Introduction

The Criminal Code of Canada contains an anti-loan sharking provision which makes it a criminal offence to charge interest rates in excess of sixty per cent per annum. Section 347 has been used to regulate a wide variety of consumer and commercial transactions, regardless of their form or the amount at issue. This paper will begin by providing a brief review of the history of s. 347 before examining recent developments in the related case law. It will be argued that while the section could ultimately serve a useful purpose, it is currently being interpreted and applied so broadly by the courts that it is not fulfilling its prosecutorial mandate.

Historical Background

Canadian lawmakers have long grappled with controlling the problem of loan sharking in which a lender, commonly referred to as a “loan shark,” lends money at an extortionate rate of interest. Parliament first responded to this threat by regulating interest rates on small consumer loans through the creation of the Money-Lender’s Act. The Act limited the rates of interest on loans under $500 made by money lenders to 12 per cent per annum. Such legislation quickly proved ineffective, however, as lenders disguised their usurious interest charges as “legitimate” lending fees required as a pre-condition for the granting of a loan.

Parliament then introduced the Small Loans Act, which placed a limit on the amount of interest that could be charged on loans up to $1,500. The small loans legislation was created during a highly restrictive consumer credit market, when there were only a small handful of lenders available to grant small loans to ordinary consumers. The legislation reflected the need to protect vulnerable consumers who were often driven into the hands of street-level loan sharks.

The Small Loans Act was not free from criticism, however. The $1,500 ceiling became unworkable given the dramatic increase in the cost of...
money. The amount was also relatively low and therefore easy for lenders to circumvent. These concerns led Parliament to repeal the Small Loans Act in 1980 and introduce a new section into the Criminal Code.\(^7\)

The rationale behind s. 347 was a request by the police to provide them with a workable definition of loan sharking that would not require proof of threats, violence or fraud.\(^8\) Unlike the Small Loans Act, which appears to have been more directly targeted at street-level loans, s. 347 is not limited to consumer transactions. The current provision is extremely broad. It extends far beyond the reach of the Small Loans Act, by criminalizing a fixed rate of interest for the first time, and by imposing a ceiling on all types of credit arrangements without regard to the sophistication of the parties or the actual sum involved.\(^9\)

Review of the Section

Section 347 provides that everyone who enters into an agreement or arrangement to receive “interest” at a “criminal rate” or receives payment or partial payment of “interest” at a “criminal rate” is guilty of an offence and is liable to a $25,000 fine, or a maximum of five years imprisonment, or both. A “criminal rate” of interest is defined as, “an effective annual rate of interest calculated in accordance with generally accepted actuarial practice and principles that exceeds sixty per cent on the credit advanced under an agreement or arrangement.” The annual rate of interest is calculated on the “credit advanced” to the borrower, not what the lender would realize on his investment.\(^10\)

Implicit in the definition of “criminal rate” is the assumption that virtually any rate of interest exceeding sixty per cent annually is extortionate.

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\(^7\) S. 305.1 was added to the Criminal Code by Bill C-44 in December 1980 and came into effect April 1, 1981. Such section was later renumbered as 347 – for the sake of convenience, I will refer to the section as such throughout this paper.

\(^8\) See M.A. Waldron, supra note 2 at 60.


and criminal in nature. Such an assumption is quite unsound when the borrower acted as a free agent and was not coerced, threatened or intimidated by the lender. Assume for example that an employee requests a $1.00 loan from his co-worker, and promises to repay him $1.10 at the end of the day. This loan, with a 10 per cent per day rate of interest, would result in an “effective annual rate of interest” of 3,650 per cent. If the same loan were granted at a rate of 10 per cent on a weekly basis, the annual rate of interest would amount to 520 per cent per annum. Although in both cases there was actually a very small sum of interest charged to the borrower (few would argue that a ten cent charge of interest on a one dollar loan is excessive), the rate of interest in both cases was grossly criminal.

The expansive definition of “interest” includes all charges paid or payable for the advancing of credit, whether in the form of a fine, fee, penalty, commission or other similar charge. While such inclusive wording was designed to ensure that usurious lenders are unable to conceal criminal interest rates in the form of other less apparent charges, the language of the statute indicates that s. 347 was intended to have a far wider reach than to simply assist with the prosecution of loan sharks. “Interest” has been found to include a wide range of charges, such as lawyer’s and broker’s fees required to be paid by the borrower, bonus fees, and commitment fees. The section has been applied to a great number of commercial transactions which bear little resemblance to true loan sharking agreements.

The results are frequently not criminal prosecutions but civil actions in which the borrower has asserted the common-law doctrine of illegality in an attempt to avoid an interest payment, or to render an otherwise legitimate agreement void. The provision has therefore attracted widespread criticism from commercial lawyers and academics, many of whom have called for the section’s amendment or repeal. It is therefore curious that the courts have not attempted to narrow the scope of the application of this section to commercial loan agreements.

While there is a need to protect consumers from those who lend money at an excessive rate of interest, there is also a need to encourage commercial lending for risky yet potentially beneficial transactions. Compensation for the cost of delayed recovery is the hallmark of credit arrangements. Typically, the rational investor will invest only if the expected returns are sufficient given the risks – the riskier the investment, the higher the anticipated return will be because the savvy investor will demand additional compensation for that risk.

If the legislation circumvents the relationship of risk and return by restricting the lender’s recovery, it inhibits the potential for sound investment decision-making. This could hardly have been the intent of Parliament when it set out to regulate the impact of loan sharking upon the average consumer.
However, the courts have developed a body of case law that links s. 347 with the commercial loan, assuming that Parliament intended to make the charging or receiving of interest at a criminal rate illegal, whatever the parties’ motives, financial position or access to legal advice.19

Review of the Case Law

Until recently, courts tended to abide by the notion that parties who entered into an agreement which did not expressly require the borrower to pay a criminal rate of interest were not guilty of an offence under the Code.20 In Nelson,21 the Court held that s. 347 was not breached as a result of the borrower voluntarily repaying a mortgage loan before the expiry of the term. In that case, if the interest rate was calculated over the short period that the mortgage was outstanding, the interest rate exceeded 60 per cent. If calculated over the actual term of the mortgage, however, the annual rate of interest was less than 60 per cent.

The majority of the Court held that a criminal rate of interest must always be calculated with regard to the contractual terms of the loan, and not to an earlier repayment date selected by the mortgagor. Therefore, in calculating the annual rate of interest, one must ask what the payments would have amounted to had they been spread out over the entire period of the loan, and thus arrive at a lower rate of interest than would technically have resulted from the borrower’s decision to pre-pay early.

The judicial thinking behind the decision was simply that there is no definitive reason why the same loan agreement should be treated as either criminal – as a result of the borrower’s decision to pre-pay at an early date – or not, merely as a result of the borrower’s decision to make payments to the lender over the entire course of the loan. The result would be that parties to virtually any loan transaction would face unlimited uncertainty as to whether s. 347 would ultimately be breached. Such concern was well expressed by the trial judge in the Nelson case, who stated that:

By applying a repayment date which is solely in the discretion of the borrower, there is no certainty as to what the rate will be. It will never be known and could never be ascertained and a prospective lender could be in an anomalous position in a perfectly innocuous interest rate of 6 per cent being repaid the following day that could amount to a rate in excess of 60 per cent.22

Similar reasoning was expressed by Anderson J.A. at pp. 225-227, who found that any other interpretation would lead to an "absurd result" which Parliament could not have intended:

Parliament cannot have intended that the words "criminal rate" have two different meanings within the same section or that an innocent mortgagor who has entered into a perfectly lawful agreement should as

19 Waldron, supra note 15 at 3.
21 Ibid.
22 Ibid. at 223.
the result of a voluntary act of the mortgagor in prepaying the mortgage become guilty of an offence under [s. 347(1)(b)].

The purpose of [s. 347] was to make unlawful in agreements or arrangements which require the borrower to pay interest at a criminal rate. The mortgage here does not require payments of interest at an unlawful rate. The exercise of an option by the borrower does not therefore fall within [s. 347(1)(a) or (b)].

This approach was called into question, however, with the simultaneous release of two cases concerning the scope of s. 347. In Degelder, for example, the Court denied that “a criminal rate of interest must always be calculated by reference to the contractual terms of the loan,” and instead held that “…subs. (1)(a) and (1)(b) are separate and independent provisions: the first targets transactions that are inherently illegal, and the second catches transactions that are illegal in their operation.” While the Court in Garland expressly indicated that it was not overruling Nelson, it broadened the reach of s. 347 in a manner which is difficult to reconcile with previous judicial thought. A voluntary act on the part of a borrower might now, along with a certain amount of encouragement by the lender, be sufficient to bring an otherwise legitimate loan agreement within the confines of s. 347. In so deciding, the Court adopted the “wait and see” approach to lender liability: the receipt of interest at a criminal rate may now occur at any stage in the agreement between the parties, whether or not expressly contemplated in the contract itself.

An unfortunate illustration of the application of the court’s new approach is found in Garland. In that case, the respondent, Consumers’ Gas Company Limited (“Consumers’ Gas”), was a regulated utility which provided gas to consumers in Ontario. Consumers’ Gas billed its customers on a monthly basis and each bill specified a “due date” by which outstanding accounts were requested to be repaid. Customers who did not pay by the specified date incurred a “late payment penalty” which amounted to 5 per cent of the charges owing that month. Such penalty was simply a one-time charge and did not increase or compound over time.

A brochure offered by Consumers’ Gas to its customers, entitled “Getting to Know Us,” explained the reasoning behind the late payment penalty. It explained to customers that:

> You should pay your gas bill on or before the due date shown on the bill, in order to avoid late payment charges. These charges are designed to encourage late paying customers to pay their accounts promptly, thus minimizing the cost of carrying outstanding accounts.

The appellant, Gordon Garland, had been a Consumers’ Gas customer since 1983. He had paid roughly $75 worth of late payment penalty.

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24 Ibid. at 104.

25 Ibid. at 106.

26 Garland, supra note 9 at 121.
penalty charges in the period between 1983 and 1995. Garland commenced a class action law suit on behalf of over 500,000 Consumers’ Gas customers on the basis that the late payment penalty charges were “interest” in excess of 60 per cent per annum and therefore that the gas utility had violated s. 347 of the Criminal Code. The Supreme Court of Canada agreed.

The first obstacle that the Supreme Court faced, however, was that s. 347 typically arises in transactions which involve an advance of money in the form of either a loan, a mortgage or financing agreement. The gas utility contended that it was not advancing credit and that the late payment penalty did not amount to “interest” within the meaning of the Code. Clearly, in this case, the gas utility was not lending money to its customers.

The court nonetheless found that the provision of goods and services to customers under contract, for which payment may be deferred, constitutes “credit advanced,” within the meaning of s. 347. The Court noted that such payments were nothing more than charges for the purpose of compensating the gas company for having to maintain overdue accounts. The gas utility therefore had an agreement or arrangement with its customers by which it would advance credit (provide gas) in return for a payment which included a 5 per cent charge of interest. The late payment penalty was therefore a “charge...in the form of a...penalty...payable for the advancing of credit under an agreement or arrangement.”27 The Court noted, at p.143:

The conclusions reached in this appeal may not follow intuitively from those concepts of “credit” and “interest” as those terms are employed at common law and in every day life. The result here is mandated by the extremely broad compass given to those terms by Parliament under s. 347.

The next challenge was for the court to get around Nelson, in which the British Columbia Court of Appeal held that a criminal rate of interest would not arise where it was the result of a voluntary act of the borrower seeking, for example, to pay off an overdue account early. The gas utility argued that it did not actually require its customers to pay interest at a criminal rate as customers could avoid the late payment penalty altogether by simply paying their bills on time, or by deferring payment to a later date.

Garland argued that if the customer elected to pay his or her bill almost immediately after the due date, the customer would still be required to pay the flat 5 per cent late payment penalty. Converting the one-day interest rate into an annual rate, as required by s. 347 (multiplying the 5 per cent “daily rate” by 365) yields an interest figure in excess of 1800 per cent. The actuarial evidence submitted by Garland further revealed that customers who paid the late payment penalty 38 days after incurring it would not be paying interest at 60 per cent per annum.

The Court rejected the arguments advanced by Consumers’ Gas and

27 Ibid. at 143.
found that while “strictly speaking,” customers may have delayed their payment beyond the 38 day period, there was clearly no “invitation” to do so and, in fact, most customers did not regard themselves as having the flexibility to wait that long.\textsuperscript{28} Statistical evidence submitted by Garland revealed that 81 per cent of customers elected to pay their overdue accounts within ten days of receiving the late payment penalty.

While the Court ultimately found that “Consumers’ Gas neither encourages late payments nor seeks to profit from them,”\textsuperscript{29} they nonetheless concluded that it is the substance and not the form of the transaction which is at issue. The Court found that there was clearly no violation of s. 347(1)(a) in this case: the agreement, on its face, did not expressly require customers to pay interest at a criminal rate. However, the gas utility was found liable for the fact that the penalty gave rise, in some instances, to the actual receipt of interest in excess of 60 per cent as prohibited by s. 347(1)(b).

The conclusion reached by Major J. reflects the broad interpretation now given to the wording of s. 347. Garland reveals that this section may be used to target a large number of otherwise ordinary and acceptable transactions, regardless of their actual form or the amount involved, if their net result is to encourage a borrower to repay a loan during a period in which the annual rate of interest would amount to 60 per cent or greater. It is important to keep in mind that in writing for the majority in Garland, Major J. did not ultimately conclude that s. 347 would be breached as a result of the borrower voluntarily electing to pre-pay at an earlier date. In that case, while the court acknowledged that customers did have the option to pay their gas bills at a later date, they did not actually perceive themselves as having the option to do so.

The court’s finding indicates that in order for s. 347 to be found to have been breached, there still must be some indication that the lender has compelled the borrower to pre-pay early. A strictly voluntary decision on the borrower’s part may not be sufficient to offend s. 347. The Court’s reasoning is consistent with earlier findings that interest must amount to:

\ldots a fee which is not ordinarily payable by a borrower and which directly or indirectly results in a benefit to the lender personally or to someone whom he designates. Further, it must be a condition of the agreement, imposed by the lender, that he will lend only if the borrower agrees to pay that fee...\textsuperscript{30}

If a lender were to “disguise” usurious interest charges in the form of an incentive plan, such as the reduction of interest charges, or the withholding of the imposition of a penalty, in order to encourage the borrower to pre-pay at an earlier date, such may be sufficient for the court to find that s. 347 had been breached.

\textsuperscript{28} Ibid. at 150.
\textsuperscript{29} Ibid. at 142.
\textsuperscript{30} Creswell, supra note 13 at 192 [emphasis added].
The uncertainty which arises from the “wait and see” approach raises the question of whether s. 347 is in need of legislative reform, as suggested by Major J.:

It should be noted however that s. 347 is extremely problematic law. Some of its terms are more comfortably understood in the narrow context of street-level loan sharking, while others compel a much broader application. The two facets of the statute do not comfortably co-exist. The Court is aware that the present decision may have the effect of increasing the importance of s. 347 in some consumer and commercial transactions.

Given the interpretive difficulties inherent in the provision and the volume of civil litigation which it has already spawned, it is with some reluctance that we are legally driven to this conclusion. However, the plain terms of s. 347 must govern its application. If the section is to be given a more directed focus, it lies with Parliament, not the courts to take the required remedial action.31

Such reasoning indicates that at least one member of the Supreme Court of Canada would appreciate an attempt by Parliament to narrow s. 347 and develop a bright-line test. The court could have taken a more purposive approach and concluded that a late payment penalty is not actually a fee for the advancing of credit, or that penalties do not expressly fall within s. 347. However, they were constrained by the broad definition of “interest” included by Parliament to ensure that individuals would be prevented from disguising usurious charges as other items.

The problem with adopting such a plain reading of the section is that there is no definitive reason why a company such as Consumers’ Gas should be prohibited from both catering to the needs of its customers and recovering their losses. If the true intention of s. 347 is to circumvent loan sharking, Parliament should not be regulating all transactions with interest rates of 60 per cent or greater, whether they are in fact truly usurious loan transactions or not, but rather should be seeking to identify what exactly loan sharking arrangements encompass.

**Conclusion**

Perhaps Parliament should raise the bar and criminalize transactions with an “effective annual rate” of interest far higher than 60 per cent. Parliament might also specify that there should be some element of violence, threat or intimidation involved before the section will apply. Parliament could also more tightly word the section so as to exclude its application to lending transactions which involve willing participants with the benefit of legal advice. Clearly, as the section presently stands, it is not fulfilling its ultimate, or even intended, prosecutorial mandate.

31 Garland, supra note 9 at 143.