Indexed as:

Bank of America Canada v. Mutual Trust Co.

Bank of America Canada, appellant;
v.
Clarica Trust Company, respondent.

[2002] 2 S.C.R. 601

[2002] 2 R.C.S. 601

[2002] S.C.J. No. 44

[2002] A.C.S. no 44

2002 SCC 43

File No.: 27898.

Supreme Court of Canada

2001: December 11 / 2002: April 26.

Present: McLachlin C.J. and L'Heureux-Dubé, Gonthier, Iacobucci, Major, Bastarache, Binnie, Arbour and LeBel JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO (62 paras.)

Contracts -- Breach of contract -- Damages -- Pre-judgment and post-judgment interest -- Availability of compound interest on damages award -- Whether trial judge was correct in awarding pre- and post-judgment compound interest -- Courts of Justice Act, R.S.O. 1990, c. C.43, ss. 128, 129, 130.

Courts -- Jurisdiction -- Interest -- Pre-judgment and post-judgment interest -- Interest payable by another right -- Breach of contract -- Whether trial judge had jurisdiction to award pre- and post-judgment compound interest -- Whether language of ss. 128(4)(g) and 129(5) of Courts of Justice Act encompasses right to receive compound interest in equity and at common law -- Courts

of Justice Act, R.S.O. 1990, c. C.43, ss. 128, 129, 130.

In 1987, Reemark Sterling I Ltd., planning to build a residential condominium project, entered into a Takeout Mortgage Commitment ("TOC") agreement with the respondent trust company under which the respondent would pay Reemark most of the price of the units and receive mortgage loan payments from investors at compound interest rates. Reemark and the appellant bank entered into a construction loan agreement under which the appellant would lend Reemark $33 million at compound interest rates for the project. Reemark, the appellant and the respondent also entered into a TOC assignment under which Reemark assigned its rights to receive payments from the respondent under the TOC to [page602] the appellant until the construction loan had been repaid. In 1991, with a collapsing real estate market, the respondent refused to advance the funds to the appellant under the TOC assignment or a subsequent agreement between the parties. The appellant appointed a receiver and sold the project for $22.5 million, substantially less than the appellant was owed under the loan agreement and TOC assignment. In an action against the respondent for breach of contract, the trial judge awarded the appellant damages equal to the shortfall plus interest at the compound rate set out in the loan agreement both before and after the judgment. The Court of Appeal dismissed the appeal except for the question of interest where it substituted an order for simple interest as provided in s. 128 of the Courts of Justice Act ("CJA").

Held: The appeal should be allowed and the trial judgment restored.

Although both simple interest and compound interest measure the time value of the initial sum of money, the principal, compound interest reflects the time-value component to interest payments while simple interest does not. Simple interest makes an artificial distinction between money owed as principal and money owed as interest while compound interest treats a dollar as a dollar and is therefore a more precise measure of the value of possessing money for a period of time. Compound interest is the norm in the banking and financial systems and is the standard practice of the appellant and the respondent, which were both in the business of lending.

Contract damages are determined in one of two ways. Expectation damages, focussing on the value which the plaintiff would have received had the contract been performed, and restitution damages, focussing on the advantage gained by the defendant as a result of his or her breach of contract. When awarding damages to the plaintiff, the court must first determine the dollar value of the promise to the plaintiff at the time the obligation was to have been performed and then apply the appropriate interest rate and method of calculation to account for the time during which the plaintiff was not paid. In Ontario, pre-judgment and post-judgment interest are governed by ss. 128 to 130 CJA. Sections 128(4)(g), 129(5) and 130 CJA, each of which allows the judge to award interest other than as specifically set out in ss. 128 and 129, clearly indicate that the rates and calculation methods of interest provided in ss. 128 and 129 are applicable in the absence of more appropriate rates and methods of [page603] calculation. Section 130 allows a court, where it considers it just, to vary the interest rate or the time for which interest may be awarded, while ss. 128(4)(g) and 129(5)

allow a court to award interest where interest is "payable by a right other than under this section". The court's common law power to award damages flows from the application of contract law. The language of ss. 128(4)(g) and 129(5) provides statutory authority to award compound pre- and post-judgment interest according to this common law power. It also provides statutory authority to award compound post-judgment interest according to the court's jurisdiction in equity. Absent exceptional circumstances, the interest rate which had governed a loan prior to breach would be the appropriate rate to govern the post-breach loan. The application of simple interest on the breach of a loan which itself bore compound interest would not adequately award the plaintiff the value he or she would have received had the contract been performed and would provide incentives to breach contracts. This analysis applies equally to pre-judgment interest and post-judgment interest.

In this case, the trial judge was correct in awarding compound pre- and post-judgment interest. His award yields a satisfactory result with respect to both expectation damages and restitution damages. Any lesser amount would fail to award the appellant the agreed-upon time-value of its money. Moreover, this is not a case of efficient breach. An award of compound interest will prevent the respondent from profiting by its breach at the expense of the appellant.

Cases Cited

Referred to: Hungerfords v. Walker (1989), 171 C.L.R. 125; Haack v. Martin, [1927] S.C.R. 413; Costello v. Calgary (City) (1997), 152 D.L.R. (4th) 453; Rowan v. Toronto R.W. Co. (1918), 43 O.L.R. 164; Brock v. Cole (1983), 142 D.L.R. (3d) 461; Claiborne Industries Ltd. v. National Bank of Canada (1989), 59 D.L.R. (4th) 533; Confederation Life Insurance Co. v. Shepherd (1996), 88 O.A.C. 398; Oceanic Exploration Co. v. Denison Mines Ltd., Ont. Ct. (Gen. Div.), May 8, 1998; Air Canada v. Ontario (Liquor Control Board), [1997] 2 S.C.R. 581; Westdeutsche Landesbank Girozentrale v. Islington London Borough Council, [1996] 2 All E.R. 961; Friedmann Equity Developments Inc. v. Final Note Ltd., [page604] [2000] 1 S.C.R. 842, 2000 SCC 34; Hadley v. Baxendale (1854), 9 Ex. 341, 156 E.R. 145.

Statutes and Regulations Cited

Act for the further amendment of the Law, and the better advancement of Justice, 7 Wm. 4, c. 3 (U.C.).
Act to amend the Common Law Procedure Act of Upper Canada, S. Prov. C. 1866, 29 & 30 Vict., c. 42.
Administration of Justice Act, 1884, S.O. 1884, ch. 10.
Courts of Justice Act, R.S.O. 1990, c. C.43, ss. 128 to 130.
Judicature Act, R.S.O. 1887, c. 44, s. 88.

Authors Cited

Sorter, George H., Monroe J. Ingberman, and Hillel M. Maximon. Financial Accounting: An Events and Cash Flow Approach. New York: McGraw-Hill, 1990.

Waddams, S. M. The Law of Damages, 3rd ed. Aurora, Ont.: Canada Law Book, 1997.
Waldron, Mary Anne. The Law of Interest in Canada. Scarborough, Ont.: Carswell, 1992.

APPEAL from a judgment of the Ontario Court of Appeal (2000), 184 D.L.R. (4th) 1, 130 O.A.C. 149, 30 R.P.R. (3d) 167, [2000] O.J. No. 704 (QL), affirming in part a decision from the Ontario Court (General Division) (1998), 18 R.P.R. (3d) 213, [1998] O.J. No. 1525 (QL). Appeal allowed.

Frank J. C. Newbould, Q.C., Benjamin T. Glustein, and Aaron A. Blumenfeld, for the appellant.
Earl A. Cherniak, Q.C., and Kirk F. Stevens, for the respondent.

[Quicklaw note: Please see complete list of solicitors appended at the end of the judgment.]

The judgment of the Court was delivered by

MAJOR J.:--

I. Introduction

1 Whether a court has jurisdiction to award compound interest on an award for damages has been the subject of debate. That question, renewed in this appeal, is: can the court order the payment of compound pre- and post-judgment interest? The [page605] trial judge in the Ontario Court (General Division) said yes but was reversed by the Ontario Court of Appeal.

2 Sections 128 and 129 of the Ontario Courts of Justice Act, R.S.O. 1990, c. C.43 ("CJA"), prescribe interest rates and methods of calculation before and after judgment and also permit a court to award other rates and methods of calculation in accordance with those sections.

3 Is the appellant entitled, on a breach of contract claim, to compound interest both before and after judgment? I conclude that it is and, as a result, the appeal is allowed.

II. Facts

4 In 1987, Reemark Sterling I Ltd. ("Reemark") planned to build a 300-unit residential condominium project in Scarborough, Ontario. Reemark intended to sell the units to investors. On November 12, 1987, Reemark entered into an agreement with the respondent, Mutual Trust Company (now Clarica Trust Company), under which the respondent trust company agreed to

provide mortgage financing to investors to allow them to purchase the units from Reemark. This agreement was the Takeout Mortgage Commitment (the "TOC"). Under this arrangement, the respondent trust company would be entitled to interest on the loans compounded semi-annually. The aggregate amount available under the TOC was $36.5 million.

5 Reemark would not receive funds pursuant to the TOC until units had been sold and the mortgages were arranged. In the meantime, Reemark needed money to start construction of the project. On December 1, 1988, Reemark and the appellant bank entered into a construction loan agreement (the "Loan Agreement") under which the appellant bank agreed to provide Reemark with a construction loan of $33 million for the project. The Loan Agreement [page606] required Reemark to repay the loan with interest equal to the appellant bank's prime lending rate plus one percent compounded monthly.

6 On December 16, 1988, the appellant bank, Reemark and the respondent trust company executed an Assignment of Takeout Financing Commitment ("TOC Assignment") by which the respondent trust company would pay the proceeds of the TOC to the appellant bank rather than Reemark until the construction loan was repaid.

7 On July 31, 1991, against the background of the collapsing real estate market of the early 1990s, the respondent trust company refused to advance funds under the TOC and declared that it would do so only if additional conditions were met. Following negotiations, the respondent trust company, the appellant bank and Reemark executed a further agreement on December 18, 1991, called the Amended Takeout Mortgage Commitment ("ATOC"). It provided a renegotiated basis upon which the respondent was to advance the long-term mortgage financing to the appellant. The respondent again refused to advance funds to the appellant. The appellant appointed a receiver of the project and sold the building for $22.5 million, which left a significant shortfall of principal and accrued compound interest.

8 The appellant brought an action against the respondents for breach of contract. At trial, Farley J. found that the respondent had breached the TOC, the TOC Assignment, and the ATOC. He awarded damages to the appellant with compound interest at the rate specified in the Loan Agreement as referenced in the TOC Assignment both before and after the judgment. The Ontario Court of Appeal dismissed the appeal except for the question of interest where it substituted an order for simple interest as provided in s. 128 CJA. The difference between compound and simple interest on the damages awarded is approximately $5 million or more.

[page607]

III. Relevant Statutory Provisions

9 Courts of Justice Act, R.S.O. 1990, c. C.43

128.--(1) A person who is entitled to an order for the payment of money is entitled to claim and have included in the order an award of interest thereon at the prejudgment interest rate, calculated from the date the cause of action arose to the date of the order.

...

(4) Interest shall not be awarded under subsection (1),

...

(b) on interest accruing under this section;

...

(g) where interest is payable by a right other than under this section.

129.--(1) Money owing under an order, including costs to be assessed or costs fixed by the court, bears interest at the postjudgment interest rate, calculated from the date of the order.

...

(5) Interest shall not be awarded under this section where interest is payable by a right other than under this section.

130.--(1) The court may, where it considers it just to do so, in respect of the whole or any part of the amount on which interest is payable under section 128 or 129,

(a) disallow interest under either section;
(b) allow interest at a rate higher or lower than that provided in either section;
(c) allow interest for a period other than that provided in either section.

(2) For the purpose of subsection (1), the court shall take into account,

[page608]

(a) changes in market interest rates;
(b) the circumstances of the case;
(c) the fact that an advance payment was made;
(d) the circumstances of medical disclosure by the plaintiff;
(e) the amount claimed and the amount recovered in the proceeding;
(f) the conduct of any party that tended to shorten or to lengthen unnecessarily the duration of the proceeding; and
(g) any other relevant consideration.

IV. Judicial History

A. Ontario Court (General Division) (1998), 18 R.P.R. (3d) 213

10 The trial judge found the respondent in breach of contract for a number of reasons, namely it breached its takeout financing commitment and acted in bad faith on its agreement by refusing to fund the TOC in 1991 and the ATOC in 1992; by causing unreasonable delay in replacing its counsel; by sending out invalid requisitions when it knew or ought to have known that they were invalid and only used for "negotiating purposes"; and, finally, "by taking a position at the end of February 1992 that it was relieved of its obligations to provide takeout financing as of March 1, 1992".

11 The trial judge held that under the TOC, the appellant would have received $36.5 million less $400,000 legal fees and disbursements and less a $182,500 commitment fee payable on closing of the individual mortgages for a net amount of $35,917,500. The appellant received proceeds from the sale of the building. Subtracting this amount from amounts owing on the construction loan, at the end of May 1993, meant that $11,045,200.79 of principal and $4,473,665.01 of interest (as per the Loan Agreement, calculated at the BAC prime rate plus one percent per annum compounded monthly) remained outstanding for a total of $15,518,865.80. From this amount, the trial judge deducted $600,000 [page609] representing the higher than expected vacancy rate for a total of $14,918,865.80 owed by the respondent to the appellant as of June 1, 1993. The trial judge adjusted this figure by adding monthly compounded interest at the BAC prime rate plus one percent per annum compounded monthly, the rate provided for in the Loan Agreement.

12 In deciding the appropriate measure of pre-judgment and post-judgment interest, the trial judge agreed with the appellant that it should be awarded the interest rate provided for in the Loan Agreement because, although it only intended to be an interim lender, the breach by the respondent resulted in the appellant becoming a long term lender which resulted in the appellant missing other investment opportunities as the money due to it was not paid and not available for other loans. The

appellant also submitted that awarding simple interest would result in a windfall for the respondent as it would lend the money it owed to the appellant to customers at its usual compound interest rates.

13 The respondent opposed the award of compound interest for three reasons. First, the appellant's statement of claim did not plead compound interest. Second, the appellant did not miss investment opportunities for lack of funds because it could have obtained funds from its parent corporation or other lenders. Finally, the interest rate in the Loan Agreement should not apply to the respondent as it was not a party to the contract.

14 The trial judge rejected these arguments. He confirmed that the statement of claim could be amended at any stage of the proceeding and that the respondent was not prejudiced in this case by the appellant raising the issue of compound interest at trial as the respondent was fully aware of the issue. He decided that financial institutions could not borrow money without cost and that the respondent was not a stranger to the Loan Agreement but was, in effect, [page610] to step into the place of the appellant, as lender to Reemark.

15 Farley J. considered ss. 128 and 129 CJA, but relied on s. 130 to exercise his discretion in varying the award of interest. The trial judge referred to Mason C.J. and Wilson J. in Hungerfords v. Walker (1989), 171 C.L.R. 125 (Aust. H.C.), at pp. 145-46 and at pp. 149-50, and concluded that this case involved a breach of financing with the attendant deprivation to the plaintiff from receiving the funds on a timely basis in accordance with the contract and the reciprocal benefit to the defendant in retaining and investing funds it should have paid. This led him to conclude that there should be a compounding provision for the pre- and post-judgment interest particularly when, as here, the plaintiff and the defendants are financial institutions whose business is lending money regularly at compound rates.

16 It is part of the record that each of the relevant agreements, the Loan Agreement, the TOC and the TOC Assignment, involved compound interest. The respondent agreed that was so but claimed that compound interest ceased upon its breach of the contract.

17 In summary, the trial judge determined that in 1987, Reemark began plans to build the condominium project. On November 12, 1987, Reemark and the respondent trust company entered into the TOC under which the respondent would pay Reemark most of the price of a unit and receive mortgage loan payments from investors at compound interest rates. On December 1, 1988, Reemark and the appellant bank entered into the Loan Agreement under which the appellant loaned Reemark $33 million at compound interest rates. On December 16, 1988, Reemark, the appellant and the respondent entered into the TOC Assignment under which Reemark assigned its rights to receive payments from the respondent under the TOC to the appellant until the construction loan had been repaid. Upon learning that the respondent would not perform its obligations pursuant to the TOC Assignment or [page611] a subsequent agreement between the parties, the appellant appointed a receiver of the project and sold the project for $22.5 million, substantially less than the

appellant was owed under the Loan Agreement and TOC Assignment. The trial judge awarded the appellant damages equal to the shortfall plus interest at the compound rate set out in the Loan Agreement.

B. Ontario Court of Appeal (2000), 184 D.L.R. (4th) 1

18 The Ontario Court of Appeal affirmed the trial judgment other than the award of compound interest. Goudge J.A. stated that the court cannot presume that simply because the appellant was engaged in the lending business that it lost profits equal to the interest rate it was entitled to under the Loan Agreement. He concluded that lost profits must be proved.

19 As well, Goudge J.A. held that the discretion granted to the court under s. 130 CJA to vary an interest award from what is prescribed under ss. 128 and 129 does not include the authority to award compound interest. He found that the court's jurisdiction to award compound interest stems from the court's general equitable jurisdiction. If the principles of equity warrant an award of compound interest, it is, in the language of ss. 128(4)(g) and 129(5), "payable by a right other than under this section". As a result, this being in his view a simple breach of contract, equitable principles did not warrant damages at compound interest rates.

V. Issue

20 Did the trial judge have the jurisdiction to award compound pre-judgment and post-judgment interest and, if so, was he correct in doing so?

[page612]

VI. Analysis
A. Jurisdiction

(1) The Time-Value of Money

21 The value of money decreases with the passage of time. A dollar today is worth more than the same dollar tomorrow. Three factors account for the depreciation of the value of money: (i) opportunity cost (ii) risk, and (iii) inflation.

22 The first factor, opportunity cost, reflects the uses of the dollar which are foregone while waiting for it. The value of the dollar is reduced because the opportunity to use it is absent. The second factor, risk, reflects the uncertainty inherent in delaying possession. Possession of a dollar today is certain but the expectation of the same dollar in the future involves uncertainty. Perhaps the

future dollar will never be paid. The third factor, inflation, reflects the fluctuation in price levels. With inflation, a dollar will not buy as much goods or services tomorrow as it does today (G. H. Sorter, M. J. Ingberman and H. M. Maximon, Financial Accounting: An Events and Cash Flow Approach (1990), at p. 14). The time-value of money is common knowledge and is one of the cornerstones of all banking and financial systems.

23 Simple interest and compound interest each measure the time value of the initial sum of money, the principal. The difference is that compound interest reflects the time-value component to interest payments while simple interest does not. Interest owed today but paid in the future will have decreased in value in the interim just as the dollar example described in paras. 21-22. Compound interest compensates a lender for the decrease in value of all money which is due but as yet unpaid because unpaid interest is treated as unpaid principal.

24 Simple interest makes an artificial distinction between money owed as principal and money owed as interest. Compound interest treats a dollar as a dollar and is therefore a more precise measure of [page613] the value of possessing money for a period of time. Compound interest is the norm in the banking and financial systems in Canada and the western world and is the standard practice of both the appellant and respondent.

(2) Contract Damages

25 Contract damages are determined in one of two ways. Expectation damages, the usual measure of contract damages, focus on the value which the plaintiff would have received if the contract had been performed. Restitution damages, which are infrequently employed, focus on the advantage gained by the defendant as a result of his or her breach of contract.

(a) Expectation Damages

26 Generally, courts employ expectation damages where, if breach is proved, the plaintiff will be entitled to the value of the promised performance (S. M. Waddams, The Law of Damages (3rd ed. 1997), at p. 267).

27 See Haack v. Martin, [1927] S.C.R. 413, per Rinfret J., at p. 416:

> The case is governed by the general rule applicable to all breaches of contract, and laid down as follows by Parke B. in Robinson v. Harman (1848) [1 Ex. 850, at p. 855].
>
> > The rule of the common law is, that where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed.

28 Since the value of money decreases with the passage of time, an award, at trial, to a plaintiff of the dollar amount he or she expected to receive had the contract been performed on time would not put the plaintiff in the same position as if the contract had been performed. The party would receive less than his or her expectation damages because of the [page614] (i) opportunity cost, (ii) risk and (iii) inflation. The plaintiff would fail to receive the benefit of the bargain.

29 To award the plaintiff damages equal to the value of the contract as if it had been performed on time, the court must first determine the dollar value of the promise to the plaintiff at the time the obligation was to have been performed, and then apply the appropriate interest rate and method of calculation to account for the time during which the plaintiff was not paid what was rightfully due.

(b) Restitution Damages

30 The other side of the coin is to examine the effect of the breach on the defendant. In contract, restitution damages can be invoked when a defendant has, as a result of his or her own breach, profited in excess of his or her expected profit had the contract been performed but the plaintiff's loss is less than the defendant's gain. So the plaintiff can be fully paid his damages with a surplus left in the hands of the defendant. This occurs with what has been described as an efficient breach of contract. In some but not all cases, the defendant may be required to pay such profits to the plaintiff as restitution damages (Waddams, supra, at p. 474).

31 Courts generally avoid this measure of damages so as not to discourage efficient breach (i.e., where the plaintiff is fully compensated and the defendant is better off than if he or she had performed the contract) (Waddams, supra, at p. 473). Efficient breach is what economists describe as a Pareto optimal outcome where one party may be better off but no one is worse off, or expressed differently, nobody loses. Efficient breach should not be discouraged by the courts. This lack of disapproval emphasizes that a court will usually award money damages for breach of contract equal to the value of the bargain to the plaintiff.

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32 However, where a sum of money is required to be paid as of a certain date, the benefit to the defendant of the money during the interval between when the money is owed and when the money is paid is, all other things being equal, exactly the same as the detriment to the plaintiff of not having that money during the same interval. This is not a Pareto optimal outcome, but, rather, a zero-sum outcome. The defendant's gain is the plaintiff's loss, the value of which, but for the defendant's breach, would have belonged to the plaintiff.

33 To prevent defendants from exploiting the time-value of money to their advantage, by delaying payment of damages so as to capitalize on the time-value of money in the interim, courts must be able to award damages which include an interest component that returns the value acquired

by a defendant between breach and payment to the plaintiff.

(3) Judgment Interest in Canada

34 The history of interest at law was identified in Costello v. Calgary (City) (1997), 152 D.L.R. (4th) 453 (Alta. C.A.), by Picard J.A., at pp. 492-94:

> The history of interest at law is long and miserly. Traditionally, pre-judgment interest generally was denied because it was thought usurious and the case against compound interest was considered particularly strong because of the (supposed) difficulty of calculation: M.A. Waldron, The Law of Interest in Canada (Scarborough, Ont.: Carswell, 1992) at pp. 1-10, 142. In time, at least the former rationale was abandoned and the harshness of the law's position was recognized. The legislative response, however, initially was limited. Section 28 of the Civil Procedure Act, 1833 (U.K.), 3 & 4 Will. 4, c. 42 (better known as Lord Tenterden's Act), merely provided for the availability of interest upon "Debts or Sums certain"... .
>
> Of course, that is not to say that non-statutory, pre-judgment interest was entirely foreign to the common law. Exceptions have always existed. Most obviously, interest has long been granted when provided for by [page616] agreement of the parties or when implied by usage of trade: Page v. Newman (1829), 9 B. & C. 378, 109 E.R. 140.

35 Judgment interest in Canada has had statutory authorization since 1837 with the passage of An Act for the further amendment of the Law, and the better advancement of Justice, 7 Wm. 4, c. 3 (U.C.). See Rowan v. Toronto R.W. Co. (1918), 43 O.L.R. 164 (C.A.), at p. 173. The first statute which provided for interest on judgments for debt or sum certain in Upper Canada was the Act to amend the Common Law Procedure Act of Upper Canada, S. Prov. C. 1866, 29 & 30 Vict., c. 42. The Administration of Justice Act, 1884, S.O. 1884, c. 10, provided for post-judgment interest in certain cases in tort and the first provision generally allowing post-judgment interest appeared in The Judicature Act, R.S.O. 1887, c. 44 s. 88. Today in Ontario, each of pre-judgment and post-judgment interest is governed by ss. 128 to 130 CJA.

(4) Interest as Compensation

36 In The Law of Interest in Canada (1992), at pp. 127-28, M. A. Waldron explained that the initial theory underpinning an award of judgment interest was that the defendant's conduct was such that he or she deserved additional punishment. The modern theory is that judgment interest is more appropriately used to compensate rather than punish. At pp. 127-28, she wrote:

> Compensation is one of the chief aims of the law of damages, but a plaintiff who

> is successful in his action and is awarded a sum for damages assessed perhaps years before but now payable in less valuable dollars finds it quite obvious that he has been shortchanged. Equally obviously, payment of interest on his damage award from some relevant date is one way of redressing this problem.
>
> The overwhelming opinion today of Law Reform Commissions and the academic community is that [page617] interest on a claim prior to judgment is properly part of the compensatory process. [Citations omitted.]

37 After acknowledging that historically compound interest was not available at common law, Waddams, supra, at p. 437, concludes that an award of compound interest should be available to courts so as to allow them to award full compensation to a plaintiff.

> [T]here seems in principle no reason why compound interest should not be awarded. Had prompt recompense been made at the date of the wrong the plaintiff would have had a capital sum to invest; the plaintiff would have received interest on it at regular intervals and would have invested those sums also. By the same token the defendant will have had the benefit of compound interest.

38 Although not historically available, compound interest is well suited to compensate a plaintiff for the interval between when damages initially arise and when they are finally paid.

(5) Sections 128 to 130 of the Courts of Justice Act

39 Sections 128 to 130 CJA entitle a person with an award for damages to interest on the damages for the period between the date that the cause of action arose and the judgment ("pre-judgment interest") as well as for the period between the judgment and the time when payment is made in full ("post-judgment interest"). The legislation recognizes the unfairness of awarding a plaintiff damages, at trial, in the amount to which he or she was entitled as of the date that the cause of action arose, and no more for the period in between which is frequently years. Sections 128 and 129 CJA, therefore, contain interest rates and methods of calculation to serve for pre-judgment and post-judgment interest, respectively, in those cases for which there is no evidence of a more appropriate interest rate and/or method of calculation.

40 Sections 128(4)(g), 129(5) and 130 CJA, each of which allows the judge to award interest other than as specifically set out in ss. 128 and 129, clearly [page618] indicate that the rates and calculation methods of interest provided in ss. 128 and 129 are applicable in the absence of more appropriate rates and methods of calculation. Section 130 allows a court, where it considers it just, to vary the interest rate or the time for which interest may be awarded. Sections 128(4)(g) and 129(5) allow a court to award pre-judgment and post-judgment interest, respectively, where interest is payable by another right.

(6) Interest Payable by Another Right

41 Equity has been recognized as one right by which interest may be awarded other than as specifically stated in ss. 128 and 129 CJA, including an award of compound interest. (See Brock v. Cole (1983), 142 D.L.R. (3d) 461 (Ont. C.A.); Claiborne Industries Ltd. v. National Bank of Canada (1989), 59 D.L.R. (4th) 533 (Ont. C.A.); Confederation Life Insurance Co. v. Shepherd (1996), 88 O.A.C. 398 (C.A.); Oceanic Exploration Co. v. Denison Mines Ltd., Ont. Ct. (Gen. Div.), May 8, 1998.) It is of some interest that in Air Canada v. Ontario (Liquor Control Board), [1997] 2 S.C.R. 581, at para. 85, approving Brock, supra, Iacobucci J. emphasized that in equity the awarding of compound interest is a discretionary matter. Simple breach of contract does not require moral sanction and is usually governed by common law, not equity.

42 In this case, the Court of Appeal recognized that the court has the jurisdiction to award compound interest under the court's general equitable jurisdiction and that an award of compound interest grounded in equity is, in the language of ss. 128(4)(g) and 129(5) "payable by a right other than under this section". The Court of Appeal found that equity did not apply and therefore the court had no jurisdiction to award compound interest. Implicit in their holding was that the only "right other than under this section" was the right to receive compound interest in equity. This is not so, as a common law right of interest can be an "other right".

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43 The common law right in contract law to be awarded expectation damages is another such other right. As noted in Westdeutsche Landesbank Girozentrale v. Islington London Borough Council, [1996] 2 All E.R. 961 (H.L.), at p. 969, the power to award compound interest was not traditionally available at common law, although it is now. This is so because, as our jurisprudence demonstrates, the common law has been able to grow and adapt to changing conditions. In Friedmann Equity Developments Inc. v. Final Note Ltd., [2000] 1 S.C.R. 842, 2000 SCC 34, at para. 42, this Court outlined the following conditions where the rules of common law may be changed if necessary:

(1) to keep the common law in step with the evolution of society,
(2) to clarify a legal principle, or
(3) to resolve an inconsistency.

It warned that the changes should be incremental, and their consequences capable of assessment.

44 Compound interest is no longer commonly thought to be, in the language quoted in Costello, supra, at pp. 492-93, usurious or to involve prohibitively complex calculations. Compound interest is now commonplace. Mortgages are calculated using compound interest, as are most other loans, including such worthy endeavours as student loans. The growth of a company or a country's gross

domestic product over a period of years is often stated in terms of an annually compounded rate. The bank rate, which garners much attention as an indicator of the health and direction of the economy, is a compound interest rate. It is for reasons such as these that the common law now incorporates the economic reality of compound interest. The restrictions of the past should not be used today to separate the legal system from the world at large.

45 If the court was unable to award compound interest on the breach of a loan which itself bore [page620] compound interest, it would be unable to adequately award the plaintiff the value he or she would have received had the contract been performed. To keep the common law current with the evolution of society and to resolve the inconsistency between awarding expectation damages and the courts' past unwillingness to award compound interest, that unwillingness should be discarded in cases requiring that remedy for the plaintiff to realize the benefit of his or her contract.

46 A contrary rule would lead to inequity and provide incentives to breach contracts. If courts were restricted to simple interest in assessing damages for breach of contract, an apparent abuse could occur in the following way. Money lent at compound interest would accrue compound interest until there was a breach of contract by the borrower. The lender would then sue and only be entitled to simple interest on the judgment. This would encourage borrowers not to repay loans. Contract law is not the enemy of parties to an agreement but, rather, their servant. It should not frustrate their mutually agreed intentions but, instead, absent overriding policy concerns, should permit those parties to obtain the benefit of their intended agreement.

47 I find support for these conclusions in Hadley v. Baxendale (1854), 9 Ex. 341, 156 E.R. 145. In Hadley the Court of Exchequer was confronted with the issue of the proper measure of damages for a breach of contract. In that case, the plaintiffs, who owned a flour mill in Gloucester, sent a broken shaft, without which the mill was inoperable, to the Gloucester office of the defendants, who were common carriers. The shaft was to be taken to Greenwich to serve as a model to make a new one. The plaintiffs sued the defendants for failing to deliver the shaft to Greenwich within a reasonable time. Plaintiffs sought profits which were lost because the mill was inoperable. At p. 151, [page621] Alderson B. explained the general rule of contract damages:

> "There are certain established rules," this Court says, in Alder v. Keighley (15 M. & W. 117), "according to which the jury ought to find." And the Court, in that case, adds: "and here there is a clear rule, that the amount which would have been received if the contract had been kept, is the measure of damages if the contract is broken."
>
> Now we think the proper rule in such a case as the present is this: -- Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising

> naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

48 The court held that the unreasonable delay of delivery of the shaft to the engineer would not necessarily lead to the cessation of operations of the mill. The plaintiffs might have had a substitute shaft which could have been used in the interim. The court found for the defendants, holding that the stoppage of milling did not naturally arise from the delay in delivery nor was this result and the concomitant cost to the plaintiff in the contemplation of both parties at the time they made the contract.

49 With respect to the failure to repay the loan in this appeal when due, it cannot be said that the cost of such delay was not in the contemplation of both parties at the time they made the contract, particularly as both parties were in the business of lending. A loan agreement with a specified interest rate is an agreement between parties on the cost of borrowing money over a period of time. Absent exceptional circumstances, the interest rate which had governed the loan prior to breach would be the [page622] appropriate rate to govern the post-breach loan. The application of a lower interest rate would be unjust to the lender.

50 This analysis applies equally to pre-judgment interest and post-judgment interest. Pre-judgment interest is necessary to compensate a plaintiff for the period from when the money was initially owed until the date of the judgment. Contract law principles may require such interest to be compounded so as to award the plaintiff the benefit of the bargain. Damage awards, however, are not necessarily paid at the date judgment is rendered. Contract law entitles the plaintiff to the full value of the benefit of the bargain at the time payment is finally made. Where the parties have earlier agreed on a compound rate of interest, or there are circumstances warranting it, it seems fair that a court have the power to award compound post-judgment interest as damages to enable the plaintiff to be fully compensated when the award is finally paid.

51 Additionally, it would be illogical and unfair to the plaintiff to change to a simple rate of interest charged upon the judgment at the post-judgment phase. This would delay but not eliminate the period when the defendant gains a benefit that belongs to the plaintiff by not paying compound interest. It would encourage the defendant to delay paying the judgment award. As noted above, equity is another jurisdiction under which compound interest may be ordered in accordance with s. 129(5) CJA. In light of the illogical and inequitable result that would be occasioned by refusing to extend an award of compound interest to the post-judgment phase, in addition to common law remedies, it may be appropriate to extend that award on equitable grounds where it has been already determined that compound interest was part of the damages for breach in the pre-judgment phase.

52 The court's common law power to award damages flows from the application of contract law. In addition, ss. 128(4)(g) and 129(5) CJA, provide [page623] statutory authority to award

compound pre-judgment and post-judgment interest according to this common law power. The court also has an equitable power to award compound interest, as has traditionally been done in cases of, inter alia, wrongful retention of funds and s. 129(5) CJA provides statutory authority to award compound post-judgment interest according to this equitable power.

B. Was the Court Below Correct to Award Compound Interest?

53 At trial, Farley J. found that the respondent had breached the TOC and the TOC Assignment. Under the TOC Assignment, the parties agreed that the respondent would pay to the appellant money owed under the TOC by the respondent to Reemark until the construction loan from the appellant to Reemark had been repaid. The Loan Agreement was incorporated by reference in the TOC Assignment, including the compound interest rate.

54 The respondent submitted that the appellant had not pleaded damages at compound interest, this was raised at the trial where the trial judge determined that there was no prejudice to the respondent by raising that issue as the appellant at the time had the ability if requested by the respondent to call evidence on the question of what the interest component of the damages should be. The manner in which a trial should proceed is properly left to the discretion of the trial judge, and, absent prejudice or error, an appellate court should not lightly interfere.

55 An award of compound pre- and post-judgment interest will generally be limited to breach of contract cases where there is evidence that the parties agreed, knew, or should have known, that the money which is the subject of the dispute would bear compound interest as damages. It may be awarded as consequential damages in other cases [page624] but there would be the usual requirement of proving that damage component.

56 The award by the trial judge considered both the expectation and restitution aspects of damages.

(1) Expectation Damages

57 From the date of the TOC Assignment until the repayment of the construction loan, the funds to be paid by the respondent accrued interest at the interest rate set forth in the Loan Agreement which was the appellant's prime lending rate plus one percent compounded monthly. This was included by reference in the TOC Assignment. This was the cost of that loan.

58 The respondent breached the TOC Assignment by failing to repay the construction loan. This breach caused the outstanding balance of the loan to increase at the compound interest rate specified in the Loan Agreement. Had that loan been paid in accordance with the TOC Assignment, the appellant would have received the initial principal amount of the loan plus interest at the appellant's prime lending rate plus one percent over the entire period from the date interest first accrued until the date of payment in full compounded monthly. Any lesser amount would fail to award the appellant the agreed-upon time-value of its money.

(2) Restitution Damages

59 The respondent is a financial institution whose business is to make loans at compound interest. At the hearing, it was clear that loans made by the respondent since the time of the breach of contract would have been made at compound interest. The trial judge found that as the real estate market [page625] collapsed, the respondent was under pressure from each of the Office of the Superintendent of Financial Institutions and the Office of the Ministry of Financial Institutions at a time when the respondent needed the approval of these regulatory bodies to increase its multiplier and avoid any reduction of its capital base by the removal from it of any deemed "troubled" loans. Having fallen below the required ratio of capital to loans, it is reasonable to conclude that the money which should have been paid to the appellant was used by the respondent to support loans already made at compound interest rates.

60 If required to pay damages at only simple interest, the respondent would have earned compound interest on the appellant's money while paying only simple interest. By breaching the contract, the respondent would have conferred on itself a profit which the contract envisaged for the appellant.

61 This is not a case of efficient breach. The respondent's gains have come at the appellant's expense. An award of compound interest will prevent the respondent from profiting by its breach at the expense of the appellant. The award of the trial judge yields a satisfactory result with respect to both expectation damages and restitution damages.

VII. Conclusion

62 The courts have the jurisdiction to award pre-judgment and post-judgment interest at both common law and equity. Sections 128(4)(g) and 129(5) CJA allow courts to award interest by means of these powers as a substitute for the interest prescribed by those sections. This is such a case. As a result, the order of the Court of Appeal is set aside and the trial judgment restored. Accordingly, the appeal is allowed. The appellant is entitled to costs throughout.

[page626]

Solicitors for the appellant: Borden Ladner Gervais, Toronto. Solicitors for the respondent: Lerner & Associates, Toronto.

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