



A PRACTICAL GUIDE TO SECTION 347 OF THE CRIMINAL CODE - CRIMINAL RATES OF INTEREST

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INTRODUCTION

Between the Criminal Code sections on extortion and break and enter is s. 347.ⁱ This section makes it a criminal offence to enter into an agreement or arrangement to receive, or to receive, payments for advancing credit exceeding 60% of the total value of the credit advanced. Parliament enacted s. 347 to control loan-sharking. However, the courts have interpreted s. 347 so that commercial lawyers, who might assume the Criminal Code has little relevance to their practices, overlook this section at their and their clients' peril. Failure to consider s. 347 in structuring a loan transaction can result in criminal charges and significant civil consequences. If the courts find a transaction provides for a rate of interest exceeding 60% the borrower may have an unexpected defence to the lender's attempt to enforce their agreement. The courts may deprive a lender of some or all of its anticipated return. The lender's principal may even be at risk.

THE LEGISLATION

Section 347, numbered s. 305.1 until 1989, creates two criminal offences (see Appendix). Section 347(1)(a) makes it an offence to enter into an agreement or arrangement to receive interest at a criminal rate. Section 347(1)(b) makes it an offence to receive a payment or partial payment of interest at a criminal rate.

A criminal rate of interest is defined as an effective annual rate of interest, calculated in accordance with generally accepted actuarial practices and principles, that exceeds 60% of the credit advanced.

Interest is defined to include all charges and expenses paid or payable for the advancing of credit under an agreement or arrangement by or on behalf of the borrower, regardless of to



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whom such charges and expenses are or are to be paid or payable. There are specific exceptions to this inclusive definition.

Credit advanced is defined as the total value of the benefits actually advanced or to be advanced under an agreement or arrangement, less specified amounts.

Section 347(3) deems a person receiving a payment or partial payment of interest at a criminal rate to have knowledge of the nature of the payment and that it was received at a criminal rate, in the absence of evidence to the contrary.

LEGISLATIVE HISTORY AND OBJECT

The offences created by s. 347 are separate from the interest rate disclosure provisions in the Canada Interest Act and the Bank Act and in provincial consumer protection legislation.

Parliament enacted s. 347 in 1980 as part of An Act to Amend the Small Loans Act and to Provide for its Repeal and to Amend the Criminal Codeⁱⁱ. The House of Commons passed the Act unanimously without debate.ⁱⁱⁱ The Senate referred the Act for study to its Standing Committee on Banking, Trade and Commerce, which recommended its adoption without amendment.^{iv} The Senate did so on December 17, 1980.^v

Parliament had enacted the Small Loans Act in 1939. Its object was to protect borrowers seeking small loans, not then normally made by financial institutions, from usurious loan charges. It did so by regulating the comprehensively defined "cost" of loans under \$1,500. Parliament repealed the Act in 1980 because, with changes in the Canadian economy, small loans were more widely available. Parliament believed market forces would more effectively protect borrowers. However, it still wished to control the perceived problem of loan-sharking. Parliament enacted s. 347 for that purpose.^{vi}

There have been several constitutional challenges to s. 347. None have been successful. The Supreme Court of Canada has held that s. 347 is not ultra vires Parliament for regulating matters within the exclusive jurisdiction of the provinces under s. 92(13) of the Constitution Act, 1867.^{vii} The courts have also held that s. 347 does not violate the rights guaranteed by ss. 7 and 11(d) of the Charter of Rights and Freedoms.^{viii}



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To appreciate the potential impact of s. 347 one must understand how it defines, and how the courts have dealt with, the terms "agreement or arrangement to receive interest," "credit advanced," "interest" and "criminal rate of interest." Two basic principles underlie the courts' interpretation of s. 347. First, the courts focus on the substance of the transaction under review, not on their form, mechanics or characterization by the parties. Second, the courts consider the transaction as of the time the agreement is concluded, not some later date, such as when the borrower pays interest or defaults or when the lender seeks to enforce its security. Another common element in the caselaw is the courts' shying away from the consequences of the plain meaning of s. 347(1)(b), which makes it an offence to receive interest at a criminal rate.

AGREEMENT OR ARRANGEMENT

Section 347 does not define "agreement or arrangement to receive interest." This is one area where the courts have focused on the substance of the transaction. If a transaction is, in substance, an agreement or arrangement to receive interest at a criminal rate the courts will hold s. 347 to apply, regardless of how the parties characterize the transaction.^{ix} Section 347 most often becomes relevant in the context of straightforward loan transactions. An example is where the vendor of real property, or a third party, loans the purchaser part of the purchase price in return for a mortgage of the property, or other security. However, the courts have also held a sale of real property with an option to repurchase^x and a conditional sale agreement concerning a truck^{xi} to be agreements within the meaning of s. 347.

An example of the lengths to which the courts have gone to give effect to the substance of a transaction is Re D.C. Properties Ltd., in which two related corporate lenders required a borrower to borrow 75% of the amount advanced from one and 25% from the other and to secure the loan with separate mortgages to each. The lenders' object was to permit one of them to circumvent a statutory prohibition against lending more than 75% of the value of a property. One of the mortgages, when read alone, required the borrower to pay a criminal rate of interest. The B.C. Court of Appeal held that, because all three parties had treated the two mortgages as one agreement, they were one agreement as a matter of law. Thus the overall interest rate was legal.^{xii}



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The B.C. Court of Appeal held in Nelson v. CTC Mortgage Corporation, in *obiter dicta*, that s. 347 does not apply to demand mortgages. In such a mortgage the lender can demand repayment of principal and interest in full on a stated event such as the borrower's bankruptcy. The courts cannot determine the interest rate in advance because the mortgage has no fixed term.^{xiii}

Assuming a demand mortgage does not call for a criminal rate of interest on its face, this is consistent with s. 347(1)(a), which makes it an offence to agree to receive interest at a criminal rate. At the time the parties agree, the mortgage requires a legal rate of interest.

However, this is inconsistent with s. 347(1)(b), which makes it an offence to receive interest at a criminal rate. If a borrower became bankrupt during the term of the loan and the lender then demanded repayment in full, the effective annual interest rate could exceed 60% of the credit advanced because of the shortened term. The interest rate would then be criminal. For the lender to receive that interest would be a criminal offence. The lender's right to receive that interest should not be enforceable.

However, as discussed below, the courts have held that s. 347 only applies to agreements which, at the time of agreement, require the borrower to pay a criminal rate of interest. They have also held that the borrower cannot by its own later act make the interest rate criminal.

Perhaps the resolution of this conflict should depend on the structure of the transaction. If the agreement automatically accelerates the full amount payable on a stated event, such as the borrower's default, then the borrower could cause the increase in the effective annual interest rate by defaulting. This should not affect the lender's ability to enforce the agreement. If the agreement gives the lender the option of demanding repayment in full on the occurrence of the stated event, then the borrower could not alone cause the increase. The lender would also have to act, by exercising its option. Here the agreement should not be enforceable by the lender, because to enforce the agreement would permit the lender to receive a criminal rate of interest partly as a result of its own act. The courts have not yet dealt with this issue on its merits. Until they do, lenders having such demand rights should be cautious before exercising them.



"CREDIT ADVANCED" AND "INTEREST"

Section 347(2) defines a criminal rate of interest as an effective annual rate of interest, calculated in accordance with generally accepted actuarial practices and principles, exceeding 60% of the credit advanced. Both "interest" and "credit advanced" are also defined terms. Here again the courts have considered the substance of the transaction. They have held the focus of these definitions to be on the actual benefit to the borrower, that is the real amount put in the borrower's hands less all costs incurred, and on the real cost to him of borrowing.^{xiv} The return to the lender is irrelevant.^{xv}

"Interest" includes all charges and expenses paid or payable by or for the borrower in return for the advancing of credit. There are only six statutory exceptions:

1. repayments of principal;
2. "insurance charges" (the cost of insuring the lender's risk, so long as the face amount of the insurance does not exceed the credit advanced);
3. "official fees" (fees the borrower must pay to governmental authorities to perfect security);
4. "overdraft charges" (charges of up to \$5 for the creation of or increase in an overdraft);
5. "required deposit balances" (amounts advanced under the loan agreement required to be deposited or invested by or for the borrower which may be available to the lender on default); and
6. in mortgage transactions, amounts the borrower must pay for property taxes.

Given this comprehensive definition, the courts have naturally taken a broad approach to what is included as interest. They will consider as interest virtually all elements of the cost of borrowing, regardless of how the parties have characterized them. Costs which have been considered interest include the following:

- commitment fees;^{xvi}



- initial fees;^{xvii}
- loan fees;^{xviii}
- loan advance fees;^{xix}
- facility fees;^{xx}
- finance charges;^{xxi}
- bonuses;^{xxii}
- legal fees;^{xxiii}
- extension fees;^{xxiv}
- capitalized interest;^{xxv}
- bonus interest;^{xxvi}
- compensation for interest lost on money advanced on short notice;^{xxvii}
- lender's costs;^{xxviii}
- an increase in the outstanding balance of the purchase price if the borrower does not pay the original balance within a set time;^{xxix}
- amounts the borrower is to pay in addition to repaying principal, for example where the lender advanced US\$150,000 and the borrower agreed to repay US\$232,500, plus interest and other charges, in 90 days;^{xxx} and
- the borrower's estimated share of the profit on resale of the property concerned, which the borrower agreed to pay to the lender in addition to repaying the amount advanced.^{xxxi}

In Ingram v. Dorian the borrower paid a finder's fee to the broker who arranged the loan. The broker had no previous relationship with the lender. The Ontario Court - General Division held



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the finder's fee was not interest. The Court's rationale was that the borrower paid the finder's fee to the broker under a separate agreement. The Court admitted that the loan may have cost the borrower more than 60%, but noted the interest received by the lender was less than 60%.^{xxxii} In the face of the definition of interest in s. 347(2), namely all charges paid by the borrower for the advancing of credit "irrespective of the person to whom any such charges and expenses are or are to be paid or payable", the Court's conclusion that the finder's fee was not interest is wrong. However, the result, the enforcement of agreement, is correct. The lender neither agreed to receive nor actually received interest at a criminal rate.

The Ontario Court of Appeal said in William E. Thompson Associates Inc. v. Carpenter that it would permit no erosion of the public's protection by the broad definition of interest.^{xxxiii} Most decisions on this issue confirm this approach. If the parties wish to have the lender receive a return of over 60%, it will have to be other than through "interest," perhaps by true profit sharing.^{xxxiv}

Section 347(2) defines "credit advanced" as the total value of the money and other benefits actually advanced or to be advanced to the borrower, less any "required deposit balance" and any fees incurred under the loan agreement or any collateral agreement.

The amounts which the courts will consider interest and the amounts they will deduct from the benefits advanced to the borrower to arrive at the credit advanced are similar. The courts could either include charges such as commitment fees, facility fees and legal fees as interest or deduct them from the benefits advanced. The Supreme Court of B.C. held in BCorp Financial Inc. v. Baseline Resort Developments Inc. that it would be double counting to do both.^{xxxv} Such fees should be included only in one of these calculations.

One example of the courts' approach of considering a loan transaction as of the time of the parties' agreement is that they will consider whether the agreement called for a criminal rate of interest at that time.^{xxxvi} This approach has several consequences.

The B.C. Court of Appeal held in Nelson that Parliament intended s. 347 only to cover situations where the agreement or arrangement at the outset **requires** the borrower to pay interest at a criminal rate. A borrower cannot by its own later act make the interest rate criminal.^{xxxvii}



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The Supreme Court of B.C. held in Re D.C. Properties that mortgage discharge fees, which the borrower had to pay to the lender on sales of condominium units, were not interest. The terms of the loan agreement only required the borrower to pay them if it wished partial discharges of the mortgage. The borrower had the options of not selling the units or not applying for partial discharges of the mortgage as it did so.^{xxxviii} How the borrower was to sell the units and repay the loan otherwise is unclear. This result, while perhaps tenable in theory, is unrealistic. It is also inconsistent with the courts' usual focus on the substance of the transaction.

In Kebet Holdings Ltd. v. 351173 B.C. Ltd. the lender obtained for the borrower a letter of credit payable to the vendor on the date the borrower's promissory note for the balance of the purchase price fell due. The B.C. Court of Appeal held the letter of credit was part of the credit advanced, but not until it was payable. The lender could not include the value of the letter of credit in the total value of benefits advanced when the loan was made. The Court considered the letter of credit to have no value until it was payable. This reduced the credit advanced sufficiently to make the interest rate criminal.^{xxxix}

This decision illustrates why lawyers should carefully review proposed loan transactions in light of s. 347. In this case both lender and borrower believed the effective interest rate to be under 60%. While they disagreed about the value of the letter of credit, and so about the effective rate, both considered the lender to have advanced the letter of credit on the same date as the principal amount.

CALCULATION OF THE INTEREST RATE

A borrower seeking to rely on s. 347 bears the onus of proving that the interest rate required by the agreement at inception is over 60%. It must do so on a balance of probabilities.^{xi} Subsection 347(4) provides that the certificate of a Fellow of the Canadian Institute of Actuaries is, unless there is evidence to the contrary, proof of the effective annual rate of interest. The courts have held this is not the only acceptable mode of proof.^{xii} For example, the courts have also accepted actuaries' affidavits and actuaries' reports attached as exhibits to affidavits of non-actuaries.^{xiii}



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In 1984 the Supreme Court of B.C. held in Creswell v. Raven Bay Holdings Ltd. that the onus of proof was on the borrower to prove beyond a reasonable doubt that a fee paid to the lender was not ordinarily payable by a borrower, that it directly or indirectly benefitted the lender or its designate, and that the lender would not advance the money unless the borrower paid it.^{xliii}

More recent decisions have superseded this. While any fee satisfying this test should qualify as interest, this test was a restrictive gloss on the comprehensive definition of interest in s. 347. As can be seen from the list of interest charges above, more recent decisions have not required borrowers to prove interest is of this narrow type. With respect to the necessary standard of proof, to hold the borrower to the criminal standard in civil proceedings is wrong on principle. More recent decisions have not imposed this standard.^{xliv}

Having determined the amount of credit advanced and the interest payments required, actuaries should calculate the effective rate of interest by determining mathematically the rate which makes the discounted value of the payments due from the borrower to the lender equal to the amount advanced. This calculates the cost to the borrower, which is the courts' concern. The courts have disapproved of determining the effective rate of interest by accumulating both sides of the equation to the maturity date, using a re-investment rate for the money received by the lender from the borrower, because this calculates the return to the lender. This may differ from the cost to the borrower, and is thus irrelevant.^{xlv}

In situations where there is a conflict between the parties' actuaries' opinions on the interest rate, or between the parties' evidence about the nature of payments, a determination of the effective annual rate of interest may be sufficiently difficult to prevent its resolution on a summary basis.^{xlvi}

In determining the interest rate, the courts again look at the substance of the transactions. For example, in Pacific National Developments Ltd. v. Standard Trust Company, where a loan agreement contained a meaningless repayment date intended to make it appear that the effective interest rate did not exceed 60%, the Supreme Court of B.C. calculated the interest rate based on the effective repayment date and term of the agreement.^{xlvii}



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The courts have held that "calculated" in the definition of criminal rate means "compounded," by analogy to the law regarding calculation of interest in a mortgage.^{xlviii} The courts have, however, been inconsistent about how actuaries should calculate this compound rate of interest. In 1991 the B.C. Court of Appeal held in TerraCan Capital Corporation v. Pine Projects Ltd. that interest should be calculated using annual, rather than continuous, compounding.^{xlix} The Ontario Court - General Division had earlier held in T.F.P. Investments Inc. Estate v. Beacon Realty Co. that s. 347 was ambiguous on this point. Resolving the ambiguity in favour of the lender, that Court found that calculation using continuous compounding was an appropriate method of calculation.^l

The Canadian Institute of Actuaries issued a statement in 1992 to the effect that generally accepted actuarial practices and principles require the calculation of an effective rate of interest using annual compounding. Using continuous compounding calculates a nominal rate of interest. It is no longer accurate to say, as the Ontario Court - General Division did in T.F.P. Investments, that to respond to the borrower's evidence of the effective interest rate the lender need only show there is some method by which the interest rate can be calculated which results in a legal rate of interest.^{li}

A borrower which intends to allege a criminal interest rate must have the necessary actuarial evidence prepared for the hearing at which it wishes to do so. Calculations prepared by counsel are inadequate and often inaccurate.^{lii} In the early decision of Mira Design Co. Ltd. v. Seascope Holdings Ltd. (No.1), where the parties had been unaware until a week before a foreclosure hearing that their agreement called for a criminal rate of interest, the Supreme Court of B.C. adjourned the hearing to permit an inquiry to be held by a registrar into the rate of interest.^{liii} This is not the usual practice.

Another consequence of the courts' focus on the loan agreement at the time of the parties' agreement is that whether the parties have the option of agreeing to extend the term of the loan, or have actually done so, is irrelevant to the calculation of the rate of interest. In 677950 Ontario Ltd. v. Artell Developments Ltd., where a mortgage was, on its face, due in three months, the Ontario Court of Appeal held that optional extensions of 9 months and 5 years were not part of the term of the loan. They only gave the borrower an option to extend the term of the loan. It did not exercise that option.^{liv} Even in TerraCan Capital, where the parties actually



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agreed to extend of the term of the loan, the B.C. Court of Appeal refused to use the extensions to average the interest rate below a criminal rate. The Court held that, because the interest rate under the initial term of the agreement was criminal, it could not be saved by modification.^{lv} The lender may not have actually received interest at a criminal rate, because of the extensions, but it agreed to do so.

Because the courts have held s. 347 to apply only where the loan agreement requires the borrower to pay interest at a criminal rate, a borrower cannot create a criminal rate by its own act of prepaying the loan and shortening its effective term.^{lvi} Nor can the borrower do so by defaulting on its repayments and accelerating the balance outstanding.^{lvii} This is difficult to reconcile with s. 347(1)(b), making it an offence for the lender to receive interest at a criminal rate.

In TerraCan Capital the B.C. Court of Appeal left open the question of how to deal with a loan for a fixed term at a variable interest rate.^{lviii} If the courts are consistent in their approach of considering transactions at time the parties agree, then so long as the interest rate at that time is legal a variable rate loan should be enforceable.

If the courts will not permit the act of the borrower to create a criminal rate of interest, they should not permit the act of a third party, such as a financial institution raising its prime interest rate, to do so. On the other hand, if a variable rate of interest increases above 60% it would then be criminal. Section 347(1)(b) would make it an offence for the lender to receive interest at that rate. The borrower should have no obligation to pay it. The lender should be unable to enforce payment.

THE RELEVANCE OF INTENT

Section 347(3) deems the recipient of interest at a criminal rate to know he was receiving such a rate of interest, in the absence of evidence to the contrary. That a lender did not intend to receive a criminal rate of interest, or did not know it would receive such a rate, is irrelevant in determining whether the rate is criminal. It is not relevant that an interest rate of over 60% may be an accurate estimate of the lender's risk.^{lix} It is not relevant that the borrower agreed to pay the criminal interest rate.^{lx} The only intent required to make an interest rate criminal is the intent



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to enter an agreement which does in fact result in a criminal rate of interest. This is true in both criminal and civil proceedings.^{lxi}

DISCLAIMER CLAUSES

To avoid the effect of s. 347, parties have included disclaimer clauses in loan agreements. Such clauses often state that the parties do not intend the lender to receive a criminal rate of interest. If that is the effect of the agreement, the parties agree to sever the offending provisions from the balance or modify them to require the borrower to pay only a legal rate of interest. Because any intention of the parties (other than to enter the agreement) is irrelevant, such a disclaimer clause will not be effective. However, a properly worded disclaimer clause may ensure that the courts sever the portions of the agreement which make the interest rate criminal and enforce the balance of the agreement.

A lender cannot avoid the impact of s. 347 by simply abandoning a claim for criminal interest.^{lxii} Nor can a lender protect itself by a disclaimer only that the parties did not intend the lender to receive a criminal rate of interest.^{lxiii}

A disclaimer simply stating that the maximum amount payable to the lender was not to exceed the criminal rate of interest did not modify the agreement to require the borrower only to pay the maximum legal amount, because it did not specify how the interest rate was to be adjusted downward below the legal limit. In BCorp Financial, the Supreme Court of B.C. declined to make a new agreement for the parties in this respect.^{lxiv} As the Court held in Pacific National Developments, while the courts should interpret penal provisions strictly, they should not find ways to avoid the application of s. 347 or to help those who strain to do so.^{lxv}

In Pacific National Developments a similar disclaimer was effective to reduce the interest claimed to a legal rate. In this case, the interest rate was criminal only because of a \$700,000 bonus, to which the lender abandoned its claim. The Supreme Court of B.C. severed the bonus provision and enforced repayment of the principal amount and payment of contractual interest at prime plus 2%.^{lxvi}



THE EFFECT OF AN ILLEGAL INTEREST RATE

Entering into an agreement to receive, or receiving, a criminal rate of interest is a criminal offence.^{lxvii} Criminal prosecutions under s. 347 require the consent of the Attorney General (s. 347(7)). If the Attorney General consents, the lender can be prosecuted by indictment or summarily. He is liable to imprisonment for a term not exceeding 5 years if found guilty of an indictable offence. He is liable to a fine of up to \$25,000 or to imprisonment not exceeding 6 months or both if found liable on summary conviction.

Contravening s. 347 can also have important civil consequences. Entering into an agreement to receive a criminal rate of interest is an illegal act. The courts will not enforce payment of a criminal rate of interest. To do so would approve an illegal act, one prohibited by statute. It would also violate the principle that no one should profit from his own wrongdoing.^{lxviii}

The most common consequence of the courts' refusal to enforce payment of a criminal rate of interest appears when a lender seeks to enforce a loan agreement, often by foreclosing on the property the borrower used the funds to purchase. If a court finds the agreement calls for a criminal rate of interest, it must then determine whether it can sever the provisions of the agreement requiring the payment of that interest from the valid portion of the agreement.

In Tower Projects Ltd. v. Mt. Lehman Projects Ltd., the Supreme Court of B.C. held that a finding that the interest rate is criminal only affects the interest component of loan. The Court held that a criminal rate of interest was not a defence to a foreclosure proceeding, and implied that the principal amount loaned would be recoverable regardless.^{lxix} Other decisions show this analysis to be simplistic.

The first question the courts will ask is whether severance is possible, that is whether the language of the loan agreement permits them to excise the offending provisions. The courts must be able to do so without affecting the borrower's obligation to repay the principal amount and without making a new agreement for the parties.^{lxx} Of course, by not enforcing the criminal interest rate, the courts are making a new agreement. However, while the courts are willing to excise provisions from loan agreements, they will not go further and rewrite the remaining provisions. These must stand alone.^{lxxi}



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The second question the courts will ask is whether, as a matter of public policy, they should sever the offending provisions from the valid portion of the agreement. They have held this to depend on whether the agreement was void from the beginning for illegality because it was entered for an illegal purpose. In considering this the courts commonly consider four issues.

1. Will severance of the offending provisions undermine the object and policy of s. 347 to protect the public from loan-sharking? Since s. 347 neither prohibits agreements to receive a criminal rate of interest nor declares them void, the courts have held they do not undermine the object and policy of s. 347 by severance for "proper reasons."
2. Did the parties enter the agreement for an illegal purpose, intending to break the law? The intention of the lender may be relevant here. Also relevant is whether the illegal provisions are substantially the whole of the agreement and whether the parties can perform the agreement without breaking the law.
3. Is this a case of a desperate borrower forced to submit to terms dictated by a sophisticated usurious lender, or of two sophisticated, professionally advised parties of equal bargaining power, one of which is now seeking to avoid its voluntarily assumed obligations by reliance on s. 347?
4. If the courts do not sever the offending provisions so that the entire loan agreement is unenforceable, will the borrower have been unjustly enriched by not having to repay the principal advanced?^{lxxii}

In most cases the courts have found that they can and should sever the criminal interest provisions and enforce the remainder of the agreement. In these cases, the parties did not intend to break the law. They were sophisticated and legally advised. Because the borrower did receive the needed principal amount, it would be unjustly enriched if the court did not enforce its obligation to repay at least that amount. For these reasons, the courts have held that severing the criminal interest provisions would not subvert the public policy behind s. 347.^{lxxiii}



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However, in Croll v. Kelly the Supreme Court of B.C. found the lender to have entered a loan agreement purely as an investment tool to yield a high rate of return and held the agreement to be fundamentally illegal and entirely unenforceable.^{lxxiv}

Which of the borrower's remaining obligations under the loan agreement the courts will enforce will depend partly on the terms of the agreement itself. In most cases, the courts require borrowers only to repay the principal amounts advanced, plus pre-judgment interest.^{lxxv}

In British Columbia, the courts will normally award pre-judgment interest at the rates used by the District Registrar from time to time.^{lxxvi} The courts should award pre-judgment interest only from the date the lender's cause of action for repayment of the principal arose. For example in TerraCan Capital, where parties agreed to extend the term of a loan, the Supreme Court of B.C. awarded pre-judgment interest only from the expiry of the last extension, the lender having no right to claim repayment before that time.^{lxxvii}

In some cases, where the loan agreement calls for repayment of the principal amount advanced, plus interest at a contractual rate, and requires the borrower to pay fees which make the effective interest rate criminal, the courts have severed the borrowers' obligations to pay those fees and enforced their obligations to repay the principal amounts plus contractual interest.^{lxxviii}

The best way to protect a lender against s. 347 is to analyze carefully the proposed transaction to ensure that it does not result in a criminal rate of interest. As an additional precaution, these decisions suggest it would be wise to structure the transaction so that there is a contractual rate of interest which is clearly below 60%. The agreement should impose any fees which might raise the effective interest rate above 60% in separate and severable clauses. The agreement should contain a disclaimer clause. The disclaimer should specify how the agreement is to be modified to preserve the lender's entitlement to contractual interest if the agreement does call for a criminal interest rate. This might be done by providing that the provisions imposing any fees which make the effective rate criminal are to be severed but that the borrower agrees to honour the balance of its obligations, including the payment of contractual interest.



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Whatever rate of interest the courts enforce, they should credit all payments made by the borrower to the amount outstanding. Arguably, they should credit these payments towards the principal amount outstanding.^{lxxxix}

Another issue which may arise is the enforceability of guarantees of the borrower's obligations where the loan agreement calls for a criminal rate of interest. If the guarantor is a party to the loan agreement and his guarantee or promissory note forms part of that agreement, the courts may hold those obligations to be an essential part of the loan transaction and so unenforceable.^{lxxx} If the courts do not find the guarantor's obligations to be an essential part of the loan agreement, they may enforce them to the extent of repayment of the principal amount only.^{lxxxi}

Borrowers most often raise the issue of criminal rates of interest when lenders seek to enforce their security. There have been cases where borrowers have sued lenders to recover principal and interest paid under loan agreements calling for a criminal rate of interest. In Nelson, the only case where a borrower pursued a claim for the recovery of both principal repaid and interest, it was unsuccessful. The B.C. Court of Appeal held the loan agreement in question did not call for a criminal rate of interest.^{lxxxii}

As a matter of principle, borrowers should not be able to recover repayments of principal. The borrower required the principal for some purpose, agreed to repay it, received it and used it for that purpose. It would unjustly enrich the borrower at the expense of the lender to permit the borrower to keep or recover the principal.^{lxxxiii}

Prof. Ziegel has argued that the borrower should have no difficulty in recovering interest payments exceeding 60%, but that it would result in a windfall if it were able to recover interest payments below 60% which it freely and legally agreed to make.^{lxxxiv} This distinction is correct on principle. In Trillium Computer Resources Inc. v. Taiwan Connection Inc., the Ontario Court - General Division did order the lender to return to the borrower interest paid in excess of 60%.^{lxxxv}

In Bon Street Developments Ltd. v. TerraCan Capital Corporation and Vandekerhove v. Litchfield, the Supreme Court of B.C. held it will determine whether the borrower is able to



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recover interest according to the general principles of when money paid under an illegal contract is recoverable. The general principle is that such money is not recoverable. The court will usually leave the parties as it finds them. There are four recognized exceptions to this rule:

1. Mistake of fact/unjust enrichment;
2. Fraud, oppression or undue influence;
3. Withdrawal by the borrower from the illegal transaction before full execution; and
4. Where the borrower can show that Parliament enacted s. 347 to protect persons in its situation and that it was less at fault in entering into the illegal transaction than the lender.^{lxxxvi}

The courts have dealt with the issue of the borrower's ability to recover interest payments under the first and last of these four exceptions.

In Vandekerhove, where the borrower sought to bring itself within the mistake of fact exception, the Supreme Court of B.C. adopted the Supreme Court of Canada's view that the distinction between mistake of fact and mistake of law is irrelevant. The issue should be whether the borrower has unjustly enriched the lender. The Court held that had occurred. It viewed the object of s. 347 as deterring lenders from entering into agreements calling for a criminal rate of interest. It held that policy would not be served by permitting the lender to keep interest exceeding 60%, and granted the borrower judgment on its claim to recover the interest paid in excess of that amount.^{lxxxvii} This is consistent with principle. It is also consistent with the cases where the courts have required the borrowers only to repay the principal amount advanced plus pre-judgment interest. If the courts take this approach, then borrowers should be able to recover interest payments exceeding 60% in most cases.

In Bon Street Developments, the borrower tried to recover its interest payments by arguing that Parliament enacted s. 347 to protect persons in its situation and it was less at fault than the lender in entering into the illegal loan transaction. The borrower was unsuccessful on both counts. The Supreme Court of B.C. held that Parliament had directed s. 347 primarily at loan-sharking and that intended it to protect the weak and needy from unscrupulous, oppressive and



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sometimes violent makers of small loans. The Court held that the borrower was a sophisticated property developer, represented by counsel and with actual knowledge that criminal law forbade interest exceeding 60%. In addition, the Court found the borrower was not desperate for the loan, but only wanted it to accelerate by a short time its receipt of a windfall profit on the resale of commercial property. The Court held that the borrower was not the sort of person Parliament intended to protect and was equally at fault with the lender in entering into the transaction, and dismissed the borrower's claim.^{lxxxviii}

There is a conflict between the Court's approaches in these two decisions, if not between the results. The ability of a borrower to recover interest payments will no doubt see further litigation.

CONCLUSION

While one can argue with the policy of using legislation to protect borrowers from usurious interest rates, and with the way in which s. 347 carries out that policy, because of the broad definitions of "credit advanced" and "interest" and the general focus of the courts on the substance of loan transactions it is clear that s. 347 has the potential to affect many commercial transactions with a lending component. Lawyers involved in such transactions should review the law on s. 347 carefully and have actuaries calculate the effective interest rate to be received by the lender, as there defined, before finalizing the transaction or giving an opinion on its validity.

Lawyers and their clients can avoid the effect of s. 347 by structuring their transactions and drafting their loan documentation appropriately, using an effectively worded disclaimer clause. To accomplish this, lawyers must be aware of s. 347 and consider all aspects of the transactions.

Lawyers' failure to do so can result in the courts depriving a lender, even one unaware of the effective interest rate called for by the transaction or of the existence of s. 347, of some or all of the return it contracted to receive in return for risking its capital. The lender could even lose the right to recover that capital. If the borrower's lawyer is similarly unaware, the borrower may miss an opportunity to significantly reduce its obligations.



APPENDIX

Section 347 of the Criminal Code

347. (1) Notwithstanding any Act of Parliament, every one who

- (a) enters into an agreement or arrangement to receive interest at a criminal rate, or
- (b) receives a payment or partial payment of interest at a criminal rate, is guilty of
- (c) an indictable offence and liable to imprisonment for a term not exceeding five years, or
- (d) an offence punishable on summary conviction and is liable to a fine not exceeding twenty-five thousand dollars or to imprisonment for a term not exceeding six months or to both.

(2) In this section,

"credit advanced" means the aggregate of the money and the monetary value of any goods, services or benefits actually advanced or to be advanced under an agreement or arrangement minus the aggregate of any required deposit balance and any fee, fine, penalty, commission and other similar charge or expense directly or indirectly incurred under the original or any collateral agreement or arrangement;

"criminal rate" means an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds sixty per cent on the credit advanced under an agreement or arrangement;

"insurance charge" means the cost of insuring the risk assumed by the person who advances or is to advance credit under an agreement or arrangement, where the face amount of the insurance does not exceed the credit advanced;

"interest" means the aggregate of all charges and expenses, whether in the form of a fee, fine, penalty, commission or other similar charge or expense or in any other form, paid or payable for the advancing of credit under an agreement or arrangement, by or



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on behalf of the person to whom the credit is or is to be advanced, irrespective of the person to whom any such charges and expenses are or are to be paid or payable, but does not include any repayment of credit advanced or any insurance charge, official fee, overdraft charge, required deposit balance or, in the case of a mortgage transaction, any amount required to be paid on account of property taxes;

"official fee" means a fee required by law to be paid to any governmental authority in connection with perfecting any security under an agreement or arrangement for the advancing of credit;

"overdraft charge" means a charge not exceeding five dollars for the creation of or increase in an overdraft, imposed by a credit union or caisse populaire the membership of which is wholly or substantially comprised of natural persons or a deposit taking institution the deposits in which are insured, in whole or in part, by the Canada Deposit Insurance Corporation or guaranteed, in whole or in part, by the Quebec Deposit Insurance Board;

"required deposit balance" means a fixed or an ascertainable amount of the money actually advanced or to be advanced under an agreement or arrangement that is required, as a condition of the agreement or arrangement, to be deposited or invested by or on behalf of the person to whom the advance is or is to be made and that may be available, in the event of his defaulting in any payment, to or for the benefit of the person who advances or is to advance the money.

(3) Where a person receives a payment or partial payment of interest at a criminal rate, he shall, in the absence of evidence to the contrary, be deemed to have knowledge of the nature of the payment and that it was received at a criminal rate.

(4) In any proceedings under this section, a certificate of a Fellow of the Canadian Institute of Actuaries stating that he has calculated the effective annual rate of interest on any credit advanced under an agreement or arrangement and setting out the calculations and the information on which they are based is, in the absence of evidence to the contrary, proof of the



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effective annual rate without proof of the signature or official character of the person appearing to have signed the certificate.

(5) A certificate referred to in subsection (4) shall not be received in evidence unless the party intending to produce it has given to the accused or defendant reasonable notice of that intention together with a copy of the certificate.

(6) An accused or a defendant against whom a certificate referred to in subsection (4) is produced may, with leave of the court, require the attendance of the actuary for the purposes of cross-examination.

(7) No proceedings shall be commenced under this section without the consent of the Attorney General.

(8) This section does not apply to any transaction to which the Tax Rebate Discounting Act applies.

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i R.S.C. 1985, c. C-46

ii S.C. 1980-81-82-83, c. 43

iii J.S. Ziegel, "Bill C-44: Repeal of the Small Loans Act and Enactment of a New Usury Law" (1981), 59 Can. Bar Rev. 188, at 188-190

iv Canada, Senate, Proceedings of the Standing Committee on Banking, Trade and Commerce (29 October, 4 and 18 November, 1980)

v Canada, Senate, Debates (17 December 1980) p. 1476-8

vi William E. Thomson Associates Inc. v. Carpenter (1989), 69 O.R. (2d) 545, at 546-7 (C.A.); R. v. Chomski [1986] O.J. No. 1595 (Prov. Ct. - Crim. Div.); R. v. McRobb (1984), 20 C.C.C. (3d) 493, at 501 (Ont. Cy. Ct.) affirmed (1986), 32 C.C.C. (3d) 479 (Ont. C.A.); J.S. Ziegel, "The Usury Provisions in the Criminal Code: The Chickens Come Home to Roost" (1986), 11 C.B.L.J. 233; M.A. Waldron, "Can Canadian Commercial Law be Rehabilitated? A Question of Interest" (1992), 20 C.B.L.J. 357, at 373

vii 677950 Ontario Ltd. v. Artell Developments Ltd., [1993] 2 S.C.R. 443

viii R. v. Chomski, supra, note 6, p. 31; R. v. Dimerman, [1992] M.J. No. 558 (Q.B.) p. 7-8; affirming [1991] M.J. No. 308 (Prov. Ct.)

ix Mira Design Co. Ltd. v. Seascope Holdings Ltd. (No. 1) (1981), 34 B.C.L.R. 55, at 58 and 60 (S.C.)

x Creswell v. Raven Bay Holdings Ltd. (1984), 54 B.C.L.R. 182 (S.C.)

xi Inland Kenworth Ltd. v. Disco Holdings Ltd. (20 September 1988) Prince George Registry No. 12415/87 (S.C.B.C.)

xii Re D.C. Properties Ltd. (1990), 47 B.C.L.R. (2d) 72, at 82-85 (C.A.); reversing on this point (1989), 34 B.C.L.R. (2d) 371 (S.C.)

xiii Nelson v. CTC Mortgage Corporation (1984), 59 B.C.L.R. 221, at 227-8 (C.A.); affirmed [1986] 1 S.C.R. 749

xiv Mira Design (No. 1), supra, note 9, p. 60

xv BCorp Financial Inc. v. Baseline Resort Developments Inc. (1990), 46 B.C.L.R. (2d) 89, at 96 (S.C.)

xvi BCorp Financial, supra; note 15, Bon Street Developments Ltd. v. TerraCan Capital Corp. (18 December 1992) Vancouver Registry No. C916881 (S.C.B.C.)

xvii Aectra Refining & Marketing Inc. v. Lincoln Capital Funding Corp. (1991), 6 O.R. (3d) 146 (Gen. Div.)

xviii TerraCan Capital Corporation v. Pine Projects Ltd. (1991), 60 B.C.L.R. (2d) 354 (S.C.); affirmed (1993), 75 B.C.L.R. (2d) 256 (C.A.)

xix T.F.P. Investments Inc. Estate v. Beacon Realty Co. (1991), 3 O.R. (3d) 537 (Gen. Div.)

xx William E. Thomson Associates, supra, note 6



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- xxi Inland Kenworth, supra, note 11
- xxii Re Castle Rentals Inc. (1984), 60 B.C.L.R. 40 (S.C.); 618469 Ontario Ltd. v. Szanto (1990), 16 R.P.R. (2d) 100 (Ont. Gen. Div.); Vandekerhove v. Litchfield (1993), 103 D.L.R. (4th) 739 (S.C.B.C.)
- xxiii Nelson, supra, note 13; William E. Thomson Associates, supra, note 6; BCorp Financial, supra, note 15; Aectra Refining, supra, note 17; Bon Street Developments, supra, note 16
- xxiv TerraCan Capital, supra, note 18
- xxv Mira Design (No. 1), supra, note 9
- xxvi Aectra Refining, supra, note 17
- xxvii T.F.P. Investments, supra, note 19
- xxviii Milani v. Banks (1992), 98 D.L.R. (4th) 104 (Ont. Gen. Div.)
- xxix Mira Design (No. 1), supra, note 9
- xxx Croll v. Kelly (1983), 48 B.C.L.R. 306 (S.C.); Georgia 50.4 Syndicate v. Butler (1990), 49 B.C.L.R. (2d) 383 (S.C.)
- xxxi 677950 Ontario Ltd. v. Artell Developments Ltd. (1992), 75 C.C.C. (3d) 343 (Ont. C.A.); reversing [1989] O.J. No. 1317 (H.C.J.); affirmed [1993] 2 S.C.R. 443
- xxxii Ingram v. Dorian, [1992] O.J. No. 276 (Gen. Div.) p. 4-6
- xxxiii William E. Thomson Associates, supra, note 6, p. 550
- xxxiv Pacific National Developments Ltd. v. Standard Trust Company (1991), 53 B.C.L.R. (2d) 153, at 163 (S.C.)
- xxxv BCorp Financial, supra, note 15, p. 96
- xxxvi Nelson, supra, note 13, p. 225; Milani, supra, note 28, p. 107; BCorp Financial, supra, note 15, p. 98
- xxxvii Nelson, supra, note 13, p. 227
- xxxviii Re D.C. Properties Ltd., supra, note 12 (S.C.B.C.) p. 83 (affirmed without dealing with this issue)
- xxxix Kebet Holdings Ltd. v. 351173 B.C. Ltd. (1992), 74 B.C.L.R. (2d) 198, at 204 (C.A.); affirming (12 March 1992) Vancouver Registry No. H910230 (S.C.B.C.)
- xl BCorp Financial, supra, note 15, p. 96 and 98; T.F.P. Investments, supra, note 19, p. 540-1; J.S. Ziegel, supra, note 6, p. 239
- xli BCorp Financial, supra, note 15, pp. 95-96; Aectra Refining, supra, note 17, p. 152-4; contra J.F. Grieve "Criminal Interest on Lending Transactions: the British Columbia Experience" (1991), 6 Nat. Cred. Debt. Rev. 46, at 47
- xlii T.F.P. Investments, supra, note 19, p. 539; Simon v. Kopas & Burritt Funding Inc., [1991] B.C.J. No. 2710 (S.C.) p. 9-10
- xliiii Creswell, supra, note 10, p. 193; see also Simon, supra, note 42, p. 11
- xliv T.F.P. Investments, supra, note 19, p. 540-1
- xlvi Simon, supra, note 42, p. 10-11
- xlvii Pacific National Developments, supra, note 34, p. 163
- xlviii Genera Investments Inc. v. Chester (27 November 1991) Vancouver Registry No. H910217 (S.C.B.C.) p. 4-7
- xliv TerraCan Capital, supra, note 18, pp. 268-9
- i T.F.P. Investments, supra, note 19, p. 542
- ii T.F.P. Investments, supra, note 19, p. 542
- lii 618469 Ontario, supra, note 22, at 101-102; J.F. Grieve, supra, note 41, p. 46
- liii Mira Design (No. 1), supra, note 9, at 61-62
- liv 677950 Ontario, supra, note 31, pp. 353-4 (Ont. C.A.)
- lv TerraCan Capital, supra, note 18, pp. 265-6; Kebet Holdings Ltd. v. 351173 B.C. Ltd. (24 March 1992) Vancouver Registry No. H910230 (S.C.B.C.)
- lvi Nelson, supra, note 13; Aectra Refining, supra, note 17, p. 150; for comment see M. Feldman "Criminal Interest Rates in the Context of Early Payment of a Debt Obligation" (1985), 2 Bus. & Law 70 and J.S. Ziegel, supra, note 6, p. 235-8
- lvii Inland Kenworth, supra, note 13, p. 6; Bradfield v. Martin [1990] O.J. No. 695 (Dist. Ct.) p. 14; for comment see J.S. Ziegel, supra, note 6, p. 240
- lviii TerraCan Capital, supra, note 18, p. 266
- lix Pacific National Developments, supra, note 34, p. 165
- lx McRobb, supra, note 6; Dimerman, supra, note 8
- lxi TerraCan Capital, supra, note 18, p. 265; McRobb, supra, note 6, pp. 500-501; R. v. Dimerman, supra, note 8 (Man. Prov. Ct.)
- lxii Mira Design Co. Ltd. v. Seascope Holdings Ltd. (No. 2) (1982), 36 B.C.L.R. 354, at 357-8 (S.C.)
- lxiii BCorp Financial, supra, note 15, p. 100; Genera Investments, supra, note 48, pp. 7-8
- lxiv BCorp Financial, supra, note 15, p. 100



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- lxv [Pacific National Developments](#), supra, note 34, p. 163
- lxvi [Pacific National Developments](#), supra, note 34, p. 166
- lxvii [BCorp Financial](#), supra, note 15, p. 96
- lxviii [Mira Design \(No. 1\)](#), supra, note 9, p. 58-59; [William E. Thomson Associates](#), supra, note 6, p. 551
- lxix [Tower Projects Ltd. v. Mt. Lehman Projects Ltd.](#) (16 November 1992) Vancouver Registry No. H920560 (S.C.B.C. - Master) p. 4
- lxx [William E. Thomson Associates](#), supra, note 6, p. 552
- lxxi [TerraCan Capital](#), supra, note 18, p. 272
- lxxii [William E. Thomson Associates](#), supra, note 6, pp. 554-556; [TerraCan Capital](#), supra, note 18, p. 271; [Mira Design \(No. 2\)](#), supra, note 62, p. 361; for comment see R.A. Thompson, "Caveat Lender: William E. Thomson Associates v. Carpenter" (1990), 5 Bank. & Fin. L. Rev. 373
- lxxiii For example, [TerraCan Capital](#), supra, note 18; [Mira Design \(No. 2\)](#), supra, note 62; [Re Castle Rentals](#), supra, note 22; [William E. Thomson Associates](#), supra, note 6; [BCorp Financial](#), supra, note 15; [Pacific National Developments](#), supra, note 34; [Genera Investments](#), supra, note 48; [677950 Ontario](#), supra, note 31; [Milani](#), supra, note 28; [Kebet Holdings Ltd. v. 351173 B.C. Ltd.](#) (11 August 1992) Vancouver Registry No. H910230 (S.C.B.C.)
- lxxiv [Croll v. Kelly](#), supra, note 30, p. 312
- lxxv [Mira Design \(No. 2\)](#), supra, note 62; [Ezzy v. Sheck](#) (1988), 30 B.C.L.R. (2d) 135 (S.C.); [William E. Thomson Associates](#), supra, note 6; [BCorp Financial](#), supra, note 15; [Genera Investments](#), supra, note 48; [Milani](#), supra, note 28; [Kebet Holdings](#), supra, note 73; [TerraCan Capital](#), supra, note 18
- lxxvi [Kebet Holdings](#), supra, note 73, p. 11
- lxxvii [TerraCan Capital Corp. v. Pine Projects Ltd.](#) (1991), 62 B.C.L.R. (2d) 368 (S.C.)
- lxxviii [Pacific National Developments](#), supra, note 35; [677950 Ontario](#), supra, note 31
- lxxix J.F. Grieve, supra, note 41, p. 53
- lxxx [Georgia 50.4 Syndicate](#), supra, note 30, p. 388-9
- lxxxi [William E. Thomson Associates](#), supra, note 6
- lxxxii [Nelson](#), supra, note 13
- lxxxiii J.S. Ziegel (1986), supra, note 6, p. 243
- lxxxiv J.S. Ziegel, supra, note 6, p. 243
- lxxxv [Trillium Computer Resources Inc. v. Taiwan Connection Inc.](#) (24 June 1993) Waterloo File No. 4430/92 (Ont. Gen Div.)
- lxxxvi [Bon Street Developments](#), supra, note 16, pp. 5-8; [Vandekerhove](#), supra, note 22, pp. 753-4
- lxxxvii [Vandekerhove](#), supra, note 22
- lxxxviii [Bon Street Developments](#), supra, note 16