The specific compound interest problem occurs when the plaintiff could have earned such interest if the defendant had paid punctually or if the plaintiff has had to pay compound interest which, in the event of defendant's punctual payment, would have been avoided.

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The later alternative is more easily proved and is exemplified by an important English Court of Appeal decision. A building contract provided that if in the event of a variation of work the contractor has been involved "in direct loss and/or expense" the amount of such loss or expense shall be recoverable from the building owner. To finance this additional work, the contractors had borrowed money from their bank and paid interest and compound interest for the loan.

[...]

It should be clear that "direct loss and/or expense" is, independently of a contractual provision, also the prerequisite of a claim for damages flowing from a breach of contract or tort. It follows that even in the absence of a clause indemnifying a contracting party against "direct loss and/or expense", compound interest reasonably incurred by the injured party should be recoverable as an item of damage. This, fit is submitted, should not only be English law, but should be accepted wherever damages are allowed and should, therefore, be treated as a general principle of law.

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It is a fact of universal experience that those who have a surplus of funds normally invest them to earn compound interest. This applies, in particular, to bank deposits or savings accounts. On the other hand, many are compelled to borrow from banks and therefore must pay compound interest. This applies, in particular, to business people whose own funds are frequently invested in brick and mortar, machinery and equipment, and whose working capital is obtained by way of loans or overdrafts from banks.

[...]

If, in accordance with the usual formula, damages are intended to afford restitutio in integrum (complete compensation for the wrong suffered) such items of damage should not be excluded. One is not dealing with the payment or repayment of liquidated sums such as the price of goods or a loan or even arrears of agreed interest due in respect of a loan; in such circumstances the general practice of municipal laws or courts does not normally allow the payment of more than simple interest. But as soon as any liability for damages arises, different considerations apply and demand the elimination, by the payment of money, of all foreseeable injuries.

46 Id.
48 It is at present uncertain whether the submission made in the text will be accepted in England. On English law relating to interests, see Mann, "On Interest, Compound Interest and Damages", 101 Law Q. Rev. 30 (1985).

Referring Principles:

- VII.7 - Right to charge compound interest