

# focus

## on Financial Services



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### CRIMINAL INTEREST CONTINUED

Shortly after the decision of the Ontario Court of Appeal in *Transport North American Express Inc.* (reported in Issue Nos. 52 and 54), the British Columbia Court of Appeal issued its decision in *Boyd*. The court said that although the royalty payment at issue was payable pursuant to a separate agreement, it was consideration for the loan made. Therefore, it fell within the expanded definition of "interest" in the *Criminal Code*.

**The *Boyd* decision has confirmed that revenue participation "sweeteners" or "kickers" are caught by the definition of interest under the *Criminal Code* if they are consideration for the loan. The use of a separate agreement does not avoid the inclusion of a payment of money as "interest" where the only relationship of the parties is debtor/creditor.** Also, the fact that the borrower controlled the price and scale of production did not make the royalty a voluntary payment. The royalty was required to be paid if the product was manufactured and sold, and doing so was the very business contemplated by the agreements.

Interestingly, the court said that this case was different from the *Transport* case because it fell under a different subsection of the *Criminal Code*. In *Boyd*, there was no issue of severing terms from an agreement that from the outset provides for a criminal rate of interest in order to lower the interest rate so it is no longer illegal. The court said that the royalty was payable until such time as the total of all amounts received by the lender exceeded an effective annual rate of 60%. This depended not only on the quantum of the royalty payments but also the timing of the lender's actual receipt of royalty payments. Therefore **the lender was successful in obtaining judgment for past due royalty payments which, had they been paid on time, would have resulted in an effective rate over 60%.**

Leave to appeal to the Supreme Court of Canada has been requested in the *Transport* case. If leave is granted, the SCC will have an opportunity to clarify whether notional severance by "writing down" the effective rate of interest to the legal limit is a permissible approach. We will continue to follow the progress of this case.

If you would like to discuss the *Boyd* case or other criminal interest rate issues, please call **Stephanie Campbell** (Calgary office) at (403) 268-7186, **Barbara Grossman** (Toronto office) at (416) 863-4417 or **Chris Woodbury** (Toronto office) at (416) 863-4773.

### LIMITATION OF ENVIRONMENTAL LIABILITIES

On December 1, 2002, a number of sections of the *Brownfields Statute Law Amendment Act, 2001* came into force. These sections **provide statutory protections to secured creditors, receivers and trustees in bankruptcy from environmental administrative orders under Ontario environmental legislation.**

The general principle under the Act is that except in prescribed circumstances, administrative orders will not be issued to a receiver, secured creditor or trustee in bankruptcy under Ontario's *Environmental Protection Act*, *Ontario Water Resources Act* and *Pesticides Act*. Such orders may be issued where there is gross negligence or wilful misconduct on the part of those persons. Similar protections are also extended under the Act to a secured creditor to take actions to preserve or protect a secured property in pre-enforcement circumstances and to a secured creditor which has become an owner of a secured property by virtue of foreclosure.

The Act also imposes obligations on secured creditors, receivers and trustees in bankruptcy to disclose the existence of environmental conditions and to report in prescribed circumstances.

The remaining amendments in the Act relate, in part, to the filing of records of site condition for environmentally affected properties. These amendments will not likely be in force before mid-2003.

The protections for secured creditors, receivers and trustees in bankruptcy are in addition to those which are contained in the federal *Bankruptcy and Insolvency Act*.

If you would like further information on the Act please contact **Joseph Marin** of our Toronto office at (416) 863-4730.

### **SNEAKY SUBORDINATION**

Secured creditors should be very careful when including the concept of **permitted encumbrances in their general security agreements**. In *Engel Canada*, the Ontario court found that **a vendor's purchase money lien, which was not a valid purchase money security interest (a PMSI), had priority over a prior registered security interest**.

In *Engel*, a lender provided credit to a debtor and was granted a security interest in all of the debtor's present and future personal property by way of a general security agreement. An equipment manufacturer later provided equipment to the debtor and was granted security over the equipment. However, the manufacturer did not obtain the super priority of a PMSI, as it did not register its financing statement within ten days of shipping the equipment to the debtor.

The manufacturer said that the lender implicitly subordinated its security interest in the equipment since "purchase money liens" were permitted under the lender's GSA.

The court found that the provisions in the GSA permitting "purchase money liens" anticipated and explicitly permitted future encumbrances. The GSA clearly allowed the debtor to purchase specified encumbered assets. The court stated that allowing the purchase of a specified encumbered asset without granting priority to the encumbrance would be a hollow right that does not make commercial sense. Therefore the court found that the GSA was implicitly subordinate to the manufacturer's "purchase money lien", even though the GSA did not include any language with respect to priority or rank.

If you would like further information on the *Engel* case, or on permitted encumbrance provisions that can help reduce its effect, please contact **Charles Rich** of our Toronto office at (416) 863-4606.

### **GUARANTORS ON THE HOOK**

In the recent *Charest* appeal, the Ontario Divisional Court said that **failure to give notice to the guarantors under the PPSA did not prevent a bank from suing on the guarantee**.

The Bank provided credit facilities to Dynamic and took two general security agreements and chattel mortgages. After default, the bank demanded payment from Dynamic. The bank then gave notice to Dynamic under the PPSA that it intended to sell Dynamic's assets, but did not give notice to the guarantors. The assets were sold, and there was a deficiency in recovery of the debt. The bank then sued the guarantors for the deficiency.

The court said that the trial judge was correct in saying that the Bank had a contractual right to sue the guarantors. **The wording of the guarantee made the guarantors liable for the balance after realization of the security.**

**Even though the guarantors were entitled to notice under the PPSA, the bank's failure to give notice did not prevent it from enforcing the guarantee in this case.** The court said: (a) the bank had a right to sue Dynamic for the deficiency; (b) the terms of the guarantee made the guarantors liable for the balance; and (c) the guarantee did not say the guarantors had to receive notice.

If you would like to discuss the decision in *Charest*, please contact **Anita Joshi** of our Toronto Office at (416 ) 863-4590.

### **WHAT'S NEW AT FMC:**

Following the appointment of FMC's Chairman **David Smith**, P.C., Q.C. to the Senate of Canada, **Jeff Barnes** was recently appointed as FMC's new Chairman. Jeff is a senior partner in our Toronto Business Law Department and Managing Partner of the firm's New York City office. Jeff was recently named as one of Canada's "Top 30 Corporate Dealmakers" by LEXPERT. In addition, he has been recognized in many other publications including the American Lawyer Media, LEXPERT Guide to the 500 Leading Lawyers in Canada and Chambers Global, "The World's Leading Lawyers".

### **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:

- Assisting a foreign bank in obtaining necessary Canadian regulatory approvals to establish new data processing arrangements outside of Canada for the Canadian operation.
- Assisting in the establishment of precious metal safekeeping arrangements and documenting the related agreements.
- Assisting a bank client to enforce its rights in respect of a defaulted franchise loan.
- Acting for a non-bank financier in taking an assignment of federal tax credits as security for short term bridge financing to emerging companies.