

## **A Compound Answer to a Simple Question ~ Sempra Metals Limited (formerly Metallgesellschaft Limited) v Her Majesty's Commissioners of Inland Revenue and another**

**By Ewan West <sup>1</sup>  
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With its long-awaited judgment in *Sempra Metals Limited (formerly Metallgesellschaft Limited) v. Her Majesty's Commissioners of Inland Revenue and another ("Sempra Metals")* handed down on 18 July, the House of Lords has brought to an end proceedings initiated nearly twelve years ago. However, such are the wide-ranging implications of the judgment that its effects are likely to reverberate for some considerable period to come. The decision that a taxpayer who had paid tax prematurely was entitled to interest on a compound basis moves the law considerably further forward in recognising commercial and business realities.

As Lord Nicholls said:

*"We live in a world where interest payments for the use of money are calculated on a compound basis. Money is not available commercially on simple interest terms. This is the daily experience of everyone, whether borrowing money on overdrafts or credit cards or mortgages or shopping around for the best rates when depositing savings with banks or building societies. If the law is to achieve a fair and just outcome when assessing financial loss it must recognise and give effect to that reality."*

The judgment will obviously be of most immediate benefit to those companies that were part of the group litigation order for which Sempra Metals was the lead claimant and other potential claimants whose position is directly analogous. However, given the fundamental shift away from the Courts' longstanding reluctance to entertain claims for interest on a compound basis, it is to be expected that the boundaries of their Lordships' judgment will be more widely tested in due course.

The claim has its foundations in the application of a particular category of taxation that was abolished nearly ten years ago: Advance Corporation Tax ("ACT"). Under the regime for ACT provided by section 247 Income and Corporation Taxes Act 1988, a subsidiary company was permitted, under a process known as "group income election", to pay dividends to its parent company without accounting for ACT provided that the parent company was located within the United Kingdom. In 1995 Sempra Metals (then known as Metallgesellschaft), a United Kingdom subsidiary of a

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German parent company, commenced proceedings claiming that these provisions were in breach of the EC Treaty, in particular the principle of freedom of establishment protected by Article 43. The case was referred to the European Court of Justice ("ECJ") (Joined Cases C-397/97 *Metallgesellschaft and Others v Commissioners of HMRC and HM Attorney General* and C-410/98 *Hoechst AG and Hoechst UK Ltd v Commissioners of Inland Revenue and HM Attorney General*).

The essence of the claim was not the amount of ACT itself, but that a company in Sempra Metal's position suffered a timing disadvantage in that it was required to pay over ACT sooner than a company with a United Kingdom-based subsidiary. The ECJ upheld this claim, finding that the United Kingdom's ACT regime was indeed discriminatory and in breach of Article 43. It agreed that Sempra was entitled to a remedy by way of interest on the amounts of ACT it had paid over prematurely, though it was for the domestic courts to determine the rate and method by which the interest was to be calculated. In particular, in paragraph 81 of its judgment, the ECJ held that:

*"In the circumstances, it is for the claimants to specify the nature and basis of their actions (whether they are actions for restitution or actions for compensation for damage), subject to the supervision of the national court."*

Furthermore, in paragraph 96, the ECJ also held that:

*"While, in the absence of Community rules, it is for the domestic legal system of the Member State concerned to lay down the detailed procedural rules governing such actions, including ancillary questions such as the payment of interest, those rules must not render practically impossible or excessively difficult the exercise of rights conferred by Community law"*

Unsurprisingly, the ECJ's judgment initiated a spate of claims from companies whose position was similar to Sempra Metals. These were consolidated, with Sempra Metals as the lead claimant. Her Majesty's Commissioners of Inland Revenue ("the Revenue") accepted that it was required to pay interest in relation to the amounts of tax it had levied prematurely, but contended that calculation on a simple interest basis would provide a sufficient legal remedy within the terms of the ECJ's ruling. In 2004, Park J held, however, that Sempra was entitled to an award of compound interest on the amounts of ACT paid over prematurely, calculated on a conventional basis: that is, a normal commercial rate that did not take into account Sempra's particular commercial circumstances. Park J considered that, irrespective of the position in domestic law, the ECJ required that Sempra Metals be fully compensated, which required an award of compound interest. That judgment was subsequently upheld (with a change over the precise method of calculation) by the Court of Appeal in 2005, following which the Revenue appealed to the House of Lords.

The headlines of the House of Lords' majority ruling can thus be summed up: a company that has paid tax too early and has a restitutionary claim against the Revenue is entitled to an award of compound rather than simple interest on the amount paid over prematurely, for which the rate of interest should be calculated by reference to market rates for Government borrowing at the relevant time. In principle, it is also now always open to a claimant to plead and prove his actual interest losses caused by late payment of a debt, subject to the normal rules on remoteness, failure to mitigate and so forth.

That summary is, however, the distillation of a much more complex and wide-ranging discussion, inevitable in the light of the ECJ having declined to discuss what form the remedial proceedings for breach of Article 43 EC should take. As well as considering the domestic court's historical approach to the payment of interest, in particular compound interest, their Lordships also examined Sempra Metal's potential entitlement under breach of statutory duty, tax paid pursuant to an unlawful demand, and payments made under a mistake of law. Furthermore, it is significant to note the fundamental basis upon which their Lordships proceeded. They did not conclude the ECJ's ruling meant it was unnecessary to consider domestic law. Rather, having conducted their extensive historical review of the treatment of interest claims in domestic law, their Lordships concluded that the remedy in this case was a matter for domestic law, subject to the Community law principles of equivalence and effectiveness.

### **Breach of statutory duty**

As Lord Nicholls observed, breach of Article 43 is characterised in English law as a breach of statutory duty, giving rise to a claim in tort. The broad common law principle is that a claimant can recover damages for losses caused by a breach of contract or a tort subject to the usual remoteness tests. Claims for interest losses by way of damages for breach of a contract to pay a debt are the one exception to this principle however.

Having reviewed the history of that exception, Lord Nicholls concluded that it was "the unprincipled remnant of an unprincipled rule" and that "the House should now hold that, in principle, it is always open to the claimant to plead and prove his actual interest losses caused by late payment of a debt. These losses will be recoverable, subject to the principles governing all claims for damages for breach of contract, such as remoteness, failure to mitigate and so forth". However, such loss must be proved: an unparticularised or unproven claim simply for "damages" will not be sufficient.

Lord Nicholls's approach was closely mirrored by Lord Hope and Lord Walker, who both agreed that a claim may include compound interest, provided that the claimant can prove actual loss. Lord Scott, while agreeing that interest losses caused by breach of contract or tortious wrong should in principle be recoverable, nonetheless disagreed that compound interest should be recoverable in cases of late payment. In his view, the existence of various statutory provisions relating to interest, such as section 35A Supreme Court Act 1981 and the Arbitration Act 1996, rendered it inappropriate for their Lordships to seek to improve upon what Parliament had enacted. Finally, Lord Mance concluded that loss of interest might be recoverable as damages for breach of contract, provided it was within the reasonable contemplation of the parties when the contract was made. In his view, "the present case should not therefore be seen as a charter for claims, still less for claims on a compound basis, in respect of interest losses following a breach of contract, where there is no contractual stipulation for its recovery."

### **Unlawful demand/mistake of law**

Sempra Metals also advanced two restitutionary causes of action, namely that it paid ACT in response to an unlawful demand and under a mistake of law. By virtue of their Lordship's earlier ruling in *Deutsche Morgan Grenfell Group plc v Her Majesty's Commissioners of Inland Revenue and another* [2006] UKHL 49, if Sempra Metals could succeed under mistake of law, it could potentially look to the effect of premature payments of ACT going back more than 30 years.

Historically, the courts have had no jurisdiction to award compound interest on a personal claim for restitution for a sum of money paid by mistake or following an unlawful demand. In reviewing the history of this doctrine, Lord Nicholls drew particular attention to *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* ("*Westdeutsche*") [1996] AC 669, where their Lordships had held by a bare majority that there was no jurisdiction in equity to award compound interest. Against that background, Lord Nicholls considered that it was open to their Lordships to consider the question conceded and not discussed in *Westdeutsche*, namely whether interest might be awarded by the courts in exercise of their common law jurisdiction to grant personal restitutionary relief.

Lord Nicholls considered that there could be only one answer to this question: that "an award of compound interest is necessary to achieve full restitution and, hence, a just result" for, as he had earlier observed, "the payment of ACT was the equivalent of a massive interest free loan". Again, Lord Hope agreed with Lord Nicholls, though he distinguished *Westdeutsche* on the basis that in the present case the interest in question was the principal sum itself. For that reason, there was no need to overrule *Westdeutsche*.

For Lord Walker, the recognition of a restitutionary remedy at common law was problematic: that would be to follow a course which in *Westdeutsche* was "not so much rejected as assumed not to be open". However, he nonetheless believed that their Lordships should follow the course they came close to taking in *Westdeutsche* and extend the court's equitable jurisdiction to award compound

interest. This would be a "principled development in the still-evolving relationship between equity and the common law", and its discretionary nature would provide the necessary flexibility. Furthermore, either the common law route or the equitable route would lead to the same conclusion.

In Lord Mance's view, it would also be a step too far to reverse the common law approach to restitution for money had and received. Consequently, unlike Lords Nicholls and Hope, Lord Mance did not feel that *Westdeutsche* could be set aside. However, like Lord Walker, he considered that *Westdeutsche*'s findings in relation to a potential award in equity could be revisited and that the minority approach in that case could be adopted. However, this should be limited to providing relief in respect of any actual interest benefit received from any principal sum paid by mistake, even though that sum might be recouped before action was brought, not for the time value of money.

Finally, Lord Scott disagreed that Sempra had any right to a claim in restitution in relation to interest. He was unable to accept the premise on which such a claim was based, namely that the mere possession of mistakenly paid money was sufficient to justify a restitutionary remedy not just for its recovery, but also for the "wholly conceptual benefit of an ability to use the money". In his view, the appropriate remedy to enable Sempra to be compensated for the premature payment of ACT was a tortious one, or for breach of statute.

A reconciliation of these judgments thus leads to the overall conclusion that an award of interest on a compound basis should be available for restitutionary claims of the kind pursued by Sempra Metals despite differences in approach over the precise legal basis upon which a claim is believed to rest.

### ***Rate of interest for restitutionary claims***

At first instance, it had been held that the appropriate rate of compound interest would be on a conventional basis: that is, the rate at which companies would normally borrow commercially. Before their Lordships, this matter was considered further in the light of submissions on the law of restitution, in particular in the light of the principle of enrichment, whereby it is the circumstances of the person enriched, in this case the Revenue, that should be considered. In this regard, the Government was clearly in a unique position, since it could, by definition, borrow more cheaply than any commercial organisation.

In the view of Lord Hope, it followed that if the person enriched could show that it was able to borrow at more favourable rates or on more favourable terms than those available in the ordinary commercial market, then it should be those rates that were applicable. In this case, the applicable rate should therefore be the Government borrowing rate. That view was also accepted by Lord Walker and by Lord Nicholls. Both Lord Scott and Lord Mance took a different position, namely that the rate should reflect the actual benefit received by the Revenue as a result of the premature payment.

### ***Conclusion***

The description "landmark judgment" is often over-used, but this is a case to which it may be aptly applied. As is clear from their Lordships' survey of the courts' historical approach to awards of interest, the pre-existing statutory, common law and equitable rules were extremely restrictive. Moreover, despite the fact that simple interest is to all intents and purposes a theoretical rather than a practical construct, and of only limited application in the commercial world, the circumstances under which compound interest might be available were even more restrictive. In recognising that an award of compound interest should be available in appropriate circumstances, their Lordships have therefore significantly extended the scope of remedies available to claimants. The judgment has obvious application to future claims against the Revenue for recovery of taxes wrongly paid, though its wider deployment will now be watched with interest.

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