

focus

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FRASER MILNER CASGRAIN LLP

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THE FINAL WORD ON CRIMINAL RATE OF INTEREST SEVERANCE

Peter Cavanagh and Eric Hoffstein of Fraser Milner Casgrain recently argued the *Transport North American Express Inc.* case (see our earlier comments in Issue Nos. 52, 54, 56 and 57) at the Supreme Court of Canada. The court **“read down” illegal interest rate provisions of a contract to allow the rate of interest to fall within the legal limit.** The court said that doing so would most closely preserve the original intentions of the parties. **This decision substantially broadens judges’ powers to cure illegal contracts.**

Transport North American Express Inc. signed a commitment letter with New Solutions Financial Corp. for a proposed credit facility. TNAE was to make various payments for interest, monitoring fees, standby fees, commitment fees, legal costs and royalty payments.

TNAE was unable to maintain its payments of interest and other fees in accordance with the commitment letter. TNAE argued that the agreement contained an interest component that contravened s. 347 of the Canadian *Criminal Code* which makes it illegal to charge interest in excess of 60% per annum. The effective annual interest rate under the commitment letter was 90.9%. Of that percentage, monthly interest amounted to 60.1%. Fees, royalties and other charges, which fall under the definition of interest for the purpose of s. 347, amounted to 30.8%.

The traditional “blue pencil” approach would have resulted in the court severing the 60.1% interest provision and enforcing the provisions amounting to 30.8%. The court however, upheld the trial judge’s approach of applying “notional” severance to reduce the effective annual interest rate to the statutory maximum of 60%. It remains to be seen whether “notional” severance will have a broader application in the law of contracts beyond s. 347 cases.

If you would like to discuss this case, or if you would like more information about criminal rates of interest, please contact **Peter Cavanagh, Barbara Grossman, Chris Woodbury** or **Eric Hoffstein** at our Toronto office main number (416) 863-4511.

NO GUARANTEES

Recently, a B.C. court said that **contractual language that says a guarantor is liable as a principal debtor does not necessarily protect a lender where the limitation period against the borrower (but not the guarantor) has expired.**

In the *Papke* case, Hutchinson guaranteed his company’s debt to the bank. The guarantee included a clause making Hutchinson liable as “principal debtor” even if an any act or omission of the bank or the borrower would otherwise have discharged his obligations as guarantor.

The borrower defaulted under the loan in July of 1996. The bank demanded payment under the guarantee on October 18, 1996. No further action was taken until the bank sued Hutchinson on October 9, 2002. The bank had waited too long to pursue the borrower, but filed its claim against Hutchinson within 6 years of its demand under the guarantee.

The expiry of the limitation period in respect of the borrower extinguished the debt. Was the guarantee still enforceable? The court distinguished a guarantee from an indemnity by describing it as being accessory to and “coterminous” with the underlying debt. **Unless the parties agree otherwise, the guarantor’s obligations cease when those of the borrower do.** The common law of guarantee allows for

the parties to agree to opt out of this protection, provided that the wording is clear. The court said that a “principal debtor” clause does not have that effect. Hutchinson would be liable in the event of a discharge or partial discharge arising from any act or omission of the bank or the borrower. However, in this case, the discharge arose by operation of the *Limitations Act* and the common law of guarantee (neither of which were contemplated by the “principal debtor” clause). Hutchinson was not liable.

If you would like to discuss the *Papke* case, please contact **Jennifer Dezell** of our B.C. office at (604) 443-7146.

RESPS: SOME CAUTIONS FOR GRANDPARENTS

Increasingly, registered education savings plans (RESPs) are becoming the vehicle of choice to fund post-secondary education for children. Both the tax-sheltered nature of the RESP and, more recently, the federal government “top-up” to RESP contributions (that is, the Canada Education Savings Grant) have made it an attractive solution to deal with rapidly rising tuition fees at Canadian universities. Grandparents are often in a comfortable financial position to be able to fund RESPs for their grandchildren. However, there are pitfalls of which they — and the financial institutions which offer, or advise on, RESPs — must be wary.

Barry Corbin, a tax and estates practitioner in our Toronto office, has written an article about this subject. If you are interested in receiving a copy of it, please contact him at (416) 863-4722.

GOODBYE CUMMER-YONGE

At the end of January, the Supreme Court of Canada expressly overruled the longstanding decision of the Ontario Court of Appeal in *Cummer-Yonge*. The SCC **confirmed the continuing liability of both lease guarantors and the original tenant where the original tenant (or the assignee of the original tenant) becomes bankrupt or makes a proposal, and the Trustee disclaims the lease.**

The SCC said: “Post-disclaimer assignors and guarantors ought to be treated the same with respect to liability. The disclaimer alone should not relieve either from their contractual obligations.”

In this case, the original tenant’s assignee became insolvent and filed a proposal under the *Bankruptcy and Insolvency Act*. As part of the proposal proceedings, the real estate leases in question were disclaimed. The landlords received compensation payments equivalent to six months rent upon approval of the proposal. The landlords then asserted their right to recover outstanding rent or damages for the unexpired balance of the lease terms from the original tenant (the assignment clause in the leases confirmed the continuing liability of the original tenant notwithstanding the assignment).

The SCC agreed with the landlords that the original tenant still remained liable under the disclaimed leases. The disclaimer of the leases under the proposal provisions of the BIA benefits only the insolvent party (here the assignee). Nothing in the BIA protects third parties, including assignors and guarantors, from continued liability following an insolvent’s repudiation/disclaimer of a commercial lease.

This decision does clarify the law and considerably improves the position of landlords in a bankruptcy or proposal. However it does not save a landlord from drafting pitfalls which may still result in a landlord losing the benefit of a lease guarantee, indemnity, or a letter of credit when the lease is disclaimed following the original tenant’s bankruptcy or proposal. The outcome may still turn on the wording.

If you would like to discuss this case, please contact **Barbara Grossman** of our Toronto Office at (416) 863-4417.

WHAT’S NEW AT FMC?

Malcolm MacKillop, Kristin Taylor and Jamie Knight of our Toronto Employment and Labour Group authored “How to Conduct a Workplace Human Rights Investigation” published by Carswell. This book provides readers with a sound understanding of the legal principles that inherently come into play in every human rights investigation.

Curtis McDonnell of our Toronto Employment & Labour Group recently appeared on Report on Business Television to discuss the effect that new privacy legislation is having on businesses and what organizations should be doing.

WHAT WE’VE BEEN DOING IN FINANCIAL SERVICES

Here are just some of the recent transactions on which our various offices across Canada have worked:

- Acting as Canadian counsel for Safety-Kleen Corp. and its Canadian affiliates in connection with senior secured financing facilities totalling U.S.\$295 million extended to the restructured Safety-Kleen entities on their emergence from bankruptcy protection.
- Acting for a major international bank in its multijurisdictional financing of an agricultural enterprise.
- Advising a payment system operator as to the regulatory aspects of a proposed business.
- Advising a consortium in connection with the financing and construction of a new community complex as a public-private partnership.