

Compounding interest on damages

by DOUG JONES

WHEN it comes to damages for breaches of a construction contract involving non-payment or late payment of debts owing to contractors, interest is more than just a matter of interest, and interest on interest can make an even bigger difference.

The courts are often criticised for awarding damages which do not truly reflect the harm incurred or truly restore a wronged party to the position they would have been in but for the breach.

So how do the courts handle the matter of interest, and especially compound interest?

Statutes keep it simple

At the outset, it is important to distinguish between two quite distinct bases on which interest may be taken into account by the courts: "interest upon damages" and "interest as damages".

"Interest upon damages" essentially seeks to compensate for the lateness of the payment of damages. It may be interest accruing from the time the wrong was committed to the time the judgment is delivered ("pre-judgment interest") or interest accruing as a result of a late payment of a judgment debt ("post-judgment interest").

The courts have no common law power to order payment of either form of "interest upon damages". This means that apart from some particular equity jurisdiction situations, "interest upon damages" can be awarded by a court only under a statute, a contract or an arbitration agreement.

In Australia this power is granted, for example, in the States' Supreme Court Acts and in the Commonwealth legislation establishing the Federal Court.

There are two main problems with these statutory schemes for "interest upon damages": the prescribed interest rates rarely reflect prevailing interest rates, and the legislation prohibits the awarding of compound interest, even though this is an integral part of business practice and the "cost of money".

So an award of simple interest for the delay in obtaining damages will not always realistically relate to the true cost of the delay.

But a claim for compound interest is not entirely excluded, because the legislation explicitly disallows the awarding of statutory interest when there is another right to claim interest, for example under an agreement, and thus impliedly recognises these rights may exist, including rights under the common law.

Common law compounds

The second category of interest is "interest as damages".

At common law, two questions are asked by a court in assessing a claim for damages arising from a breach of contract.

The first is what kind of damages should be compensated. This is assessed according to the first and second "limbs" of the "rule in Hadley v Baxendale":

"The damages which the innocent party ought to receive for breach of contract should be such as may fairly and reasonably be considered either to have arisen naturally from the breach itself or to have been in the contemplation of both parties at the time they made the contract as the probable result of its breach."

The second question is the amount of compensation. The plaintiff is entitled to be placed in the position that it would have been in had the contract been performed.

Historically, the courts' ability to award compound interest as damages was enormously constrained by the House of Lords' 1893 decision in London, Catham & Dover Railway Co v South Eastern Railway Co, which held there was no power at common law to award compound interest as compensation for the late payment of a debt, unless there was an agreement or statutory provision to the contrary.

It was not until 1952 that this fetter was partly lifted by a UK Court of Appeal decision that losses caused by the late payment of a debt might be recoverable under the second limb of Hadley v Baxendale, and

in was not until 1981 that the House of Lords, England's highest court, followed suit.

So the courts became able to award compound interest as "special damages" in those limited circumstances where it was known or reasonably contemplated by the wrongdoer that a loss in terms of compound interest would be suffered.

But compound interest could still not be part of "general damages" under the first "limb". In other words, the courts refused to acknowledge that in a commercial environment it is foreseeable that non-payment of money can result in losses such as the loss of use of the money and the cost of borrowings necessitated by the non-payment.

In England, this judicial blindness, creating a discrepancy between the accrual of interest in the business world and the accrual of award and damages interest, continues to this day.

Hungerfords

Fortunately, in Australia the High Court came to the rescue in 1989, in Hungerfords v Walker.

In this case accountants had been negligent in preparing tax returns, causing their client to overpay tax for seven years. The client brought a claim to recover the amount of overpaid tax which it could not recover from the tax office, plus compound interest at the market rate it had paid on money borrowed to finance its business at the time. As an alternative to its claim for interest, the client claimed damages for loss of the use of the money it had overpaid.

The accountants argued that when a purely financial loss is inflicted, compensation for the consequential unavailability of money should not be allowed. They also argued that in any event, when a court awards interest as damages it can only do so as simple interest at the rate prescribed under the relevant Supreme Court Act.

The High Court rejected both arguments. Further, it held that if the loss suffered could only be accurately estimated by reference to compound interest rates, the plaintiff was

entitled to compound interest, and that both "opportunity costs" and "incurred expense" were foreseeable and thus fell within the first, "general damages" limb of Hadley v Baxendale.

This was interest as damages, rather than interest upon damages. A clear distinction was drawn between an order for interest to be awarded upon damages for late payment — under the statutes — and an award of damages to compensate a plaintiff for the loss of the use of money, "a loss assessed by reference to the interest which would have been earned by safe investment of the money or which was in fact paid upon borrowing money".

This distinction means the Australian statutes do not impose a ceiling on interest recoverable as damages, and a plaintiff can receive a much greater return under the Hungerfords measure of loss.

So if a late progress payment forces a contractor to borrow money to finance its work, the contractor may well be entitled to recover, as part of its damages, compounded interest at its overdraft rate rather than just simple interest at the statutory rate.

Of course, the contractor cannot recover both Hungerfords and statutory interest. For the Hungerfords principle to apply, however, there must be an amount due at a certain date which was not paid, or there must be an expenditure incurred at a certain date which was not reimbursed.

Further, the plaintiff must prove it has expended or borrowed money as a direct result of the non-payment. Otherwise, it has not been wrongfully deprived of the use of the amount of money and will not be entitled to interest as damages, even though it may still be entitled to simple interest under the Supreme Court Act for the delay in payment.

Arbitration

It is still unclear whether arbitrators have the power to award compound interest as damages in Australia. ■

Doug Jones is a construction partner with national law firm Clayton Utz.

□ GHD, consultants in management, engineering and environment, has appointed Tom Pinzone to manage the development of new business in transport in Australia and overseas. Pinzone has been involved in major transport developments, including the Ultimo-Pyrmont Light Rail Transit project and extensions, and Australian Airport's bid in the privatisation of Melbourne, Brisbane and Perth airports. He is the author of the 2001 Infrastructure Report Card, an independent rating prepared on behalf of the Australian Infra-

structure Commission, which has been formed through the recent merger of Lindores Cranes and Rigging and Lindores Rigging. He has 19 years experience in the construction industry, including 14 years with building materials company Pioneer International.

□ Douglas Partners has appointed Bob Lumsdaine as a senior associate in its geotechnical group in Sydney. Lumsdaine has 25 years of professional experience, mostly in geotechnical engineering. He rejoins Douglas Partners from Coffey Geo-

technical NSW. Having served his apprenticeship in the resources boom with Fluor and Dravo, Stewart brings to Austin his experience in large capital projects. His experience will complement Austin's speciality of providing clients with single-source responsibility for the total concept-to-completion of complex engineering projects.



□ Pyrotek has appointed Dean Twining account manager with its Sydney office.

technics. Twining has been a plumber for seven years and a specifier in the building industry for four years.

□ Steve Blencowe has been appointed managing director of Austin Australia's new subsidiary Austin South East Asia in Singapore. Blencowe, who is relocating to Singapore from the company's Sydney office, has 16 years of experience with Austin and 20 years experience with projects in South East Asia.

□ Australian Industry Group has appointed

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