



March 19, 2007

The Honourable Senator Jerahmiel S. Grafstein, Q.C.
Chair
Senate Committee on Banking, Trade and Commerce
The Senate
Ottawa, ON K1A 0A4

Dear Senator Grafstein:

Re: Bill C-26 and *Criminal Code* section 347

We are writing on behalf of the National Business Law and Real Property Sections of the Canadian Bar Association to highlight some problems that will remain unsolved if the pending amendments to section 347 of the *Criminal Code* in Bill C-26 are adopted.

When the Senate Banking Committee considered Bill S-19 in 2005, the CBA brought to your attention that it would have the unintended effect of making many legitimate loan transactions between business parties unlawful.¹ Your Committee amended Bill S-19 to address the problem. That Bill died on the Order Paper. Unfortunately, Bill C-26 fails to address the business problems caused by section 347.

For example, short-term bridge financing in a real estate project may have an annualized rate of interest in excess of 60% per annum when extrapolated to the full year. High-risk business, such as start-ups and technology companies, often borrow money from “mezzanine financing” lenders by providing an “equity kicker” to the party prepared to make the loan. Such equity amounts can take the annual “interest” earned by the lender in excess of 60% per annum. Indeed, in the three cases relating to criminal interest considered in the past ten years by the Supreme Court of Canada², none had to do

¹ Letter to Senator Grafstein from Catherine Wade and Richard Wenner, dated January 25, 2005. Copy attached for ease of reference.

² *Garland v. Consumers' Gas*, [1998] 3 S.C.R. 112; 40 O.R. (3d) 479; (1998), 165 D.L.R. (4th) 385. (5% late payment penalty on consumers' gas bills); *Degelder Construction Co. v. Dancorp Developments Ltd*, [1998] 3 S.C.R. 90; 165 D.L.R. (4th) 417; 20 R.P.R. (3d) 165; 5 C.B.R. (4th) 1. (contract terms for repayment vs the time actually taken to repay the mortgage loan); *Transport North American Express Inc. v. New Solutions Financial Corp.*, [2004] 1 S.C.R. 249; (2004), 235 D.L.R. 385. (arms length loan to borrower in financial trouble, represented by legal counsel, and applying notional severance to the offending contract interest provisions vs “blue pencil test” adopted by the Ontario Court of Appeal).

with the targeted crime of loan sharking, but rather with commercial disputes where a party was endeavouring to find a contractual provision unenforceable by reason of illegality for breach of section 347 of the *Criminal Code*.

In 2005, the CBA commended to the Senate Banking Committee the work of the Uniform Law Conference of Canada.³ We recommended changes to section 347 to avoid business and real estate contracts contravening the section:

1. The definition of “interest” should exclude the value of consideration for a loan that takes the form of participation in the borrower’s profits, whether by an equity share, a royalty for use of property or a genuine pre-estimate of profits. It should also exclude the value of fees paid to independent professionals.
2. The criminal rate of interest should be raised significantly. The figures should be selected in consultation with law enforcement agent authorities. (Although, unlike ULCC, we would restrict this to non-commercial financing).
3. The civil consequences of violating the criminal provision should be restricted unless the transaction is subject to criminal prosecution.

These recommendations have not yet been incorporated into section 347 and should be. Bill C-26 presents an ideal time to do so.

The CBA applauds the government’s efforts to better protect consumers of payday loan operations. However, business problems caused by section 347, which have nothing to do with the crime of loan sharking, remain a real issue for Canadians. We urge you to consider further amendments to section 347.

Yours truly,

Original signed by Tamra L. Thomson for Jennifer Babe and George Lamontagne

Jennifer Babe
Chair
National Business Law Section

George Lamontagne
Chair
National Real Property Section

cc. Line Gravel, Clerk, Senate Banking Committee

³ Prof. Mary Anne Waldron, “Section 347 of the Criminal Code: A Deeply Problematic Law”, prepared for Uniform Law Conference of Canada. See paper and 2003 annual meeting presentations at www.ulcc.ca.



THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

The Voice of
the Legal Profession
La voix de la
profession juridique

January 25, 2005

The Honourable Senator Jerahmiel S. Grafstein, Q.C.
Chair
Standing Committee on Banking, Trade and Commerce
The Senate
Ottawa ON K1A 0A4

Dear Senator Grafstein:

Re: Bill S-19: Criminal Interest Rate

We write as Chairs of the Canadian Bar Association Business Law and Real Property Law Sections (CBA Sections) to express our concerns about the impact of the amendment to section 347 of the *Criminal Code* proposed in Bill S-19.

The CBA is a national association representing over 38,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

Bill S-19 would amend the designated rate of criminal interest from 60% per annum, to the inter-bank rate plus 35% per annum.¹ While the laudable intent of Bill S-19 may be to increase consumer protection against payday loan operations, the unintended effect will be to make many legitimate loan transactions between business parties unlawful. For example, short-term bridge financing in a real estate project may have an annualized rate of interest in excess of 60% per annum when extrapolated to the full year. High-risk business, such as start-ups and technology companies, often borrow money from "mezzanine financing" lenders by providing an "equity kicker" to the party prepared to make the loan. Such equity amounts can take the annual "interest" earned by the lender in excess of 60% per annum.

The Uniform Law Conference of Canada (ULCC) has recommended amendments to the definition of "interest" in section 347 which would take these consensual business financings out of the application of section 347. We endorse the ULCC's recommendations that deal specifically with business:

¹ The current inter-bank rate is 2.5%, so the rate designated to be criminal would be 2.5% + 35% = 37.5%

1. The definition of “interest” should exclude the value of consideration for a loan that takes the form of participation in the borrower’s profits, whether by an equity share, a royalty for use of property or a genuine pre-estimate of profits. It should also exclude the value of fees paid to independent professionals.
2. The criminal rate of interest should be raised significantly. The figures should be selected in consultation with law enforcement agent authorities. (Although, unlike ULCC, we would restrict this to non-commercial financing).
3. The civil consequences of violating the criminal provision should be restricted unless the transaction is subject to criminal prosecution.

The issues raised by the ULCC are of key concern for business deals and should be taken into consideration in draft specific amendments to section 347. If Bill S-19 becomes law without changing the definition of “interest” for arms length commercial financing, the result will be to make *bona fide* business loans unlawful.

We enclose the letter from the ULCC to the Minister of Justice of January 28th, 2004 for your reference. The papers of Professor Waldron referred to in it are available at www.ulcc.ca.

We strongly recommend against the adoption of Bill S-19 without the necessary changes to the definition of interest. The CBA Sections would welcome the opportunity to meet with the Senate committee to discuss Bill S-19 at greater length.

Yours truly,

(Original signed by Trevor M. Rajah on behalf of Catherine E. Wade and Richard Wenner)

Catherine E. Wade
Chair, Business Law Section

Richard Wenner
Chair, Real Property Law Section

cc: The Honourable Senator Madeleine Plamondon

Encl.

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January 28, 2004

The Honourable Irwin Cotler
Minister of Justice and Attorney General of Canada
284 Wellington Street
Ottawa, Ontario K1A 0H8

Dear Sir:

Re: Amendment of s. 347 of the *Criminal Code of Canada*

The Uniform Law Conference of Canada is an inter-governmental forum comprised of lawyers and policy analysts from the federal Department of Justice and the Departments of Justice of the provinces and territories as well as private lawyers and academics. Its object is to harmonize provincial and territorial law and, where appropriate, federal law. The Conference meets each August. The head of the Canadian delegation on the civil side is Ms. Kathryn Sabo, Acting Senior General Counsel, Public Law, Policy Section, Department of Justice and on the criminal side, Ms. Catherine Kane, Senior Counsel/Director, Policy Centre for Victim Issues, Department of Justice.

At the meeting of the Uniform Law Conference of Canada held in August, 2002 Yellowknife, Northwest Territories, the Conference considered a paper submitted by Professor Mary Anne Waldron of the Faculty of Law of the University of Victoria on the effect of s. 347 of the *Criminal Code of Canada*. Professor Waldron's paper identified concerns created by s. 347 with respect to activities in the area of commercial lending which may constitute a criminal offence given that the effective annual rate on credit advanced under an agreement or arrangement may be in excess of 60% and contained the following recommendations for amendments to s. 347:

1. The definition of "interest" should exclude the value of consideration for a loan that takes the form of participation in the borrower's profits, whether by an equity share, a royalty for use of property or a genuine pre-estimate of profits. It should also exclude the value of fees paid to independent professionals.

2. The criminal rate of interest should be raised significantly. The figure should be selected in consultation with law enforcement agent authorities.
3. The civil consequences of violating the criminal provision should be restricted unless the transaction is the subject of a criminal prosecution.
4. Certain industries which are subject to separate regulation should be exempted from operation of the statute entirely. This could include pay day lenders, as well as utilities already subject to scrutiny by regulatory agencies.

At the 2002 meeting, the Conference requested that the paper be made available for consultation and that a further report with final recommendations be made to the 2003 meeting.

Although the consultation was undertaken, there was not a significant response. Professor Waldron's further report was considered by the Conference at its 2003 meeting in Fredericton, New Brunswick. The Conference resolved to accept Professor Waldron's recommendations and to forward them to you for your consideration.

I trust that you will give this matter your consideration. If I can be of any further assistance, please do not hesitate to contact me.

Yours truly,



Gregory K. Steele, Q.C.
President
GKS/mf



The Honourable / L'honorable Irwin Cotler, P.C., O.C., M.P./c.p., o.c., député
Ottawa, Canada K1A 0H8

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Mr. Gregory K. Steele, Q.C.
President
Uniform Law Conference of Canada
c/o 622 Hochelaga Street
Ottawa, Ontario K1K 2E9

Dear Mr. Steele:

Thank you for your correspondence concerning the Uniform Law Conference of Canada's recommendations for amendments to section 347 of the *Criminal Code*. I regret the delay in responding.

Issues relating to section 347 of the *Criminal Code* have been a matter of ongoing review by federal, provincial, and territorial officials. This examination has focused on short-term consumer credit, such as "pay-day loans." Professor Mary Ann Waldron's paper entitled *Section 347 of the Criminal Code: "A Deeply Problematic Law,"* from which the Uniform Law Conference drew its recommendations, examines the issue of short-term consumer credit, and also considers issues related to this section from a larger perspective, including its effect on commercial loans. In providing this broader perspective, Professor Waldron's analysis is a valuable addition to the policy review process.

The policy review currently underway has not determined what, if any, changes to the law may be advisable in this area. However, I am grateful for the input of the Uniform Law Conference of Canada, which will be of significant assistance in the consideration of the issue.

Thank you again for writing.

Yours sincerely,

Irwin Cotler

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