Interest on awards of damages revisited

Farstad Supply AS v Enviroco Ltd [2013] CSIH 9.

Those of you with particularly long memories might recall my discussion of this case in the November 2011 edition of this newsletter. It concerns the appropriate level of interest which is to be applied to principal sums either awarded or conceded by way of damages.

To recap on the facts of the case, Farstad sued the defenders for £2.5m in damages in respect of loss sustained when a fire broke out on an oil rig supply vessel in 2002. After very lengthy litigation over a number of years, the action was finally settled out of court for £1.75m. Farstad sought interest on the principal sum dating from 31 December 2002 at the judicial rate of 8% per annum. The defenders argued that the judicial rate of interest was not realistic standing present market conditions and pointed out that in the Commercial Court and the Admiralty Court in England and Wales, the practice has been to award interest at 1% above base rate. The judge, who heard the case in relation to this outstanding issue only, held that he had discretion to award interest at a rate other than the judicial rate, based upon and interpretation of section 1 of the Interest on Damages (Scotland) Act 1958. In applying that discretion, he awarded the full judicial rate up until 4 December 2008, but applied the rate of 4% per annum after that date. The reason for the selection of that date in particular was that it was the point at which there had been a rapid fall in the base rate figure between November 2008 (when it had been 4.5%) to a mere 2% as of that date. As readers are aware, the base rate fell yet further and has been at 0.5% since 5 March 2009.

The defenders appealed against that decision contending that the applicable rate ought to have been the lower one contended by them at all times, whereas the pursuers cross-appealed on the basis that the full judicial interest rate of 8% ought to have applied throughout. The Inner House of the Court of Session issued its decision on both appeals two days ago and upheld the decision of the Commercial judge who heard argument on the issue in 2011.

It was accepted by both parties that the principle behind applying interest on damages is in order to compensate the party who has been kept out of payment of that sum pending resolution or determination of the action. It is not meant, however, to be penal in its application. Also, neither party contested the validity of the selection of the date of 4 December 2008 by the Commercial Judge to apply a differentiation in the interest rates applicable. With that said, the Inner House agreed that the judicial rate is intended to apply broadly in order to comply with the principle of compensation only, but held that it still did so. It was noted that to apply a rate other than the full judicial rate was a departure from the normal practice and approach of the courts in countless decrees that have been issued since the financial crisis. It also noted that the practice in the English Commercial Court and Admiralty Court has been criticised as being incoherent by legal commentators and the Law Commissions in both England and Wales and Scotland. The latter had recommended change which had not been taken up by the government. Accordingly, to adopt the approach sought by the defenders would be to retroactively follow the practice and procedure of those English Courts which have been subject to criticism. It agreed with the "mismatch" between the current judicial rate and the interest rates prevailing in the market remarked upon by the Commercial Judge but stated that if there is to be change, that is a matter for consideration by the Rules Council and not by the Court. It is not for the courts to legislate when the government has declined to do so.

Having said that, the Inner House went on to hold that the variation to 4% after the date of 4 December 2008 was within the discretion of the Commercial Judge in terms of the 1958 Act. That being agreed, his discretion could not be challenged unless it was "plainly wrong" or if he had taken into account extraneous or irrelevant factors. Neither party contended that was the case. It follows that in commercial cases of high value, particularly ones of a protracted nature, it is still open to defenders, and a worthwhile exercise at that, to seek to have the Court exercise its discretion to vary the application of the full judicial rate of interest.

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