

CORPORATE

FINANCE

BULLETIN

March 2003

PRE AND POST JUDGMENT INTEREST

The recent decision of the Supreme Court of Canada (“SCC”) in *Bank of America v. Mutual Trust Co.* (2002), 211 D.L.R. (4th) 385 (“BAC”) marks a significant shift in the way Canadian courts treat pre and post judgment interest. In a unanimous decision the SCC held that, despite considerable precedent to the contrary, compound pre and post judgment interest could be recovered as contractual damages.

In *BAC*, both parties were financial institutions who lent money at compounded rates. Therefore, the cost of breaching the contract as contemplated by the parties should have included the time value of money calculated at a compounded rate. Since expectation damages are awarded to compensate for breach of contract, the trial judge reasoned that pre and post judgment compound interest should be awarded in order to put the innocent party in the position it would have been in had the contract been performed.

Prior to *BAC*, Ontario courts had accepted that section 128 of the *Courts of Justice Act* (“CJA”) prohibited an award of compound pre and post judgement interest. Based on this reasoning, the Ontario Court of Appeal overturned the trial judge’s decision to award compound interest. Nevertheless, at the SCC, Mr. Justice Major, writing for the full court, agreed with the trial judge. He asserted that compound interest may be awarded by virtue of the court’s discretionary power in sections 128(4)(g), 129(5) and 130 of the *CJA*, which “allow a court to award pre-judgment and post-judgment interest...where interest is payable by another right.”

Mr. Justice Major also stated that the courts have long accepted that the proper measure of damages for breach of contract is the expected profit of the non-defaulting party. In a financial context that expectation is based upon compound, rather than simple, interest. Of note, as well, is the fact that the rate of interest awarded was the same as that which would have been payable if the loan agreement had not been breached.

In order for financial market participants to take advantage of the ruling, they should ensure that their credit documentation clearly sets out that any interest on overdue amounts is to be paid on a compounded basis both prior to and after judgment. This will provide the court with clear evidence that the parties intended that any award of damages for breach of contract be made with reference to compound interest, rather than with reference to the provisions of the *CJA*.

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The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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