Blue Pencil Blues

by Albert S. Frank, LL.B.

In my article ***Downright Criminal Interest***, which appeared in the Mid-September, 2001 issue of ***The Bottom Line***, I discussed section 347 of the Criminal Code. I referred to the case of ***Transport North American Express Inc. v. New Solutions Financial Corp.*** (2001), 54 O.R. (3d) 144. Since then the Court of Appeal for Ontario has reversed the decision in that case, at (2002), 60 O.R. (3d) 97.

Criminal Interest Rate

Section 347 of the *Criminal Code* creates the offence of charging a criminal interest rate. This offence is committed by anyone who agrees to receive, or actually receives, interest at a "criminal rate." A "criminal rate" means:

an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds 60 per cent on the credit advanced under an agreement or arrangement[.]

As is usually the case with criminal offences, the prosecution would have to show that the accused acted with the necessary "*mens rea,*" which can be translated as "wrongful purpose" or

"criminal intent." Thus, if the accused has entered into an agreement providing for the receipt of over 60 per cent interest, the prosecution would have to show that the accused voluntarily entered into the loan agreement and that the loan agreement provided for the receipt of a criminal rate of interest.

The prosecution does not, however, have to show that the accused knew that charging a rate of interest above 60 per cent was illegal.

In the ***Transport North*** case there was a dispute as to whether various charges and expenses were "interest" within the meaning of section 347. Under the circumstances of that case a monitoring fee, legal and administrative fees, a commitment fee, and a so-called "royalty payment" were all found to be part of the interest. This was on top of the stated interest of 4 per cent per month, which 4 per cent by itself would have been slightly over 60 per cent per year. The judge originally hearing the case therefore ordered a "severance" to reduce the effective rate of interest, including the various fees, to 60 per cent.

Blue Pencils: Three Approaches to Severance

It was clear to all three Court of Appeal judges hearing the appeal that the lender had charged too much. They also agreed that under the circumstances it was reasonable to have a severance. The issue

was whether the original judge had severed correctly.

It is sometimes said that there can be a severance when the part to be severed can be cut out by running a blue pencil through it. The Court of Appeal, though, said that this is not the true test. The true test is whether the subtraction affects the ***meaning*** of the remainder, which would not be a good severance, or only the ***extent*** of the remainder, in which case there could be a good severance.

The Court of Appeal for Ontario agreed with the British Columbia Court of Appeal in finding that a judge has the discretion to apply severance to an agreement that offends against the criminal interest rate provisions. The Court of Appeal for Ontario said that there are three approaches to severance.

Where the loan resembles a traditional "loan sharking arrangement," the court may refuse to sever and may instead find the whole loan unenforceable, including even the obligation to repay the principal. At the other extreme the court could sever only those portions of the agreement that put the effective annual rate over 60 per cent, leaving the borrower obliged to repay the principal and some interest. Closer to the centre, the court could sever all interest provisions but leave the borrower obliged to repay the principal.

Dissent

The dissenting judge at the Court of Appeal thought that the original judge had severed appropriately, as:

it would be unduly artificial and formalistic to refuse the remedy of reading down the effective rate of interest to 60 per cent simply because the parties inadvertently exceeded the maximum permissible rate by one tenth of one percent in the interest provision. To allow the appellant to pay a significantly lower rate of interest would show less respect for the sanctity of the bargain between the parties…. To secure the funds it required, the appellant needed to pay and agreed to pay a significant premium. It would unjustly enrich the appellant to reduce this premium considerably.

Deterrence

The two judges who formed the majority in the Court of Appeal, however, severed the four per cent per month (60.10 per cent per year) interest rate, and allowed the lender only the return of the principal plus the various fees and charges.

In their view severing in the way done by the original judge would be a "major innovation at the behest of those who *prima facie* stand in violation of the criminal law." This would be inconsistent with the aims of deterring violations of the criminal law.

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Research has NOT been done to see if this article is still good law. Also, this is general information that might not apply to your particular situation.

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