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Modern Commercial Reality Triumphs in Interest Act Decision

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By Jonathan Yantzi

A recent decision from the Court of Appeal for Ontario has reaffirmed the court's decision in *Solar Power Network Inc. v. ClearFlow Energy Finance Corp.*[1] that section 4 of the *Interest Act*[2] should be interpreted in accordance with "modern commercial reality."[3]

TFS RT Inc. v. Dyck involved an appeal of a summary judgment to enforce guarantees in favour of the respondents, which guaranteed the obligations of Green Patch Environmental Consulting Ltd. (the "**Borrower**"). The guarantors were the directing minds of the Borrower. The Borrower and its lenders, the respondents, had entered into a loan agreement, which provided that interest would accrue at the rate of 2.5% per 30 days before maturity, and at an additional rate of 0.416% per 30 days after maturity. During the life of the loan and after maturity, the Borrower was provided with loan statements showing that interest was calculated at 30% prior to maturity, and 35% after maturity.[4]

The Borrower defaulted, and following formal demands by the lenders, the Borrower and the guarantors entered into a forbearance agreement with the lenders (the "**Forbearance Agreement**"). The Forbearance Agreement contained covenants that the loan agreement and guarantees were binding and that there were no defences to the amount owed. The Forbearance Agreement also provided the amount then owing for principal and interest. When the Borrower did not make certain payments required under the Forbearance Agreement, the lenders commenced proceedings to appoint a receiver over the assets of the Borrower.[5]

Pending the receivership proceedings, an endorsement was made documenting certain agreements between the Borrower and the lenders, including the agreement to "forego any further argument, defence, counterclaim, etc. regarding the quantum of the outstanding obligations owing to [the lenders], including any dispute as to the principal, accrued and accruing interest, default interest, legal fees and other professional fees" (the "**June Agreement**").[6] Subsequently, a receiver was appointed. As the amounts realized from the Borrower's assets were insufficient to satisfy the indebtedness, the action under the guarantees was commenced.

At the motion for summary judgment, the guarantors argued the loan agreement lacked an express statement of the yearly rate of interest, as required by section 4 of the *Interest Act*. As we have **discussed previously**, section 4 requires that any written agreement for the payment of interest at a rate or percentage per day, week, month or any period less than one year, contain an express statement of the yearly rate or percentage of interest to which the other rate or percentage is equivalent. Failure to comply with section 4 will result in a default interest rate of a maximum of 5% *per annum*. In rejecting this argument, the motion judge held that, because of the Forbearance Agreement, orders consented to in connection with the receivership proceedings, and the June Agreement, the debtors could not make a section 4 *Interest Act* argument.

On appeal, the guarantors argued: (i) the section 4 *Interest Act* violation; (ii) that the Forbearance Agreement and June Agreement could not have the effect the motion judge gave them, as this would constitute a contracting out of the *Interest Act* protections; and (iii) that the debtors were not party to the June Agreement and, accordingly, did not waive any *Interest Act* defence.

In rejecting the debtors' arguments, Rouleau, van Rensburg and Zarnett JJA referenced the Court of Appeal's earlier decision, in *ClearFlow*, that the *Interest Act*[7] should be interpreted in accordance with "modern commercial reality."[8] The court held that the loan agreement and corresponding statements,

when taken together with the sophistication of the parties, constitute the express statement of the yearly rate or percentage of interest required by section 4.

The court also found that disputes under the *Interest Act* can be consensually resolved and that such resolutions are binding. In this instance, under the June Agreement, the Borrower agreed to forego any *Interest Act* argument. Finally, the court found that, as the directing minds of the Borrower, the guarantors were party to the June Agreement:

when they directed the Borrower to make the [June Agreement], they had knowledge of the potential *Interest Act* issue and must be taken to have consented to the waiver by the Borrower of any defence or dispute based on it, confirming the Borrower's obligations which they had guaranteed.[9]

Lenders should take comfort from this decision, as the court has reaffirmed its decision in *ClearFlow* that modern commercial reality must inform interpretation of section 4 of the *Interest Act*. However, lenders should continue to exercise caution and ensure that borrowers clearly understand their obligations and that interest rate provisions meet the section 4 requirements.

The Financial Services Group at Aird & Berlis LLP regularly advises lenders on their obligations under the *Interest Act*. Details are available at our **Financial Services web page**.

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[1] ***Solar Power Network Inc v. ClearFlow Energy Finance Corp.*, 2018 ONCA 727** (leave to appeal to the Supreme Court of Canada dismissed).

[2] *Interest Act*, RSC, 1985, c I-15.

[3] ***TFS RT Inc v. Dyck*, 2019 ONCA 25** at para 13.

[4] *Ibid* at para 2.

[5] *Ibid* at para 4.

[6] *Ibid* at para 7.

[7] *Interest Act*, RSC, 1985, c I-15.

[8] *TFS RT Inc v. Dyck*, 2019 ONCA 25 at para 13.

[9]

Ibid

at para 13.

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