakes. Even when the rules are applied correctly, they bear little relationship to commercial reality."

[10][2013] HKCFA 93 at paragraph 140-143

awarded on equitable compensation on the basis of gains that would have accrued to the claimant if the fiduciary duty had been performed rather than breached (as opposed to focussing on what the fiduciary might have done with the money). Reliance was placed on *Westdeutsche Bank v Islington London Borough Council*[11]. Given the development of English law in the next case I shall mention, I respectfully query whether an English Court would regard an award of compound interest on facts such as those in *Libertarian* as involving double-counting or punishment.

But I am still struck by a particular practical problem which seems to affect many cases.

In England there appeared to be a huge leap forward with the *Sempra Metals Ltd* case[12]. In legal terms there was, with the departure[13] from the decision in *President of India v La Pintada Cia Navigation SA*[14], in which the House of Lords had felt hemmed in by the *London, Chatham and Dover Railway* decision[15] and the subsequent Parliamentary attention to the problem.

The apparent leap forward has not been so visible in practice. Leaving aside for the moment the question whether one should differentiate between the cases of claimants who have always been cash positive and those who have been cash negative, in many cases interest is decided on a broad brush basis. The application of the broad brush is liable to produce the occasional, or I would say more than occasional, splodge.

There has been publicity for to recent cases in Hong Kong, raising the question whether interest should be awarded by reference to HSBC prime lending rate or to the very much

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[11][1996] A.C. 669 at p.701C-702E

[12]*Sempra Metals Ltd v. Inland Revenue Commissioners* [2007] UKHL 34 [2008] 1 A.C. 561

[13]See particularly paragraphs16, 100, 165.

[14][1985] A.C. 104

[15]*London, Chatham and Dover Railway Co v South Eastern Railway Co* [1893] A.C. 429

lower HIBOR. *Waddington Ltd v Chan Chun Hoo Thomas*[16] and *Sunny v Bank of America*[17], and indeed *Li Xiao Yun v China Gas Holdings Ltd*[18], have resolved that issue. In the first two of those cases, followed in the third, the Court re-affirmed the practice of using HSBC prime rate + 1% absent evidence displacing it, but the possibility that banking evidence of the way in which rates are fixed and/or applied in particular circumstances might displace it was readily recognised.

In England, to whose practice reference was made, the Commercial Court used to have a practice, helpfully set out in the Commercial Court Guide, that in the absence of circumstances justifying a different award a successful claimant would be awarded interest at 1% over an appropriate rate (either base rate, or LIBOR for sterling cases; and other reference rates for other currencies as appropriate). In the aftermath of the financial crisis, it was recognised that interest for even commercial parties started to move substantially away from that rate, and the Commercial Court dropped that practice and substituted no other[19]. That the minutiae of practice as to interest are easily missed is shown by the Court of Appeal decision in F & C Alternative Investments (Holdings) Ltd v. Barthelemy (no. 3)[20]. Certain observations were made about the Commercial Court practice, but the Court of Appeal was not made aware that the Commercial Court practice had changed.

Am I alone in thinking that it is easy to be less aware than one might of the importance of interest, and that it is a difficult subject to handle?

The two examples I have given, and there will be two more, will have reminded you as well as me that interest really matters to the net result of the case.

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[16][2016] HKCA 200, decision of 20 May 2016; see particularly paragraph 185.

[17][2016] HKCA 201, decision also of 20 May 2016; see particularly paragraphs 182-184.

[18][2016] HKCA 219, decision of 26 May 2016; see paragraph 3.

[19]The change was made in the 9th edition of the Commercial Court Guide, published in 2011 and printed at p.355 of volume 2 of the 2011 White Book, the relevant paragraph being the newly introduced paragraph J14. The Guide was most recently revised in March 2016, and the paragraph quoted is unaltered.

[20][2012] EWCA Civ 843 [2013] 1 W.L.R. 548

Quite apart from the general desirability of facilitating legislation as seen in the field of arbitration, practitioners can make a real difference by focussing on the evidence problem. Recurrent themes are that it is convenient to have default practices (even if the English Commercial Court does not have one); that a default option can be overridden by evidence; that the Court is often hamstrung by lack of evidence. That was evidently so in the Hong Kong cases mentioned; an important English case is *Jaura v. Ahmed*[21], in which the Court of Appeal wanted to, and did, recognise the difference between the well-heeled corporation and the small individual, but was uneasy that it lacked the necessary evidence of borrowing costs for such people, which was clearly regarded as admissible.[22]

But it is often not adduced, and attempts to adduce it are sometimes not welcomed by the Courts, which can be reluctant to allow much time for interest to be argued, even when it is financially very important. Are our attitudes right?

First, we all need to be mathematically aware of the importance of the subject. The potential impact of interest awards on the net result of a case is huge.

Second, reference rates, in the sense of base rates or inter-bank rates, are readily available and the Courts should surely accept these published sources without qualms.

Third, the fear of compound interest being a practical problem is usually misplaced now, such are the resources for computation. In the *Sempra Metals* case, Lord Hope, who agreed to the ground-breaking change, remarked[23] that:

" ...the virtue of simple interest is its simplicity. That cannot be said of compound interest, which can be calculated in different ways leading to different results. This creates the potential for dispute, which is one of the more important objections to its use generally."

It should not, I suggest worry us much now with the computational resources available.

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[21][2002] EWCA Civ 210 [2002] All ER (D) 289

[22]This was exactly the problem in the *Sunny* appeal: see paragraph 184.

[23]at paragraph 42

Fourth, the Court should be ready to receive evidence designed to show the sort of rates that would have been applicable to borrowers of the type in question. Although proportionality of expense and allocation of Court time are important, it should be remembered that the decision matters even to, or perhaps more to, the small business person or private individual. It is notorious that late payment is one of the most serious problems that many small businesses face; to some extent that has been addressed by legislation in England[24], but it is still a very serious problem.

Fifth, the Courts should be ready to provide sufficient time to enable interest to be addressed properly. There is a case[25] raising this point which is pending in our Court of Appeal, at the moment on a permission application. On 2 December 2016, a Friday, the Judge circulated his draft judgement of 897 paragraphs. Argument on all consequential matters was scheduled for the seventh working day following, 12 December. The claimants claimed interest on the damages, which were provisionally expressed in the judgement in US dollars, and served a report about interest rates on US dollars in the Eastern Caribbean, which was where the events in question had taken place, on the working day after the draft judgment was made available. At the hearing the defendant took a number of points, one of which was that the claimants neither had permission to serve evidence of such interest rates nor had given them adequate time before the hearing. One of the points that the Court of Appeal is asked to allow to be considered is how such a question of interest should be tackled. The only point of contention about interest was as to the rate. Each 1%, or, if you prefer, 100 basis points, difference in the award makes about £500,000 difference for the result of the case - here, $HK5 million. The judge actually awarded interest at UK base rate +1.5%. Given that for the relevant period base rate in the United Kingdom has been 1% or less, and that at the relevant time prime lending rate in the relevant island in the Caribbean has constantly been 9%, and that it was not disputed that the claimant had been an uncreditworthy company which could not borrow at prime rate anywhere[26], it is easy to see how much is at stake on this point – perhaps up to £3 million. There was also a currency point to be decided that day

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[24]The Late Payment of Commercial Debts (Interest) Act 1998

[25]*Harlequin Property (SVG) Ltd v Wilkins Kennedy* [2016] EWHC 3188 (TCC); [2017] 4 W.L.R. 30; [2016] EWHC 3233 (TCC); [2016] 6 Costs L.R. 1201: the point arises on the second of these decisions.

[26]Connoisseurs of decisions on interest will read *Kowalishin v. Roberts* [2015] EWHC 1333 (Ch), where the Judge, for purposes of a restitutionary claim, ordered interest at 29.5%, compounded quarterly, to a company which had been in a parlous financial position.

which concerned £1.78 million. These ancillary points concern very large sums of money and deserve, I suggest, a willingness to receive evidence, proper time for both sides to adduce it and prepare argument, and reasonable judicial time for determination.

So, too, in the case of private individuals the very much smaller sums matter, particularly when litigation is so ghastly and successful parties lose part of their winnings to costs. I saw another decision of this type this very month: *Kitcatt v MMS UK Holdings Ltd*[27].

As it happens, the decision reminds one of the difficulty of obtaining practice conformity, the Commercial Court Judge referring, at paragraph 5, to the usual Commercial Court rate as 1% over base rate (which the Guide says has been abandoned).

What is more important is this. The claimants appear to have been 12 individuals. The judgment sum was £2.6m, which the Judge had awarded 6 days earlier. He held it disproportionate to allow time and delay so that there could be evidence on the issue of the interest. The difference between the rate he awarded, and the rate which the claimants sought was 300 basis points. The interest period was 1 May 2014 to 4 Apr 2017 - 3 years less 27 days. The difference between his award (of simple interest) and that sought by the claimants amounts to £228,230. Is it really unreasonable of the claimants to have asked him to allow time to put in evidence, and if the parties could not compromise the issue to determine, a claim equivalent to HK$2,282,300? If the Commercial Court was in doubt, could it not decide the period (which was also in issue) and refer the question of rate to a junior Judge? Should we have a designated Judge, perhaps one authorised to sit in the more modest Mercantile Court, still a part of the High Court, to whom a question of interest should be referred?

That last question is important. Interest may be an ancillary subject. It may not attract specialist attention. But it matters to the parties. Practitioner recognition of it is desirable. And the Court's facilitation of the means of addressing properly is long overdue for a subject which has long been regarded as a blot on distinguished history of judicial development of the law.

Nicholas Davidson Q.C.

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[27][2017] EWHC 786 (Comm). I don't believe I typed the claimant's name into the Amazon search referred to in footnote 5 ...

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