



Scottish Law Commission  
*promoting law reform*

## Report on Interest on Debt and Damages

Report on a reference under section 3(1)(e) of the Law Commissions Act 1965  
Laid before the Scottish Parliament by the Scottish Ministers

September 2006

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



# SCOTTISH LAW COMMISSION

*Report on a reference under section 3(1)(e) of the Law Commissions Act 1965*

## **Report on Interest on Debt and Damages**

To: Ms Cathy Jamieson MSP, Minister for Justice

We have the honour to submit to the Scottish Ministers our Report on Interest on Debt and Damages.

(Signed)

RONALD D MACKAY, *Chairman*

GEORGE L GRETTON

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COLIN TYRE

Michael Lugton, *Chief Executive*  
1 September 2006



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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."

1.2 The law of Scotland in relation to entitlement to interest on claims for payment of money has evolved over a period of many centuries. Although interest has now 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, there has never been a comprehensive statutory scheme determining 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>2</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."

In this Report we recommend the creation of a general statutory entitlement to interest, to run from the time when a sum of money becomes due by one person to another, whether by way of debt or damages.

## Consultation and research

1.3 Our Discussion Paper on Interest on Debt and Damages was published in January 2005. We invited comment on our proposal to introduce a statutory entitlement to interest on sums which have fallen due for payment which would apply regardless of the nature of the

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

<sup>2</sup> 1997 SC 126 at 133.

creditor's claim. We also sought views on the appropriate rate of interest and on the question whether the entitlement should be to simple or to compound interest. We are grateful to all those who responded to the Discussion Paper.<sup>3</sup>

1.4 In preparing the Discussion Paper and this Report we have been assisted by an Advisory Group whose members are listed below.<sup>4</sup> We held a meeting with a representative of the Forum of Scottish Claims Managers<sup>5</sup> to discuss our proposals in relation to interest on sums due under contracts of insurance. We also discussed our proposals regarding interest on judicial expenses with the Auditor of the Court of Session.<sup>6</sup> The contributions of all those who have provided us with the benefit of their advice are much appreciated.

1.5 Prior to publication of the Discussion Paper, we carried out a study of claims made in court in order to ascertain what kind of interest was usually claimed in practice. Our methods and an analysis of our results were set out in an appendix to the Discussion Paper. The results of this exercise were inconclusive. There was some evidence that interest under the Late Payment of Commercial Debts (Interest) Act 1998 was not always claimed by pursuers in circumstances where it appeared prima facie that a claim would be valid. In other cases, a variety of interest rates were claimed in summons and initial writs, which seemed to bear little relation to the nature of the claim. We suggested in the Discussion Paper that if any conclusion could be drawn from our research, it was perhaps that entitlement to interest is not always considered carefully by court practitioners at the time when the writ is drafted and lodged.

### **Guiding principles**

1.6 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 been unable to benefit from the use of the money or, alternatively, has incurred loss as a consequence of not having it to hand. 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 of damages 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 then benefits from delaying settlement or judicial determination of the dispute.

1.7 An award of interest can also 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>7</sup> under which the rate

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<sup>3</sup> A list of consultees who submitted a written response to the Discussion Paper is at Appendix C.

<sup>4</sup> Mr John Downie, formerly Head of Press and Parliamentary Affairs, Federation of Small Businesses in Scotland; Dr Lucy O'Carroll, Economist, HBOS; Mr David Stevenson, Solicitor, Thompsons; Sheriff Principal James Taylor; Mr Michael Wood, Solicitor, Simpson & Marwick.

<sup>5</sup> Mr Andrew Wilkinson.

<sup>6</sup> Mr Neil Crichton.

<sup>7</sup> See para 2.3.

of interest is deliberately set well above bank minimum lending rates<sup>8</sup> in order to penalise 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>9</sup> which has from time to time exceeded commercial rates of interest by several percentage points. 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 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 pursuer 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.

1.8 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.

1.9 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.

1.10 In the Discussion Paper we invited comment on our proposal to adopt the following principles as guidance for reform of the law of Scotland relating to interest on contractual and non-contractual debt and on damages:

- 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.

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<sup>8</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>9</sup> Rules of the Court of Session, rule 7.7 as amended; Sheriff Courts (Scotland) Extracts Act 1892, s 9 as amended.

- 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.
- 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.

Our consultees were agreed that these principles afforded a coherent basis for reform of the present law. In the draft Bill annexed to this Report we have endeavoured to give them statutory effect.

### **Summary of our main recommendations**

1.11 Part 3 of the Report deals with debts of both contractual and non-contractual origin. We recommend the introduction of a statutory entitlement to interest. Such an entitlement exists already<sup>10</sup> in relation to certain types of contract where both parties are acting in the course of a business, but our recommendations would apply to a wider range of contracts and in particular to contracts where at least one of the parties is not acting in the course of a business. In contrast to the 1998 Act, our recommendations would apply to all debts and not merely to debts arising from the supply of goods or services. We recommend a general rule that interest should start to run on the date when payment is due. In relation to contracts for the supply of goods and services we recommend 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. In relation to loans, we recommend retention of the current presumption that interest runs from the date when the loan is made. As regards insurance claims we recommend that interest should begin to run 30 days after the date when a claim in respect of the occurrence of the event insured against is intimated to the insurer and vouched in accordance with the conditions of the contract, with special provision for cases where the insurer's obligation is to repair, reinstate or replace rather than to make a payment to the insured. Our recommendations would also apply to sales and leases of land, and to earnings from employment. There would, however, be a Ministerial power to exclude specified categories of debt from the scope of statutory interest.

1.12 The statutory entitlement which we recommend 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. 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 recommendations.

1.13 We recommend that the statutory scheme should also apply to non-contractual pecuniary claims such as claims based on unjustified enrichment, claims for legal rights, claims for salvage and claims for aliment.

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<sup>10</sup> Under the Late Payment of Commercial Debts (Interest) Act 1998.

1.14 In Part 4 of our Report we recommend a change in the existing statutory provisions which determine the commencement date for the running of interest on damages. 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 recommendations, these discretionary powers would be replaced by an entitlement to interest on each head of loss (including solatium for personal injury) from the date when the loss in question was sustained.<sup>11</sup> For some types of loss this is not intended to lead to any change from existing practice and we believe that it will clarify the law in relation to others.

1.15 In Part 5 we consider in relation to both interest on debt and interest on damages the extent, if any, to which a discretion should be given to the court to remit interest: in other words to decide that interest which would be payable in terms of our draft Bill need not be paid. Our recommendation is that the court should have a limited power, as regards both interest on debt and on damages, to decide that, by reason of the conduct of the person to whom interest would be payable, no interest, or a lesser amount of interest, should be paid.

1.16 Part 6 applies the principles of our recommendations to tenders, interim payments and judicial expenses.

1.17 Part 7 contains our recommendations in relation to the rate at which statutory interest should run. We believe that the rate selected should provide adequate compensation for the creditor but should not be punitive like the rate under the 1998 Act. We consider that a rate 1.5% above the Bank of England rate would give effect to this principle, being a rate at which large businesses can borrow and at which small businesses and consumers can also borrow by secured loan. We recommend that statutory interest should be simple and not compound interest, although our other recommendations would not be affected if it were decided to specify a compound rate.

1.18 Parts 8 and 9 apply our recommendations to disputes resolved by tribunals, arbiters and adjudicators.

### **Legislative competence**

1.19 The recommendations made in this Report generally lie within the legislative competence of the Scottish Parliament. None would result in amendment to any of the enactments set out in Schedule 4 to the Scotland Act 1998 which cannot be modified by the Scottish Parliament. Certain consequential provisions in our draft Bill might be regarded as relating to reserved matters, such as the proposed amendments to the Bills of Exchange Act 1882, the Partnership Act 1890 and the Insolvency (Scotland) Rules 1986 and to the interest-awarding powers of employment tribunals. However, our view is that the purpose of these amendments is to apply our recommendations in relation to rate of interest consistently to these types of payment as to others.<sup>12</sup> If a contrary view were to be taken, any implementing legislation would to that extent have to be enacted by the UK Parliament.

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<sup>11</sup> See paras 4.3-4.6.

<sup>12</sup> Cf Scotland Act 1998, s 29(4).

1.20 In our view our recommendations and the provisions of the draft Bill would not give rise to any breach either of the European Convention on Human Rights or of European Community law.

## Part 2                    Summary and criticisms of the present law

### Summary of the present law

#### *Interest on debt*

2.1     The historical development of the law of interest on debt in Scotland is described in Part 2 of the Discussion Paper. The law 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; (b) by express statutory provision; (c) by implication at common law; or (d) because the principal sum has been wrongfully withheld. We examine each of these categories below.

2.2     (a) *Interest due by agreement*: parties to a contract may agree by express contractual provision for the circumstances in which interest will run, the period for which interest is payable and the rate of interest to be paid. The rate agreed may be fixed or fluctuating, simple or compound, although it must not be extortionate,<sup>1</sup> and it must not be a penalty clause.

2.3     (b) *Interest due by express statutory provision*: interest due by statute is imposed in a wide range of circumstances.<sup>2</sup> Statutory provisions cover interest payable in relationships between private persons, between individuals and local or central government and vice versa. The Late Payment of Commercial Debts (Interest) Act 1998<sup>3</sup> provides for a statutory entitlement to interest to run on the late payment of debts arising from contracts for the supply of goods and services where both parties are acting in the course of a business. This is done by inserting an implied term into contracts within the scope of the Act.<sup>4</sup> The rate of interest set is punitive, and is designed to act as a deterrent to late payment of debts.<sup>5</sup>

2.4     (c) *Interest due by implication at common law*: the circumstances in which entitlement to interest is implied at common law can be broadly grouped into three categories:

*Loans*: a rebuttable presumption on the right to interest exists from the date on which a loan of money is advanced until the date of repayment.<sup>6</sup> Where no rate is

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<sup>1</sup> See Consumer Credit Act 1974, ss 137-140, applicable to all "credit agreements" as defined in s 137 and not only to regulated consumer credit agreements.

<sup>2</sup> A non-exhaustive list is contained in Appendix B of the Discussion Paper.

<sup>3</sup> The Act as amended is reproduced in Appendix B of this Report. It gives effect to the UK's obligation to implement Directive 2000/35/EC 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 Act was brought fully into force in 2002 and amended to render it fully compliant with the Directive.

<sup>4</sup> Subsections 1(1) and 1(2).

<sup>5</sup> Section 6.

<sup>6</sup> See, for example, *Neilson v Stewart* 1991 SC (HL) 22 at 40 (Lord Jauncey of Tulliechettle).

stipulated, the judicial rate will normally be awarded by the court.<sup>7</sup> This presumption does not apply to an IOU, unless it can be proved to vouch for a loan of money. Otherwise, interest on an IOU will not run until the date of judicial demand.<sup>8</sup>

*Possession of heritable property without payment:* A purchaser is obliged to pay interest on the price to the seller by legal implication from the date of possession until the date of payment.<sup>9</sup> Good reason for withholding payment does not prevent interest from running.<sup>10</sup> It is unclear from the case law whether the payment of interest is to be regarded as equivalent to payment of rent by the purchaser for use of the property or as compensation to the seller for not having received the price.<sup>11</sup>

*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. For example, a trustee must invest trust funds or he will be liable for the interest which should have accrued on the funds.

2.5 (d) *Interest due on money wrongfully withheld:* Money is "wrongfully withheld" when there has been a judicial demand for payment and the creditor withholds payment. The concept of the "wrongful withholding" of money is based upon two 19<sup>th</sup> Century decisions. The first, *Carmichael v Caledonian Railway Co*, held that 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>12</sup> This does not (as might first appear) offer a broad discretion to the courts to decide whether money has or has not been wrongfully withheld. It has been qualified by the decision in *Blair's Trs v Payne*,<sup>13</sup> which together with the earlier *Carmichael* dictum created the general rule that money is not considered wrongfully withheld unless and until a judicial demand for payment has been made. Typically, this has led to awards of interest commencing not earlier than the date of citation.<sup>14</sup> In *Dean Warwick Ltd v Borthwick*,<sup>15</sup> it was stated 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."

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<sup>7</sup> *Ibid* at 35.

<sup>8</sup> *Winestone v Wolfson* 1954 SC 77.

<sup>9</sup> *Durie v Ramsay* (1624) M 542: "It is against reason and conscience both to retain the money, without paying annual therefor, and to bruike also the whole profits of the land." 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.

<sup>10</sup> *Stirling v Paunter* (1627) M 544; Erskine, Institute III.iii.79; *Grandison's Trs v Jardine* (1895) 22R 925.

<sup>11</sup> See para 2.21 of the Discussion Paper, fn 95 and fn 96.

<sup>12</sup> *Carmichael v Caledonian Railway Co* (1870) 8M (HL) 119 at 131 (Lord Westbury).

<sup>13</sup> (1884) 12R 104.

<sup>14</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 at 6 (Lord Clyde).

<sup>15</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.

Despite this apparently invariable rule, there have been many attempts to identify the date from which money has been wrongfully withheld, leading to inconsistent results. Unascertained debt has caused particular problems, leading to awards of interest running from both before citation and commencing on the date of citation in similar circumstances.<sup>16</sup> Occasionally, it has been accepted that interest will run before the date of citation upon consideration of the whole circumstances of the case.<sup>17</sup> An exception to the general rule is that formal intimation to a debtor that interest shall be payable from a certain date on an "open" account can also enable interest to run from the date of intimation.<sup>18</sup>

### *Interest on damages*

2.6 Before statutory intervention in 1958 and 1971, development of the law of interest on damages followed a path similar to that taken by the law on interest on debt. The courts relied on the concept of "wrongful withholding" and were reluctant to award interest on unascertained claims. This led to interest most commonly being awarded only from the date of decree.

2.7 *Statutory intervention.*<sup>19</sup> The Interest on Damages (Scotland) Act 1958 ("the 1958 Act") 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". This test was applied to each individual head of damage. The Act did not change existing rules of law on the granting of interest. As a result the courts interpreted the Act as allowing interest to be awarded from the date of citation provided the quantum of a head of loss was capable of ascertainment prior to the raising of the action.<sup>20</sup> No interest was awarded on solatium prior to the date of decree.

2.8 The Interest on Damages (Scotland) Act 1971 repealed section 1 of the 1958 Act and replaced it with subsection 1(1) which extended the discretionary scope of the courts to award interest on damages for any period from "the date when the right of action arose". Subsection 1(1A) directed the courts to exercise the new discretionary powers in subsection 1(1) when considering claims for damages and solatium in personal injury cases, unless there were reasons special to the particular case for not doing so. A further new provision, subsection 1(1B), allowed for a tender to be treated as inclusive of interest due to the claimant to whom the tender is made, unless otherwise stated.

2.9 Despite these attempts to clarify the position of interest on damages, the pre-existing reliance on "wrongful withholding" and the difficulty of awarding interest on unquantifiable claims have persisted.

2.10 (a) *Damages other than for personal injury.* When a court grants decree for payment of damages other than for personal injury, section 1(1) of the 1958 Act grants a wide discretion over all aspects of the award in relation to interest. The interlocutor may include

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<sup>16</sup> See para 2.23 of the Discussion Paper.

<sup>17</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>18</sup> See, for example, *Linlithgow Oil Co Ltd v North British Railway Co* (1904) 12 SLT 421 and other cases referred to at para 2.13 of the Discussion Paper.

<sup>19</sup> The current statutory provisions are set out in full, as amended, in Appendix B.

<sup>20</sup> *Macrae v Reed and Mallik Ltd* 1961 SC 68.

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. The courts have been reluctant to view this discretion as unqualified and continue to apply the concept of wrongful withholding when establishing the date from which interest can run on damages.<sup>21</sup> As a result, interest on out-of-pocket expenses may be held to run from the date when these were incurred, or perhaps from the date when they were capable of being quantified.<sup>22</sup> Interest on loss of past profits will run from the date on which they would have been earned but for the event giving rise to the claim. Other losses may attract interest from the date of judicial demand. The rate of interest in all of these heads of loss will normally be the judicial rate specified in rules of court.<sup>23</sup>

2.11 (b) *Damages for personal injury.* Subsection 1(1A) of the 1958 Act directs the court to include an award of interest in terms of subsection 1(1) when granting decree for damages or solatium for personal injury, unless there are reasons special to the particular case not to do so. This direction applies to claims for loss of support, distress and grief in fatal cases as well as claims made by the person who has sustained the injury.<sup>24</sup> In practice, the court distinguishes between past and future solatium and lost earnings, with interest only applicable to the elements of the award intended to compensate for past losses. Past awards are for a cumulative loss over a period of time since the injury occurred. To avoid excessive compensation to the pursuer, it is common practice where sums have been accruing at regular intervals for interest to be awarded on the whole past sum at half the judicial rate.<sup>25</sup> Generally, where 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 injury. Where, however, the effects of an injury have ceased prior to the date of decree, interest at the full judicial rate may be awarded from the date when the effects of the injury ceased.<sup>26</sup> Adjustment may be made to an award of interest where an interim payment or award of damages has been made to the pursuer.<sup>27</sup> Where a sum claimed in a personal injury action includes an element which does not represent damages for personal injury or solatium, such as the cost of repair of a car damaged in a collision, this element is not subject to the special rule in section 1(1A)<sup>28</sup> and accordingly the power to award interest is at the discretion of the court under section 1(1).

#### *Interest on sums other than debts or damages*

2.12 The following sums which can be categorised as neither contractual debts nor damages have been held to bear interest:

(a) *Awards in respect of unjustified enrichment.* Such authorities as there are on the running of interest on sums due in order to reverse unjustified enrichment suggest

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<sup>21</sup> *James Buchanan & Co v Stewart Cameron (Drymen) Ltd* 1973 SC 285; *Boots the Chemist Ltd v GA Estates Ltd* 1992 SC 485.

<sup>22</sup> *Boots the Chemist Ltd v GA Estates Ltd* 1992 SC 485.

<sup>23</sup> Rules of the Court of Session, rule 7.7, as amended; Sheriff Courts (Scotland) Extracts Act 1892, s 9, as amended.

<sup>24</sup> *Plaxton v Aaron Construction (Dundee) Ltd* 1980 SLT (Notes) 6; *Prentice v Chalmers* 1985 SLT 168.

<sup>25</sup> *Smith v Middleton* 1972 SC 30.

<sup>26</sup> See para 2.35 of the Discussion Paper.

<sup>27</sup> For example *Jarvie v Sharp* 1992 SLT 350.

<sup>28</sup> See words in parenthesis in s 1(1)(A), Interest on Damages (Scotland) Act. See also *Orr v Metcalfe* 1973 SC 57 at 60 (Lord President Emslie).

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.<sup>29</sup>

(b) *Payments relating to ship collisions and salvage.* English case law has been applied in admiralty actions to ensure a uniform practice between Scotland and England. Interest has been held to run on the amount of the limitation fund until the date when the fund is paid into court.<sup>30</sup> Interest on salvage runs from the date of termination of the salvage services.<sup>31</sup>

(c) *Legal rights in a deceased's estate.* 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>32</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.

(d) *Aliment and financial provision on divorce.* Under the Family Law (Scotland) Act 1985,<sup>33</sup> the court has the power to backdate an award of aliment to the date of the bringing of the action, or to such date as the court sees fit – which may, on special cause shown, be set prior to the date of the bringing of the action.<sup>34</sup> There is no power to award interest on the sum which falls due by reason of the backdating of an award. Interest can, however, be awarded on arrears of aliment. In an action for divorce either party may apply to the court for the payment of a capital sum by the other party. Setting the date from which interest on this sum should run may be done by incidental order. Interest will run at the judicial rate. 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.<sup>35</sup>

## Criticisms of the present law

2.13 In our Discussion Paper we identified five areas of concern with the existing law, and concluded that it does not conform to the guiding principles set out in paragraph 1.10 above. We examine each of these in turn.

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<sup>29</sup> *Parkhill v Batchelor* (1748) M 550; *Glasgow Gas-Light Co v Barony Parish of Glasgow* (1868) 6M 406; *Duncan, Galloway & Co Ltd v Duncan, Falconer & Co* 1913 SC 265; cf *Countess of Cromertie v Lord Advocate* (1871) 9M 988. For a fuller discussion, see para 2.37 of the Discussion Paper.

<sup>30</sup> *The "Olga" v The "Anglia"* (1905) 7F 739, following *The "Crathie"* [1897] Prob Div 178.

<sup>31</sup> *The "Ben Gairn"* 1979 SC 98, following *The "Aldora"* [1975] QB 748.

<sup>32</sup> *Ross v Ross* (1896) 23R 802.

<sup>33</sup> Section 1.

<sup>34</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. Power to backdate has been extended to variations of agreements on aliment by s 20 of the Family Law (Scotland) Act 2006 (in force 4 May 2006).

<sup>35</sup> See paras 2.41 and 2.42 of the Discussion Paper.

### *Inconsistent treatment of debt and damages*

2.14 There is a significant difference between the treatment of interest on contractual debts and interest on damages. Injured parties suing for damages may, in terms of the Interest on Damages (Scotland) Act 1958, claim damages from the date when the right of action arose. However, a party pursuing a contractual debt may claim interest only from the date of judicial demand. Whether a claim arises from damages or from debt, the pursuer has lost the use of his or her money from a specific date; and there seems to us to be no principled reason why a legal entitlement to interest is less generous in one type of claim than in another. Our consultees agreed.

2.15 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 may depend upon the nature of the claim. If the debt is a loan, interest runs *ex lege* from the date when the loan was made. Otherwise, interest will not run until an action for payment is raised.<sup>36</sup> Again, we see no reason to perpetuate this distinction.

### *The concept of "wrongful withholding"*

2.16 The treatment of interest on contractual debts flows from the development by the courts in the 19<sup>th</sup> century of the concept of "wrongful withholding". Interest would not be payable on a debt unless the payment had been wrongfully withheld, and this came to be recognised as the date on which court proceedings commenced. The consequence<sup>37</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.

2.17 As we observed in the Discussion Paper, 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. Read in this way, it 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. For this reason, as the court appears to have done in *Elliott v Combustion Engineering Ltd*,<sup>38</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

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<sup>36</sup> *Winestone v Wolfson* 1954 SC 77. For criticism of this decision, see Professor J Murray, "Interest on Debt" 1991 SLT (News) 305.

<sup>37</sup> Except in circumstances where the creditor is entitled to, and does, demand interest under the Late Payment of Commercial Debts (Interest) Act 1998. The interaction of our recommendations with the 1998 Act is discussed at paras 3.37-3.41 below.

<sup>38</sup> See para 1.2 above.

interest during the period of deprivation. 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 to interest. Except in so far as it has a residual application in English law, wrongful withholding does not feature in any of the legal systems which we have examined.<sup>39</sup>

### *Interest on damages*

2.18 Some of the initial difficulties in interpreting the Interest on Damages (Scotland) Act 1958, and the amendments made to it in 1971, which attracted judicial criticism,<sup>40</sup> have been resolved by a pragmatic approach in the courts. Nevertheless, uncertainty remains with regard to the starting date for interest to run on particular heads of claim. For example, the decision of the Second Division in *Boots the Chemist Ltd v GA Estates Ltd*<sup>41</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. The post-1958 law in relation to interest on damages continues to be 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. 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.

2.19 Our consultees supported the proposal to re-formulate the statutory entitlement to interest on damages although the Faculty of Advocates cautioned that there was a danger that re-formulation would lead to uncertainties and encourage reinterpretation. We address these concerns below.<sup>42</sup>

### *Interest in other circumstances*

2.20 So far as interest on claims of a pecuniary nature other than for contractual debt or for damages is concerned,<sup>43</sup> there has been a dearth of case law in Scotland on the basis of which it could be asserted that the law is clear. We suggested in the Discussion Paper 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. Our consultees agreed, provided that due allowance can be made for the equitable nature of some extra-contractual remedies.

### *Rate of interest*

2.21 Presently, the judicial rate does not fluctuate in line with changes to the Bank of England base rate and often may not reflect the real cost of money to the creditor or the debtor. The result is often an award of interest which is not truly compensatory because the debtor may pay interest at a rate higher than the creditor could have obtained in the market. The view which we expressed in the Discussion Paper was that if an award of interest is to

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<sup>39</sup> See para 3.13.

<sup>40</sup> See para 2.29 of the Discussion Paper and *Smith v Middleton* 1972 SC 30.

<sup>41</sup> 1992 SC 485.

<sup>42</sup> See Part 4.

<sup>43</sup> Eg claims for repetition, recompense, salvage etc. Certain other types of claim are already dealt with by express statutory provision: see para 2.3.

be truly compensatory, a new system for determining and changing the rate of interest payable to claimants is needed. Again, this view was shared by our consultees.

## Part 3            A statutory entitlement to interest on debt

### Introduction

3.1 In this Part we set out our recommendations in relation to the introduction of a general statutory entitlement to interest on debt. Such an entitlement already exists under the Late Payment of Commercial Debts (Interest) Act 1998 in respect of business-to-business contractual debts. The principal consequence of our recommendations is to extend an entitlement to interest to non-business debts in respect of which no express provision is made either in a contract between the parties or by any other statutory provision. The entitlement will differ from that conferred by the 1998 Act in respect that our recommendation is that interest should run at a compensatory and not a punitive rate.<sup>1</sup> We also recommend that the statutory entitlement be extended to debts which originate otherwise than from a contractual relationship.

### INTEREST ON CONTRACTUAL DEBT

3.2 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").

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>2</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>3</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

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<sup>1</sup> Our recommendations in relation to rate of interest are in Part 7 below.

<sup>2</sup> (1884) 12R 104: see para 2.5 above.

<sup>3</sup> See the cases discussed at para 2.5, fn 18.

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.

3.3 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 since the 19<sup>th</sup> century 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. 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. This deferred entitlement approach was adopted, and continues to be used,<sup>5</sup> in most Commonwealth jurisdictions which began by adopting the 19<sup>th</sup> century English legislation. 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>6</sup> This approach has also now 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.

3.4 In the Discussion Paper we expressed the view that 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. Our reasoning is that 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>7</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 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 for payment. He expressed the view,<sup>8</sup> with which we agree, 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."

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

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<sup>4</sup> Section 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> 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>6</sup> Eg France (Code Civil, art 1153); Belgium (Code Civil, art 1153); Germany (Bürgerliches Gesetzbuch, § 288(1)); Italy (Codice Civile, art 1224); Netherlands (Burgerlijk Wetboek, art 6:119); also Quebec (Civil Code, art 1617).

<sup>7</sup> [1985] 1 AC 104 at 122.

<sup>8</sup> *Ibid* at 129.

proceedings in order to recover the debt. Our consultees agreed. We therefore recommend that, as a general rule:

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

(Draft Bill, sections 1(1), 2(a) and 2(c))

### **Exceptions to the rule**

3.5 The general rule as we have stated it in Recommendation 1 above contains two exceptions, namely (i) where the parties to a contract have agreed that interest should run on a basis different from the statutory entitlement which we propose or should not run at all; and (ii) where an entitlement to interest is conferred or excluded by any other statutory provision. As regards the first exception, the question whether the parties to a contract should be permitted to contract out of the general rule is discussed further below,<sup>9</sup> as is the interaction of the general rule with the entitlement of a creditor under the Late Payment of Commercial Debts (Interest) Act 1998.<sup>10</sup> We also emphasise at this stage that our recommendation 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 or for a lesser sum by way of interest running, for example, from a later date.

3.6 The second exception is necessitated by the fact that there are a large number of existing statutory provisions which create an entitlement to interest. Some of these relate to circumstances in which interest is payable as a matter of private law by one person to another (whether under a contract or otherwise) rather than where it is payable as a matter of public law to or by a central or local government body. Where another statute specifies the conditions under which interest is payable on a private law debt, we consider that the provisions of this Act should be excluded. We do, however, recommend elsewhere in this Report that the *rate* of interest chargeable on such debts should be the statutory rate.<sup>11</sup>

3.7 In the course of our consultation the question arose whether further exceptions to the general rule were needed. Citizens Advice Scotland expressed concern in their response that the introduction of a general entitlement to interest on all debt might lead to exacerbation of the difficulties of individuals with multiple debts including, for example, utilities debt (especially gas and electricity) and housing debt upon which interest is not usually charged under a contractual provision. They point out that larger debts might result in utility companies applying harsher sanctions more frequently, leading to increases in disconnections and in customers being forced to pay by the more expensive means of pre-payment meter.

3.8 In our Discussion Paper we had drawn attention to this issue,<sup>12</sup> noting our understanding that for public relations reasons it is uncommon in practice for utility

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<sup>9</sup> Paras 3.42-3.45.

<sup>10</sup> Paras 3.37-3.41.

<sup>11</sup> See para 7.25.

<sup>12</sup> Discussion Paper, para 4.35.

companies to enforce any existing contractual entitlement to interest unless court proceedings are raised. Under our recommendations it would remain open to utility companies to contract out of any entitlement to statutory interest on unpaid debts or, alternatively, simply not to demand it in addition to any principal sum owed. It should also be noted that in one category of case to which Citizens Advice Scotland referred, namely a build-up of payment arrears due to an error in the supplier's automated billing system, interest would not begin to run until a demand had been made for the correct amount.

3.9 We can see no distinction, as a matter of law, between utility and other debts which are incurred by individual debtors. However, we recognise that as a matter of social policy it may be felt desirable to exclude certain types of debt from the scope of statutory interest entitlement. Rather than attempt to define these types of debt exhaustively in the legislation, we have concluded that the matter can best be dealt with by reserving a ministerial power, exercisable by statutory instrument, to exclude specified types of debt from the general rule. Consideration could then be given to whether, for example, utility debts as a category should not bear statutory interest, leaving suppliers to make contractual provision for interest should they so desire. We therefore recommend that:

- 2. A power should be reserved to the Scottish Ministers to exempt specified categories of debt from the general entitlement to statutory interest.**

(Draft Bill, section 2(e))

3.10 Certain taxes and duties payable to local or central government do not presently bear interest. An example is 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>13</sup> Such debts do not fall within the scope of our reference and we make no recommendation regarding the creation of a new liability to interest in such circumstances.

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

3.11 The current position in relation to contractual debts is that there is no scope for the exercise of judicial discretion, except that interest due under the Late Payment of Commercial Debts (Interest) Act 1998 may be remitted by the court if the interests of justice require, by reason of any conduct of the creditor. In contrast, the court has a wide discretion in relation to interest on damages under the Interest on Damages (Scotland) Act 1958.<sup>14</sup> We consider, as a matter of principle, that it is desirable for the same degree of discretion (if any) to be available to the court in relation to all categories of claim upon which interest runs. Our recommendation, which is that judicial discretion should be exercisable only where the interests of justice require by reason of any conduct of the creditor, is discussed in Part 5 below.

#### **Starting date from which interest runs**

3.12 A central issue in relation to contractual debt is identification of the appropriate date from which the creditor in the obligation should become entitled to interest if payment is not

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<sup>13</sup> Local Government Finance Act 1992, Sch 8, para 2(2).

<sup>14</sup> Section 1(1), as amended in 1971.

made by the debtor. It is presumed that before interest will run payment by the debtor must have 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.

Our view is that statutory interest should not run in such circumstances.

3.13 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>15</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. Within the United States there are a number of different formulations including the date when the cause of action accrues, the date of breach of contract and the date of notice of claim. The most popular choice is the date when payment was due. In France and Belgium interest begins to run on the date of demand for payment.<sup>16</sup> In Germany and the Netherlands interest runs during the period of default,<sup>17</sup> and in Italy from the date of default.<sup>18</sup> 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. In none of the systems examined (other than four US states) does entitlement to interest, even after the raising of proceedings, run only from the date when an action has been commenced. 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.

3.14 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>19</sup> In the Discussion Paper we suggested that this formulation expresses in a succinct

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<sup>15</sup> For fuller details of the statutory provisions in Commonwealth and United States systems, see the Discussion Paper, para 4.11.

<sup>16</sup> Code Civil (France), art 1153; Code Civil (Belgium), art 1153.

<sup>17</sup> Bürgerliches Gesetzbuch (Germany), § 288(1); Burgerlijk Wetboek (Netherlands), art 6:119.1.

<sup>18</sup> Codice Civile, art 1224.

<sup>19</sup> Lando and Beale (eds), Principles of European Contract Law Parts I and II, art 9:508. A similar formulation is used by many US states.

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. Our consultees agreed.

3.15 For certain types of debts, it will be desirable to specify in the legislation the date at which "payment is due". We discuss a variety of different types of contractual debt below. We recommend, however, that as a general rule:

**3. Interest on a debt arising under a contract should run from the date when payment is due by the debtor until payment.**

(Draft Bill, section 1(4))

**Application of the general rule to particular contracts**

3.16 We now consider the way in which the general rule stated above, that interest should run from the date when payment is due by the debtor, may be applied to debts arising out of different types of contract.

*Supply (including sale) of goods and services*

3.17 The most common type of pecuniary obligation is the obligation to pay for goods or services received by the debtor. In the Discussion Paper we suggested using as a model the existing provisions of the Late Payment of Commercial Debts (Interest) Act 1998, section 4. These 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<sup>20</sup> has notice from the supplier of the amount of the debt or of the amount claimed by the supplier.

The period of 30 days specified in the Act appeared to us to represent 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. 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.

3.18 Consultees were in agreement with this proposal. One consultee suggested, however, that a 28-day period might be preferable to a 30-day period because the latter will

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<sup>20</sup> "Purchaser" is defined as the buyer in a contract of sale or the person who contracts with the supplier in any other contract for the supply of goods and services: s 16.

start and finish on different days of the week and could finish in a weekend. We understand that the use of a 30-day period for payment is usual in commercial practice. It is not, of course, necessary to take action on the very day when payment falls due. In these circumstances we conclude that there is no strong reason to depart from the 30-day period used in the 1998 Act. We therefore recommend that:

4. **Statutory interest should run on a debt due for the supply of goods or services from the following date:**
  - (a) **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;**
  - (b) **In any other case, 30 days after the later of:**
    - (i) **the day on which the supplier's obligation is performed; or**
    - (ii) **the day on which the purchaser has notice of the amount of the debt or of the amount claimed by the supplier.**

(Draft Bill, section 3(4))

3.19 Entitlement to payment for goods or services 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. Where the creditor's entitlement to receive payment is dependent upon a determination by a third party such as an arbiter, it has been held that interest did not begin to run until the arbiter had determined the principal sum due.<sup>21</sup> The consequence of our recommendation above is that if a claim is not covered by a contractual provision regarding payment following certification, interest will 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, supported by our consultees, 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 therefore recommend that:

5. **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.**

#### *Sale or lease of heritable property*

3.20 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

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<sup>21</sup> *British Railways Board v Ross & Cromarty County Council* 1974 SC 27; *Farrans (Construction) Ltd v Dunfermline District Council* 1988 SC 120.

Commercial Debts (Interest) Act 1998 does not apply to heritable property,<sup>22</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. Our recommendation above in relation to supplies of goods and services generally is capable of applying to sales of heritable property. Entitlement to statutory interest would arise only where the debtor was in default in failing or refusing to make payment. If a purchaser has good reason for refusing payment, for example because the seller is as yet unable to give entry or exhibit a good title to the subjects of sale, we do not consider that statutory interest should run. The seller's entitlement, if any, to interest in these circumstances would be left to be determined, in absence of express agreement, by the common law.<sup>23</sup>

3.21 We also proposed in the Discussion Paper 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 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. We did observe that there might be concern regarding the potential effect of extending a statutory entitlement to interest to public sector landlords such as local authorities and registered social 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. The charging of interest would not, of course, be compulsory: a public sector landlord could, if it wished, include a provision in its tenancy agreements that interest would not run on arrears of rent. Tenancy agreements entered into prior to the new legislation taking effect which did not provide for arrears of rent to be interest-free could be amended by agreement to introduce such a provision.

3.22 Concern regarding the inclusion of public sector housing debt in the general rule was expressed in responses to the Discussion Paper by Citizens Advice Scotland and the Scottish Consumer Council. Among the points which they made were that the consequence of non-payment of housing debt is likely to be eviction, and that it was impossible to predict how different public sector landlords would react to the introduction of an entitlement to charge interest on arrears of rent. It could not be assumed that all would contract out of the statutory entitlement or decline to enforce it when the time came to collect a debt.

3.23 As with utility debt, we see no distinction, as a matter of law, between public sector housing debt and other debts likely to be incurred by individuals upon which there is no contractual right to interest. We recognise that financial hardship could be exacerbated if landlords collecting arrears of rent were also entitled to statutory interest. The ministerial power which we have recommended in paragraph 3.9 above could, if the Scottish Ministers considered it appropriate, be exercised to exclude public sector rents from the scope of the statutory entitlement to interest. In summary, we recommend that:

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<sup>22</sup> The term "goods" is defined as in the Sale of Goods Act 1979, s 61(1).

<sup>23</sup> See the discussion of *Cadzow v Wilson* (1830) 5 Mur 98; *West Highland Railway Co v Place* (1894) 21R 576; *Grandison's Trs v Jardine* (1895) 22R 925 and *Prestwick Cinema Co v Gardiner* 1949 SC 645 (affd 1951 SC 98) at paras 4.19–4.20 of the Discussion Paper.

- 6. Interest should run on payments due for the purchase or letting of heritable property as it runs on other sums which have fallen due for payment, subject to any exercise of the ministerial power to exempt a specific category of debt such as arrears of rent owed to a public sector landlord.**

(Draft Bill, sections 1(1) and 2(e))

*Insurance and other claims for indemnity*

3.24 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>24</sup> In principle there seems to be no reason why late payment by an insurer, or by a party other than an insurer who is liable under a contract of indemnity, should not result in entitlement to statutory interest. However, the model which we borrowed for contractual debt from the 1998 Act requires 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. Certain other forms of insurance, such as life assurance, are in a different position in respect that they do not necessarily involve the insured sustaining a loss. On the other hand, the date when the insurer's liability is triggered in these cases is not in doubt. In all cases, the insurer may require time to investigate the claim.<sup>25</sup>

3.25 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 policyholder has sustained a loss as a consequence of the occurrence. In cases such as third party liability claims this will not occur until the policyholder has had to make a payment (which may itself include an element of interest) to the third party, whether as a result of a court decree or not; and
- (iii) the claim has been intimated to the insurer in the manner provided for by the contract. This may require the policyholder to have produced appropriate vouching of the occurrence of the event insured against and of the amount of his loss.

3.26 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

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<sup>24</sup> *Scott Lithgow Ltd v Secretary of State for Defence* 1989 SC (HL) 9 at 20 (Lord Keith of Kinkel).

<sup>25</sup> Eg *The Rosarino* [1973] 1 Lloyds Rep 21.

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. In the Discussion Paper we expressed the view that a period for investigation should be allowed before interest begins to run. We proposed a period of 30 days as appropriate for investigation. One consultee<sup>26</sup> regarded the period of 30 days as arbitrary, emphasising that large and complicated claims would take longer than this to investigate. It was suggested to us that it would be preferable simply to state that a reasonable period would be allowed before interest runs. We accept that for complicated claims the period of 30 days is unlikely to be sufficient to enable the investigation to be completed. Without specification of a starting date, however, it would not be possible to determine entitlement to interest without court action: something we are seeking to avoid. As pointed out by another consultee, the rate of interest which we are proposing is not punitive and the insurance company has the use of the funds during the period of investigation whereas the loss has already been sustained. This is consistent with our recommendation in relation to damages, on which interest will run although the claimant has not yet produced adequate vouching of his claim.<sup>27</sup> Taking these arguments into account, we remain of the view that it is appropriate for interest to begin running after 30 days even if the insurer is not acting unreasonably in failing to complete his investigation during that period.

3.27 We noted above that one of the conditions which must be satisfied is that the claim has been intimated to the insurer with appropriate vouching. It was suggested to us by the Forum of Scottish Claims Managers that interest should not run during a period when an insurer reasonably declines to make payment because he has not yet been provided with the documentation necessary to satisfy him as to the value of the claim. We see force in this suggestion where the failure properly to vouch the claim constitutes a failure on the part of the policyholder to implement his obligations under the contract of insurance. In such circumstances the insurer is not in default in failing to make payment and, consistently with our other recommendations, it seems reasonable to restrict the running of interest to the period of default. We therefore consider that the 30-day period to which we have referred should not begin to run until the policyholder has met his obligations in relation to provision of appropriate vouching.

3.28 It has been assumed in the discussion above that the obligation of the insurer under the contract is to indemnify the policyholder for the loss which he has sustained. In practice, however, in many – indeed most – contracts of insurance, the insurer's obligation will be one of repair, reinstatement or replacement rather than indemnification for loss. For example, buildings insurance will typically provide for reinstatement of the building in the event of damage or destruction. The same is true of house contents insurance and some motor insurance. In such cases there will be no time at which the insurer may be said to be in default as a consequence of failure to pay (because there is no obligation to pay), although he may have delayed unreasonably in failing to meet his obligation of repair or replacement.<sup>28</sup> It was suggested to us by the Forum of Scottish Claims Managers that an insured whose policy provides for reinstatement should not be in a worse position than one who is entitled to indemnity, and that there should in principle be an entitlement to interest

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<sup>26</sup> The Faculty of Advocates.

<sup>27</sup> It is also consistent with our recommendation at para 3.19 above that interest should run pending a determination or certification by a third party.

<sup>28</sup> The case of *Davidson v Guardian Royal Exchange Assurance* 1979 SC 192 affords an example of such a failure.

from the same time as that set out in Recommendation 7 below. We agree that there would be merit in creating such an entitlement in the interests of consistency, but we have taken the view that this does not fall within our terms of reference, which are concerned exclusively with claims for payment of money. The obligation of an insurer to repair, reinstate or replace is an example of an obligation *ad factum praestandum* which is not distinguishable in principle from other such obligations. We do not consider it appropriate to recommend legislation introducing a statutory entitlement to interest in relation to one particular category of obligation not involving the payment of money. A failure by an insurer to implement timeously his obligation of repair, reinstatement or replacement could give rise to a claim by the insured for damages upon which interest would of course run in the usual way.

3.29 We therefore restrict our recommendation to circumstances in which a contract of insurance provides for payment of a sum of money, and we recommend that:

7. **Interest on a sum payable under a contract of insurance, or other contract of indemnity, 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 vouched in accordance with the conditions of the contract; 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.**

(Draft Bill, sections 3(5) and 3(6))

*Cautionary obligations: cautioner's right of relief*

3.30 In accordance with our proposed general rule, we suggested in the Discussion Paper that the date when payment is made by a cautioner should be regarded as the date when payment is due to him by the principal debtor. Our consultees agreed. We therefore recommend that:

8. **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.**

(Draft Bill, section 3(7))

*Loans*

3.31 As we have noted, there is at common law a presumption that a right to interest exists from the date on which a loan of money is advanced until the date of repayment. The presumption may be displaced by circumstances or by agreement to the contrary. Where no rate of interest was agreed, the judicial rate has normally been awarded by the court. In the Discussion Paper we proposed<sup>29</sup> that the common law presumption should be retained, but

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<sup>29</sup> Para 4.51.

that the rate of interest payable, in absence of contrary agreement, should be the statutory rate which we are recommending. Our consultees supported this approach.

3.32 We also proposed, independently of the common law presumption, that statutory interest should run on a loan from the time when it fell due for repayment but was not repaid. We suggested that where no date had been agreed by the parties for repayment, interest should run from the date 30 days after the day when the creditor demanded repayment. Having considered this suggestion further, we have concluded that there is no need to draw any distinction between loans which have not yet fallen due for repayment and those which have. In each case, we consider that the rule should simply be that statutory interest should run so long as the loan remains outstanding unless the parties have intended otherwise. Such contrary intention will normally be demonstrated by express agreement that interest should run on a different basis – or, alternatively, that it should not run at all – but it will remain open to a party to rely upon surrounding circumstances to demonstrate the parties' intention.<sup>30</sup> Similarly, as regards the rate of interest, we propose no change to the existing rule that where a rate was agreed, this will continue after default, after an action for payment has been raised and even after decree.<sup>31</sup> We recommend that:

**9. In the absence of agreement to the contrary, statutory interest should run on a loan of money from the date on which the loan is made until the date of repayment.**

(Draft Bill, sections 2(a) and 4)

*Contracts of employment*

3.33 In the Discussion Paper we proposed that debts falling due under contracts of employment should fall within the scope of statutory interest, and noted that one consequence of this would be that awards by an Employment Tribunal under the Employment Rights Act 1996, section 13 (unauthorised deductions from wages) would include statutory interest.<sup>32</sup> We expressed the view that the exclusion of contracts of service and apprenticeship from the scope of the Late Payment of Commercial Debts (Interest) Act 1998 should not be reproduced in the more general scheme which we were proposing. We also noted that the general rule in relation to supplies of goods and services required some adaptation to make it work for earnings. We suggested 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. We also noted that as it will seldom occur that an employee would give notice of the amount which he claims is due to him, 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

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<sup>30</sup> In cases such as *Smellie's Trs v Smellie* 1933 SC 725 where the common law presumption was displaced by evidence of the circumstances of the making of the loan, it is clear that what the court was seeking in the surrounding circumstances was evidence of the parties' intention.

<sup>31</sup> *Bank of Scotland v Davis* 1982 SLT 20.

<sup>32</sup> At present the entitlement to interest of a claimant in an 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 recommendations.

regard it as appropriate that the running of interest should be deferred until a rate has been proposed or agreed.

3.34 Consultees were in favour of including employment income within the scope of the statutory interest entitlement. One consultee<sup>33</sup> considered that there should be no departure from the general rule that interest begins to run from the date when payment falls due. Thus, for example, where an employee is paid weekly, interest should begin to run 30 days after the end of the week in question rather than 30 days after the end of the month in which that week occurs. We agree with this suggestion, and recommend that:

**10. (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 begin to run 30 days after the end of the period in respect of which the service under the contract is remunerated.**

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

(Draft Bill, section 5)

#### *Obligations to account for money belonging to another*

3.35 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.<sup>34</sup> 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>35</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. For example, in *Wellwood's Trs v Hill*,<sup>36</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 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.

3.36 The provisional view which we expressed in the Discussion Paper was that entitlement to statutory interest 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

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<sup>33</sup> Aberdeen University School of Law.

<sup>34</sup> Circumstances not arising out of a contractual relationship are discussed at paras 3.46-3.65.

<sup>35</sup> Bowstead and Reynolds, *Agency* (16<sup>th</sup> edn), para 6-101.

<sup>36</sup> (1856) 19D 187.

the date when payment fell due in accordance with the general rule. Any 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 came to be held. Our consultees agreed. The general rule achieves this result without any further special provision. We recommend that:

- 11. 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.**

(Draft Bill, section 1(4))

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

3.37 A statutory entitlement to interest exists in respect of commercial contracts under the Late Payment of Commercial Debts (Interest) Act 1998. This Act, as amended in 2002, implements a European Directive<sup>37</sup> which requires member states to provide for interest on business to business debts at what is effectively a punitive rate. The rate payable under the 1998 Act is currently Bank of England base rate plus 8%. The legislation which we are proposing in relation to all debts cannot deprive creditors of rights which they must be given in terms of the Directive. On the other hand we do not intend to restrict the scope of the new legislation to debts other than commercial debts.

3.38 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 statutory interest under our proposed legislation, 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 recommendations 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. A research project which we carried out prior to issuing the Discussion Paper indicated that not all creditors who would be entitled to claim interest under the 1998 Act are doing so. Why this should be is unclear. There may, however, be sound practical reasons why a creditor 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.

3.39 The legislative technique adopted in the 1998 Act was to make entitlement to what is referred to therein as "statutory interest" an implied term of every contract to which the Act applies (that is, to contracts for supplies of goods and services where both parties are acting in the course of a business). It may therefore be said that there is a prospective entitlement to interest on default throughout the duration of the contract. In other words, it is an immediate entitlement if payment is not made on time and not a deferred entitlement which is dependent upon a declaration by a court that interest is payable. We are proposing, similarly, to make entitlement to interest (on all debts, including commercial debts) a statutory entitlement, not dependent for its existence upon the raising of a court action. We do not recommend use of the "implied term" technique. It would be unsatisfactory for two statutes to create two mutually inconsistent implied terms for every commercial contract. The consequence of our recommendations will be that where a debtor in a commercial

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<sup>37</sup> Directive 2000/35/EC of the European Parliament and Council, 29 June 2000, on combating late payment in commercial transactions.

contract defaults in making payment when due, the creditor will have two parallel statutory rights to receive interest: one at the punitive rate under the 1998 Act and another at the compensatory rate under the new legislation. Obviously he ought not to be able to claim both. Equally, as noted above, he cannot be deprived of his right to claim at the punitive rate.

3.40 Our proposed solution, supported by our consultees, is to avoid conflict between the two regimes by providing that a debt does not carry interest under the 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 new scheme. We note that section 7(2) of the 1998 Act, dealing with express contract terms which are inconsistent with the statutory implied term, acknowledges that the parties are free, after the time when the debt is created, to agree terms dealing with the debt. There is, equally, no reason why a creditor should be obliged to exercise his implied contractual right under the 1998 Act if he does not wish to do so. Moreover, we consider that the creditor should be permitted to change his mind. If, having demanded interest on one basis he subsequently chooses to demand it on the other, our proposed legislation will allow him to do so. We recommend that:

- 12. 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.**

(Draft Bill, section 2(d))

3.41 An amendment to the 1998 Act is also required. Section 3(2) of that Act provides:

"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)."

Left as it is, that subsection would exclude entitlement to interest under the 1998 Act in every case to which the new legislation applied: in other words, the 1998 Act would invariably be overridden. This would, in our view, be a breach of creditors' rights under the Directive and we therefore consider that it is necessary to amend section 3(2) by inserting a reference to the new Act.<sup>38</sup>

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

3.42 Section 8(1) of the Late Payment of Commercial Debts (Interest) Act 1998<sup>39</sup> prohibits parties from contracting out of entitlement to interest under that Act by providing 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."

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<sup>38</sup> Draft Bill, sch 1, para 9.

<sup>39</sup> Implementing Art 3(3) of Directive 2000/35/EC.

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.

3.43 In the Discussion Paper we expressed the view that there was no need to prohibit parties from contracting out of the running of interest generally on contractual debt, for the following reasons. Firstly, there is less of an incentive for a party to contract out of payment of interest at a compensatory rather than a punitive rate. Secondly, it would seem to be wrong to prohibit parties from agreeing that one shall have interest-free use of the other's money or property. It seems right, for example, that the parties to a public sector 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. There will be many circumstances in which debts are outstanding between family members or friends where there is no intention on the part of the creditor to receive interest. Thirdly, the statutory provisions will be in general terms which are unlikely to work equally well in all circumstances. Fourthly, the situation envisaged in the DTI Consultation Paper of a large business putting pressure on a small business to contract out does not seem likely to arise in the case of debts to which the 1998 Act is not applicable. 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.

3.44 We also suggested that no distinction needed to 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. 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.

3.45 Our proposal in the Discussion Paper was that there was no need for statutory provision to prohibit parties from contracting out of the creditor's entitlement to interest under the new legislation. Consultees who responded to this proposal agreed with our view. We now consider that this should be expressly stated, for the avoidance of doubt, in the new legislation. We therefore recommend that:

- 13. Parties should be free to contract out of the creditor's entitlement to interest under the proposed new legislation.**

(Draft Bill, section 2(a))

## INTEREST ON NON-CONTRACTUAL DEBT

### Introduction

3.46 There are a variety of circumstances in which a pecuniary claim may be made otherwise than as a consequence of a contractual relationship, raising the question of entitlement to interest on the sum claimed. Examples are: certain forms of claim based on unjustified enrichment, notably 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, a person may hold funds on behalf of another 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 person's estate. A sum claimed by way of aliment or financial provision on divorce is neither of the nature of debt nor of damages. Each of these examples is currently governed, to some extent, by common law or statutory rules.<sup>40</sup>

3.47 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. In the Discussion Paper, however, we stated that we saw 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.

Consultees were in agreement that it was appropriate in principle to extend the statutory scheme to non-contractual debts. As in the case of contractual debt, we do not recommend any amendment to existing statutory provisions which already create an entitlement to interest on non-contractual claims,<sup>41</sup> except in so far as our proposals could affect the *rate* of interest payable under certain statutory provisions.<sup>42</sup> We recommend that:

- 14. There should be a general statutory entitlement to interest on non-contractual debts except where an entitlement to interest is conferred or, alternatively, excluded by another statutory provision.**

(Draft Bill, sections 1(1) and 2(c))

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<sup>40</sup> See para 2.12.

<sup>41</sup> Eg Trusts (Scotland) Act 1921, s 29; Adults with Incapacity (Scotland) Act 2000, s 81.

<sup>42</sup> See paras 7.24-7.31.

## Date from which interest runs

3.48 For contractual debts we have recommended the general rule that interest should run from the date when payment is due by the debtor.<sup>43</sup> We consider that the same general rule should, in principle, apply to the various different types of non-contractual debt which we have identified. The question then arises whether it is necessary or desirable to formulate specific statutory provisions applying this general rule to different categories of debt. We consider each in turn below.

## Unjustified enrichment

3.49 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>44</sup> In relation to unjustified enrichment we have considered not only whether specific provision is necessary in order to apply our general rule, but also whether the starting date for interest should be determined according to some entirely different criterion.

3.50 *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>45</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. We consider that it is 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.

3.51 *Recompense.* As regards claims for recompense, the measure of the claim is the value of the benefit to the defender<sup>46</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 view is that the general rule should be that interest will run from the date when payment is due, thus excluding any period during which the creditor intends the debtor to have the benefit of the money. It would be for the court to apply the general rule which we have proposed to the circumstances of a particular case.

3.52 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. In a

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<sup>43</sup> Paragraph 3.14 and recommendation 3.

<sup>44</sup> Useful examples of both are found in *Shilliday v Smith* 1998 SC 725.

<sup>45</sup> See para 2.12.

<sup>46</sup> See R Evans-Jones, *Unjustified Enrichment*, Vol 1, chapter 9.

response to our Discussion Paper, Professor Robin Evans-Jones questioned whether it was fair to treat all debts arising from unjustified enrichment in the same way. He cites by way of example the situation of a pensioner who, through the negligence of an employee of the Department of Work and Pensions, is overpaid his pension and spends the money in good faith on food. Unless the pensioner is able to claim change of position, the Department will be entitled to recover the overpayment. Having suffered the hardship of making such a repayment, should the pensioner also be obliged to pay interest?

3.53 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. Although we see the force of the contrary argument, we consider that, as a general rule, whilst it is appropriate for equitable principles to determine whether any sum is payable to the pursuer and, if so, how much, there is no reason to deprive him of the full financial compensation which an award of interest ensures. However, in line with our recommendations in relation to other forms of debt, we have concluded that there should be a measure of judicial discretion to remit interest which would otherwise be payable, by reason of the conduct of the creditor. This would, we believe, enable the court to reach an equitable solution in hard cases such as the one described above.

3.54 Accordingly, subject to the exercise of the general judicial discretion discussed below,<sup>47</sup> we recommend that:

- 15. Where a sum of money is due by way of redress for unjustified enrichment, interest should be payable, in accordance with the general rule, from the date when payment of the principal sum is due by the debtor to the creditor.**

(Draft Bill, section 1(4))

## Salvage

3.55 In *The "Ben Gairn"*,<sup>48</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, interest was allowed on the salvage award from the date when the salvage services ceased. We proposed in the Discussion Paper that this decision should be given statutory effect. Our consultees agreed. We have decided, however, that it would be preferable to make no express legislative provision in this regard, so that entitlement to interest will be determined according to the proposed general rule that interest runs from the date when the principal sum is due. It would then be for the law of salvage to determine, in the circumstances of a particular case, the date on which the principal sum falls due. It does not appear to us that this approach, which is consistent with our recommendations regarding unjustified enrichment,<sup>49</sup> would disturb the decision in *The "Ben Gairn"*. The Lord Ordinary accepted in that case that a claim for salvage is based upon a common law right to recompense, and considered that the date when the salvage services ceased was the equitable date to choose.

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<sup>47</sup> See Part 5.

<sup>48</sup> 1979 SC 98, Lord Ordinary (Allanbridge).

<sup>49</sup> See paras 3.49–3.54.

## Limitation funds

3.56 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 both England and Scotland<sup>50</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. Our provisional view that it should simply be excluded from the scope of our proposed legislation was shared by consultees. We recommend that:

- 16. The new statutory scheme should not apply to interest on claims on limitation funds established under the Merchant Shipping Acts or similar legislation.**

We do not consider that any express provision is required in the Bill in order to achieve this result.

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

3.57 At paragraph 3.35 above, 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 will 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;
- the right of an outgoing partner to be paid the value of his share in the partnership.

In the Discussion Paper we suggested that it would be 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. We remain of that view. However, as with obligations arising out of contract, we consider that entitlement to statutory interest should be restricted to circumstances in which the debtor is in default in failing to pay the principal sum to the creditor. The general rule which we have recommended will apply, and no specific statutory provision applying it to non-contractual obligations to account is required. 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

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<sup>50</sup> *The "Olga" v The "Anglia"* (1905) 7F 739, following *The "Crathie"* [1897] P 178.

regulated by the substantive law applicable to the parties' relationship: the law of trusts or otherwise as the case may be.

3.58 We therefore recommend that:

- 17. Where a claim is made for payment based upon a non-contractual obligation to account for funds, statutory interest should be payable from the date when the holder is in default in failing to make over the funds to the person entitled to them.**

(Draft Bill, section 1(4))

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

3.59 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>51</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".

3.60 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. 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, we make no recommendation for amendment of 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, the position is in our view no different from any other where a person holding funds to which another is entitled delays in making them over. Our recommendation, supported by our consultees, is that in these circumstances statutory interest should run at the prescribed rate. As with obligations to account for trust funds, we consider that the general rule that interest runs from the date when the principal sum is due is sufficient without the need for a specific legislative provision. Nor do we see a need for a wider judicial discretion than that which we propose for all claims and which is related to the conduct of the creditor.<sup>52</sup> We recommend that:

- 18. Where a claim is made for a sum due in respect of legal rights in a deceased person's estate, statutory interest should be payable from the date when the executor or trustee is in default in failing to make payment to the claimant.**

(Draft Bill, section 1(4))

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<sup>51</sup> *Ross v Ross* (1896) 23R 802.

<sup>52</sup> See Part 5 of this Report.

### *Rate of interest where trustee or executor in default*

3.61 As regards trustees and executors, a further 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 the residue. The same applies to a claim for interest on legal rights. 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 ought to be a claim against the executor personally in recognition of the fact that the delay in distribution is a breach of trust.

3.62 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 yield (whether in the form of interest or otherwise) actually achieved 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. We are satisfied that this result would flow from the general rule that interest runs from the date when payment is due, when applied against the background of the law of trusts.

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

3.63 Entitlement to a sum by way of aliment<sup>53</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 recommendations in relation to the *rate* of post-decree interest.<sup>54</sup> In relation to aliment, however, the court has power in certain circumstances to backdate the award<sup>55</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. In the Discussion Paper we suggested that interest ought to 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. Once again, we consider that this result is achieved

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<sup>53</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>54</sup> See the Discussion Paper, paras 7.48-7.52.

<sup>55</sup> Family Law (Scotland) Act 1985, s 3(1)(c): see para 2.12.

by our proposed general rule, and that there is no need for specific statutory provision applying only to aliment. We recommend that:

**19. Where an award of aliment has been backdated, statutory interest should be payable from the date or dates when the instalments ought to have been paid.**

(Draft Bill, section 1(4))

3.64 One of our consultees<sup>56</sup> suggested that an automatic right to interest might be difficult to justify, on the grounds, firstly, that the amount and date from which aliment ought to have been paid will not be known by the defender until after the decree has been pronounced and, secondly, that there may have been earlier offers rejected by the claimant. It appears to us, however, that if the court decides that aliment ought to have been paid on a particular date then, regardless of whether the date or amount could not have been ascertained until the date of decree, the "compensation" principle on which we have based our recommendations dictates that interest should be payable. The limited judicial discretion which we are proposing<sup>57</sup> should allow the court to address the point regarding rejection of earlier offers.

3.65 Under the present law, arrears of aliment which are recoverable by court action probably carry interest.<sup>58</sup> Given the range of remedies available to enforce an award of aliment, it seems that actions to recover arrears of aliment awarded under a previous court order will be rare. We consider that the effect of our general recommendation (ie that interest runs on a sum of money from the date when it falls due for payment) is that such arrears will carry interest from the date or dates when they ought to have been paid in terms of the previous order. No special provision is necessary to achieve this result.

## **DEBTS DUE UNDER STATUTE TO PUBLIC AUTHORITIES**

3.66 We have taken the view that 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>59</sup> Our draft Bill<sup>60</sup> excludes from entitlement to statutory interest any debt upon which interest is due under any other enactment.

3.67 There are also, however, statutory provisions which impose taxes (such as council tax) or fines and penalties payable to public authorities without making express provision regarding interest. Without such express provision, interest will not presently run on the debt due. It is not our intention to create an obligation to pay interest in such cases: this, too, would lie outside the scope of our reference. We propose to deal with this by a further specific exclusion from entitlement to statutory interest. We therefore recommend that:

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<sup>56</sup> The Faculty of Advocates.

<sup>57</sup> See Part 5 of this Report.

<sup>58</sup> See the Discussion Paper, para 2.41.

<sup>59</sup> See for example the Taxes (Interest Rate) Regulations 1989 (SI 1989/1297), as amended. These regulations set out formulae for the purposes of s 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>60</sup> Section 2(c): see para 3.6.

20. **Where any enactment imposes a tax, fine or penalty but makes no provision for interest to run on the sum due, statutory interest should not run on that sum.**

(Draft Bill, section 2(b))

## Part 4            Interest on damages

### Introduction

4.1     In this Part we set out our recommendations in relation to re-formulation of the existing legislative provisions regarding interest on damages. Statutory intervention has already taken place in 1958 and 1971 in relation to interest on damages and, despite judicial criticism which was made of the legislation on each occasion shortly after enactment, its operation in practice 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. Nevertheless, we considered in the Discussion Paper whether the law relating to interest on damages should be subject to a statutory re-statement in somewhat amended form. We suggested that such re-statement was justified for the following reasons:

- (i)     The current statutory provisions depend 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.

4.2     For these reasons, we sought views as to whether the law relating to interest on damages is in need of statutory re-statement. Most of our consultees supported our

proposal that the law be re-formulated, although the Faculty of Advocates expressed concern that this might cause unforeseen difficulties of interpretation. We have concluded that a re-formulation, substituting a general principle for the present reliance upon exercise of a judicial discretion, is desirable. We recommend that:

**21. The legislation relating to interest on damages should be re-formulated.**

**Date for commencement of running of interest**

4.3 As with interest on contractual debt, our guiding principle has been 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. For example, where earnings are 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>

4.4 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. Here 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.

4.5 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". Whilst this has the merit of affording the court the possibility of awarding interest from the earliest possible date, it requires to be applied in practice in such a way as to take account of the fact that not all 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 such a large extent on the exercise of judicial discretion.

4.6 The solution which we proposed in the Discussion Paper 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

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

claim which does not depend upon applying the criterion of "wrongful withholding". Our consultees were supportive of this approach.<sup>2</sup> We consider that by using the date when the loss is incurred as the benchmark the legislation would provide significantly greater guidance to the court than does the present law. We recommend that:

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

(Draft Bill, section 6(1))

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

4.7 The next question which we consider is whether there is a need for elaboration in the legislation of how the principle would apply to different types of loss.

#### *Out-of-pocket expenses*

4.8 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.

#### *Other pecuniary losses*

4.9 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 or loss of profits. The main obstacle to the straightforward application of this principle in such cases is 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. The current Scottish 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.

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<sup>2</sup> Mr Harvey McGregor QC regarded it as "an excellent proposal".

4.10 In its response to the Discussion Paper, the Faculty of Advocates expressed a number of concerns regarding our proposal. Even in simple cases there would require to be 12 calculations per year (or 52 if the claimant was paid weekly) over what might be a lengthy period of years. The fact that the calculation of wage loss is inevitably an approximation of the claimant's actual loss, based upon the best available comparators, suggests that such detailed calculation is inappropriate. Moreover, the need to carry out calculations in greater detail would lead to increased expense and reduced prospects of extra-judicial settlement, because advisers might no longer be able to adopt a broad-brush approach in the face of legislation which prescribed a specific method of calculation. Other consultees also indicated concern regarding the complexity of the calculation.

4.11 We are, of course, anxious that any legislative change which we recommend should not result in increased expense or create an obstacle to extra-judicial settlement. We believe that what we are proposing merely reflects the current practice, which forms part of existing Scots law because it has been utilised consistently by judges as the means of calculating wage loss. As matters stand, the court is prepared to take "short cuts" in the calculation not because judges consider that the discretion conferred on them by the 1971 Act entitles them to award a pursuer more or less than he has actually lost, but because, as the Faculty points out, the whole calculation requires a degree of approximation and so adopting practices such as calculating interest at half rates over a given period may avoid an impression of spurious accuracy. There may be cases in which strictly accurate calculation is both feasible and desirable, but in most cases we see 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. In short, we do not consider that our recommendations effect any material change in the law except that they make the claimant's statutory entitlement express, rather than depending upon the courts' application of the power currently conferred on them.

4.12 In the Discussion Paper we invited comment on whether special legislative provision was required in relation to losses accruing periodically during the time since the date of the event giving rise to the claim. The majority of our consultees did not consider that this was required, although some suggested that special provision might be desirable for losses consisting of a large number of individual items of loss sustained at different times, such as wage loss or costs of care. Such special provision could take the form of an express sanction to the court to adopt a method of "averaging" such as awarding interest on the total loss over the whole period at half rates.

4.13 We do not consider that such averaging is precluded by our proposed statutory reformulation. We reiterate that we do not see it as a change in the law but rather as a statutory expression of the existing practice. For the avoidance of doubt, however, our draft Bill includes a provision confirming that the court may continue to treat a loss in respect of which an award of damages is made as having been sustained over a period of time. A degree of approximation will thus continue to be acceptable in calculating the pursuer's loss.

## *Solatium*

4.14 Section 1(1A) of the 1958 Act requires interest to be "included" in the damages awarded in respect of solatium for personal injury.<sup>3</sup> In the Discussion Paper we asked whether clarification was required with regard to the application to awards of solatium of the simply-expressed test which we are recommending. 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. Our consultees agreed that this was the better interpretation. We do not wish to interfere with the existing practice of treating solatium as compensating a loss which is sustained over a period of time, and, as with pecuniary losses, we have concluded that it would be desirable for this to be made clear in the Bill. We envisage that solatium would continue to be calculated at a rate which is one-half of the statutory rate or, indeed, at such other fraction of the statutory rate as the court considers appropriate in the circumstances of a particular case.<sup>4</sup> We recommend that:

- 23. The existing practice whereby the court when awarding damages in relation to personal injury may treat a loss (including a non-patrimonial loss) as having been sustained over a period of time should be preserved.**

(Draft Bill, section 6(2))

## *Property lost or destroyed*

4.15 Another situation with which the re-formulated provision will require to deal 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>5</sup> The pursuers engaged the defenders to carry a load of whisky and advertising material by road. The defenders' lorry was stolen and the goods lost. It was 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. The Lord Ordinary (Lord Maxwell) 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 are proposing 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? As between these two alternatives, we consider the latter to be a better 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, however, 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 treat the loss of profit on their re-sale as occurring at the time when they would have been used for profit.

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<sup>3</sup> For criticism of this formulation see *Smith v Middleton* 1972 SC 30 at 39 (Lord Ordinary (Emslie)).

<sup>4</sup> Where, for example, the pursuer has made a full recovery prior to the date of the hearing, the court might award solatium at half rate up to the time of full recovery and solatium at full rate thereafter, which equates to a rate somewhere between half and full rate over the whole period to date.

<sup>5</sup> 1973 SC 285.

4.16 Different dates might be appropriate for 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 loss 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 us 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>6</sup> If, on the other hand, the material was not replaced then, as discussed in paragraph 4.18 below, the only possible date for the calculation of interest on whatever loss was claimed would appear to be the date of the theft.

4.17 The principle may be further tested by applying it to the facts of *Boots the Chemist Ltd v GA Estates Ltd*.<sup>7</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 are proposing, the situation as regards the out-of-pocket expenses will be no different. The position as regards the lost stock will 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 is that there will be no "safety net" of date of citation for a pursuer who fails to prove when the loss was sustained.

4.18 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 4.8 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>8</sup>

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<sup>6</sup> If in addition the pursuers had sustained consequential loss as a result 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>7</sup> 1992 SC 485.

<sup>8</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) 11 LT 622. Where on the other hand a

and it seems to us that the statutory provision which we propose is capable of applying in all of the foregoing circumstances in a fair and reasonable way.

4.19 Another example is afforded by the English case of *Metal Box Co Ltd v Currys Ltd*.<sup>9</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>10</sup> awarded interest from a date midway between the date of the fire and the date when the action was raised. Applying our proposed statutory rule, 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>11</sup> Leaving that matter aside, however, it seems to us that our result would have been reasonable in the circumstances of the *Metal Box* case.

4.20 In the light of this discussion, we proposed in the Discussion Paper that:

- 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.
- 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.
- 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.

4.21 Our consultees agreed with all of these proposals. We also invited comment on whether there was a need for express statutory provision setting out these proposals or, alternatively, whether they could be regarded as following naturally from the general principle that interest runs from the time when loss is sustained. Consultees who responded to this question were of the view that no special statutory provision was required, and we accept this view.

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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>9</sup> [1988] 1 WLR 175.

<sup>10</sup> Supreme Court Act 1981, s 35A.

<sup>11</sup> Paras 5.5 and 5.13.

## **Judicial discretion to remit interest**

4.22 The current statutory provisions afford a wide discretion to the court to restrict the period during which interest on damages runs. This is necessary because the 1958 Act simply permits the awarding of interest from any date after the right of action arose. Our view is that under our recommendations there is no need for such a wide discretion and further that the same degree of discretion should apply to awards of interest on damages as applies to awards of interest on debt. Our recommendation, which is that judicial discretion should be exercisable only where the interests of justice require by reason of any conduct of the creditor, is discussed in Part 5 below.

## Part 5            Judicial discretion

### Introduction: the current position

5.1     An issue which arises in relation to all types of pecuniary claim is the extent to which the awarding of interest to a creditor should be a matter of judicial discretion. Some systems, notably those of England and Wales and many Commonwealth jurisdictions, afford the court a wide discretion in relation to the award of interest, in particular as regards the date from which it begins to run. Other systems, such as the Continental systems, make no provision for judicial discretion. Scots law has hitherto adopted differing approaches with regard to different types of claim.

#### *Interest on contractual and non-contractual debt*

5.2     Interest on *contractual* debt, which is a matter of common law, has been held to be due from the date when the principal sum was wrongfully withheld. As discussed above,<sup>1</sup> payment is not wrongfully withheld unless and until either an action for payment has been raised or express intimation has been given that interest will be charged if payment is not made by a specified date. There is therefore no scope for the exercise of discretion. Interest due under the Late Payment of Commercial Debts (Interest) Act 1998 may, however, be remitted by the court if the interests of justice require, by reason of any conduct of the creditor.

5.3     As regards the various types of *non-contractual* debt,<sup>2</sup> it is not possible on the basis of the case law to state any general rule in relation to the existence of a judicial discretion to award interest.

#### *Interest on damages*

5.4     By way of contrast with the position regarding debt, the current statutory provision<sup>3</sup> regarding interest on damages appears to confer a wide discretion on the court: interest may be awarded "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". There are four separate discretions here:

- whether to award interest at all;
- the rate or rates of interest;
- whether to award interest on the whole or on only part of the principal sum; and
- the period during which interest runs.

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<sup>1</sup> See para 2.5.

<sup>2</sup> Discussed at para 2.12.

<sup>3</sup> Interest on Damages (Scotland) Act 1958, s 1(1), as amended in 1971.

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.

5.5 Despite the width of the statutory wording, the courts have been reluctant to interpret it as conferring an unfettered discretion, preferring to apply the provisions of the 1958 Act against the common law background of "wrongful withholding". In practice, certain principles have evolved as to how interest will be awarded on different types of loss: for example, interest will be awarded on out-of-pocket expenses from the date of the expenditure; interest will run on solatium at half the judicial rate throughout the period of past loss, and so on. At one time the courts were inclined to exercise the discretion in such a way as to restrict entitlement to interest where there was unreasonable delay on the part of the pursuer in prosecuting a claim.<sup>4</sup> However, this approach was disapproved by the Second Division in *Boots the Chemist Ltd v GA Estates Ltd*<sup>5</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. It has also been used to restrict entitlement to interest where an interim payment has been made by the defender.

5.6 We consider, as a matter of principle, that it would be desirable for the same degree of discretion (if any) to be available to the court in claims for interest on debt as in claims for interest on damages. Put another way, we see no reason for retaining a discretion in relation to some categories of claim and not others. It is necessary to consider, firstly, whether there is a need to retain any judicial discretion at all.

### **Arguments for and against a judicial discretion to remit interest**

5.7 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, for a reason other than ensuring the accuracy of compensation, it might be regarded as unfair to the debtor to have to pay interest on the whole sum due for the entire 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 a bill which B refuses to pay because he considers it to be excessive. After several months, A sends a bill for a lesser amount which B pays. A demands interest on the sum eventually paid from the date of the previous, excessive bill. B could not have paid earlier because A would not have accepted a cheque for a lesser sum than that initially demanded. On one view, A should not be entitled to interest because he has himself to blame for his failure to receive earlier payment. On the other hand, it could be argued that where the rate of interest is compensatory and not penal, A should be entitled to interest on the lesser amount eventually

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<sup>4</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>5</sup> 1992 SC 485 at 497 (Lord Justice Clerk Ross).

paid. A has gained nothing by submitting an excessive bill for unsatisfactory work. B loses nothing because he has had the use of the money for a longer period.

5.8 The question whether there should be an element of judicial discretion also arises in relation to delay by trustees and executors in making over funds to beneficiaries entitled to them. If, as we have recommended,<sup>6</sup> the statutory scheme is to apply 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. On the other hand, 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.

5.9 In the Discussion Paper we referred to another 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, that is, systems where entitlement to interest arises only if proceedings have been raised. We are proposing an "immediate entitlement" system in which statutory interest runs irrespective of the raising of proceedings. Inclusion of a judicial discretion might be regarded as inconsistent with a statutory entitlement to interest. In any event, it might lead to uncertainty as to the parties' rights in the absence of court action and thus discourage the resolution of claims for interest on debts paid late without recourse to the court.

5.10 Our consultees were divided on this issue. Those in favour of the retention of a discretion pointed out that what we are proposing represents, at least in relation to interest on debt, a significant change in the law. The results might not always be predictable and judicial discretion could address any consequences of our proposals which would lead to injustice. Judicial discretion allows the law to be adapted to suit varying and unpredictable circumstances. Those against retention of a discretion argued that if what we are proposing is fair, and interest is intended to compensate for loss and not to penalise, then there should be no scope for judicial discretion. Discretion creates uncertainty. Citizens Advice Scotland expressed a preference for judicial discretion which would allow the courts to take account of individual circumstances and suggested that courts could consider the effect of an inequality of power between the parties.

5.11 As mentioned above,<sup>7</sup> the Late Payment of Commercial Debts (Interest) Act 1998 contains a discretion to remit interest on commercial debts, but only by reason of any conduct of the supplier. For example, A Ltd carries out work for B Ltd (without having agreed a price in advance) and then submits a bill which B Ltd refuses to pay on the ground that the charge is exorbitant. A Ltd does nothing about this for more than four years but eventually raises an action for payment of a lesser, reasonable sum within the prescriptive period. Because the rate of interest under the 1998 Act is set intentionally high to penalise late payment, it may be regarded as unfair to require a debtor to pay interest at such a rate when the delay is wholly or mainly due to the conduct of the creditor. It is not so obviously unfair to require a debtor to pay interest at a rate which merely compensates the 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.

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<sup>6</sup> See paras 3.57-3.60 and recommendations 17 and 18.

<sup>7</sup> Para 5.2.

## Conclusion

5.12 Having considered the matter in the light of consultees' responses, we have decided that if judicial discretion is to be retained, then the legislation should specify limits within which the discretion may be exercised. If the courts were left free to apply common law principles, the effect could be to revive rules which our recommendations are intended to replace, such as "wrongful withholding". We have sought to identify a principle which can be applied to all the circumstances in which judicial discretion is an issue and have concluded that a limited discretion, similar to that contained in the 1998 Act, should be retained. We are attracted by this approach, which allows an element of judicial discretion in the interests of justice but limits it to the conduct of the creditor. It addresses most of the circumstances which have occurred to us in which it might be thought unjust to award statutory interest.

### *Example 1*

C is informed by her electricity supplier that due to an administrative error she has been undercharged for the last two years and now owes over £2,000 in arrears. C is unable to afford to pay this as a lump sum and has to pay by instalments over a period of more than a year. The supplier demands interest on the instalments. Under our recommendations, statutory interest would not start to run on any part of the arrears until 30 days after the demand for payment has been made. In addition, the court would have a discretion to remit some or all of the interest accruing thereafter in the interests of justice because the debt arose as a result of the creditor's negligent conduct.

### *Example 2*

D orders goods from a website. In terms of the contract of sale, payment of £1,500 is due 30 days after receipt of the goods. The company supplying the goods sends an invoice showing the sum due to be £2,500. D immediately complains and requests an invoice for the correct amount. After four weeks the company's accounts department sends a reminder which also demands payment of the wrong amount. D complains again and asks for an invoice for the correct amount. After another four weeks the company sends an invoice for the correct amount which D pays promptly. The company demands interest from the date when payment was due in terms of the contract. The court would have a discretion to remit some or all of the interest demanded if it were considered to be in the interests of justice to do so.

5.13 It would be for the courts to determine the types of conduct which justified remission of interest, but since the rate of interest will be set at a level which is merely compensatory, we would not envisage that mere delay in prosecuting a claim would be regarded as sufficient to warrant remission. We recommend, whether the claim is for contractual debt, non-contractual debt or damages, that:

- 24. There should be a judicial discretion to remit interest in whole or in part in respect of a period for which it would otherwise run where the interests of justice so require, but only by reason of any conduct of the creditor.**

(Draft Bill, section 9)

## Part 6                    Tenders, interim payments and judicial expenses

### Tenders

6.1     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.

6.2     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. The defender was held entitled to expenses from the date of the tender. This decision provided an authoritative interpretation of section 1(1B) which seems to us to produce a fair and reasonable result. Its effect is reflected in the wording of the new statutory provision which we propose with regard to tenders.

6.3     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. In the Discussion Paper we proposed that its scope be extended to cover awards of interest on sums other than damages. Our consultees agreed. We therefore recommend that:

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<sup>1</sup> As substituted by the Interest on Damages (Scotland) Act 1971.

<sup>2</sup> 2002 SLT 448.

**25. 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.**

(Draft Bill, section 10)

### **Interim payments**

6.4 There is at present no statutory provision dealing specifically with interim payments in part satisfaction of a debt or a liability for damages. So far as damages are concerned, interest runs under the current legislation<sup>3</sup> 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.<sup>4</sup> Where the defender makes an interim payment of damages, interest ceases to run on the sum paid.<sup>5</sup> At present, this obviously sensible result is achieved in relation to damages by operation of the judicial discretion in s1(1) of the 1958 Act.

6.5 We consider that this result could equally be achieved by legislation which makes clear that interest runs only on the sum outstanding from time to time. In our draft Bill, this result is achieved by the general provision<sup>6</sup> that interest runs on a sum of money until the date or dates of payment of the principal sum.

### **Judicial expenses**

6.6 Parties to litigation incur expenses such as legal fees and fees paid to expert witnesses which, in complex cases, may amount to a significant expense. A successful party who has been awarded judicial expenses (or who has accepted an offer to settle which includes payment of judicial expenses) may, depending upon the view of the auditor, be entitled to recover such fees and outlays from the unsuccessful party. There is, however, no general entitlement to interest on expenses prior to the date of decree. The established rule is that it is competent for the court to award interest on properly incurred outlays from a date prior to the date of decree, but that this will only be done in special circumstances.<sup>7</sup> Thus, for example, in *Presslie v Cochrane McGregor Group Ltd (No 2)*,<sup>8</sup> the fees of architects instructed to support the pursuers' claim were held by the auditor to be exceptional in nature and interest was allowed from the dates of disbursement. The Lord Ordinary (Lord Penrose) observed in that case that there was no consistent pattern in previous cases in which awards of interest had been made.

6.7 One of our consultees<sup>9</sup> suggested to us that the "established rule" is too narrow in scope in respect that the test for recovery of interest on outlays for a period prior to decree is too demanding. It also appears to us to be uncertain in scope. In practice, we understand

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<sup>3</sup> Interest on Damages (Scotland) Act 1958, s 1(1) (as substituted by the Interest on Damages (Scotland) Act 1971).

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

<sup>5</sup> *Redman v McRae* 1991 SLT 785; *Jarvie v Sharp* 1992 SLT 350.

<sup>6</sup> Section 1(3).

<sup>7</sup> *Craig Line Steamship Co Ltd v North British Storage and Transit Co* 1921 SC 114; *Phillips v Upper Clyde Shipbuilders* 1990 SLT 887; *Presslie v Cochrane McGregor Group Ltd (No 2)* 1999 SLT 1242.

<sup>8</sup> 1999 SLT 1242 at 1244-5.

<sup>9</sup> Mr Robert Howie QC.

that the burden of such outlays is often borne by the parties' solicitors pending resolution of the litigation. We agree that in modern practice, where it is common for expert witnesses to be instructed at considerable expense and also for lengthy periods to elapse between payment of such witnesses' accounts and recovery of that expense from the unsuccessful party, there is no good reason to restrict entitlement to interest to "special circumstances". Nor do we see any reason in principle to distinguish between outlays on the one hand and fees paid by the successful party to his solicitor on the other. It would be consistent with our guiding principles for interest to run both on legal fees and on outlays from the date of payment at the compensatory rates which we are proposing. We therefore recommend that:

- 26. Where a party to litigation is found entitled to recover fees and outlays in judicial expenses from another party, statutory interest should be payable on such expenses from the dates when they were respectively paid.**

(Draft Bill, section 11)

## Part 7            Rate of interest

### Introduction

7.1     The principle underlying our recommendations 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 was expressed by Lord Denning MR in *Harbutt's Plasticene Limited v Wayne Tank and Pump Co Limited*<sup>1</sup> as follows:

"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."

This principle can be applied quite clearly to a case of debt where a liquid sum has been retained by one party when it should have been paid over to 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.

7.2     Applying this principle, the rate of interest should reflect the "cost of money" during the period when interest runs. This can 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. It could, however, be seen as 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.

These two measures of interest are not the same. It generally 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, which is intended to be of universal application must choose one or other of these two measures or, alternatively, attempt to achieve a compromise which takes account of both measures but reflects neither precisely.

7.3     A number of factors affect commercial interest rates. In theory, interest may be broken down into three elements:

- (i)     a "time preference" element representing the real return on money borrowed and which determines how fast the value of money invested will increase over time;
- (ii)    an "inflation" element which takes account of the fact that the prices of all other goods and services in the economy will change over time; and

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

- (iii) a "risk" element which will vary according to the lender's assessment of the risk of default on the part of the borrower.

In practice, interest rates for loans and deposits tend to take account of a number of factors, including:

- the monetary authority's base (nominal) interest rate<sup>2</sup> and longer-term interest rates on the financial markets which determine the rate at which lenders can borrow in order to lend on to their customers, and which in turn take account of actual and anticipated rates of inflation;
- the degree of competition among lenders; and
- the risk of default.

An interest charge may also include an element to allow for the expense of the transaction or a penal element to encourage prompt payment.

7.4 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. We do not, however, favour this approach. As we are proposing the introduction of a statutory entitlement to interest which does not depend upon the raising of court proceedings, it would not in our view be appropriate to leave the rate of interest to be determined by the circumstances of a particular case. Even where an action had been raised it would create uncertainty for litigants. Although various mechanisms for determining the appropriate rate of interest exist in other systems throughout the world, there is invariably prescription of an appropriate rate for all cases. Such a rate will inevitably have a "one size fits all" quality: it may seem generous in some cases, or fail to compensate fully in others. We have likewise taken the view that it is necessary in the interests of certainty that a basis for calculating the rate of interest be prescribed by statute.

### **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>3</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>4</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."

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<sup>2</sup> In the United Kingdom, the Bank of England's repo rate: see para 7.11.

<sup>3</sup> SI 1994/1443, as amended (although no amendments have been made to RCS 7.7).

<sup>4</sup> The interest rate in s 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.

The rate was changed to its current level in 1993.<sup>5</sup> 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% in 1993.<sup>6</sup> A rate of 8% also applies to awards by Employment Tribunals sitting in Scotland.<sup>7</sup>

7.6 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.<sup>8</sup> 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.<sup>9</sup> There may also be a lingering reliance on the notion of a "legal rate" – a rate of 5% fixed by statute which originated as a statutory maximum rate of interest<sup>10</sup> and continued to apply 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 for periods other than post-decree,<sup>11</sup> despite the concept of a fixed "legal rate" having been firmly laid to rest by Lord President Cooper in *Kearon v Thomson's Trustees*.<sup>12</sup>

7.7 The main problem with using the judicial rate for awards of interest is that it is amended relatively infrequently and tends not to reflect the true cost of money during a given period. 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 indeed the principle underlying the rate of 8%, then it has rarely been adhered to in practice. Over the last five years, the judicial rate has been on average 3.34% above the Bank of England rate<sup>16</sup> despite the fact that the judicial rate can be amended by Act of Sederunt. 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. We consider that such a principle can best be given effect by replacing the judicial rate by statutory prescription of a fluctuating rate linked to a suitable base.

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<sup>5</sup> SI 1993/770. When the Rules of the Court of Session were consolidated in 1965, the rate was set at 5%. It was amended to 7% in 1970, 11% in 1975, 12% in 1983, and 15% in 1985.

<sup>6</sup> Act of Sederunt (Interest in Sheriff Court Decrees and Extracts) 1993 (SI 1993/769).

<sup>7</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>8</sup> See eg *Neilson v Stewart* 1991 SC (HL) 22 at 35 (Lord President Hope).

<sup>9</sup> See eg *Smith v Middleton* 1972 SC 30 at 38 (Lord Emslie).

<sup>10</sup> See the Discussion Paper, para 2.1.

<sup>11</sup> See eg Lord Cullen in *Quinn v Bowie (No 1)* 1987 SLT 575 or Lord Morison in *Starkey v NCB* 1987 SLT 103.

<sup>12</sup> 1949 SC 287 at 295.

<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 September 2006 was 4.66%.

## Prescription of the statutory rate

7.8 The prescribed rate of interest must be capable of universal application but also truly reflect the cost of money. One solution is to specify a fixed rate of interest which, at the time when it is set, is at a suitable level above a base rate such as the Bank of England base rate. 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, this method of prescription is not sensitive to frequent fluctuations in interest rates which are available in the market. A 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.

7.9 An alternative approach is to specify a fixed rate 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 (ie a specific percentage). 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 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.

7.10 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 statutory instrument<sup>17</sup> which sets the rate of interest payable under the Late Payment of Commercial Debts (Interest) Act 1998, as follows:

"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."

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 parties. 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>18</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

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<sup>17</sup> Late Payment of Commercial Debts (Rate of Interest) (Scotland) Order 2002 (SSI 2002/336), art 4.

<sup>18</sup> In these actions a valuation of each head of claim, including the calculation of interest, must be lodged in court (Rules of the Court of Session, rule 43.9 and Form 43.9).

fairer and more accurate calculation of the pursuer's loss. Concerns of complexity and accessibility are addressed by the availability, discussed below, of an on-line calculator together with printed tables.<sup>19</sup>

### **Selection of base rate**

7.11 The "Bank of England rate" is not the only rate which could 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>20</sup> is the rate set by the Monetary Policy Committee 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 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.

7.12 In the Discussion Paper we suggested the following alternative bases:

- the inflation rate;
- the LIBOR (London Inter Bank Offer Rate): the rate at which banks offer to lend money to each other;
- an average of the lending rates of six UK clearing banks;
- the weighted<sup>21</sup> standard variable mortgage rate ("SVR"); and
- the European Central Bank ("ECB") rate.

We expressed the view that the Bank of England rate provides a more appropriate base rate than any of these alternatives. The clearing 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 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 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

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<sup>19</sup> See paras 7.14 and 7.37.

<sup>20</sup> In this Report 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>21</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.

Committee. Our consultees agreed that the Bank of England rate provided the best available base rate.

7.13 On top of this base rate is to be added a figure so that the total reflects the cost of prudent borrowing. Most of our consultees agreed that the statutory interest rate should not be far above the Bank of England rate, although one was of the view that it should be 3 to 4% above to reflect the cost of borrowing. We agree that the statutory rate should be closely related to the cost of 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. It has been suggested that the rate at which smaller businesses can borrow money is closer to 3% above base. 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. 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. These rates are all higher than can be obtained on an instant access deposit account or a timed deposit account,<sup>22</sup> but considerably less than the rates paid on credit cards or unsecured personal loans.<sup>23</sup> On balance, we have concluded that 1.5% above base would presently be a fair rate of interest to be set in the proposed legislation. It may be, however, that circumstances would change in future, rendering it fairer to increase or decrease the figure added to base. We therefore recommend that:

- 27. There should be a prescribed fluctuating rate of interest which is a specified percentage above the official dealing rate of the Bank of England. The percentage above the Bank of England rate could be amended from time to time by statutory instrument.**

(Draft Bill, sections 7(1), 16(1) and 16(2))

### **Calculation of interest on a particular claim**

7.14 A consequence of our recommendation is 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 will be necessary to apply different rates to portions of the relevant period to deal with fluctuations.<sup>24</sup> This most accurately compensates the creditor and would certainly be the appropriate way to calculate interest on a debt. Consultees who gave their view on this matter agreed that this was the most accurate way of calculating interest but some expressed concern regarding the complexity of the calculation. In the Discussion Paper we suggested that such concerns could be met by the provision on an appropriate website of a calculator which is kept up to date whenever the base rate changes.<sup>25</sup> If necessary, printed

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<sup>22</sup> An account with a minimum notice period for withdrawal, such as three months.

<sup>23</sup> Graphs comparing all of these rates during the period 1998-2004 are contained in Appendix D to the Discussion Paper.

<sup>24</sup> As was done with a changing judicial rate in, eg, *Preston v Grampian Health Board* 1988 SLT 435 and *Keicher v NCB* 1988 SLT 318.

<sup>25</sup> A specimen calculator, programmed to calculate compound interest at Bank of England base rate plus 1%, was made available on the Scottish Law Commission website during the period between publication of the Discussion Paper and submission of this Report.

tables for the calculation of interest could also be made available at appropriate locations such as court buildings and public libraries. In any event, it would always remain open to parties, if they saw fit, to agree a figure in respect of a particular claim which had been calculated to a lesser degree of accuracy. We recommend that:

- 28. 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 could also be made available in appropriate places such as court buildings and public libraries.**

### **Judicial discretion**

7.15 In those situations where pre-judgment interest is available, there is presently a broad judicial discretion, albeit seldom exercised, to apply a rate higher or lower than 8%. Since under our recommendations pre-judgment interest will run for a longer period (at least in relation to debt), a question arises as to whether there should be a judicial discretion regarding the rate to be applied in the particular circumstances of an individual case. The defender, through no fault of his own, may have obtained no interest, or only a lower rate of interest, on the sum which he is found due to pay. He may have a reasonable explanation of why the funds had not been placed in an account with a higher rate of interest. 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. Conversely, the person holding the funds may have obtained a rate of interest *higher* than the prescribed rate.

7.16 One argument against the retention of a judicial discretion in a system where interest runs whether or not court proceedings have been raised is that it reintroduces an element of uncertainty as to the parties' entitlement. In the absence of such a discretion, parties to a dispute can be confident that, at the end of the day, interest will be payable at a known rate which generally reflects the rates available in the market. Another is that if the purpose of the award of interest is to compensate the claimant for loss of the use of the funds during a given period, what the debtor has been doing with them during the same period is irrelevant.

7.17 Consultees were divided on this issue but the majority was against retention of a discretion. In our view such a discretion is unnecessary. It will be recalled that we have recommended that there should be a limited judicial power to remit interest in whole or in part if, by reason of any conduct of the claimant, it is in the interests of justice to do so. Subject to our recommendation regarding foreign currency awards below,<sup>26</sup> we consider that no additional discretion in relation to the *rate* of interest awarded is necessary. We therefore recommend that:

- 29. There should be no judicial discretion to award statutory interest at a rate other than the prescribed rate.**

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<sup>26</sup> See paras 7.18-7.20.

## Foreign currency awards

7.18 It is competent for Scottish courts to award decree for a sum of money in a currency other than sterling.<sup>27</sup> Difficulties could be created if our Recommendation 29 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 nearest equivalent for the currency concerned of the Bank of England's official dealing rate. 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%.<sup>28</sup>

7.19 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 cases, it may be desirable to leave it to the court to fix a rate of interest which is fair to both parties and reasonable in the circumstances. Our consultees supported the grant of a discretion to the court in such cases.

7.20 We therefore recommend that:

**30. (a) Where the court grants decree for payment in a currency other than sterling and the award includes an element of interest, such interest should run at the specified percentage above the currency's nearest equivalent to the Bank of England's official dealing rate.**

**(b) If the court is unable to identify such an equivalent, interest should be awarded at such rate as appears to the court to be fair and reasonable in the circumstances.**

(Draft Bill, section 8)

## Post-decree interest

7.21 The "judicial rate" at which interest runs on sums for which decree has been granted is set by the judges of the Court of Session who make the relevant subordinate legislation<sup>29</sup> as "the Lords of Council and Session". During the period since we received our reference, the rate has been mildly penal.<sup>30</sup> On one view, a rate which penalises delay in payment after decree is right and proper since it operates as a means of enforcement of the will of the court. This view was supported by some of our consultees, including the Faculty of Advocates. On the other hand, it may be argued that since a system of diligence is available to enforce the will of the court, there is no need also to use interest rates to reward a successful pursuer. Application of our guiding principles would tend to suggest that the rate

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<sup>27</sup> *Commerzbank AG v Large* 1977 SC 375. See also *Miliangos v George Frank (Textiles) Ltd* [1976] AC 443.

<sup>28</sup> If the principal sum is converted to sterling when decree is granted, interest should run thereafter by reference to the Bank of England rate, and the form of interlocutor would require to reflect this.

<sup>29</sup> See the Discussion Paper, para 7.5.

<sup>30</sup> The Bank of England base rate was 4.5% from 4 August 2005 until 3 August 2006 when it was raised to 4.75%.

of interest post-decree should continue to be compensatory only and not penal, and this was the view expressed by others who responded to our questions in the Discussion Paper on this point.

7.22 If it were considered necessary to apply a higher rate of post-decree interest, then it could continue to be set by Act of Sederunt as at present. However, care would require to be taken to ensure that the post-decree rate was at all times higher than the pre-decree rate. This could best be done by setting a judicial rate which also fluctuated with the applicable bank rate. For example, if the formula for pre-decree interest is "1.5% over the official dealing rate", then the formula for post-decree interest could be "2.5% over the official dealing rate", or even higher. A period of fourteen days, or perhaps thirty days, might be allowed after which the higher rate of interest would apply.

7.23 On balance, we are not persuaded that there is a need for post-decree interest to run at a higher rate than the statutory rate which, under our recommendations, will run from the starting date when payment falls due or, in the case of damages, when the head of loss is sustained. The statutory scheme which we are proposing is not intended to operate as a mechanism for enforcing payment; it is simply a means of compensating a claimant for delay in receiving payment. In our view the same principle ought to apply after decree has been granted. In cases where a defender seeks to profit from delay in payment after decree, for example because he will have to borrow at a higher rate than the statutory rate in order to fund payment of the principal sum, the pursuer has remedies in diligence to enforce payment. It will also be recalled that where the parties have agreed a contractual rate of interest, it is, under existing law and under our recommendations, this rate which continues to run after decree. It seems to us to be anomalous to continue the operation of a penal rate in cases where no rate has been agreed. Finally, we are not convinced that the current difference between commercial rates of interest and the judicial rate has been caused by anything other than a failure in recent years to maintain the judicial rate broadly in line with market rates. We recommend that:

- 31. Interest after the date of decree should run on the same basis as it does prior to decree and the applicable rate pre- and post- decree should be calculated by the same method.**

In our draft Bill, this recommendation is accommodated by the general provision that statutory interest runs until the date or dates of payment of the principal sum. One consequence of the recommendation is that there would no longer be any need for a "judicial" rate of interest to be specified by rules of court.

### **Rates of interest under other existing statutory provisions**

7.24 There are a large number of existing statutory provisions which create an entitlement to interest. 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 and are excluded from the scope of the new statutory scheme by the section in our draft Bill<sup>31</sup> which provides that statutory interest is not payable on a sum if any other enactment makes provision for interest to run on it or, alternatively, makes provision for no interest to run on it.

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<sup>31</sup> Sections 2(b) and 2(c).

7.25 On the other hand, we consider that there is merit in standardising the rate of interest payable under a variety of statutory provisions applicable to private law relationships. The existing statutory provisions which we have identified fall into three broad categories:

- (i) where 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) where no rate of interest is specified; and
- (iii) where a rate of interest is specified which is peculiar to the provision in question.

We address each of these in turn.

7.26 **Judicial rate specified.** Examples of legislation in which there is a reference to the judicial rate<sup>32</sup> include the Debtors (Scotland) Act 1987, sections 50(5) and 55(7),<sup>33</sup> and the Adults with Incapacity (Scotland) Act 2000, section 81.<sup>34</sup> An equivalent rate is found in the Bankruptcy (Scotland) Act 1985. In section 51 of the 1985 Act, the "prescribed rate"<sup>35</sup> is set by the Bankruptcy (Scotland) Regulations 1985.<sup>36</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>37</sup>

7.27 Section 81 of the Adults with Incapacity (Scotland) Act 2000 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>38</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.

7.28 These provisions would be affected by our recommendations in relation to the rate of interest applicable post-decree in sheriff court actions.<sup>39</sup> If, as we are proposing, the post-decree rate of interest is aligned with the "compensatory" rate of statutory interest which we have proposed, then this will apply wherever there is existing legislation which provides for

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<sup>32</sup> That is, 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 7.5 above.

<sup>33</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>34</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>35</sup> Section 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>36</sup> SI 1985/1925, as amended. Relevant amendments were made by the Bankruptcy (Scotland) Amendment Regulations 1993 (SI 1993/439), reg 4.

<sup>37</sup> Regulation 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%.

<sup>38</sup> Paragraph 8 of sch 2.

<sup>39</sup> Discussion Paper, paras 7.43-7.52.

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. Formal amendment is needed to existing statutory provisions to achieve this result.

**7.29 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>40</sup> and the Trusts (Scotland) Act 1921, section 29.<sup>41</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. We suggested in the Discussion Paper<sup>42</sup> that it would be appropriate for the rate of interest due under these provisions to be the new statutory rate which we are proposing. We remain of this view but, contrary to the suggestion in the Discussion Paper, we now recommend that this be achieved by amendment of the existing provisions themselves.

**7.30 Rate other than the judicial rate specified.** Examples of legislation with its own rate specified include the Partnership Act 1890, sections 24(3)<sup>43</sup> and 42(1),<sup>44</sup> the standard conditions in Schedule 3 to the Conveyancing and Feudal Reform (Scotland) Act 1970<sup>45</sup> and the Insolvency (Scotland) Rules 1986, rule 4.66.<sup>46</sup> Again, we suggested in the Discussion Paper<sup>47</sup> that there would be advantages in bringing such statutes in line with our proposals regarding a statutory rate of interest which reflects commercial rates, and we so recommend.

**7.31** The statutory provisions which we have identified above may not be the only ones in respect of which it would be advantageous for interest to run at the new statutory rate. On the other hand, there may be provisions which we have not identified where it would be desirable for a rate other than the statutory rate to continue to apply. In order to apply the statutory rate as widely as possible without creating unintended and undesirable consequences, we recommend as follows:

**32. (a) The statutory provisions which we have identified above should be amended to provide for interest to run on any sum due by one person to another at the statutory rate instead of any other rate which may currently apply expressly or by implication.**

**(b) Ministers should be given a power to amend any enactment by statutory instrument to substitute the statutory rate for another rate (or vice versa).**

(Draft Bill, sections 12, 14 and schedule 1)

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<sup>40</sup> Interest recoverable "as damages" on bills dishonoured by non-acceptance or non-payment which may, however, be withheld "if justice require it" (s 57(3)).

<sup>41</sup> Sums improperly advanced by a trustee on inadequate security.

<sup>42</sup> Paragraph 7.59.

<sup>43</sup> On advances by a partner beyond the capital which he has agreed to subscribe: rate of 5% specified.

<sup>44</sup> Option of outgoing partner to demand interest on his share of assets until paid: rate of 5% specified.

<sup>45</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".

<sup>46</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>47</sup> Paragraph 7.60.

## Compounding of interest

7.32 Historically, compound interest or "interest on interest" has not generally been considered an appropriate method of calculating interest on awards by courts in Scotland. Erskine<sup>48</sup> and Bell<sup>49</sup> both stated the principle that there should be no interest on interest but provided little in the way of reasoning to support this position. Judicial opinion has followed a similar pattern, assuming the basic rule against compounding to be so well established as not to require further explanation. What scant reasoning there has been in judgments highlights the perception of compound interest as penal in nature;<sup>50</sup> only if circumstances are held to be "special and exceptional" will an award of compound interest be considered.<sup>51</sup>

7.33 On the basis of the reported cases there are three such exceptions to the general rule:

- (i) Where there is express agreement that compound interest should apply.<sup>52</sup> Where interest is to be paid in terms of a contractual agreement, it should be paid according to the contractual obligation.
- (ii) In cases of breach of trust or failure in an obligation to invest and accumulate.<sup>53</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 established commercial usage allowing interest on interest such as in the case of bank accounts or bank loans.<sup>54</sup>

7.34 The rule against "interest upon interest" also extends to awards of damages.<sup>55</sup> There is, however, a further exception to the rule against compounding, namely where post-decree interest is added to awards which already contain some element of interest.<sup>56</sup>

7.35 Compounding of interest is consistent with the second of our guiding principles, namely that the primary goal of an award of interest should be the realistic compensation, in commercial terms, of loss of the use of money or property. Typically, compounding is the way by which financial institutions administer interest on both commercial and consumer debt and credit, whether in the form of an overdraft, credit card, current or savings account. As such, compounding provides the most accurate way to compensate for the pursuer's loss by reflecting the value of interest that would have accrued had the loss never been sustained and the pursuer had retained full use of his money or property.

7.36 If interest is to be applied to a liquidated debt, and the intention is to compensate the claimant for loss of the sum due, then it should run from the date on which the debt fell due

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<sup>48</sup> Institute III.iii.81.

<sup>49</sup> Commentaries, Vol I, 5<sup>th</sup> edn, 651.

<sup>50</sup> Eg *Maclean v Campbell* (1856) 18D 609.

<sup>51</sup> *Roxburgh Dinardo's JF v Dinardo* 1992 SC 188.

<sup>52</sup> *Bank of Scotland v Davis* 1982 SLT 20.

<sup>53</sup> *Cranston & Hay v Scott* (1826) 5S 62; *Douglas v Douglas's Trs* (1867) 5M 827; *Roxburgh Dinardo's JF v Dinardo* supra.

<sup>54</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* supra.

<sup>55</sup> Interest on Damages (Scotland) Act 1958, s 1(2)(a).

<sup>56</sup> See para 7.40.

and should be compounded at regular intervals – mirroring the frequency at which commercial credit is compounded – until paid. With an award of damages, the intention is to place the pursuer in the same situation as if the loss had not been sustained, and the same argument which justifies compounding interest on a liquidated debt applies to an award for damages: on both occasions realistic compensation for loss of the use of the debt or award should be due from the date it was suffered. The provisional view which we expressed in the Discussion Paper was that statutory interest should be compounded at regular intervals,<sup>57</sup> and this approach found favour with some of our consultees.<sup>58</sup>

7.37 Despite the argument that only compound interest provides true compensation and the widely accepted use of compounding in the financial services market, it would seem that it is still viewed with some suspicion as a statutory entitlement. Some consultees expressed concerns about the complexities of administering compound interest, in terms of both the calculations required and the difficulty of creating a system that was easy for both the public and practitioners to understand.<sup>59</sup> We consider that these difficulties could be overcome by making a computer program available on the internet which would calculate the appropriate interest based on the value of the principal sum and the period outstanding. This could be used both by parties to litigation and to creditors calculating interest on debt in respect of which litigation is not, or not yet, in contemplation. An example of this type of program was made available on the Scottish Law Commission website during the consultation period.

7.38 A further concern, expressed by both the Scottish Consumer Council and Citizens Advice Scotland, was that compounding would convert manageable debt into unmanageable debt by increasing any sum owed more quickly than if a simple rate of interest were applied. Our response to this concern is that the interest rate we propose is different in character from that used by most commercial lenders in that our rate would contain no element of risk. The risk element of a commercial rate reflects the likelihood of the creditor being repaid. If someone has a poor credit history and the risk of non-repayment is high, the interest rate applied to the loan will also be high. It is when these higher rates, including the risk element, are compounded that debt can become unmanageable. Because the rate which we propose is compensatory only, the effect of compounding is not significant unless applied to awards of high value and only after the lapse of a significant period of time. Indeed, the difference between using a compound rate of interest and a slightly higher rate of simple interest (Bank of England Base Rate + 2%) is small, as shown by the graph below.<sup>60</sup>

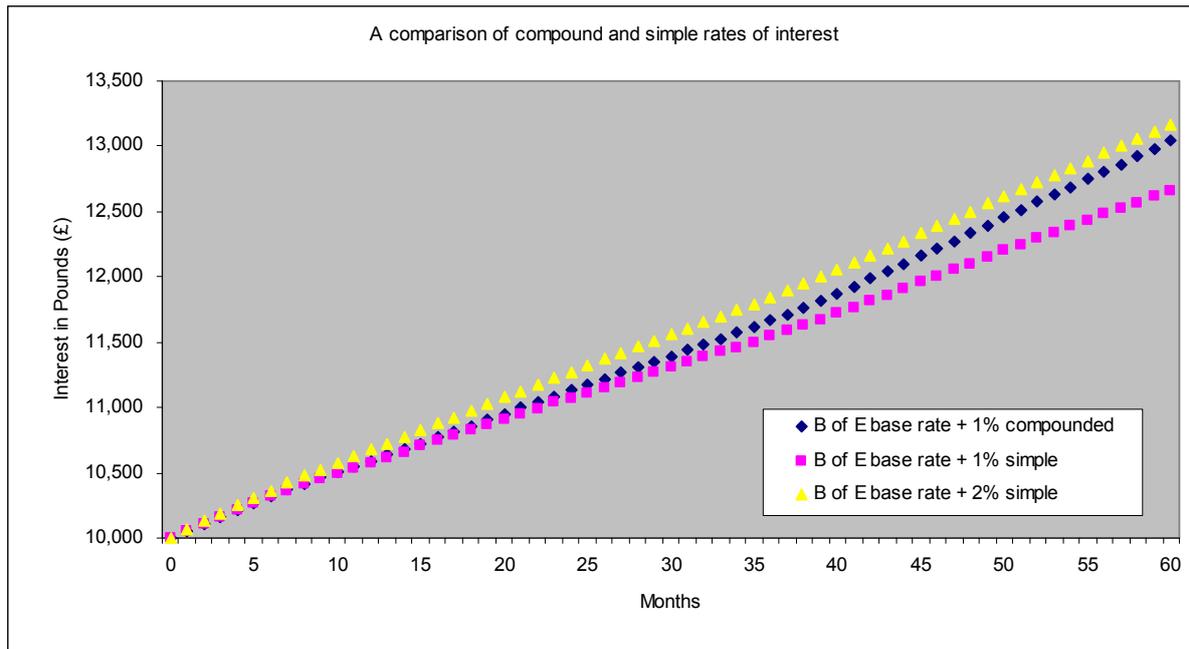
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<sup>57</sup> Discussion Paper, paragraph 8.38 and proposal 41.

<sup>58</sup> The Faculty of Advocates, Aberdeen University School of Law and Harvey McGregor QC.

<sup>59</sup> Scottish Consumer Council and Citizens Advice Scotland.

<sup>60</sup> The graph shows the effect of three different rates of interest on a sum of £10,000 over a five year period between February 2001 and February 2006. During this period the base rate varied between 3.5% (July 2003) and 5.75% (March 2001).



7.39 We remain of the opinion that compounded interest is the most accurate way to calculate the value of loss of use of money, but we acknowledge the strength of the concerns which have been expressed with regard to its use. As we have observed, the difference between compound interest and a slightly higher rate of simple interest makes little difference to the amount of interest accruing. In light of this, we are not recommending at this time that statutory interest should be compound. Our proposed scheme does, however, provide for changes to be made to both the rate and formula by which statutory interest is calculated. This would allow the case for compound interest to be reconsidered at a later date and for an entitlement to compound interest to be incorporated into the legislation if that were considered to be appropriate. Subject to what we say in paragraph 7.40 below regarding compounding at the date of decree, we recommend that:

**33. Statutory interest should be simple interest.**

(Draft Bill, section 7(2))

**Compounding of interest at date of decree**

7.40 Under existing practice in relation to *damages*, where decree is granted for payment of a sum which includes an element of interest accrued to date (for example, on past loss of earnings or solatium attributable to the past), any interest charged post-decree at the judicial rate is in effect awarded upon the accrued interest as well as the principal. Despite the long-standing strictures against "interest upon interest" and the fact that the Interest on Damages (Scotland) Act 1958 explicitly states that nothing in section 1 "...shall...authorise the granting of interest upon interest,...", the courts have held, as a matter of interpretation of section 1(1A), that interest runs from the date of decree until payment on the whole sum awarded in

the decree including any element of pre-decree interest.<sup>61</sup> To put it another way, there is, at the date of decree, a one-off compounding of interest accrued to that date.

7.41 If, as we recommend, post-decree interest and pre-decree interest are set at the same rate, then it could be argued that interest should simply continue to run from the appropriate pre-decree date – or dates – until payment and that the granting of decree ought not to affect it in any way. There would then be no compounding at the date of decree. In our view, however, there are both principled and practical reasons for retaining the existing practice of having a single compounding or "rest" at date of decree. As a matter of principle we consider that it should be recognised that the character of a creditor's claim changes when decree is granted. He is no longer seeking redress for loss sustained but rather implementation of an award made by the court in his favour. From a practical point of view, an award of damages is usually made up of a number of components and it would create a significant complication if, having calculated interest on each of these to the date of decree, parties had then to re-calculate interest on each component up to the date of payment. Another reason is that the amount for which decree has been granted may have to be enforced by diligence. It is necessary for these purposes to know precisely the amount of the award. If interest simply continued to run it would be necessary for the creditor to re-calculate the award at the time when the charge is served. We would regard this as an unsatisfactory side effect of our recommendations and would prefer to avoid it by making express statutory provision for post-decree interest to run on both the principal sum and on any interest accrued on that sum to date of decree.

7.42 Our recommendations elsewhere in this Report afford two further reasons for fixing the amount of the award, including interest to date, at the date of the court order. The first is that the court may have exercised its discretion to remit some or all of the interest which would otherwise have been due.<sup>62</sup> The factors taken into account by the court will not, however, continue to apply after decree has been granted and so in this situation interest will run differently pre- and post-decree. The second occurs where decree is granted in a foreign currency and the amount, together with interest accrued to date, requires to be converted into sterling. Again the applicable rate of interest may be different.

7.43 We consider that most of these arguments apply equally to interest on *debt*, and that the current practice of having a single "rest" at date of decree should also apply to court orders<sup>63</sup> for payment of sums other than damages. It is worth noting in this context that under our recommendations statutory interest will have accrued from the time when payment fell due and not, as is the case at present in relation to contractual debt, merely from the date of citation. Amounts of interest recoverable under decrees are therefore likely to be greater than at present because it will have been running for longer. A significant practical consequence of this change will be that where decree is granted in an undefended action, interest will require to be calculated to the date of decree. We envisage that this task would be carried out by the creditor, prior to instructing enforcement action, rather than by the court.

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<sup>61</sup> See eg *Smith v Middleton* 1972 SC 30 at 39 (Lord Ordinary (Emslie)); *Mouland v Ferguson* 1979 SLT (Notes) 85 at 86 (Lord Ordinary (Stewart)).

<sup>62</sup> See paras 5.12-5.13.

<sup>63</sup> Including orders for payment by tribunals and awards by arbiters.

7.44 We make no recommendation in relation to sums recoverable otherwise than under a decree: for example, sums recoverable under a document which has been registered for execution in the Books of Council and Session or the sheriff court books, or under a foreign judgment or document which is enforceable in Scotland.<sup>64</sup> Our understanding is that the practice of creditors, in relation to debts upon which compound interest is due in terms of a contract, is to compound the interest at the time when the certificate of indebtedness is registered for execution.<sup>65</sup> On the other hand, as regards debts upon which simple interest is due in terms of a contract, we understand that it is not usual practice to carry out a one-off compounding when the certificate is registered. (Indeed, it is not easy to identify a legal basis upon which a creditor would be entitled to carry out any such one-off compounding.) We do not consider that registration of a document for execution effects the same change of character of a debt as does the granting of a court order for payment. Nor do the practical considerations discussed above<sup>66</sup> apply to debts which are enforceable by registration of a document for execution. We therefore propose to leave existing practice in relation to such debts unaltered.

7.45 We recommend that:

- 34. Interest should run post-decree on the amount of interest accrued to the date of decree, as well as on the principal sum, until payment.**

(Draft Bill, section 7(3))

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<sup>64</sup> Civil Jurisdiction and Judgments Act 1982, s 13(1); Civil Jurisdiction and Judgments (Authentic Instruments and Court Settlements) Order 1993 (SI 1993/604). The Rules of the Court of Session provide that, in application for enforcement of a foreign judgment, details must be given of the rate of interest, the date from which interest is due and the date on which interest ceases to accrue (rule 62.28(2)(e)(ii)).

<sup>65</sup> *Cruickshank v British Linen Co* (1834) 13 S 91 provides some old authority for such a practice.

<sup>66</sup> Paras 7.41-7.42.

## Part 8 Tribunals

8.1 Although the terms of our reference include interest on claims for payment of money within the jurisdiction of tribunals, most tribunals have an administrative jurisdiction and rarely express their decisions 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. There are, however, some tribunals which are exceptional in that they make monetary awards and have statutory powers to award interest. Tribunals which sit in Scotland<sup>1</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. Those in the latter category<sup>2</sup> are not within the scope of our proposals as the claimant's entitlement to interest will depend upon the terms of the legislation which the Tribunal is applying. Tribunals in the former category are the following:

- 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>3</sup> The prescribed rate is currently set at 8%, in line with the judicial rate.<sup>4</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>5</sup>

8.2 In the Discussion Paper we proposed that, with one exception, the statutory powers of tribunals to award interest should be excluded from the scope of the reforms proposed in the paper. 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>6</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 from certain specified 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. The effect of our recommendations will be that there will no longer be a "judicial rate" applying either before or after decree in court actions. It would therefore be anomalous to continue to use it in discrimination claims to an Employment Tribunal.

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<sup>1</sup> Some tribunals with interest-awarding powers, such as the Copyright Tribunal and the Competition Appeal Tribunal may in theory sit in Scotland but in fact rarely or never do.

<sup>2</sup> Eg the Unified Appeals Tribunal in relation to social security; and the VAT and Duties Tribunal for Scotland, the General Commissioners of Income Tax and the Special Commissioners of Income Tax in relation to taxation.

<sup>3</sup> The Employment Tribunals (Interest) Order 1990 (SI 1990/479), art 2. See para 8.2 below regarding awards for discrimination cases.

<sup>4</sup> *Ibid* art 4. This provision applies the rate specified in s 17(1) of the Judgments Act 1838.

<sup>5</sup> Law Reform (Miscellaneous Provisions) (Scotland) Act 1980, s 18. Interest is awarded at the judicial rate.

<sup>6</sup> SI 1996/2803.

8.3 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>7</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>8</sup> As with discrimination cases, we propose that there should be substituted an entitlement to interest at the rate specified for statutory interest. This entitlement will in any event be superseded, to some extent, by our recommendations that arrears of income from employment should carry statutory interest.<sup>9</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 might 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 will, under our recommendations, be entitled to interest from the date when the loss is sustained. We consider, however, that if the Tribunal's powers in this regard are to be amended, this should be done on a UK-wide basis, and we suggest that this apparent anomaly be referred to the Council on Tribunals for further consideration.

8.4 As noted in the preceding paragraphs, there may be situations in which an award made by a tribunal will be for payment of a sum upon which statutory interest runs in terms of our recommendations. We have considered whether tribunals should have the same power as the court to remit statutory interest in whole or in part in the same circumstances as the court would be empowered to do, ie where it would be in the interests of justice to do so by reason of any conduct of the person to whom interest would be payable. Our view is that tribunals should have the same power.

8.5 We therefore recommend that:

- 35. (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) Where a sum awarded by a tribunal carries statutory interest, the tribunal should have the same power as would a court to remit the interest in whole or in part.**
- (c) In all other respects, the powers of particular tribunals to award interest should remain unaffected by our recommendations.**

(Draft Bill, sections 9 and 16(1); schedule 1, Part 2)

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<sup>7</sup> Employment Tribunals (Interest) Order 1990 (SI 1990/479).

<sup>8</sup> *Ibid* art 4. The rate under s 17 of the 1838 Act is presently the same as the judicial rate in Scotland.

<sup>9</sup> See Recommendation 10.

## Part 9                    Arbitration, adjudication and other forms of dispute resolution

### Introduction

9.1     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 addressed in the Discussion Paper were, 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

9.2     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. Where, however, an arbiter is appointed to resolve a dispute regarding a principal sum claimed and there is no express power conferred to award interest, the current law is less satisfactory. In *John G McGregor (Contractors ) Ltd v Grampian Regional Council*,<sup>3</sup> the Second Division held that an arbiter has no implied power to award interest for any period prior to the date of his final decree.

9.3     We consider that this problem is resolved by our principal recommendation in this Report that a general statutory entitlement to interest on contractual debt should be introduced. The effect of the legislation which we are proposing will be that any sum awarded by an arbiter will carry statutory interest from the date when payment fell due. Interest will run even though the claimant's entitlement to the principal sum, or the quantification of the sum due, has not yet been determined by the arbiter. The position of the claimant in an arbitration will therefore be no different from that of a pursuer claiming payment in a court action.

9.4     It remains to consider whether arbiters should be given a wider discretion in relation to the awarding of interest than the limited judicial discretion which we are recommending<sup>4</sup> in relation to claims for payment which are decided by the court. Arbitration agreements often

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<sup>1</sup> See para 9.6.

<sup>2</sup> See para 9.7.

<sup>3</sup> 1991 SLT 136.

<sup>4</sup> See paras 5.12-5.13.

confer a wide discretion on the arbiter to award interest (including compound interest) at such rate and between such dates as he sees fit. We suggested in the Discussion Paper that 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. 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."

9.5 One consultee<sup>5</sup> urged us to recommend the enactment of the wide discretion to award interest contained in Clause 22(1) above. This would give Scottish arbiters powers comparable with those accorded to arbitrators sitting in England.<sup>6</sup> We have, however, concluded that it would be anomalous for arbiters to be granted a broad statutory discretion to award interest when the corresponding discretion afforded to the courts is restricted. As noted above, the main current difficulty, namely that interest does not run on arbitration awards at all, will be resolved by our recommendations. If arbiters are to be given statutory powers wider than those available to the courts, we consider that this should be done as part of a comprehensive statutory regime for arbitration in Scotland. In the meantime, it remains open to the parties to agree to confer a wider discretion on the arbiter than that which will apply under our proposed legislation. We recommend that:

**36. The power of an arbiter to award interest should be co-extensive with the powers of the court in relation to interest (on the various categories of pecuniary claims) under the proposed new legislation.**

This does not require the making of any specific provision for arbitration in our draft Bill, other than to extend the power to remit interest in whole or in part to arbiters.<sup>7</sup>

9.6 In addition to arbitration agreements at common law, there are a number of statutory regimes which provide that disputes must be referred to arbitration.<sup>8</sup> 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. We consider that an arbiter appointed under one of these provisions should, in the

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<sup>5</sup> Professor John Murray.

<sup>6</sup> Under the Arbitration Act 1996, s 49(3).

<sup>7</sup> Draft Bill, ss 9 and 16(1).

<sup>8</sup> These are discussed in F Davidson, *Arbitration* (2000). Some were listed in the Discussion Paper at para 11.8.

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. Again, this is achieved by the introduction of a general statutory entitlement to interest from the date when payment became due and no special legislation is needed to extend this entitlement to claimants in statutory arbitrations.

## **Adjudication**

9.7 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>9</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."

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. In the Discussion Paper we asked whether any difficulty was arising in practice in relation to the power of an adjudicator to award interest. One consultee suggested that it was doubtful whether paragraph 20(2)(c) of the Scheme (set out above) permitted an adjudicator to award interest which would not run as a matter of law unless the parties had made contractual provision for it. If this doubt is well founded, then we consider that the problem which it raises will, as with arbitration, be resolved by the introduction of a general statutory entitlement to interest from the date when payment fell due, irrespective of whether entitlement to the principal sum has still to be determined by the adjudicator. Accordingly, there seems to be no need to make any specific legislative provision other than to ensure that the limited discretion to remit interest in whole or in part applies to adjudications.<sup>10</sup>

## **Other forms of dispute resolution**

9.8 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

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<sup>9</sup> SI 1998/687.

<sup>10</sup> Draft Bill, ss 9 and 16(1).

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.

9.9 It would be difficult to anticipate in a statutory provision all the forms which dispute resolution might take. In the Discussion Paper we expressed the provisional view 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. We invited comments as to whether in addition to these there was 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. None was suggested to us. We therefore recommend that:

- 37. There is no need to make specific legislative provision for entitlement to interest as regards any form of dispute resolution other than those already discussed in this Report.**

## Part 10 Transition

10.1 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.

10.2 In the Discussion Paper we identified four options for commencement of application of the new legislation in relation to interest on contractual debts and three options in relation to interest on damages. The options for contractual debts<sup>1</sup> were:

- (i) all obligations to pay which are created or come into existence on or after the commencement date;
- (ii) all debts which become due on or after the commencement date;
- (iii) all actions for payment (including claims to tribunals and claims in arbitration) raised on or after the commencement date;
- (iv) all decrees for payment granted on or after the commencement date.

The options for damages which we identified were:

- (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.

10.3 We suggested that 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 (a) 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 (b) 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. We considered that option (iv) above in relation to debt would give rise to an unacceptable degree of retrospectivity, although one consultee supported its counterpart, option (iii), in relation to damages because this would avoid having two parallel regimes in existence. The other consultees who responded to this question supported the application of the new legislation to all pecuniary claims except those in respect of which an action has been raised prior to the commencement date. We also favour this approach. There would then be a period during which actions not subject to the new regime will work their way through the

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<sup>1</sup> Options for non-contractual debts were the same except that option (i) has no counterpart.

court system. It may be that there will be an incentive for claimants for damages to raise actions prior to the commencement date if, at the time when the act comes into force, the judicial rate of interest continues to be a little higher than the statutory rate which we are proposing. On the other hand, creditors suing for payment of a debt in respect of which there is no contractual entitlement to interest may have an incentive to await commencement before raising an action. The fact that these (relatively minor) distortive transitional effects could occur suggests that a reasonably brief period should be allowed between Royal Assent and entry into force of the legislation.

10.4 We recommend that:

- 38. The new legislation should apply to all pecuniary claims except those in respect of which an action has been raised prior to the commencement date.**

(Draft Bill, section 13)

## Part 11 List of recommendations

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

(Paragraph 3.4)
2. A power should be reserved to the Scottish Ministers to exempt specified categories of debt from the general entitlement to statutory interest.

(Paragraph 3.9)
3. Interest on a debt arising under a contract should run from the date when payment is due by the debtor until payment.

(Paragraph 3.15)
4. Statutory interest should run on a debt due for the supply of goods or services from the following date:
  - (a) 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;
  - (b) In any other case, 30 days after the later of:
    - (i) the day on which the supplier's obligation is performed; or
    - (ii) the day on which the purchaser has notice of the amount of the debt or of the amount claimed by the supplier.

(Paragraph 3.18)
5. 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 3.19)
6. Interest should run on payments due for the purchase or letting of heritable property as it runs on other sums which have fallen due for payment, subject to any exercise of the ministerial power to exempt a specific category of debt such as arrears of rent owed to a public sector landlord.

(Paragraph 3.23)

7. Interest on a sum payable under a contract of indemnity insurance, or other contract of indemnity, 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 vouched in accordance with the conditions of the contract; 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 3.29)
8. 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 3.30)
9. In the absence of agreement to the contrary, statutory interest should run on a loan of money from the date on which the loan is made until the date of repayment.
- (Paragraph 3.32)
10. (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 begin to run 30 days after the end of the period in respect of which the service under the contract is remunerated.
- (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 3.34)
11. 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 3.36)
12. 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 3.40)
13. Parties should be free to contract out of the creditor's entitlement to interest under the proposed new legislation.
- (Paragraph 3.45)

14. There should be a general statutory entitlement to interest on non-contractual debts except where an entitlement to interest is conferred or, alternatively, excluded by another statutory provision.

(Paragraph 3.47)
15. Where a sum of money is due by way of redress for unjustified enrichment, interest should be payable, in accordance with the general rule, from the date when payment of the principal sum is due by the debtor to the creditor.

(Paragraph 3.54)
16. The new statutory scheme should not apply to interest on claims on limitation funds established under the Merchant Shipping Acts or similar legislation.

(Paragraph 3.56)
17. Where a claim is made for payment based upon a non-contractual obligation to account for funds, statutory interest should be payable from the date when the holder is in default in failing to make over the funds to the person entitled to them.

(Paragraph 3.58)
18. Where a claim is made for a sum due in respect of legal rights in a deceased person's estate, statutory interest should be payable from the date when the executor or trustee is in default in failing to make payment to the claimant.

(Paragraph 3.60)
19. Where an award of aliment has been backdated, statutory interest should be payable from the date or dates when the instalments ought to have been paid.

(Paragraph 3.63)
20. Where any enactment imposes a tax, fine or penalty but makes no provision for interest to run on the sum due, statutory interest should not run on that sum.

(Paragraph 3.67)
21. The legislation relating to interest on damages should be re-formulated.

(Paragraph 4.2)
22. 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 4.6)

23. The existing practice whereby the court when awarding damages in relation to personal injury may treat a loss (including non-patrimonial loss) as having been sustained over a period of time should be preserved.
- (Paragraph 4.14)
24. There should be a judicial discretion to remit interest in whole or in part in respect of a period for which it would otherwise run where the interests of justice so require, but only by reason of any conduct of the creditor.
- (Paragraph 5.13)
25. 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 6.3)
26. Where a party to litigation is found entitled to recover fees and outlays in judicial expenses from another party, statutory interest should be payable on such expenses from the dates when they were respectively paid.
- (Paragraph 6.7)
27. There should be a prescribed fluctuating rate of interest which is a specified percentage above the official dealing rate of the Bank of England. The percentage above the Bank of England rate could be amended from time to time by statutory instrument.
- (Paragraph 7.13)
28. 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 could also be made available in appropriate places such as court buildings and public libraries.
- (Paragraph 7.14)
29. There should be no judicial discretion to award statutory interest at a rate other than the prescribed rate.
- (Paragraph 7.17)
30. (a) Where the court grants decree for payment in a currency other than sterling and the award includes an element of interest, such interest should run at the specified percentage above the currency's nearest equivalent to the Bank of England's official dealing rate.

(b) If the court is unable to identify such an equivalent, interest should be awarded at such rate as appears to the court to be fair and reasonable in the circumstances.

(Paragraph 7.20)

31. Interest after the date of decree should run on the same basis as it does prior to decree and the applicable rate pre- and post- decree should be calculated by the same method.

(Paragraph 7.23)

32. (a) The statutory provisions which we have identified above should be amended to provide for interest to run on any sum due by one person to another at the statutory rate instead of any other rate which may currently apply expressly or by implication.

(b) Ministers should be given a power to amend any enactment by statutory instrument to substitute the statutory rate for another rate (or vice versa).

(Paragraph 7.31)

33. Statutory interest should be simple interest.

(Paragraph 7.39)

34. Interest should run post-decree on the amount of interest accrued to the date of decree, as well as on the principal sum, until payment.

(Paragraph 7.45)

35. (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) Where a sum awarded by a tribunal carries statutory interest, the tribunal should have the same power as would a court to remit the interest in whole or in part.

(c) In all other respects, the powers of particular tribunals to award interest should remain unaffected by our recommendations.

(Paragraph 8.5)

36. The power of an arbiter to award interest should be co-extensive with the powers of the court in relation to interest (on the various categories of pecuniary claims) under the proposed new legislation.

(Paragraph 9.5)

37. There is no need to make specific legislative provision for entitlement to interest as regards any form of dispute resolution other than those already discussed in this Report.

(Paragraph 9.9)

38. The new legislation should apply to all pecuniary claims except those in respect of which an action has been raised prior to the commencement date.

(Paragraph 10.4)

# Appendix A

## Interest (Scotland) Bill

[DRAFT]

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#### Section

- 1 Entitlement to interest
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- 4 Starting date: contracts of loan
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Schedule 1 — Modification of enactments

Part 1 — Modification of Acts

Part 2 — Modification of Instruments

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# Interest (Scotland) Bill

[DRAFT]

An Act of the Scottish Parliament to make provision for the creation of an entitlement to interest in certain circumstances; to change the law on entitlement to interest on damages payments; to make provision about interest and tenders in proceedings; and for connected purposes.

## **1 Entitlement to interest**

- (1) A person entitled to payment of a sum of money is entitled to interest on that sum in accordance with the provisions of this Act.
- (2) Interest to which a person is entitled under subsection (1) is in this Act referred to as "statutory interest".
- (3) In a case where a starting date falls to be ascertained in accordance with section 3, 4, 5, 6 or 11, statutory interest runs from that date until the date or dates of payment of the principal sum.
- (4) In any other case, statutory interest runs from the date on which the principal sum is due until the date or dates of payment of that sum.

### NOTE

Section 1(1) implements Recommendation 1 in part by creating a general statutory entitlement to interest where payment is due on a sum of money. This entitlement applies both to debts of various types and to damages.

Section 1(2) introduces the expression "statutory interest" which is used throughout the Bill.

Section 1(3) and (4) are concerned with the starting date from which interest runs. Certain specific types of payment are dealt with in sections 3, 4, 5, 6 and 11. For all other cases, section 1(4) provides a general rule that statutory interest runs from the date when the principal sum falls due until the date or dates when payment is made. This general rule covers a wide variety of circumstances in which payment may be due by one person to another, including sums payable in order to redress unjustified enrichment, claims for salvage, sums due by way of aliment or financial provision on divorce, and claims (including claims for legal rights in a deceased person's estate) against trustees or executors who are in default in failing to make sums over to persons entitled to them. In each of these circumstances the date when payment falls due is to be determined by application of the relevant existing law.

## **2 Circumstances in which interest not payable**

Where a person (in this section referred to as "the creditor") is entitled to payment of a sum of money from another person (in this section referred to as "the debtor"), statutory interest is not due on that sum if—

- (a) there is express or implied agreement between the creditor and the debtor—

- (i) that interest is to be due on that sum on a basis different from that provided for in this Act; or
  - (ii) that no interest is to be due on that sum;
- (b) the payment represents a fine, penalty or tax due to a public authority;
- (c) any enactment (other than this Act or the Late Payment of Commercial Debts (Interest) Act 1998 (c 20))—
  - (i) makes provision for interest to be due on that sum; or
  - (ii) provides that no interest is due on that sum;
- (d) interest is due on that sum by virtue of that Act of 1998 and is claimed as so due by the creditor; or
- (e) the payment is of a type specified by the Scottish Ministers by order made by statutory instrument.

#### NOTE

Section 2 specifies certain circumstances in which statutory interest is not payable, either because interest is payable which is not "statutory interest" under this Bill, or because no interest is payable.

Sections 2(a) and (c) implement the remainder of Recommendation 1. The general statutory entitlement to interest in section 1(1) does not apply where interest is due on a different basis (or not due at all) by reason of an express or implied agreement or by another statutory provision (see paragraphs 3.5–3.6 of the Report).

Section 2(b) excludes fines, penalties or taxes from the scope of statutory interest. Accordingly, where a statutory provision imposes a fine, penalty or tax without making reference to interest, statutory interest under this Bill will not run.

Section 2(d) implements Recommendation 12. It is intended to avoid conflict between the interest regime created by the Late Payment of Commercial Debts (Interest) Act 1998 and that created by this Bill. At the same time it respects the UK's obligation to implement European Union directives (see paragraphs 3.37-3.41 for a full discussion of this point). Interest under the 1998 Act, as opposed to interest under this Bill, applies where a creditor claims the right to interest under the 1998 Act. That is, the 1998 Act will take precedence where a creditor to whom that Act applies (a creditor acting in the course of business) chooses to claim interest under it.

Section 2(e) implements Recommendation 2 which recognises that, as a matter of policy, it may be desirable to exclude some types of debt from the right to statutory interest. These debts could be excluded by the use of a ministerial power exercised by statutory instrument made under section 2(e). Certain debts such as utilities debts or housing debt do not at present usually attract interest, and even if interest is available under a contract, it is rarely claimed (see paragraphs 3.7-3.9). There may be fears that the availability of statutory interest on such debts could exacerbate problems of multiple debt. No distinction can be made between utility debts and other debts on the basis of legal principle. If, however, as a matter of social policy, it is thought necessary to make such exceptions then section 2(e) confers a power for Ministers to do so. These statutory instruments would be approved by resolution of the Scottish Parliament before being made by Scottish Ministers (section 15(2)).

### **3 Starting date: contracts generally**

- (1) This section applies where statutory interest is due on a sum of money payable under the terms of a contract.
- (2) Where a contract (other than a contract such as is referred to in section 4 or 5) makes provision as to the date on which any payment under the contract is due, that date is the starting date in respect of that payment.
- (3) Where a contract of a type referred to in subsection (4), (5) or (7) makes no such provision, the starting date is to be ascertained in accordance with whichever of those subsections is applicable.
- (4) In the case of a contract for the supply of goods or services, the starting date is the date 30 days after whichever is the later of—
  - (a) the day on which the supplier's obligation is performed; and
  - (b) the day on which the other party has notice of—
    - (i) the amount of the debt; or
    - (ii) where that amount is unascertained, the sum which the supplier claims is the amount of the debt.
- (5) In the case of a contract of insurance or indemnity, the starting date is whichever is the later of—
  - (a) the day 30 days after the day of claim; and
  - (b) the day on which loss is sustained in consequence of the event insured against or indemnified.
- (6) In paragraph (a) of subsection (5), "the day of claim" is—
  - (a) the day on which a claim is intimated to the insurer or indemnifier in respect of the event insured against or indemnified; or
  - (b) if the contract requires the claim to be vouched to the insurer or indemnifier and that is not done until after the claim is intimated, the day on which the claim is vouched.
- (7) In the case of a contract involving a cautionary obligation, the starting date in respect of any payment in satisfaction of the cautioner's right of relief against the principal debtor is the day on which payment under the contract is made by the cautioner.

#### **NOTE**

Section 3 implements the recommendations of this Report on the starting dates for the running of interest on various types of contractual debt (see paragraphs 3.12-3.36). Section 3(2) states the general rule that the starting date is the date when the parties agree that payment under the contract is due, and implements Recommendation 3.

Sections 3(4), 3(5) and 3(7) apply only in the absence of an agreement to which section 3(2) applies. These sections are also subject to section 2(a): if there is express or implied agreement that interest should be applied to a contract on a different basis from that in this Act, then interest

will run according to that agreement. If there is express or implied agreement that no interest will run, then statutory interest is not due.

Section 3(4) implements Recommendation 4 with regard to debts due for the supply of goods and services. The term "supply" is defined to include "sale", and "seller" is defined to include "seller" (section 16(1)).

Sections 3(5) and 3(6) apply to contracts of insurance or indemnity (see paragraphs 3.24-3.29) and implements Recommendation 7 that interest on a contract of insurance or indemnity should run from the later of (a) the date 30 days after the insured intimates a claim and (b) the date when the loss for which the claim is made is sustained. This provision gives the insurer a reasonable period of time to investigate a claim and interest only runs from when the policyholder meets his obligations (for example, in relation to vouching) under the contract of insurance (section 3(6)).

Section 3(7) implements Recommendation 8 regarding a cautioner's right of relief under a cautionary obligation.

#### **4 Starting date: contracts of loan**

In the case of a contract of loan, the starting date is the day on which the loan is made.

##### **NOTE**

Section 4 preserves the common law rule that interest on a contract of loan runs from the date on which the loan is made (see paragraphs 3.31-3.32 and Recommendation 9). Section 4 is subject to section 2(a): if there is express or implied agreement that interest should be applied to the loan on a different basis from that in this Act, then interest will run according to that agreement. If there is express or implied agreement that no interest will run, then statutory interest is not due.

#### **5 Starting date: contracts of employment or apprenticeship**

In the case of a contract of employment or apprenticeship, the starting date in respect of payment for a period of service is the day 30 days after the day on which that payment falls to be made under the terms of the contract.

##### **NOTE**

Section 5 applies to contracts of employment or apprenticeship and implements Recommendation 10 that interest should run from 30 days after the end of the period in respect of which service under the contract is remunerated. For example, if the employee is paid monthly, then interest runs from 30 days after the end of the month; if the employee is paid weekly, then interest runs from 30 days after the end of the week. Section 5 is subject to section 2(a): if there is express or implied agreement that interest should be applied to the contract on a different basis from that in this Act, then interest will run according to that agreement. If there is express or implied agreement that no interest will run, then statutory interest is not due.

## **6 Starting date: damages**

- (1) Where statutory interest is due on a sum of money payable as damages, the starting date in respect of any part of that sum representing a head of loss is the day on which the loss in question is sustained.
- (2) Nothing in this section prevents a court from treating a loss (including non-patrimonial loss) in respect of which an award of damages is made as having been sustained over a period of time.

### **NOTE**

Section 6(1) sets out the general rule that in an action for damages interest should run on each head of loss from the date on which the loss in question was sustained (Recommendation 22).

Section 6(2) preserves the existing practice in relation to losses sustained over a period of time, such as solatium for pain and suffering, of applying interest at half rate throughout the period during which the loss was sustained. This practice is intended to reflect the fact that some consequences of injury continue over a period of time and are not sustained on any particular date.

## **7 Calculation of statutory interest**

- (1) Subject to section 8, statutory interest in respect of any period runs at the statutory rate for that period.
- (2) Subject to subsection (3), statutory interest is simple interest.
- (3) Where a court orders payment of a sum of money on which statutory interest is to run, interest runs from the date of the order on both—
  - (a) the principal sum; and
  - (b) any interest accrued on that sum as at that date.
- (4) Subsection (3) does not apply in respect of—
  - (a) an order authorising execution in Scotland of a foreign judgment; or
  - (b) any order made in connection with, or in consequence of, the registration of a document for execution.

### **NOTE**

Section 7 establishes the concept of a statutory rate of interest which is compensatory rather than penal in nature. "Statutory interest" is described in section 1(2) as interest to which a person is entitled under section 1(1) and "the statutory rate" is defined in section 16(1) as "the rate 1.5% per year over the official dealing rate." Section 7 is subject to an exception in section 8 for sums which are payable in a foreign currency. The intention is that the statutory rate created in this Bill would replace the current "judicial rate" (see paragraphs 7.5-7.7).

Section 7 implements Recommendation 27: that the statutory rate should be a prescribed rate which fluctuates a specified percentage above the Bank of England rate. For example, if the Bank of England rate is 4.5% then statutory interest is 6% (1.5% above 4.5%). Section 7(1) is intended to make it clear that when the statutory rate changes (for example, if the Bank of England rate goes up) it changes the rate applicable to any sum to which this Bill applies. For example, if

statutory interest is due on an unpaid debt and the statutory rate goes up, then the rate applicable to that debt after the date of the change is the new, higher rate.

Section 7(2) provides that statutory interest should be calculated as simple interest and not compounded. However, section 7(3) provides for interest to be compounded on one occasion: at the date of decree. This is the current practice in relation to damages (see paragraphs 7.40-7.45) and it is recommended (Recommendation 34) that this practice should also apply to debts. Section 7(4) provides that there should be no such compounding for interest due in accordance with foreign judgments authorised for execution in Scotland or under documents registered for execution in the Books of Council and Session or the sheriff court books (see paragraph 7.44).

## **8 Principal sum payable in foreign currency**

- (1) Where a principal sum is payable in a foreign currency, statutory interest on that sum runs at—
  - (a) the rate 1.5% per year over such rate as is, in relation to the foreign currency in question, that currency's nearest equivalent to the official dealing rate; or
  - (b) if it is not possible to identify such an equivalent, such rate as best meets the interests of justice.
- (2) The Scottish Ministers may by order made by statutory instrument provide that paragraph (a) of subsection (1) is to have effect with the substitution, for the percentage of 1.5 specified there, of such percentage as is specified in the order.

### **NOTE**

Scottish courts may competently award decree in a currency other than sterling (see paragraph 7.18). The statutory rate prescribed in this Bill is referable to the Bank of England base rate, but this would not be appropriate for a foreign currency with its own base rate. For example, if an award were in euros then it would be more appropriate to apply a rate referable to the European Central Bank rate (see Recommendation 30). Section 8(1)(b) allows the court discretion to apply a rate which best meets the interests of justice where there is not a suitable base rate for the foreign currency. Section 8(2) makes provision for amendment of the rate in section 8(1); for example, to change it to 1% over the foreign currency's official dealing rate.

## **9 Power of court to remit interest**

- (1) If a court considers that, by reason of any conduct of the person to whom statutory interest would be payable, it would be in the interests of justice to do so, the court may decide that—
  - (a) statutory interest which, but for this section, would be payable is not to be payable; or
  - (b) an amount payable as statutory interest is to be less than, but for this section, it would be.
- (2) In subsection (1), "conduct" includes any act or omission (whether before or after the time when the principal sum fell due for payment).

## NOTE

Section 9 provides for a judicial discretion in specified circumstances to decide that it is in the interests of justice either that interest is not payable or that the amount of interest to be paid should be less than it would be under the other provisions of this Bill. Discretion is exercisable only with regard to the conduct of the person to whom statutory interest would be payable. The court's discretion applies regardless of whether the claim is one for debt or for damages. This approach to judicial discretion implements Recommendation 24 and is similar to the discretion available to the court under the Late Payment of Commercial Debts (Interest) Act 1998 (section 5).

## 10 Tenders

- (1) Where a tender is made in the course of any proceedings, the tender is, unless it states otherwise, in full satisfaction of any claim for interest in the action by any person in whose favour the tender is made.
- (2) Where a court is considering whether a sum of money payable under an order made by it is equal to or greater than an amount tendered in the proceedings, it is to leave out of account any element of the sum which represents interest in respect of the period between the making of the tender and the date of the order.

## NOTE

Section 10 implements Recommendation 25 that a tender should be presumed to be in full satisfaction of any claim for interest and in considering whether the tender has equalled or exceeded the award the court should not include interest between the date of the tender and the date the award is made. Section 10 is similar to section 1(1B) of the Interest on Damages (Scotland) Act 1958 (as amended in 1971), although the 1958 Act applies only to awards of damages.

## 11 Fees and outlays in proceedings

Where a party to proceedings is liable to pay any fees or outlays incurred by another party to those proceedings, statutory interest on the fees or outlays runs from the date on which they are paid by the other party.

## NOTE

Section 11 amends the existing law that a party to litigation does not usually have a right, if successful, to claim interest on outlays (such as fees paid to expert witnesses) incurred in the course of the litigation. In Recommendation 26 it is suggested that where a party is entitled to recover outlays in judicial expenses from another party, statutory interest should be payable on the outlays from the dates when they were paid. By virtue of section 11, statutory interest would also be payable on legal fees from the dates on which they were paid.

## 12 Power to amend enactments

The Scottish Ministers may by order made by statutory instrument amend any enactment so as to—

- (a) substitute the statutory rate for a rate of interest specified in the enactment; or
- (b) specify that interest provided for in the enactment is to run at the statutory rate.

#### NOTE

Although statutory interest under this Bill does not apply to interest specified in another enactment (see section 2(c)), section 12 empowers Scottish Ministers to amend legislation so that the statutory rate replaces another rate of interest or so that that statutory rate applies where the legislation is silent on the rate of interest. (It should be noted that schedule 1 amends certain statutory provisions by introducing references to statutory interest.)

### **13 Application of Act**

- (1) Subject to subsection (2), section 1 creates an entitlement to statutory interest in a case where a principal sum is paid on or after the date on which that section comes into force.
- (2) Where a sum of money is paid on or after the date referred to in subsection (1) but proceedings seeking payment of that sum are commenced before that date, there is no entitlement to statutory interest on that sum.
- (3) This Act binds the Crown.

#### NOTE

Section 13 sets out the provisions for transition to the new interest regime, as explained in Part 10 of this Report. The principle is that the new regime will apply to all claims for payment of money except where a court action has been raised before the date of commencement of this Bill (Recommendation 38).

### **14 Modification and repeal of enactments**

- (1) Schedule 1, which modifies enactments, has effect.
- (2) The enactments mentioned in the first column of schedule 2 are repealed to the extent specified in the second column.

#### NOTE

Statutory provisions which are to be modified are set out in schedules 1 and 2, and section 14 gives effect to those schedules.

### **15 Orders**

- (1) A statutory instrument containing an order under section 8(2) or 16(2) is subject to annulment in pursuance of a resolution of the Parliament.

- (2) No order under section 2(e) or 12 is to be made unless a draft of the statutory instrument containing the order has been laid before, and approved by resolution of, the Parliament.

#### NOTE

Section 15 sets out the Parliamentary procedure for statutory instruments made under powers given in this Bill. Most orders which may be made under the Bill, such as an order to change the way the statutory rate is calculated, are to be made by negative procedure which would allow Scottish Ministers to react quickly to changing market conditions. However, orders under section 2(e), which confers a very wide power, and section 12, which may amend primary legislation, may be made only after a resolution of the Scottish Parliament.

## 16 Interpretation

- (1) In this Act—

"court" includes any tribunal, arbiter or adjudicator;

"the official dealing rate" means the rate announced from time to time by the Monetary Policy Committee of the Bank of England ("the Bank") and for the time being in force as 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;

"principal sum" means a sum of money on which statutory interest is payable;

"starting date" means the date on which statutory interest on a sum of money begins to run;

"statutory interest" has the meaning given by section 1(2);

"the statutory rate" means the rate 1.5% per year over the official dealing rate.

"supply" includes "sale" and "supplier" includes "seller".

- (2) The Scottish Ministers may by order made by statutory instrument amend the definition of "the statutory rate" in subsection (1) so as to substitute a different rate for the rate for the time being specified in that definition.

#### NOTE

Section 16 defines certain expressions used in the Bill.

As a consequence of the definition of "court", the judicial discretion to remit interest in section 9 is also available to tribunals, arbiters and adjudicators. The definition of "the official dealing rate" means that the statutory rate of interest will be referable to the Bank of England base rate. Alternative reference rates are discussed in paragraphs 7.11-7.13 but it is recommended that the rate should fluctuate by a specific percentage above the Bank of England rate (Recommendation 27). The definition of "statutory rate" provides for the rate to be 1.5% above the Bank of England rate but Scottish Ministers may substitute a different percentage by means of a statutory instrument made by negative procedure (section 16(2)).

## **17 Short title and commencement**

- (1) This Act may be cited as the Interest (Scotland) Act 2006.
- (2) This Act (other than this section) comes into force in accordance with provision made by the Scottish Ministers by order made by statutory instrument.
- (3) Different provision may be made under subsection (2) for different purposes.

### **NOTE**

Section 17 sets out how the Bill is to be cited. It also provides for the commencement of the Bill by way of commencement order.

## SCHEDULE 1

*(introduced by section 14(1))*

### MODIFICATION OF ENACTMENTS

#### **PART 1**

#### MODIFICATION OF ACTS

##### *Bills of Exchange Act 1882 (c 61)*

- 1 In section 57(1)(b) of the Bills of Exchange Act 1882, after the word "thereon" insert "at the statutory rate (within the meaning of the Interest (Scotland) Act 2006)".

##### *Partnership Act 1890 (c 39)*

- 2 In each of sections 24(3) and 42(1) of the Partnership Act 1890, for the words "rate of five per cent. per annum" substitute "statutory rate (within the meaning of the Interest (Scotland) Act 2006)".

##### *Trusts (Scotland) Act 1921 (c 58)*

- 3 In section 29 of the Trusts (Scotland) Act 1921, after the word "interest" insert "at the statutory rate (within the meaning of the Interest (Scotland) Act 2006)".

##### *Conveyancing and Feudal Reform (Scotland) Act 1970 (c 35)*

- 4 In paragraph 7(3) of schedule 3 to the Conveyancing and Feudal Reform (Scotland) Act 1970, for the words "bank rate" substitute "statutory rate (within the meaning of the Interest (Scotland) Act 2006)".

##### *Law Reform (Miscellaneous Provisions)(Scotland) Act 1980 (c 55)*

- 5 In section 18 of the Law Reform (Miscellaneous Provisions)(Scotland) Act 1980, for the words from "same rate" to "that decree or extract" substitute "statutory rate (within the meaning of the Interest (Scotland) Act 2006)".

##### *Bankruptcy (Scotland) Act 1985 (c 66)*

- 6 In section 51(7)(a) of the Bankruptcy (Scotland) Act 1985, for the words "prescribed rate" substitute "statutory rate (within the meaning of the Interest (Scotland) Act 2006)".

##### *Insolvency Act 1986 (c 45)*

- 7 In section 189(5)(b) of the Insolvency Act 1986—
  - (a) after the words "the reference to" insert "the rate specified in"; and
  - (b) for the word "rules" substitute "statutory rate (within the meaning of the Interest (Scotland) Act 2006)".

*Debtors (Scotland) Act 1987 (c 18)*

- 8 In the definition of "specified rate" in section 73(1) of the Debtors (Scotland) Act 1987, for paragraphs (a) and (b) substitute "means the statutory rate (within the meaning of the Interest (Scotland) Act 2006)".

*Late Payment of Commercial Debts (Interest) Act 1998 (c 20)*

- 9 In section 3(2) of the Late Payment of Commercial Debts (Interest) Act 1998, after the words "of this Act" insert "or the Interest (Scotland) Act 2006".

*Adults with Incapacity (Scotland) Act 2000 (asp 4)*

- 10 In each of section 81(1) of, and paragraph 8(7) of schedule 2 to, the Adults with Incapacity (Scotland) Act 2000, for the words "rate fixed by Act of Sederunt as applicable to a decree of the sheriff" substitute "statutory rate (within the meaning of the Interest (Scotland) Act 2006)".

## **PART 2**

### **MODIFICATION OF INSTRUMENTS**

*Insolvency (Scotland) Rules 1986 (SI 1986/1915)*

- 11 In rule 4.66(2)(b) of the Insolvency (Scotland) Rules 1986, for the words from "subsection (4)" to "annum" substitute "subsections (4) and (5) of section 189".

*Industrial Tribunals (Interest) Order 1990 (SI 1990/479)*

- 12 In article 4 of the Industrial Tribunals (Interest) Order 1990—
- (a) after the word "be" insert "in England and Wales"; and
  - (b) after the word "day" insert "and, in Scotland, the statutory rate (within the meaning of the Interest (Scotland) Act 2006)".

*Industrial Tribunals (Interest on Awards in Discrimination Cases) Regulations 1996 (SI 1996/2803)*

- 13 In regulation 3(2) of the Industrial Tribunals (Interest on Awards in Discrimination Cases) Regulations 1996, for the words "rate fixed, for the time being, by the Act of Sederunt (Interest in Sheriff Court Decrees or Extracts) 1975" substitute "statutory rate (within the meaning of the Interest (Scotland) Act 2006)".

#### **NOTE**

Schedule 1 amends various enactments to provide that the rate applied is the statutory rate under this Bill. Part 1 provides for the amendment of primary legislation. Paragraphs 1 and 3 make

amendments to apply the statutory rate where no rate is currently specified. Paragraphs 2, 4, 5, 6, 7, 8 and 10 substitute the statutory rate for a rate currently specified in those Acts.

Paragraph 9 of Part 1 amends section 3(2) of the Late Payment of Commercial Debts (Interest) Act 1998 to ensure that an entitlement to interest under this Bill does not override an entitlement under the 1998 Act.

Part 2 of schedule 1 provides for the amendment of subordinate legislation. Paragraph 11 applies the statutory rate in the definition of "official rate" in the Insolvency (Scotland) Rules 1986, and paragraphs 12 and 13 ensure that the rate applied by Employment Tribunals in Scotland will be the statutory rate.

Further amendments to apply or substitute the statutory rate could be made by statutory instrument under the power in section 12 of this Bill.

SCHEDULE 2  
*(introduced by section 14(2))*  
 REPEALS

<i>Enactment</i>	<i>Extent of repeal</i>
Sheriff Courts (Scotland) Extracts Act 1892 (c 17)	Section 9.
Interest on Damages (Scotland) Act 1958 (c 61)	The whole Act.
Interest on Damages (Scotland) Act 1971 (c 31)	The whole Act.
Administration of Justice (Scotland) Act 1972 (c 59)	Section 4.

NOTE

The Interest on Damages (Scotland) Act 1958 (amended in 1971) is repealed in its entirety by schedule 2.

The other repeals in schedule 2 are related to the replacement of the "judicial rate" by the statutory rate under this Bill. Section 9 of the Sheriff Courts (Scotland) Extracts Act 1892 currently provides for a rate of 8 per cent to run on sheriff court decrees and extracts. Section 4 of the Administration of Justice (Scotland) Act 1972 provides for amendment of section 9 of the 1892 Act by Act of Sederunt.

## Appendix B Current statutory provisions

This appendix contains the text of two statutes referred to in the Report: 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>
- (2) Nothing in this section shall—

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<sup>1</sup> Section 1(1), (1A) and (1B) substituted for s 1(1) by the Interest on Damages (Scotland) Act 1971, s 1(1). The original s 1 provided that: "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 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."

- (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

*[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>2</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>3</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> Section 2 was repealed by Law Reform (Miscellaneous Provisions) (Scotland) Act 1980, s 11(2), Sch 3.

<sup>3</sup> Section 3(2) was substituted by the Interest on Damages (Scotland) Act 1971, s 1(3). The original s 3(2) provided that: "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 commerce 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 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."

## **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>4</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>5</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>4</sup> Words in italics repealed as regards Scotland by The Late Payment of Commercial Debts (Scotland) Regulations 2002 (SSI 2002/335).

<sup>5</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>6</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.

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<sup>6</sup> Subsections 3(3) and 3(4) were repealed as regards Scotland by The Late Payment of Commercial Debts (Scotland) Regulations 2002 (SSI 2002/335).

(8) In this section "advance payment" has the same meaning as in section 11.

## **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>7</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

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<sup>7</sup> Section 5A was added by The Late Payment of Commercial Debts (Scotland) Regulations 2002 (SSI 2002/335).

- (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.

## **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 C

## List of consultees who submitted written comments on Discussion Paper No 127

Aberdeen University School of Law

Citizens Advice Scotland

Employment Tribunals Scotland

Faculty of Advocates

Harvey McGregor, QC

North Lanarkshire Council

Professor Robin Evans-Jones, University of Aberdeen

Professor John Murray, QC

Robert BM Howie, QC

Scottish Consumer Council





