

What is Interest? *Tomell Investments Limited v. East Marstock Lands Limited*

The division of legislative powers under sections 91 and 92 of the *British North America Act, 1867*¹ depends not only upon which particular federal and provincial laws are examined by the courts, but also upon the order in which those laws are examined. This is particularly true because the courts have always leaned in favour of the constitutionality of laws. Illustrative of this proposition are the decisions that have attempted to rationalize the potential overlap of the exclusive provincial jurisdiction over contracts² and Parliament's exclusive jurisdiction over interest.³ As "interest" obviously is the narrower category of subject matter, the problem of overlap might have been easily solved by a constitutional challenge to the validity of the *Interest Act*.⁴ However, it was not until the Supreme Court of Canada heard *Tomell Investments Ltd v. East Marstock Lands Ltd*⁵ that such a challenge arose.

Of course, some sections of the *Interest Act*, such as sections 2 and 6, provided no problem.⁶ Parliament has used only the word "interest" in those sections and, absent any definition of interest

¹ 30-31 Vict., c. 3 (U.K.).

² Contracts fall within "Property and Civil Rights in the Province", *ibid.*, s. 92:13.

³ *Ibid.*, s. 91:19.

⁴ R.S.C. 1970, c. I-18. This statute was clearly enacted pursuant to s. 91:19, *ibid.*

⁵ (1977) 77 D.L.R. (3d) 145, 16 N.R. 139 *per* Pigeon J. (Judson, Ritchie, Spence, Dickson and Beetz JJ. concurring; Laskin C.J.C. and Martland J. concurring in the result), *aff'g* the decision of the Ontario Court of Appeal (no recorded reasons), *aff'g* 8 O.R. (2d) 396, 58 D.L.R. (3d) 172 (H.C.). [References *infra* are cited to 77 D.L.R. (3d).]

⁶ Ss. 2 and 6 read as follows:

2. Except as otherwise provided by this or by any other Act of the Parliament of Canada, any person may stipulate for, allow and exact, on any contract or agreement whatever, any rate of interest or discount that is agreed upon.

6. Whenever any principal money or interest secured by mortgage of real estate is, by the mortgage, made payable on the sinking fund plan, or on any plan under which the payments of principal money and interest are blended, or on any plan that involves an allowance of interest on stipulated repayments, no interest whatever shall be chargeable, payable or recoverable, on any part of the principal money advanced, unless the mortgage contains a statement showing the amount of such principal money and the rate of interest chargeable thereon, calculated yearly or half-yearly, not in advance.

in the Act, it has been safe to assume that those sections do not exceed Parliament's constitutional jurisdiction. It has been common ground in all the cases that the word "interest" must embrace, at a minimum, the day-to-day accrual of charges for money borrowed. Therefore, provincial legislation that sought simply to alter the rate of interest has been held to be *ultra vires*.⁷ Yet the question has been whether the meaning of "interest" for constitutional purposes was wide enough to approximate the total cost for the use of the borrowed principal. A wider definition would embrace such phenomena as bonuses and penalties. Such items can be converted to a *per diem* accrual rate, but usually are collected collaterally to the contract specifying the interest rate (particularly in the case of mortgages), and often become payable only upon the happening of such contingencies as the debtor falling into arrears or the creditor being forced to take legal action.

In a series of decisions involving provincial legislation, culminating with the decision in *A-G. Ontario v. Barfried Enterprises Ltd.*,⁸ the Supreme Court of Canada moved to restrict the meaning of "interest" to the narrowest of concepts, the *per diem* accrual.

In *Barfried, The Unconscionable Transactions Relief Act*⁹ was alleged to be legislation in relation to interest. By section 2 of that Act, the Court was empowered to rewrite a contract of lending if it concluded that the cost of the loan was excessive and the transaction harsh and unconscionable. The "cost of the loan" was defined to mean (in part): "... the whole cost to the debtor of money lent and includes interest, discount, subscription, premium, dues, bonus, commission, brokerage fees and charges [.]"¹⁰

The majority held that the legislation was in relation to property and civil rights and only incidentally affected interest. To reach this conclusion, Mr Justice Judson felt compelled to restrict the meaning of "interest":

The day-to-day accrual of interest seems to me to be an essential characteristic. All the other items mentioned in [the cost of the loan in]

⁷ *Reference Re Sask. Farm Sec. Act* [1947] S.C.R. 394, [1947] 3 D.L.R. 689, *aff'd* [1949] A.C. 110 (*sub nom. A-G. Sask. v. A-G. Can.*), [1949] 1 W.W.R. 742 (*sub nom. Ref. re The Farm Sec. Act, 1944 (Sask.)*) (P.C.); and *Board of Trustees of the Lethbridge N. Irrig. Dist. v. IOF* [1940] A.C. 513, [1940] 2 D.L.R. 273, [1940] 1 W.W.R. 502 (P.C.).

⁸ [1963] S.C.R. 570, 42 D.L.R. (2d) 137 *per* Judson J. (Taschereau C.J., Cartwright, Fauteux and Hall JJ. concurring; Martland and Ritchie JJ. dissenting), *rev'g* [1962] O.R. 1103, 35 D.L.R. (2d) 449 (C.A.).

⁹ Now R.S.O. 1970, c. 472.

¹⁰ *Ibid.*, s. 1(a).

The Unconscionable Transactions Relief Act except discount lack this characteristic. They are not interest. In most of these unconscionable schemes of lending the vice is in the bonus.¹¹

The majority also saw no conflict with section 2 of the *Interest Act* which permits parties to stipulate whatever rate of interest they wish.¹² However, Martland and Ritchie JJ. in dissent, while refusing to pass upon the validity of the Act, did see a conflict with section 2:

The power of the Court to act under this Act arises only if it has found that the cost of the loan is excessive. It is true that it must also find the transaction to be harsh and unconscionable, but it may happen, as it did in the present case, that the judge who hears the case decides that the transaction is harsh and unconscionable because of the excessive cost of the loan. The result is that the very Court to which a creditor must resort in order to enforce payment of the interest or discount which the *Interest Act* says he may exact is, by the Provincial legislation, empowered to decide whether that interest or discount is, in all the circumstances, excessive. Furthermore, if that Court decides that it is excessive and that the transaction is harsh and unconscionable, it may relieve the debtor of the obligation of paying that portion of his obligation which it considers to be excessive, and thus is in a position to relieve him from the payment of an obligation which the Parliament of Canada has stated the creditor is entitled to exact from him.¹³

In my view the meaning of "interest" subscribed to by the majority in *Barfried* is too restrictive, if not unrealistic, and, as has been indicated,¹⁴ throws doubt upon the validity of federal legislation such as the *Small Loans Act*.¹⁵

In *Tomell*,¹⁶ the Supreme Court had to rule upon the validity of section 8 of the *Interest Act*, which states:

8.(1) No fine or penalty or rate of interest shall be stipulated for, taken, reserved or exacted on any arrears of principal or interest secured by mortgage of real estate, that has the effect of increasing the charge on

¹¹ *Supra*, note 8, 575.

¹² See *supra*, note 6.

¹³ *Supra*, note 8, 582-83.

¹⁴ Rayner & McLaren (eds.), *Falconbridge On Mortgages* 4th ed. (1977), 679-80.

¹⁵ R.S.C. 1970, c. S-11, of which s. 2 reads in part: "'cost' of a loan means the whole of the cost of the loan to the borrower whether the cost is called interest or is claimed as discount, deduction from an advance, commission, brokerage, chattel mortgage and recording fees, fines, penalties or charges for inquiries, defaults or renewals or otherwise, and whether paid to or charged by the lender or paid to or charged by any other person, and whether fixed and determined by the loan contract itself, or in whole or in part by any other collateral contract or document by which the charges, if any, imposed under the loan contract or the terms of the repayment of the loan are effectively varied [.]"

¹⁶ *Supra*, note 5.

any such arrears beyond the rate of interest payable on principal money not in arrears.

(2) Nothing in this section has the effect of prohibiting a contract for the payment of interest on arrears of interest or principal at any rate not greater than the rate payable on principal money not in arrears.

Default had entitled the lender to a bonus equal to three months interest on the principal. The monthly interest on the principal was \$6,000, at the specified rate of sixteen per cent. The arrears amounted to six months, or \$36,000. The payment of the bonus would thus be \$18,000, indicating a rate of fifty per cent on the arrears. This was clearly a breach of section 8(1).¹⁷

The Court had faced the interpretation, but not the constitutionality, of section 8 in *Immeubles Fournier Inc. v. Construction St-Hilaire*.¹⁸ In that case, Mr Justice Pigeon held that the words "fine" and "penalty" must mean something more than "interest" and could not be equated thereto:

In my view, we should not in any way here decide on the extent of the federal power regarding interest. Any adoption of a construction of s. 8 by reference to the extent of that power would, at least in the circumstances of this case, be tantamount to a decision on the extent of that power. Clearly this would be the very object of any argument on constitutionality if the issue of constitutionality were raised. In my opinion, s. 8 must consequently be construed irrespective of the argument that respondent seeks to make from the provisions of the constitution, and accordingly the constitutional question must be left completely open.

As to the construction of the section by itself, I have already indicated why it does not appear to me that the words "penalty" and "fine" can be limited to what would be interest, that is to something accruing on a daily basis. This is not a case in which the maxim *nosctur a sociis* should be applied, as counsel for the respondent urged us to do, relying on certain sentences found in *Maxwell on the Interpretation of Statutes*, 10th ed., p. 332. One needs only read the cases cited by the author to see that his statement cannot apply in the present circumstances. The suggested construction would amount to no less than depriving the words "penalty" and "fine" of any meaning, since "rate of interest" obviously includes whatever may be described as interest.¹⁹

In *Tomell*, Mr Justice Pigeon reiterated both the *Barfried* and *St-Hilaire* decisions, holding that interest meant day-to-day accrual and that the words "fine" and "penalty" in section 8 must refer

¹⁷ It should be noted that if the arrears had amounted to \$112,500, the bonus of \$18,000 (three months interest) would not have offended s. 8(1), as it would then have represented a rate of 16% on the arrears.

¹⁸ [1975] 2 S.C.R. 2, 52 D.L.R. (3d) 89, 10 N.R. 541 *per* Pigeon J. (Laskin C.J.C., Spence, Dickson and Beetz JJ. concurring; Martland, Judson, Ritchie and de Grandpré JJ. dissenting), *rev'g* [1972] C.A. 35 (Que. C.A.).

¹⁹ *Ibid.*, 16.

to something other than interest.²⁰ He stressed that interest could not be equated to cost of loan.²¹ However, he did find that Parliament had the right to specify the rate of interest on arrears and that, to make the legislation effective, it also had the right to deal with matters that were not interest, such as fines and penalties: not to permit Parliament to do so would rob it of effectiveness.²² He thus found the legislation valid on the doctrine of ancillary powers:

In my opinion, s. 8 of the *Interest Act* is valid federal legislation in respect of interest because, although it does not deal exclusively with interest in the strict sense of a charge accruing day by day, it is, insofar as it deals with other charges, a valid exercise of ancillary power designed to make effective the intention that the effective rate of interest over arrears of principal or interest should never be greater than the rate payable on principal money not in arrears.²³

Chief Justice Laskin saw no need to rely upon the doctrine of ancillary powers and stated cryptically:

Parliament is, in my view, entitled to require creditors to abstain from making or exacting a charge on arrears that goes beyond the rate of interest fixed for principal not in arrears and, in that respect, to prevent them from escaping the stricture through a designation of the charge as a fine or a penalty. This is an assertion of the interest power *simpliciter*, and, as in *Attorney-General of Canada v. Nykorak* (1962), 33 D.L.R. (2d) 373, [1962] S.C.R. 331, 37 W.W.R. 660, it is unnecessary to invoke any doctrine of ancillary power.²⁴

Thus, the decision would seem to permit the enactment of federal legislation embracing matters that are not interest. If interest is not to be equated to the total cost of a loan, but Parliament may legislate with respect to charges that are not interest in order to enforce its stipulated rates, where is the line to be drawn?

The decision seems to be consistent with earlier jurisprudence in confirming that, for constitutional purposes, "interest" is confined to charges that accrue on a daily basis. Admittedly, the Laskin judgment is open to the interpretation that the meaning of "interest" is not so circumscribed.

Partly as a result of the order in which the issues have been adjudicated, the jurisdictional boundaries have been obscured and there exists at this point a measure of functional concurrency²⁵ in

²⁰ *Supra*, note 5, 150-51.

²¹ *Ibid.*, 153.

²² *Ibid.*, 151.

²³ *Ibid.*, 154.

²⁴ *Ibid.*, 147.

²⁵ See Leigh, *The Criminal Law Power: A Move Towards Functional Concurrency?* (1967) 5 *Alta L. Rev.* 237.

the field of financing of borrowed money. The provinces may clearly legislate in relation to interest in some circumstances and Parliament may clearly legislate with respect to charges that are not interest in some circumstances. As a result, the meaning of "interest" has become less important than the possibility of conflict or repugnancy between federal and provincial legislation as analysed by Martland and Ritchie JJ. in *Barfried*.²⁶ A clearer interpretation of interest might be achieved in future by a reference or private pursuit of the constitutionality of the *Small Loans Act*.²⁷

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²⁶ See *supra*, p. 123.

²⁷ R.S.C. 1970, c. S-11.

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