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Mixing Oil and Water? Redrawing the Limits of Contract Freedom After the Criminalization of Usury

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Résumé de l'article

Les théoriciens et théoriciennes qui débatent de la possibilité de donner au droit privé un caractère plus « public » tiennent rarement compte du fait qu'une collision entre le droit privé et la règlementation pourrait forcer le droit privé à se prononcer sur des questions de politique publique. Cet article présente un exemple d'une telle collision, provoquée par la criminalisation par le Parlement canadien de l'acte de percevoir des intérêts à un taux supérieur à 60 % par an. Plutôt que d'annuler les contrats des parties averties qui allaient à l'encontre de cette interdiction, les tribunaux canadiens de common law ont rapidement adapté la doctrine de l'illégalité et les règles sur la divisibilité pour les maintenir en partie : tout d'abord, les tribunaux ont supprimé l'obligation de payer tout intérêt sur le prêt ; ensuite, ils ont utilisé la divisibilité au moyen du « trait au crayon bleu » pour réduire le montant des intérêts dus ; et enfin, ils ont créé un nouveau recours, celui de la « divisibilité fictive », pour proposer un nouveau contrat pour les parties, donnant ainsi au droit des contrats un rôle directeur plutôt que facilitateur. En fin de compte, il fut décidé que la « divisibilité fictive » permet seulement d'imposer un taux d'intérêt d'exactement 60 % par an. Cet article soutient que ces changements relatifs à la doctrine étaient incohérents et les compare à la façon dont les tribunaux de droit civil du Québec ont réagi à la nouvelle disposition du *Code criminel*. Il suggère également que les théories qui mettent l'accent sur la ressemblance et la proximité entre le droit privé et la réglementation sont les mieux placées pour comprendre cette jurisprudence, par laquelle les juges ont mis de l'avant une autre vision de la liberté contractuelle, plutôt que de se référer à celle du Parlement.

Mixing Oil and Water? Redrawing the Limits of Contract Freedom After the Criminalization of Usury

Catherine Le Guerrier

THEORISTS WHO DEBATE whether private law should remain truly private rarely consider the possibility of a disruptive collision between private law and regulation that would force the former to engage with public policy concerns. This article shows an example of such a collision, which was caused by Parliament's choice to criminalize the act of agreeing to receive interest at more than 60% per year. Rather than voiding the contracts of sophisticated parties that ran afoul of the prohibition, Canadian common law courts adapted the doctrine of illegality and rules on severance rapidly to allow them to be upheld in part: first, the courts severed the obligation to pay any interest on the loan; next, they used blue-pencil severance to reduce the amount of interest owed; and lastly, they created a new remedy, "notional severance," to craft a new contract for the parties, effectively making contract law directive rather than facilitative. In the end, notional severance was interpreted restrictively as only allowing lenders to recoup interest at exactly 60% per year. This paper argues that these collective doctrinal changes were haphazard, and compares them to the ways in which the Québec civil law courts responded to the new criminal provision. It also suggests that theories which stress the resemblance and proximity of private law with regulation are best suited to understand this line of jurisprudence, through which judges made the contract law directive

LES THÉORICIENS ET théoriciennes qui débatent de la possibilité de donner au droit privé un caractère plus « public » tiennent rarement compte du fait qu'une collision entre le droit privé et la règlementation pourrait forcer le droit privé à se prononcer sur des questions de politique publique. Cet article présente un exemple d'une telle collision, provoquée par la criminalisation par le Parlement canadien de l'acte de percevoir des intérêts à un taux supérieur à 60 % par an. Plutôt que d'annuler les contrats des parties averties qui allaient à l'encontre de cette interdiction, les tribunaux canadiens de common law ont rapidement adapté la doctrine de l'illégalité et les règles sur la divisibilité pour les maintenir en partie : tout d'abord, les tribunaux ont supprimé l'obligation de payer tout intérêt sur le prêt ; ensuite, ils ont utilisé la divisibilité au moyen du « trait au crayon bleu » pour réduire le montant des intérêts dus ; et enfin, ils ont créé un nouveau recours, celui de la « divisibilité fictive », pour proposer un nouveau contrat pour les parties, donnant ainsi au droit des contrats un rôle directeur plutôt que facilitateur. En fin de compte, il fut décidé que la « divisibilité fictive » permet seulement d'imposer un taux d'intérêt d'exactement 60 % par an. Cet article soutient que ces changements relatifs à la doctrine étaient incohérents et les compare à la façon dont les tribunaux de droit civil du Québec ont réagi à la nouvelle disposition du *Code criminel*.

to assert a competing vision of freedom of contract, rather than deferring to Parliament's view.

Il suggère également que les théories qui mettent l'accent sur la ressemblance et la proximité entre le droit privé et la réglementation sont les mieux placées pour comprendre cette jurisprudence, par laquelle les juges ont mis de l'avant une autre vision de la liberté contractuelle, plutôt que de se référer à celle du Parlement.

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Mixing Oil and Water? Redrawing the Limits of Contract Freedom After the Criminalization of Usury

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I. INTRODUCTION

Karl Llewellyn once described legislation as "warts on the body of the common law,"[1] and although the similes currently used to describe the relationship between the two express less disgust, they still imply that separation is warranted. Some have claimed they are like oil and water, and do not mix;[2] others, that legislation creates unconnected islands that dot the ocean of the common law.[3] These claims suggest there is little interaction between the two and justify studying the common law and equity in isolation from their institutional context.[4] For instance, for all the theoretical debates

* PhD candidate, Osgoode Hall Law School, York University. I am grateful to Dan Priel, Jennifer Nadler, the participants of the Osgoode Hall Law School Graduate Student works-in-progress workshop, and the anonymous reviewers for their thoughtful comments on this paper. All mistakes are my own.

1 To be fair, Karl Llewellyn notes that this view is held only "[p]artly, with reason" and is one of "the relics of a sort of feud between the courts and the legislature, a pride of office" (see KN Llewellyn, *The Bramble Bush: On Our Law and Its Study*, revised ed (New York: Oceana Publications, 1951) at 79).

2 Jack Beatson, "Has the Common Law a Future?" (1997) 56:2 Cambridge LJ 291 at 300.

3 Charles R Calleros, "Introducing Civil Law Students to Common Law Legal Method Through Contract Law" (2011) 60:4 J Leg Educ 641 at 643; Andrew Burrows, "The Relationship Between Common Law and Statute in the Law of Obligations" (2012) 128:2 Law Q Rev 232 at 233.

4 Kit Barker, "Private Law as a Complex System: Agendas for the Twenty-First Century" in Kit Barker, Karen Fairweather & Ross Grantham, eds, *Private Law in the 21st Century* (Oxford: Hart Publishing, 2017) 3 ("[t]he law's relationship with these other, public and private systems is still clumsy and the norms governing the linkage of one system to another are not fully worked out. It has been customary in the past to think of each system as autonomous and discrete; and to assume that the demands of private law and corrective

on whether private law is and should be truly private, or whether it can be made to serve public policy goals, there has been little attention given to the ways in which private law might be forced to adapt in response to disruptive legislation.[5] It is generally assumed that private law will easily determine its own outer limits without encountering conflicting views on where these should be traced.[6] Concessions that private law is only relatively autonomous from public law because it is created and applied by public institutions[7] and must be justified in conjunction with other areas of law,[8] for instance, often fail to account for possible collisions. Similarly, theories that stress that external elements can and should be seamlessly incorporated into private law[9] also do little to help understand what should be done when the integration is not seamless.

This paper describes the messy adaptation of two contract law doctrines, illegality and severance, following Parliament's choice to criminalize the act of agreeing to receive interest at a rate above 60% per year in 1980. Rather than voiding the contracts that ran afoul of the prohibition,

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justice are unique, morally prior to, and rightly unaffected by the various systems that supplement, underwrite, or abut it" at 5) [Barker, "Complex System"]. See also Steve Hedley, "Looking Outward or Looking Inward? Obligations Scholarship in the Early 21st Century" in Andrew Robertson & Tang Hang Wu, eds, *The Goals of Private Law* (Oxford: Hart Publishing, 2009) 193 at 202; Kit Barker, "Private Law: Key Encounters with Public Law" in Kit Barker & Darryn Jensen, *Private Law: Key Encounters with Public Law* (New York: Cambridge University Press, 2013) 3 at 6.

5 Hanoch Dagan & Benjamin C Zipursky, "Introduction: The Distinction Between Private Law and Public Law" in Hanoch Dagan & Benjamin C Zipursky, eds, *Research Handbook on Private Law Theory* (Cheltenham, England: Edward Elgar Publishing, 2020) 1 ("what that area of the law should be used for, how it should be evaluated, who should apply it, and—maybe especially—what sorts of considerations should be brought to bear in applying it" at 5). This framing of the debate reveals that the main concern is the possibility that judges or theorists chose of their own volition to let "public" concerns drive their reasoning.

6 See e.g. William Lucy, "What's Private About Private Law?" in Andrew Robertson & Tang Hang Wu, *The Goals of Private Law* (Oxford: Hart Publishers, 2009) 47 at 59ff.

7 See e.g. Ernest J Weinrib, *The Idea of Private Law*, revised ed (Oxford: Oxford University Press, 2012) at 218; Benjamin C Zipursky, "Philosophy of Private Law" in Jules Coleman, Scott Shapiro & Kenneth Einar Himma, eds, *The Oxford Handbook of Jurisprudence and Philosophy of Law* (Oxford: Oxford University Press, 2004) 623.

8 Peter Benson, "Outline of a Public Justification of Contract Law" in Hanoch Dagan & Benjamin C Zipursky, eds, *Research Handbook on Private Law Theory* (Cheltenham, England: Edward Elgar Publishing, 2020) 75 at 79.

9 Such as Stephen Smith's view that the doctrine of illegality is not best justified by the public nature of courts, but by promissory morality, as "there is no moral obligation, and hence no legal obligation, to do an objectionable activity." See Stephen Smith, *Contract Theory* (Oxford: Oxford University Press, 2004) at 249. To keep the metaphor going, picture if you will a lava lamp; a bubble of oil floating in water without troubling it.

courts rapidly adapted the two doctrines to allow the illegal contracts of sophisticated parties to be upheld in part. At first, courts severed the obligation to pay any interest on the loan. Then, courts used blue-pencil severance to reduce the amount of interest owed, while still requiring some to be paid. Finally, courts created a new remedy, "notional severance," to craft a new contract for the parties, one that allowed lenders to claim the maximum interest rate short of illegality, irrespective of the wording of the contract.

Courts did so by first, recasting the new criminal prohibition into a form of consumer protection law by stressing the sophistication of the parties to certain loan contracts; and second, emphasizing the courts' knowledge of commercial realities. They claimed in short that lenders were entitled to a fair or commercially appropriate return on their risky investments to sophisticated borrowers. However, the Supreme Court of Canada case that upheld notional severance was eventually interpreted restrictively: courts were deemed sufficiently cognizant of commercial realities to justify refashioning both the doctrine of statutory illegality and severance, but they were not sufficiently cognizant to impose any rate of interest that seemed reasonable depending on a case's circumstances. Courts would rather be required to pick the most commercially appropriate rate among a handful of options, which are all clearly compromises.

This paper argues that these doctrinal changes are, in the end, haphazard. It does so by comparing them to the ways in which Québec civil law courts responded to the new criminal provision, guided by a better theoretical understanding of the relationship between private law and public concerns. Civil law's choice to conceptualize private law as enmeshed with public institutions and norms has helped courts integrate this limit on the freedom of contract in ways that are more normatively desirable. Québec courts' success in this regard suggests that theories which stress the resemblance and proximity of private law with regulation are best suited to understand and guide the reaction of Canadian common law courts in cases like this one. The jurisprudential changes described in this paper broke the alignment between, on one hand, the ideal of freedom of contract, and on the other, the view that contract law is facilitative, helping uphold the obligations parties have given themselves rather than imposing obligations of its choosing on them.[10] To maintain some form of freedom

10 Both these features normally work together—so much so that seeing them described as two different aspects of the law might strike readers as odd. I explain in the conclusion why I believe they can be thought of as two different features.

of contract for sophisticated parties, judges abandoned private law's facilitative character and imposed on parties obligations they had not chosen for themselves. This fact lends credence to claims that private law can and should be understood as a form of regulation, different in character from most regulation, but nonetheless, a meaningfully public institution. In turn, recognizing the similarity and proximity between both forms of law will foster a better understanding of what concerns courts should tend to when they react to regulatory encroachments by mixing oil and water.

The paper is organized as follows. In the first section, I describe the criminal provision that spurred the changes to the common law and place it in its historical and regulatory context. In the second section, I present the changes brought to contract doctrines in four steps, by offering a review of the contract law cases that involved both a violation of the criminal prohibition on usury and sophisticated parties. Finally, in the third section, I review how Québec civil law courts have responded to the new criminal prohibition and compare these remedies to those crafted by Canadian common law courts. In conclusion, I return to the issue of the relationship between common law and legislation. I argue that theories of private law that stress its similarity with legislation are better suited to explain judicial innovations like these and to guide the law towards a more desirable result.

II. THE CRIMINAL PROHIBITION ON USURY

In 1980, Parliament adopted *An Act to amend the Small Loans Act and to provide for its repeal and to amend the Criminal Code*.[11] As its title indicates, the 1980 *Act* had two purposes. First, it repealed the *Small Loans Act*, which had been enacted in 1939.[12] At the time it was repealed, it applied to loans of $1,500 or less.[13] The *Small Loans Act* had two main components. The first was interest rate caps, set out in three tiers: the first $300 could be subject to up to 2% monthly interest; the following portion of the loan, from $301 up to $1,000, was limited to 1% monthly interest; and the balance of the loan from $1,001 up to $1,500, was limited to 0.5% monthly interest.[14] The term "interest" included most charges and represented the true cost of the

11 Bill C-44, 1st Sess, 32nd Parl, 1980 (assented to 17 December 1980) [1980 *Act*].

12 *An Act respecting Small Loans*, SC 1939, c 23 [*Small Loans Act, 1939*].

13 The 1956 amendments raised the loan amount from $500 to $1,500 (see *An Act to amend the Small Loans Act*, SC 1956, c 46, amending *ibid*; see also Leon Letwin, "Canadian Consumer-Credit Legislation" (1967) 8:2 Boston College Industrial & Commercial L Rev 201 at 204).

14 Letwin, *supra* note 13 at 207.

loan, as opposed to whatever the lender labelled as interest: this broad definition distinguished the *Small Loans Act* from the previous, unsuccessful, *Money Lender's Act*.[15] The second component was licensing requirements: any lender in the business of making small loans was required to register with the Minister of Finance.[16]

The *Small Loans Act* was believed to be effective in regulating legitimate money lenders,[17] but the $1,500 "restriction had become an insubstantially low ceiling in the 1970s."[18] Furthermore, the caps no longer reflected the cost of money and a new, "more fundamental attack" against the caps also appeared, which denounced the absurdity of any attempt to regulate the cost of money.[19] A decade of intensive and highly disorganized activity in and around the Canadian Department of Corporate and Consumer Affairs was not sufficient to determine whether the *Small Loans Act* should be repealed or amended; a thesis on the matter tells a dizzying story in which key actors go back and forth on the issue, sometimes in matters of weeks.[20] A comprehensive bill was eventually presented to Parliament in 1976 but it was never adopted, in part because neither the finance sector, the provinces, nor the consumers groups liked it.[21] According to the author of the

15 *The Money Lender's Act, 1906*, SC 1906, c 32, as repealed by *Small Loans Act, 1939*, *supra* note 12. See also Micheline Gleixner, "A Canadian Financial Consumer Protection Code: Is Canada Ready for Round Three?" (2018) Annual Rev Insolvency L 57 at 64.

16 This did not apply to those who lent at a rate below 1% per month, which in the 1960s might have included credit unions. Licences both limited the lending market and served as incentives for compliance. The licensing authority was required to assess "the 'experience, character, and general fitness' of the applicant." See Letwin, *supra* note 13 at 205–06.

17 *Ibid* at 204.

18 Gleixner, *supra* note 15 at 67.

19 Jacob S Ziegel, "Bill C-44: Repeal of the Small Loans Act and Enactment of a New Usury Law" (1981) 59:1 Can Bar Rev 188 at 189 [Ziegel, "Bill C-44"].

20 To provide but one example, seemingly on the same day, November 30th 1979, (a) a number of departments (excluding Justice) agreed that the *Small Loans Act* would be repealed, then (b) discovered that the Minister of Finance had directed the Department of Justice to exempt credit unions and caisses populaires from the application of the proposed Act and that the Cabinet Committee would soon be discussing a proposal to that effect, and then (c) learned of a letter sent from the Minister of Consumer and Corporate Affairs to others Ministers in which he presented his Department's proposals to, among other things, keep the *Small Loans Act* but have it apply to loans of up to $5,000, at an interest rate ceiling of 2% (see Susan Kathleen Burns, *The Borrowers and Depositors Protection Act: A Case History in Legislative Failure* (MSc BA Thesis, University of British Columbia, 1981) [unpublished] at 171–72).

21 *Ibid* at 122. That bill was Bill C-16, *An Act to provide for the protection of borrowers and depositors, to regulate interest on judgment debts, to repeal the Interest Act, the Pawnbrokers Act and the Small Loans Act and to amend certain other statutes in consequence thereof*, 2nd Sess, 30th Parl, 1976.

thesis, "[t]he only item of agreement by all parties came on the unanimous condemnation of loan sharking activities."[22]

Parliament eventually chose to simply abolish the regulatory system put in place by the *Small Loans Act* and introduce a new section in the *Criminal Code*:[23] this was the second purpose of the 1980 *Act*. Section 305.1, now section 347, prohibits both "enter[ing] into an agreement or arrangement to receive interest at a criminal rate, or receiv[ing] a payment or partial payment of interest at a criminal rate."[24] A criminal rate is a rate that "exceeds sixty per cent," and the definition of interest is again broad and comprehensive.[25] This paper discusses the judicial reaction to the creation of the offence of *entering into* an agreement to receive interest at a criminal rate, the first of the two offences. It does not discuss the second offence of *effectively receiving* interest at a criminal rate despite the absence of an agreement to that effect, which generated a different line of jurisprudence.[26] While courts faced some difficulty determining when the second offence was breached in fact, they interpreted the first offence as prohibiting mere agreements from the outset.[27] I concentrate on the first type of offence because these are the cases where parties were *prima facie* in violation of the law, from the moment an agreement was reached.

There was little discussion of the objectives of the provision in Parliament: the three readings of the Bill took place over two days, and it was adopted unanimously.[28] Parliament cited a request by Montreal police officers to help them prosecute loan sharks as motivation for the provision, but commentators noted at the time that members of Parliament

22 Burns, *supra* note 20 at 122.

23 RSC, 1985, c C-46.

24 These two offences were initially separate (see 1980 *Act*, *supra* note 11, cl 9). They have since been folded into a single offence, with penalties ranging from fines to up to five years imprisonment (see *Criminal Code*, *supra* note 23, s 347(1)). As an indictable offence, it carried a penalty of up to five years imprisonment; as an offence punishable on summary conviction, "a fine of not more than twenty-five thousand dollars" or "imprisonment for six months or…both" (*ibid*). The maximum penalty on summary conviction has since been brought up to two years imprisonment (*ibid*).

25 *Criminal Code*, *supra* note 23, s 347(2).

26 See e.g. *Nelson v CTC Mortgage Corp*, 1984 CanLII 572 (BCCA); *Garland v Consumers' Gas Co*, 1998 CanLII 766 (SCC) [*Garland*]; *Degelder Construction Co v Dancorp Developments Ltd*, 1998 CanLII 765 (SCC) [*Degelder*].

27 The Supreme Court has confirmed that this is the proper way to interpret the first offence, writing that "[w]hether an agreement or arrangement for credit violates s. 347(1)(a) is determined as of the time the transaction is entered into" (see *Degelder*, *supra* note 26 at para 34).

28 Ziegel, "Bill C-44", *supra* note 19 at 188.

may have thought that an annual interest rate of above 60% was simply morally objectionable.[29] There is also evidence that some lawmakers were aware that the provision would prevent the creation of high interest loan agreements by sophisticated parties.[30]

The Supreme Court of Canada noted in its first treatment of the provision that it went "far beyond the scope of the *Small Loans Act*, both by criminalizing a particular interest rate for the first time, and by imposing a generally applicable ceiling on all types of credit arrangements without regard to the sophistication of the parties or the amount in issue."[31] Yet, over time, Canadian courts limited both these features of the new prohibition: giving the prohibition different consequences depending on the identity of the parties to the illegal contract and downplaying the severity of the prohibition until it was treated as an invitation to oversee the execution of loans.

III. MIXING OIL AND WATER

Jacob S. Ziegel warned from the moment the Bill was adopted that there was a high probability that debtors would invoke the new prohibition to defend themselves in civil actions by creditors collecting their debts.[32] Indeed, according to the common law doctrine of illegality, courts will not enforce contracts to do an illegal act or contracts that are prohibited, even if only by implication, by statute.[33] Most of the decisions discussed below attribute this position to *Bank of Toronto v Perkins*, where Justice Strong wrote: "[w]henever the doing of any act is expressly forbidden by statute,

29 *Ibid* at 192–93. For reference, in 1980, the prime rate was at about 14.25% (see Statistics Canada, "Canadian Economic Observer: Historical Statistical Supplement, Table 7.1: Interest rates and exchange rates" (last modified 19 December 2012), online: <www150.statcan.gc.ca/n1/pub/11-210-x/2010000/t098-eng.htm#T098FN1)>).

30 At the Senate Committee on Banking, Trade, and Commerce, a representative from the Department of Justice explained that the Canadian Banker's Association militated against setting the criminal rate of interest at 45% because it "would interfere with legitimate financial transactions such as short-term lending and the funding of high-risk ventures" (see Uniform Law Conference of Canada, *Report of the Criminal Section Working Group on Criminal Interest Rate: A Discussion Paper, Section 347 of the Criminal Code In Need of Reform* (Québec City: Uniform law Conference of Canada, 2008) at 3).

31 *Garland*, *supra* note 26 at para 23.

32 Ziegel, "Bill C-44", *supra* note 19 at 194, 196.

33 John D McCamus, *The Law of Contracts*, 2nd ed (Toronto: Irwin Law, 2012) at 453ff [McCamus, *The Law of Contracts*]; GLH Fridman, *The Law of Contract in Canada*, 6th ed (Toronto: Carswell, 2011) at 338ff.

whether on grounds of public policy or [o]therwise, the English courts hold the act, if done, to be void, though no express words of avoidance are contained in the enactment itself."[34] Yet, in the cases involving section 347, rather than voiding the contracts that were created in violation of the prohibition, judges modified the doctrine of statutory illegality and the rules governing severance; first to grant themselves "the greatest possible amount of remedial discretion"[35] to modify these contracts and impose fair, commercially reasonable rates of interest on borrowers, then to limit that discretion. In this section, I present the four steps by which the law currently governing this issue was crafted.

A. Overcoming the Doctrine of Illegality

The first case to consider the civil effects of the criminalization of usury was *Mira Design Co Ltd v Seascape Holdings Ltd* (1982).[36] A person who sold their interest in some property to another, subject to a complex payment scheme secured by a mortgage, sued to have the mortgage enforced when the buyer failed to pay the balance of the purchase price.[37] The buyer claimed that the payment scheme gave the seller an illegal rate of interest on the credit extended and that the contract should be voided *in toto*.[38] The seller did not deny that the rate of interest was criminal, but claimed that the criminal usury provision was "not meant to apply to commercial transactions between experienced business persons" and that the agreement should be enforced in full.[39]

To solve the matter, Justice Huddart analogized from cases of contracts against public policy and contracts violating regulatory statutes.[40] Courts

34 1883 CanLII 52 at 613 (SCC). Courts also quote Ritchie CJ ("[i]t would be a curious state of the law if after the [l]egislature had prohibited a transaction, parties could enter into it, and, in defiance of the law, compel courts to enforce and give effect to their illegal transactions" at 610).

35 *Transport North American Express Inc v New Solutions Financial Corp*, 2004 SCC 7 at para 40, Arbour J [*New Solutions*].

36 1982 CanLII 569 (BCSC) [*Mira*].

37 *Mira Design Co Ltd v Seascape Holdings Ltd*, 1981 CanLII 721 (BCSC) [*Mira* 1981].

38 *Mira*, *supra* note 36 at para 15.

39 *Mira* 1981, *supra* note 37 at para 9.

40 This test is applied to determine if the contracts done by people who did not hold appropriate licences (to act as an electrician or real estate agent, for instance) or violated professional rules of conduct (prohibiting securities salespeople from calling residences and trading in securities there, or requiring that a Commission's approval be obtained, for instance) should nonetheless be enforced (see Fridman, *supra* note 33 at 343–45).

had begun to relax their stance in the latter cases, considering the rise in the number of statutes. Doctrinal authors attribute this development to a 1956 English case in which the Queen's Bench refused to declare void a contract to transport cargo by boat simply because the boat was overloaded, as was prohibited by regulation.[41] The earliest Canadian case to follow this new approach was decided in 1997: in *Royal Bank of Canada v Grobman*, an "enlightened modern view" of the doctrine was put forward to determine that "[a] mortgage taken by a bank as collateral security which exceeds the loan to value ratio established by…the *Bank Act*…should not be unenforceable on the grounds of illegality."[42]

To draw an analogy between those cases and the one at hand, Justice Huddart downplayed the criminal nature of the act of agreeing to receive more than 60% annual interest on a loan. Justice Huddart claimed that severance should be used to allow the contract to stand "unless there is an intention to break the law" or the contract has an "illegal purpose."[43] Here, the point of the agreement was for the vendors to profit from the value of their property and for the buyers to own and develop it.[44] The interest was not "substantially the whole or main consideration for the promise now sought to be enforced"; rather, the mortgage was.[45] Justice Huddart also observed that the provision was designed to protect borrowers, but not "to prevent persons from entering into lending transactions per se."[46] Justice Huddart thus severed the obligation to pay interest in the form of interest and a substantial bonus, upholding the buyer's obligation to repay the seller and the seller's security.[47]

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41 *St John Shipping Corp v Joseph Rank Ltd*, (1956) 3 All ER 683, (1956) 3 WLR 870 [*St John*], cited in McCamus, *The Law of Contracts*, *supra* note 33 at 490–91.

42 1977 CanLII 1113 at 2, 24 (ONSC) [*Grobman*]. He relied on the comments made by Laskin JA (as he then was) in *Sidmay Ltd et al v Wehttam Investments Ltd*, which is why some deem the latter to be the first case (see *Sidmay Ltd et al v Wehttam Investments Ltd*, 1967 CanLII 24 (ONCA); see also *Still v MNR*, 1997 CanLII 6379 (FCA)).

43 *Mira*, *supra* note 36 at paras 20, 31.

44 *Mira* 1981, *supra* note 37 at para 14.

45 *Mira*, *supra* note 36 at para 27.

46 *Ibid* at para 25. Justice Huddart also writes that "to find that s. 305.1 necessarily prohibits the entering into of agreements or arrangements to receive interest at a criminal rate would be to accomplish that which Parliament has chosen not to do" (*ibid*). This refers to the fact that while criminal law is of federal jurisdiction, contract law is of provincial jurisdiction (see *ibid* at para 31).

47 *Ibid* at paras 28–30.

Scholars commenting at the time saw this as an unprecedented innovation.[48] While this reasoning might convincingly explain why an unlicensed electrician should nonetheless be paid for their work, this does not explain how a provision criminalizing the very act of entering into an agreement to receive interest at a criminal rate might in fact allow such agreements to be made. Yet the next civil case discussing the provision, *Croll v Kelly* (1983),[49] confirmed the plausibility of this framing. The case concerned a loan made purely as an investment, to recoup a high return in the form of criminally high interest, which was deemed "fundamentally illegal" and unenforceable.[50] While the facts of the case suggest the lender was far from a loan shark,[51] the case came to represent the "fundamentally criminal" agreement, created only for the purpose of obtaining a high rate of return on investment, which was to be distinguished from other legitimate commercial loans.

The next relevant step in the development of the law is the 1989 Ontario Court of Appeal case, *William E Thomson Associates Inc v Carpenter*,[52] which provided the test for severance that is still applied in civil cases involving section 347 today. Like Justice Huddart, Justice Blair applied the law

48 Mary Anne Waldron, "White Collar Usury: Another Look at the Conventional Wisdom" (1994) 73:1 Can Bar Rev 1 at 16–17 ("[d]espite a substantial body of law holding that a court will not enforce any part of an illegal contract, Huddart J., considering the first case of an illegal commercial loan in the courts, decided to sever a portion of the contract and enforce the remainder"). Professor Ziegel claimed that severance was not available in cases of statutory illegality; he later published an addendum to explain that a recent Privy Council decision confirming severance is available in such cases was brought to his attention after his comment was prepared, but this case was not relied on by Justice Huddart (see Jacob S Ziegel, "The Usury Provisions in the Criminal Code: The Chickens Come Home to Roost" (1985-1986) 11:2 Can Bus LJ 233 at 241 [Ziegel, "Usury Provisions in the Criminal Code"]. Still, today, some casebooks state that "[a]n agreement to do anything which is criminal or tortious is illegal and cannot be enforced by the courts" (see Fridman, *supra* note 33 at 364). Fridman simply includes a footnote mentioning that *Mira* stands for the fact that contracts to do a criminal act might be enforced (see *ibid*).

49 1983 CanLII 583 (BCSC) [*Croll*].

50 *Ibid* at para 16.

51 Mr. Croll lent $30,000 to a friend, Mr. Kelly, to invest on his behalf because Mr. Kelly "had made some money in the past" (*ibid* at para 2). Not long after that, Mr. Kelly contacted Mr. Croll to let him know that he needed to quickly provide him with another $20,000, otherwise the "funds already advanced on a project would be forfeited" (*ibid* at para 9). The loans were to be secured; however, Mr. Croll's lawyer, who was a friend of Mr. Kelly who seemed involved in his investment schemes, misrepresented the quality of the first security and failed to perfect the second: he was deemed liable for Mr. Croll's loss after Mr. Kelly became impecunious (see *ibid*).

52 1989 CanLII 185 (ONCA) [*Carpenter*].

relating to statutory illegality.[53] "The important question," Justice Blair explained, "is whether public policy prevents the severance of the agreement because it is tainted by illegality."[54] Both *Mira* and *Croll* were properly decided, Justice Blair claimed: the variation in results could be explained by the new approach to illegality developed in *Grobman*, which required assessing whether a contract should be invalidated on a case-by-case basis.[55] Justice Blair suggested that four factors would allow courts to determine whether a contract was so tainted by illegality that it should be declared unenforceable, or whether severance would be allowed.[56]

The first consideration was whether "the purpose and policy" of the criminal prohibition would be subverted by severance.[57] In the case at hand, Justice Blair reasoned that "[t]he enforcement of the valid part of the loan agreement does not absolve the respondent company from criminal responsibility under s. 347."[58] As noted by Professor Mary Anne Waldron at the time, "[i]n most civil cases, this criterion will be met."[59] Justice Blair's fourth criterion is also a given in most civil cases: it is whether one party would be unjustly enriched if the contract was held to be unenforceable.[60] Though Justice Blair is careful to restrict the analysis to the facts of the case, it seems that this criterion would almost always "militate against avoidance of the agreement to repay the principal and the guarantors' obligation"[61] in cases where the sums have already been loaned.

The second and third criteria, then, were the ones that might prevent severance. The second criterion "is whether the parties entered into the agreement for an illegal purpose or with an evil intention."[62] The loan that gave rise to the action in *Carpenter* was made as a last resort to a financially struggling company, to keep it afloat until conventional funding could be

53 *Ibid* at 10 ("that the prohibition of excessive interest is, unlike many provisions of the Criminal Code, one that can be infringed accidentally, and without evil intent"). See also *St John*, *supra* note 41.

54 *Carpenter*, *supra* note 52 at 10.

55 *Ibid* at 9.

56 *Ibid* at 9–11.

57 *Ibid* at 10.

58 *Ibid*.

59 Waldron, *supra* note 48 at 17.

60 *Carpenter*, *supra* note 52 at 11. Not having to repay the principal would certainly enrich the borrower; the question that must then be answered is whether this enrichment is unjust, and this assessment will depend on the other criteria.

61 *Ibid*.

62 *Ibid* at 10.

obtained.[63] It was thus distinguished from *Croll* and presented as analogous to *Mira*, even though the transaction was also a simple loan.[64] The third criterion "is the relative bargaining position of the parties and their conduct in reaching the agreement."[65] With this criterion, situations where desperate borrowers accept the terms of sophisticated lenders are distinguished from those where parties of equal bargaining power negotiate terms, perhaps after having obtained independent legal advice. Having applied these four criteria, Justice Blair ordered the severance of all provisions relating to interest but enforced the guarantees—the same remedy as the one ordered by Justice Huddart.[66]

Thus, the blanket rule against enforceability of contracts prohibited by the criminal law was all but eliminated for cases involving section 347. Severance was made contingent on satisfying a test that would militate in favour of severing the obligation to repay interest in cases of loans made by sophisticated parties in the context of a legitimate commercial endeavour. Conversely, contracts would be voided if they were either "fundamentally illegal" or made by unsophisticated parties.

B. Turning to a Logic of Supervision

The next jurisprudential step did not introduce any doctrinal innovation. Rather, it took the form of a willingness by courts to allow lenders to obtain some interest on the money lent. This new willingness came with a rationale justifying it: a vision of the role civil courts should play when they encounter the criminal agreements that they decided should not necessarily be voided.

Pacific National Developments Ltd v Standard Trust Co (1991), decided once again by Justice Huddart of the British Columbia Supreme Court, appears to be the earliest case to have allowed the lender to recoup interest.[67] Justice Huddart justified the decision in light of the four *Carpenter* criteria, essentially repurposing them: the criteria created to help courts decide whether an agreement should be voided were now used to decide whether some provisions relating to interest should be allowed to stand.[68]

63 *Ibid* at 2–3.
64 *Ibid* at 10.
65 *Ibid*.
66 *Ibid* at 11.
67 1991 CanLII 1644 at 14–15 (BCSC) [*Pacific National*].
68 *Ibid* at 11–13.

When applying the first criterion, the purpose and policy of the prohibition, Justice Huddart noted that the loan was "a commercial transaction between experienced business people who are bargaining the allocation of risks and the sharing of potential benefits arising from their mutual input to a large commercial enterprise," essentially repeating the third factor under the guise of the first.[69] When assessing whether the loan was done with an illegal or evil intent, Justice Huddart wrote that "the rate was a realistic estimate of the risks involved, including those inherent in the speed with which the loan had to be completed."[70] Justice Huddart also noted the presence of a severance clause.[71] Ultimately, Justice Huddart decided to enforce the obligation to repay the money lent plus agreed upon interest of about 16%, severing the obligation to pay a substantial bonus.[72]

The first Court of Appeal case to follow this approach is *677950 Ontario Ltd v Artell Developments Ltd* (1992).[73] The facts were similar to those of *Pacific National*: the borrower agreed to repay a loan at a rate of interest that was not criminal and to grant the lender a substantial bonus which was to be treated as interest under section 347.[74] Justice Blair, writing again for the majority, however, had little to say to justify the decision. Like the Superior Court judge on summary motion whose decision was appealed, Justice Blair simply ordered the borrower to repay the loan plus interest, but not the bonus.[75]

The British Columbia case, *Terracan Capital Corp v Pine Projects Ltd* (1992), was the next case concerned with a bespoke commercial loan with a variety of fees and interest rates that together brought the cost of the loan above 60% per annum.[76] Justice Spencer applied the *Carpenter* factors and concluded public policy did not prevent severance.[77] However, despite having been made aware of the recent decision in *Pacific National*, Justice Spencer did "not think the court should become involved in choos-

69 *Ibid* at 11.

70 *Ibid* at 12.

71 *Ibid* at 13.

72 The interest was to be set at prime + 2% (*ibid* at 14). However, the prime rate in 1990, when the contract was concluded, was 14% (see Statistics Canada, *supra* note 29).

73 1992 CanLII 8646 (ONCA) [1992 *Artell*], aff'd in *Artell Developments Ltd v 677950 Ontario Ltd*, 1993 CanLII 94 (SCC).

74 1992 *Artell*, *supra* note 73 at paras 3–5.

75 *Ibid* at para 31. The agreed upon interest was "the prime lending rate of the Canadian Imperial Bank of Commerce plus 5%" (see *ibid* at para 5). This represented approximately 15.5% in 1986 when the contract was concluded (see Statistics Canada, *supra* note 29).

76 1991 CanLII 11794 at para 2 (BCSC).

77 *Ibid* at paras 18–19.

ing which of the several clauses which provide for a return on the amount lent should be invalidated and which should be preserved. It is not for the court to re-calculate an acceptable commercial return by choosing from the interest, fees and bonus terms, any combination that will fit within 60 per cent."[78] In 1993, the Court of Appeal rejected the lender's contention that the Justice Spencer erred in refusing to pick a provision for interest to enforce.[79] Justice Prowse, for a unanimous court, explained: "[i]n my view, the courts should not be too quick to rewrite agreements by picking and choosing from alternative provisions which would result in a legal rate of interest. Otherwise, there will be little incentive for lenders to ensure that their agreements provide for interest at legal rates."[80]

The first Court of Appeal case to explicitly confirm that the *Carpenter* factors could justify severing only some interest provisions and not others was *Milani v Banks* (1997).[81] The trial judge in this case had followed the previous trend of severing all provisions for interest.[82] Justice McKinlay, however, accepted the lender's contention that he should have excised only the borrower's obligation to pay a $3,000 fee, and not their obligation to repay interest at the rate of 18%.[83] Justice McKinlay reasoned that this result was "a fair one in the circumstances," in light of a number of factors.[84] Some echo *Carpenter*: the parties did not interact directly but through their accountant, and did not intend to enter into an illegal transaction.[85] Some of the factors rather resemble those offered in *Pacific National*: the borrowers needed rapid access to funds, "[t]he risks inherent in advancing funds on a one-month mortgage are obvious," and the rate of 18% was "not excessive" in 1990.[86]

Thus, in both *Milani* and *Pacific National*, judges considered the way in which the market might price money, assessing whether certain rates might be "realistic" or "fair"—exactly what the judges who decided both *Terracan* cases claimed should not be done. However, Justice McKinlay went even further when he reasoned that when Parliament decided that the consent of the Attorney General was required to initiate a prosecution under section 347, it had "undoubtedly intended to exclude from prosecution, and

78 *Ibid* at para 19.
79 *Terracan Capital Corp v Pine Projects Ltd*, 1993 CanLII 2655 at paras 49, 60 (BCCA) [*Terracan*].
80 *Ibid* at para 59.
81 1997 CanLII 1765 (ONCA) [*Milani*].
82 *Ibid* at 7.
83 *Ibid* at 8.
84 *Ibid*.
85 *Ibid*.
86 *Ibid*. 18% in 1990 was, in fact, prime + 4% (see Statistics Canada, *supra* note 29).

leave to the civil courts, cases which technically come within the provisions of s. 347, but which, looking at the facts as a whole, should not be subject to criminal sanctions."[87] This interpretation implies that contracts that have not given rise to prosecution under section 347 should be deemed not to have a criminal purpose—making the second *Carpenter* criteria into yet another argument for severance and now the upholding of some interest. It also suggests that the judiciary accepted that it is entirely free to determine what the civil consequences of this prohibition should be, and that agreements that violate this prohibition were meant to be monitored and modified by civil courts.

C. Developing the Doctrine of Notional Severance

At this point in the jurisprudential evolution, severance was only possible if the blue-pencil test allowed it, meaning, "if the judge can strike out, by drawing a line through, the portion of the contract they want to remove, leaving the portions that are not tainted by illegality, without affecting the meaning of the part remaining."[88] The test is known to produce haphazard results, making severance dependant on "mere accidents of drafting."[89] Borrowers in both *Milani* and *Pacific National* might have been freed of their obligation to repay interest if, for instance, the obligation had been expressed differently in the contract. By limiting the occasions where severance will be possible, this test incentivizes drafters not to include potentially illegal clauses in contracts.[90] In *New Solutions*, however, a majority of Supreme Court judges created a second method for severance, notional severance, which entails "reading down interest rate provisions" to bring them to a legal rate.[91] In effect, the borrower can be ordered to pay interest at a rate just shy of the legal limit, regardless of their original agreement with the lender.

The loan that gave rise to this judicial innovation was for $500,000, and the borrowers were asked to repay it along with five different fees that were all interest under section 347's definition.[92] One of the fees was named interest: it was fixed at 4% per month, "calculated daily and payable

87 *Milani*, *supra* note 81 at 7.

88 *New Solutions*, *supra* note 35 at para 57, Bastarache J (as he then was), dissenting.

89 *Transport North America Express Inc v New Solutions Financial Corp*, 2001 CanLII 28232 at para 39 (ONSC) [*New Solutions ONSC*].

90 Ziegel, "Usury Provisions in the Criminal Code", *supra* note 48 at 242.

91 *New Solutions*, *supra* note 35 at para 18.

92 *New Solutions ONSC*, *supra* note 89 at para 3.

monthly in arrears," which amounted to a 60.1% annual interest rate.[93] The four other fees together amounted to 30.8% when expressed as an annual interest rate.[94]

The doctrinal innovation itself is due to an Ontario Superior Court judge, "one not particularly noted for his iconoclastic tendencies."[95] Justice Cullity noted that *Milani* extended the possibilities afforded by severance by implying that "the nature of the illegality is not, in itself, sufficient to preclude the recovery of some interest."[96] While *Carpenter* stressed the importance of avoiding the unjust enrichment of a party, Justice Cullity found that *Milani* made "fairness between the parties" another relevant consideration.[97] Here, because the parties were experienced, had negotiated a business deal at arm's length with the assistance of solicitors, did not intend to breach section 347, and fully understood the terms of the agreement, severance should be allowed.[98] Considering the gist of the reasons, it appears Justice Cullity believed these facts also justified notional severance.[99] The borrowers were ordered to pay interest on the sums borrowed at the annual rate of 60%, the highest interest rate a party can charge without committing a criminal act.[100]

The Court of Appeal allowed the appeal. In addition to pointing out that the blue-pencil test was not, in fact, as mechanical as Justice Cullity made it out to be, Rosenberg J.A. stressed that his solution gave "virtually no weight to the policy behind the criminal prohibition" and that "it would be inconsistent with the aims of deterrence for the courts to make such a major innovation at the behest of those who *prima facie* stand in violation

93 *Ibid* at paras 3, 8.

94 *Ibid* at paras 36; *New Solutions*, *supra* note 35 at para 15.

95 Stephen Waddams & Jacob S Ziegel, "Notional Severance, Usurious Contracts, and Two Comments on the Supreme Court's Decision in the New Solutions Case" (2005) 42:2 Can Bus LJ 278 at 286.

96 *New Solutions ONSC*, supra note 89 at paras 31–32.

97 *Ibid* at para 33.

98 *Ibid* at paras 32–33.

99 The majority for the Court of Appeal also understood the reasons of Justice Cullity this way. They explain, "[t]he application judge was of the view that some of the same considerations that determine whether to enforce the agreement at all should also govern the extent to which the contract is enforced" (see *Transport North American Express Inc v New Solutions Financial Corp*, 2002 CanLII 41979 at para 26 (ONCA), Rosenberg JA [*New Solutions ONCA*]).

100 *New Solutions ONSC*, *supra* note 89 at para 46. In 2000, the year the contract was concluded, prime was at around 7.27%, meaning the rate imposed was of approximately prime +52.7% (see Statistics Canada, *supra* note 29). Note the shift from a judge determining that 18%, or prime +4%, is "not excessive," to a judge determining that 30.8%, or prime +23.5%, is too low to be commercially appropriate.

of the criminal law."[101] The Court of Appeal ordered that the borrower pay the fees equivalent to 30.8% interest on the loan, severing the obligation to repay 4% monthly, calculated daily, payable in arrears.[102]

Justice Sharpe dissented and repurposed the *Carpenter* criteria yet again to determine if notional severance was warranted. Justice Sharpe claimed that the issues the criteria were originally meant to resolve were now non-issues: "[a]t the very least, the appellant must repay the principal of the loan. Further, on the present state of the law, the appellant cannot avoid the payment of some interest. The question is how much interest the appellant should be required to pay."[103] Justice Sharpe concluded that the appellant should be required to pay 60% annual interest, and that allowing notional severance would be in line with the reasoning that was first justified in *Carpenter*, then *Milani* and *Artell*.[104] What Justice Cullity treated as a fifth consideration, "fairness between the parties,"[105] Justice Sharpe tied to the fourth *Carpenter* criterion: "unjust enrichment may also result where the debtor seeks to avoid payment of an appropriate rate of interest for the loan."[106] In this case, "[t]o secure the funds it required, the [borrower] needed to pay and agreed to pay a significant premium. It would unjustly enrich the [borrower] to reduce this premium considerably."[107]

The majority of the Supreme Court of Canada agreed with Justice Sharpe. Justice Arbour, writing for the majority, agreed that notional severance was warranted: "the appropriate approach is to vest the greatest possible amount of remedial discretion in judges in courts of first instance."[108] Justice Arbour also chose to use the *Carpenter* criteria to answer two different questions: whether partial enforcement was warranted, and whether the borrower should pay a 30.8% interest rate or a 60% interest rate.[109] Applying the first criterion, Justice Arbour noted that the purpose of section 347 was to prevent loan sharking and that it did nothing to deter interest rates

101 *New Solutions ONCA*, *supra* note 99 at paras 26, 29–31.

102 *Ibid* at paras 36–37.

103 *Ibid* at para 50, dissenting.

104 *Ibid* at paras 39, 41–42.

105 *New Solutions ONSC*, supra note 89 at para 28.

106 *New Solutions ONCA*, *supra* note 99 at para 41, dissenting.

107 *Ibid* at para 52, Sharpe JA, dissenting.

108 *New Solutions*, *supra* note 35 at para 40. Arbour J also stressed that there was little danger that notional severance would be abused, as "judges are apt to be quite suspicious, and rightly so, of credit arrangements which provide for effective annual rates of interest in excess of 60 percent per annum" (*ibid* at para 39).

109 *Ibid* at paras 42–43.

up to 60% per annum.[110] It was also noted that this was "a commercial transaction engaged in by experienced and independently advised commercial parties,"[111] following the now established tradition of relating every criterion to the third one. Second, Justice Arbour found that there was no illegal purpose or evil intent, as the lender had not been prosecuted and benefitted from the presumption of innocence.[112] The contract was for ordinary commercial purposes, made to a high-risk borrower needing large sums relative to its value on short notice.[113] Third, the relative position of the parties also militated in favour of a flexible remedy.[114] Fourth, Justice Arbour claimed that "any potential for an unjustified windfall in this case arises from [the borrower] possibly not having to repay the principal and interest, or from [the borrower] possibly not having to pay a commercially appropriate rate of interest on the loan."[115] As a result of this analysis, Justice Arbour ordered the borrower to pay 60% annual interest rate on the loan.[116]

There were two dissents. Justice Bastarache argued that notional severance should be rejected altogether.[117] One of the three reasons given to justify this decision was that this new remedy would create uncertainty in the law, there being "no legal or other principled reason to limit the application of the new approach" to cases involving section 347.[118] Justice Fish, on the other hand, believed notional severance could be allowed "[i]n different circumstances" but should not apply in this case.[119] Justice Fish pointed out that the *Carpenter* criteria still needed to be applied to decide if severance, of any kind, was warranted—that could not simply be assumed.[120] Justice Fish also adapted the *Carpenter* criteria for their new

110 *Ibid* at para 43.

111 *Ibid*.

112 *Ibid* at para 44; Arbour J noted, as McKinlay JA had in *Milani*, that prosecution under section 347 required the consent of the Attorney General and claimed this meant "even a criminal remedy is not always appropriate for an infringement of s. 347, let alone a civil remedy seeking to promote the criminal law objective of deterrence" (*ibid*).

113 *Ibid*.

114 *Ibid* at para 45.

115 *Ibid* at para 46.

116 *Ibid* at para 47.

117 *Ibid* at para 50.

118 *Ibid* at para 59, Bastarache J, dissenting. The other two reasons were that this remedy is fundamentally different from striking out words from an agreement, and the new approach is "inconsistent with the general objectives expressed in the [*Criminal*] *Code*" (*ibid* at paras 52, 64).

119 *Ibid* at paras 80–81, dissenting.

120 *Ibid* at para 100, dissenting.

purpose, orienting judges in selecting an appropriate tool for severance. First, when considering "the purpose and policy" of section 347, judges should attend to classical judicial policy concerns: blue-pencil severance is generally favourable, as notional severance might "encourage lenders to run calculated risks."[121] Second, while the second criterion favoured the lenders, being allowed to receive 30.8% interest on the loan was sufficient to recognize the lack of illegal purpose or evil intent.[122] Third, Justice Fish disagreed that the lender and borrower had equal bargaining power, noting that the latter had no alternative source of financing, had agreed to a loan at many times the commercial rate, and had provided personal guarantees for the loan.[123] Finally, Justice Fish did not believe that requiring the borrower to repay the sum borrowed in full at 30.8% annual interest rate would result in unjust enrichment.[124]

D. Circumscribing the Remedial Discretion Vested in Judges

In a comment published shortly after the decision was rendered, Professor Stephen Waddams worried that *New Solutions* may be taken to mean that "a judge might select any interest rate between zero and 60% according to his or her view of the culpability of the lender."[125] This was a plausible interpretation of Justice Arbour's objective of "vest[ing] *the greatest possible amount* of remedial discretion in judges."[126] It was not the only interpretation, however. Contract cases involving section 347 decided following *New Solutions* made use of a variety of remedies.[127] Blue-pencil severance was still used to sever large bonuses.[128] Some judges imposed bespoke rates

121 Ziegel, "Usury Provisions in the Criminal Code", *supra* note 48 at 242.

122 *New Solutions*, *supra* note 35 at para 121.

123 *Ibid* at para 125.

124 *Ibid* at para 127.

125 Professor Waddams believed this would "make the rights of the parties to a civil dispute depend too much on considerations more appropriate to the criminal law" (see Waddams & Ziegel, *supra* note 95 at 281).

126 *New Solutions*, *supra* note 35 at para 40 [emphasis added].

127 I have only considered the cases that cite *New Solutions*, *supra* note 35.

128 A promise to pay $110,000 "as a condition of the approval of the transaction" by the lender was considered not to be interest because it was in fact never paid, but the judge pointed out that in the event this conclusion was mistaken, the obligation would be severed with the blue-pencil technique (see *Canada Trustco Mortgage Co v Regis and Velma Renard*, 2006 BCSC 1609 at paras 2, 206–07). In Alberta, in cases involving vulnerable consumers, blue-pencil severance was used in conjunction with the powers afforded by the *Unconscionable Transactions Act*, RSA 2000, c U-2 (see *Johnson v 957942 Alberta Ltd*, 2010 ABQB 662; see also *Lydian Properties Inc v Chambers*, 2009 ABCA 21).

of interest that were lower than 60%.[129] In at least two cases, the illegal interest rate was read down to 60%.[130] In the older of the two, *Wade v Daley*, Justice Gray explained that:

> [w]hat was sanctioned in the [*New Solutions*] case…was the reduction of the unlawful rate of interest to the maximum allowable under the Criminal Code, namely, 60% per annum. Whether or not the discretion of the Court can extend to requiring a reduction in the rate even further is something I need not consider in this case. I simply observe that if such an approach is permissible, it would authorize an even greater amount of judicial rewriting of a contract than appears to be sanctioned in [*New Solutions*].[131]

Then, in 2018, Justice Fitzpatrick at the British Columbia Supreme Court interpreted clearly and unambiguously *New Solutions* as granting the power to impose whichever interest rate she saw fit. In a complex foreclosure and receivership proceeding concerning parties involved in the construction of a large condo unit, some contracts were deemed to violate section 347 of the *Criminal Code*.[132] The parties suggested various solutions, from eliminating broker fees to reading down the rate of interest to 60%.[133] Justice Fitzpatrick wrote that *New Solutions* stood for the fact that courts have "considerable discretion is fashioning a remedy where a contract calls for a criminal interest rate" and that each *Carpenter* criterion is "relevant to the determination of the degree to which an otherwise illegal agreement will be *partially* enforced."[134] Justice Fitzpatrick eventually concluded that

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129 I have found two such cases, in addition to a small claims court case and *Forjay Management Ltd v 0981478 BC Ltd*, 2019 BCSC 238 [*Forjay BCSC*]. In *Whitrow v Hamilton*, 2010 SKCA 7, the court dealt with a loan of $5,000 at 10% annual interest rate that contained a $500 processing fee. While the trial judge severed the obligation to pay interest at 10%, keeping only the $500 fee, the Court of Appeal decided that in light of the duration of the loan, it would be best to sever the fee and uphold the obligation to repay interest. Only the order was made to repay 8%, not 10% (see *ibid* at para 20). In *Etemadi v Emami*, 2018 ONSC 4189, the amount owed as interest was $19,000, which represented a rate of 300% per year against the duration of the loan (see *ibid* at para 37). The judge decided to order the borrower to pay this sum plus pre-judgment interest at the statutory rate because this amounted to an "effective interest rate in the range of 10% annually over the time period" between the time the money was due and the trial (see *ibid* at para 30).

130 *Wade v Daley*, 2008 CanLII 59563 at paras 60–62 (ONSC) [*Wade*]; *Chong v* Abrahams, 2017 ONSC 3663 at paras 67–75.

131 *Wade*, *supra* note 130 at para 61. Gray J also attributes this position to *Eha v Genge*, 2007 BCCA 258.

132 *Forjay BCSC*, *supra* note 129 at paras 1, 163–236.

133 *Ibid* at para 237.

134 *Ibid* at paras 238, 241.

the proper remedy was to read down a lender fee to half its amount and modify the stipulated interest to 18% per annum, subject to an overriding limit of 40% per annum.[135]

The British Columbia Court of Appeal allowed the appeal: it confirmed that it is "not open to [judges] on the governing jurisprudence" to impose any rate of interest they deem fit, citing Waddams' case comment.[136] As Waddams explained, the court was neither "granting a remedy to the borrower for the lender's wrong" nor "granting a remedy to the lender for any wrong of the borrower's," but answering the question, "[t]o what extent does public policy prevent enforcement of this contract?"[137] As a result, *New Solutions* was deemed to have created a specific third remedy in addition to voiding a contract in full and using blue-pencil severance: reading-down of the rate of interest to exactly 60% per annum, no more, no less.[138] The Supreme Court denied leave to appeal.[139]

Professor Waddams' intervention reframed the issue as a matter of criminal law and public policy. It stressed that, following the logic of illegality, courts were not providing remedies to aggrieved parties, but refusing to enforce certain parts of their contract.[140] Yet, it came after nearly two decades of jurisprudence which minimized the criminal aspects of the prohibition and rather emphasized the degree of sophistication of parties and the commercial reasonableness of the terms of their loans. While at the beginning of this jurisprudential evolution the "fundamentally illegal" contract played the role of the bogeyman, it quickly disappeared from the analysis. By the time *New Solutions* had reached the Ontario Court of Appeal, *Croll* was no longer discussed: the majority supported its claim that voiding a contract *in toto* was "justified in some cases by the need to denounce such usurious practices" by pointing to a case involving a pawnbroker, that is, a lender who deals only with unsophisticated, at times desperate, parties.[141] The fact that the contract in *New Solutions* had been concluded in violation

135 *Ibid* at para 256. The overriding limit was added because Fitzpatrick J did "not have the benefit of a calculation of the resulting effective rate" at the time (*ibid*).

136 *Forjay Management Ltd v 625536 BC Ltd*, 2020 BCCA 70 at para 58 [*Forjay BCCA*]. The appeal was brought by a party to the receivership proceeding, but not to the loan contract, who argued that this disposition was prejudicial to its own interests in the proceeding (*ibid* at para 48).

137 Waddams & Ziegel, *supra* note 95 at 281.

138 *Forjay BCCA*, *supra* note 136 at para 52.

139 *Forjay BCCA*, *supra* note 136, leave to appeal to SCC refused, 39164 (1 October 2020).

140 Waddams & Ziegel, *supra* note 95 at 281.

141 *CAPS International Inc v Kotello*, 2002 MBQB 142, cited in *New Solutions ONCA*, *supra* note 99 at para 33.

of the *Criminal Code* was stressed by the Supreme Court of Canada's dissents, but downplayed by the majority.

Another legal development might also have motivated this restrictive interpretation: in 2009, five years after *New Solutions* but 11 years before *Forjay*, in a case concerning a covenant in restraint of trade, the Supreme Court restricted notional severance to cases involving section 347.[142] *Shafron* explained that notional severance could be used in these cases because the *Criminal Code* provides a bright line rule, while non-compete clauses are evaluated on a case-by-case basis for their reasonableness.[143] The Supreme Court's distinction only made sense if notional severance was used to bring interest rates just below that bright line, and not to impose any commercially reasonable rate below that line.

IV. PRIVATE LAW'S RELATIONSHIP WITH THE PUBLIC

The changes described above were motivated implicitly and explicitly by the belief that sophisticated parties should be free to contract as they wish. Of course, in these conditions, freedom of contract could not take on its usual sense: Parliament's choice to criminalize the creation of certain agreements made it impossible for common law courts to enforce the deal that parties negotiated freely. Yet, rather than claim that they could not make decisions regarding the terms of the contract *in lieu* of the parties, common law courts chose instead to enforce modified contracts that they claimed were fair, and quickly gave themselves the right to modify contracts with much more freedom than usual. Only, rather than acting on the implied claim that they are capable of determining what counts as a fair rate of return on risk on commercial loans, courts eventually limited their own remedial powers.

In this section, I argue that this leaves the law in an unsatisfactory state. I do so by comparing the state of the law in the common law provinces with the solutions devised by Québec courts. I show that Québec's solutions are more respectful of Parliament's intent and thus more coherent. I also suggest that this coherence stems from the civil law's recognition that its limits are tributary not only of private law's own logic, but also external influences like social norms and public law.

142 *Shafron v KRG Insurance Brokers (Western) Inc*, 2009 SCC 6 at para 31 [*Shafron*].
143 *Ibid* at paras 37–39.

A. Québec Civil Law's Solutions

The early Québec cases show that civil courts, like their common law counterparts, were uncertain about how to react to the prohibition of usury. In 1997, a Court of Québec judge seized with a demand to enforce a contract that ran afoul of section 347 reviewed jurisprudence from the 1920s, which affirmed that contracts made in violation of the criminal law would not be enforced by civil courts and that the sum lent could not be recovered.[144] Justice Chicoine nonetheless decided to rely on the Supreme Court of Canada's recent confirmation of the Ontario Court of Appeal's decision in *Artell* and enforced the loan contract, severing all but the obligation to repay the lent capital and "normal or usual" interest.[145] This approach was followed again in 2000, with the judge deciding that normal interest would be 25% per annum.[146]

However, in 2006, the Court of Appeal in *2960-7835 Québec inc c Saratoga Multimédia inc* explained that the proper approach was to apply the *Civil Code of Québec* (the *Civil Code*).[147] The two relevant sections state that "[a] contract is absolutely null where the condition of formation sanctioned by its nullity is necessary for the protection of the general interest" and that "[a] contract that is null is deemed never to have existed. In such a case, each party is bound to restore to the other the prestations he has received."[148] The Court believed these articles should be applied even though the loan was made by one company to another in a commercial context, and concluded that the contract was null and restitution should be ordered.[149] A recent review of the literature by Professor Frédéric Levesque confirms this solution has been popular: four Superior Court cases have followed this approach between 2010 and 2019.[150] In 2019, the Court of Appeal rejected a lender's leave to appeal for one of these decisions because the appeal had no reasonable chance of success.[151]

Another string of cases has applied article 2332 of the *Civil Code*, a reworked adaptation of the *Unconscionable Transaction Relief Act* which

144 *Distribution Minute Gourmet inc c 3109348 Canada inc*, 1997 CanLII 6691 at para 14 (QCCQ).

145 *Ibid* at paras 22–24.

146 *9026-2064 Québec inc c Morin*, 2000 CanLII 29660 (QCCQ).

147 2006 QCCA 447 at para 10.

148 *Ibid*, arts 1417, 1422 CCQ, although the court mistakenly cites art 1817 instead of 1417.

149 For the facts of the case, see *Saratoga Multimédia inc c 2960-7835 Québec inc*, 2003 CanLII 3061 (QCCQ).

150 Frédéric Levesque, "La sanction par le juge des taux d'intérêt criminels et lésionnaires : réflexion sous forme de lignes directrices" (2020) 122:3 R du N 475 at 494.

151 *Capital Transit inc c Hébert*, 2019 QCCA 192; *Hébert c Capital Transit inc*, 2020 QCCA 926.

allows courts to reopen loan contracts.[152] Some of these cite *New Solutions*, although it is, as both Professor Levesque and an oft-cited Superior Court of Québec decision point out, a common law decision.[153] Some have freed borrowers of the obligation to repay any interest,[154] while others have crafted a new interest rate by keeping some contractual clauses and rejecting others,[155] or imposed new, bespoke rates by considering prevalent interest rates at the time the contract was concluded.[156] The borrowers in the most recent of these cases have applied for leave to appeal the decision, but the Court of Appeal denied leave to uphold the principle of proportionality.[157]

Finally, there were some rare cases where the solution was akin to severance, but these were cases where whole documents or sections could be removed from the contract.[158] In one case, a loan contract was modified twice, with the second modification bringing the interest rate above 60% per annum: the Court of Appeal judged that the original contract, once

152 Article 2332 CCQ states: "[i]n the case of a loan of a sum of money, the court may pronounce the nullity of the contract, order the reduction of the obligations arising from the contract or revise the terms and conditions of the performance of the obligations to the extent that it finds that, having regard to the risk and to all the circumstances, one of the parties has suffered lesion." Lesion is defined at article 1406: "[l]esion results from the exploitation of one of the parties by the other, which creates a serious disproportion between the prestations of the parties; the fact that there is a serious disproportion creates a presumption of exploitation." Article 2332 CCQ is an adapted version of art 1040(c) CCLC, part of a new section of the Code, "De l'équité dans certains contrats," created in the early 1960s and inspired by Ontario's recent adoption of the *Unconscionable Transactions Relief Act*, RSO 1990, c U.2. See Levesque, *supra* note 150 at 488. The strand is discussed by Levesque (*ibid* at 495).

153 *Ibid* at 495; *Pépin c B2B Alliance inc*, 2016 QCCS 852 at para 21.

154 *9025-0366 Québec inc c Laniel*, 2008 QCCS 5739.

155 *Capital Transit inc c Gendron*, 2016 QCCQ 13084.

156 *2529-8738 Québec inc c 9005-3224 Québec inc*, 2007 QCCS 1052.

157 Québec's *Code of Civil Procedure* requires of parties that they "ensure that any steps they take are proportionate, in terms of the cost and time involved, to the nature and complexity of the dispute" and "observe the principle of proportionality" (arts 2, 18). Article 18 CCP also states:"[j]udges must likewise observe the principle of proportionality in managing the proceedings they are assigned, regardless of the stage at which they intervene. They must ensure that the measures and acts they order or authorize are in keeping with the same principle, while having regard to the proper administration of justice." The Court of Appeal pointed out that an appeal would only at best free the appellant from the obligation to pay $5,296.70, representing 22.90% interest on a loan of $16,967.51. See *Gendron c Capital Transit inc*, 2016 QCCA 2004 at para 6.

158 I claim it is rare because I have seen it less, and because Frédéric Levesque does not even mention it in his study of Québec courts' treatment of the provisions. See Levesque, *supra* note 150.

modified, should be enforced.[159] In another, a loan contract was the accessory to a sales contract.[160]

The first and third solution, voiding the contract or severing parts of it, were available to common law courts and compatible with the classical doctrine of illegality and severance. The civil law courts' willingness to void contracts and use severance sparingly shows that these were acceptable options in modern Canada. While the automatic nature of restitution in the civil law might have helped smooth the consequences of the decision to void, the fear that the lender might not have recovered the sums lent if they applied for restitution can only have motivated the use of blue-pencil severance, not the development of notional severance.

The second means of dealing with section 347 was to read it in conjunction with protection rules analogous to unconscionability. This approach treated the criminalization of a particular interest rate as a sign that the rate was unconscionable.[161] Yet only one of the common law cases discussed above considered unconscionability: the first instance judge in *Milani* used the Ontarian *Unconscionable Transaction Relief Act* to set aside the security granted to the lender, an order which the Court of Appeal reversed.[162] Although it was suggested by Professor Waddams that cases like *Carpenter* are best thought of as cases of unconscionability,[163] the doctrine does not fit well with the analysis that brought about notional severance. Justice Fish in *New Solutions* noted that the willingness to accept very high rates of interest because one is in urgent need of funding and has no alternatives betrays a lack of bargaining power.[164] The Supreme Court majority however seems to have read the same facts as a lender might: as a sign that this is a high-risk loan, which warrants a high rate of interest.[165]

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159 *First Québec Holdings inc c Développements Grand Ouest inc*, 2023 QCCA 583 (this was presented as a form of severance because the trial judge had considered all three documents to form an indivisible contract, while the Court of Appeal disagreed).

160 *Matériaux 3+2 ltée c Jo Giguère Construction inc*, 2016 QCCQ 5698.

161 As Levesque points out, it is also a mistake in law: a contract that is void because of illegality should not be recognized by courts. It simply cannot be enforced, even if it is read down in favour of the party who most benefits from the contract being voided (Levesque, *supra* note 150 at 496).

162 *Milani*, *supra* note 81 (the statutes were used in cases involving unsophisticated parties, however).

163 Stephen M Waddams, *The Law of Contracts*, 7th ed (Canada: Thomson Reuters, 2017) at para 576.

164 *New Solutions*, *supra* note 35 at para 125.

165 *Ibid* at para 44.

Crucially, Québec courts who rewrote contracts did so by pleading the borrower's exploitation, relying on the notion that a 60% annual interest rate was too high.[166] Almost certainly for this reason, they either stuck to the agreement or considered lower market rates; they did not innovate to allow lenders to recoup maximum interest.[167] While the common law courts modified the obligations of parties, they did not do so with an eye to ending exploitation, but by pleading the commercial reasonableness of a 60% annual interest rate. Judges spared no doctrinal innovation, not to protect the weaker party, but to ensure that contracts be upheld, and lenders compensated. They reworked the law to allow lenders to recoup as much as they technically could.

The difference between the civil law and the common law's responses to section 347 lies not in the legal mechanisms at their disposal, but in their deference to Parliament's choice to criminalize the lending of money at more than 60% per annum. Moreover, deference likely seemed to be the better choice for Québec judges because civil law recognizes the proximity of public and private.[168] The doctrines used to dispose of the cases described in this section fall under the umbrella of *l'ordre public*, or "public order," a private law category that encompasses all limits to freedom of contract meant to protect legal institutions, public morals, and at times, the legislators' choice to regulate economic exchange.[169] This acknowledgement of the existence of public intrusions in private law is a recognition that private law's connection with other legal institutions and social norms has meaningful consequences—a clear recognition which is also likely attributable to the fact that Québec has more laws, and generally more stringent laws, to protect weaker classes, like consumers, tenants, and workers. Public order is not an afterthought, but a foundational feature; it is mentioned in the first section, Enjoyment and Exercise of Civil Rights, of book one, Persons, of the *Civil Code*.[170] Since private law is intermeshed

166 *Supra* notes 152–56.

167 *Ibid*.

168 This may be true of all civil law systems. This analysis is inspired by Giuseppe Bellantuono's work comparing American and European perceptions of the relationship between private law and the state (see Giuseppe Bellantuono, "Contract Law and Regulation" in John O Haley, ed, *Comparative Contract Law* (Northampton, MA: Edward Elgar Publishing, 2017) 111 at 119–20.

169 See e.g. Pierre-Gabriel Jobin & Nathalie Vézina, *Les obligations*, 7th ed (Cowansville, QC : Éditions Yvon Blais, 2013) at paras 105–08.

170 See especially arts 8–9 CCQ ("[a] person may only renounce the exercise of his civil rights to the extent consistent with public order" and "[i]n the exercise of civil rights,

with public concerns, judges expect points of friction and attempt to minimize them.

In this case, this meant deferring to Parliament's choice and integrating it into private law. Québec courts accepted that other legal institutions, even those concerned with public welfare, might place limits on private law: they deferred to Parliament and either voided usurious contracts or relied on a form of severance more deferential than the blue-pencil kind. A third approach treated Parliament's choice to criminalize a given interest rate as a strong indicator that these contracts were unconscionable. This allowed courts to use the special, explicit powers granted to them to protect weaker parties by modifying their agreements, if needed. It also recognized that section 347 was criminal law, and not just any form of regulation, and that the party that was a victim of its transgression was likely exploited in some way. While common law courts minimized this fact, this approach gave it much weight. While it was less deferential to Parliament as a distinct source of positive law,[171] the third approach recognized the gist of Parliament's position and treated the belief that lending money at a high interest rate is condemnable, as an important social norm.

B. The Common Law's Strange In-Between

In contrast, the common law approach is more difficult to justify. It has the advantage of voiding contracts for unsophisticated parties;[172] however, the choice to create a new tool of severance to then claim that it is only justified by the existence of a bright line rule is questionable.

First, I suggest that the fact that the new prohibition was criminal in nature meant that the "bright line" of 60% annual interest rate is not as bright as it is claimed to be. Asking for less is not worthy of criminal sanction, but by choosing to give unexpected civil consequences to this provision of the *Criminal Code*, courts could and should have treated it as carrying a new norm of commercial morality, a stand against very high rates. Reducing notional severance to a tool to bring the interest rate of a loan up to exactly 60% per annum treats the criminal prohibition like an invitation to charge

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derogations may be made from those rules of this Code which supplement intention, but not from those of public order").

171 This would have required voiding contracts that violated criminal law.

172 While it is highly coherent, the choice to treat section 347 as a sign that contracts that violate it are unconscionable leads to less protection for unsophisticated parties and is a mistake in law (see *supra* note 161).

exactly 60%. While many parties to a contract might choose to respond to the prohibition by acting in this way, there is little reason for judges to help them do so when they instead violated the *Criminal Code*.

Second, it would seem that the reason why judges might help lenders who have *prima facie* violated the *Criminal Code* to obtain as much interest as they can on their loans is because this frees judges from the task of finding an appropriate rate. Yet, because notional severance is tied to the *Carpenter* criteria and this line of jurisprudence, judges must still pick and choose between notional severance and any possibility afforded by blue-pencil severance by considering the position of the parties and the possibility that one be unjustly enriched. The restrictive interpretation of *Forjay* means that Justice Arbour was not claiming 60% was the commercially appropriate rate of interest, but a more commercially appropriate rate of interest than 30.8%. Justice Fish, under this reading, claimed the opposite. It remains the case, however, that judges are relying on a sense of what is fair in the context, based on their sense of the realities of high-risk lending.

Finally, judges have the option of imposing a rate of 60% per year because they ignored the blue-pencil rule which they now claim limits their options. Courts chose to mix oil and water enough to extend the freedom of contract of sophisticated parties who violated the provision; however, they did not wish to mix it enough to properly integrate 60% as the high point of allowable interest rate. The latter solution would have offered a meaningful articulation of the relationship between private law and this rule of public law. The obligation to repay interest at exactly 60% per year is only justifiable as a compromise between two very different understandings of the appropriate way to respond to a lender asking for more than 60% annual interest rate on a loan: the one put forward by Parliament and the one put forward by common law judges.

V. CONCLUSION

The view that private law and legislation are like oil and water implies that, when threatened, private law will simply retreat without allowing itself to be tainted by the public concerns carried by legislation. Yet, judges' reactions to cases involving contracts concluded in violation of section 347 show that they preferred to participate in determining the limits of private law, even if it meant blurring those limits. John D. McCamus wrote that, in the end, the provision had proven to be "a powerful, if unintended,

instrument of consumer protection."[173] Indeed, at about the time notional severance was being developed, the first of many class actions against payday lenders based on section 347 were initiated, making lawmakers fear that the industry would be virtually eliminated.[174] However, McCamus' reading fails to highlight that the provision was made into such an instrument, through rather unpredictable changes to the common law. Judges transformed section 347 into a form of consumer protection for unsophisticated parties, although there was nothing in the wording of the section that suggested it should be given that effect. They mixed oil and water, using the common law to modulate the effects of a criminal prohibition addressing public concerns, refining its consequences by accounting for the particularities of different parties and contracts.[175] They reacted to regulation, not by carefully avoiding being tainted by it, but by attempting to make it better.[176]

I suggest such mixing was possible because private law and legislation are not like oil and water, and will not naturally stay apart. While it may be advisable to keep them separate in some cases, their separation is not inevitable. First, it matters that private law is upheld by a public institution, that "[a] plaintiff has a claim against the state to its assistance in changing the legal relations of the defendant" rather than a direct recourse against the defendant, as Benjamin Zipursky explains.[177] As a result, courts will at

173 John D McCamus, "Liquidated Damages and the Criminal Rate of Interest: More Unintended Consequences of Section 347" (2010) 25:2 BFLR 229 at 231.

174 The first class action against payday lenders was started in British Columbia in 2003 (see Iain Ramsay, "Of Payday Loans and Usury: Further Thoughts" (2003) 38:3 Can Bus LJ 386). To protect the payday loan industry, Parliament created section 347.1 of the *Criminal Code* in 2007. It allows payday lenders to charge more than 60% annual interest on their loans so long as they comply with provincial legislation. Most provinces cap the price of such loans (see Micheline A Gleixner, "Consumer Credit in Canada: A Regulatory Patchwork" (2020) 43:2 Dal LJ 697 at 740ff).

175 As I explain above, I find the view that these judicial changes were meant to bring section 347 in line with unconscionability less convincing. I believe the most important factor in determining which contracts would be voided or have their interest-related obligations severed, and which would be upheld with as high as possible an interest rate, is simply sophistication. This implies that judges relied on and amplified a distinction introduced by statutes like, for example, Ontario's *Consumer Protection Act, 2002*, SO 2002, c 30.

176 They may have succeeded in this regard, although I explain in section 4.2 that a more desirable solution was within reach: Stephanie Ben-Ishai and Emily Han stress that lending regulation is most effective when it differentiates between types of lenders (see Stephanie Ben-Ishai & Emily Han, "We Don't Talk About Section 347: An Analysis from a Commercial Perspective" in Jill Corraini Nadeau & The Honourable D Blair Nixon, eds, *Annual Review of Insolvency Law 2022* (Canada: Thomson Reuters, 2023) 331).

177 Zipursky, *supra* note 7 at 635.

times be prevented from offering some assistance because other parts of the state made certain decisions. Furthermore, the characteristics of private law that lead scholars to claim it is best explained as concerning the relationship between two parties, rather than a triangular relationship by which they are put in relation through the state, are not inevitable: they must be actively maintained. In other words, I suggest this position entails that private law is a form of regulation, as was suggested by Hugh Collins.[178] While private law has unique characteristics that differentiate it from public regulation, these characteristics can be changed, and were changed in the cases discussed here.[179]

Recognizing this, in turn, allows us to attend to how different regulatory schemes will coexist. This issue is downplayed when private law and regulation are treated like oil and water. For instance, Stephen Smith suggests in his *Contract Theory* that the doctrine of illegality is best justified by promissory morality, as "there is no moral obligation, and hence no legal obligation, to do an objectionable activity."[180] Smith is clear that this logic requires complete deference to the choices made by other branches of the legal system, either because they prohibit behaviour that is indeed immoral, or because it is a moral requirement to obey the law.[181] Smith defends the decision to void contracts that are in contravention of any law, even, for instance, trade licensing requirements.[182]

However, this line of jurisprudence shows that Smith's interpretation of illegality asks both too much and too little of judges. It asks too much because it asks for complete deference to the pronouncements of other

178 Hugh Collins, *Regulating Contracts* (Oxford: Oxford University Press, 1999). This framing is in fact taken for granted in his work: it is how he choose to describe the two bodies of law. They are both regulations because they are both sets of rules that attach to the type of human association known as contract and both provide answers to the question, "should sanctions be ordered?" (*ibid* at 17, 31).

179 *Ibid* at 8. Hugh Collins explains that the differences between each body of law had been actively maintained by scholars: "[s]pecialists in private law ignored the impact of regulation upon their elaborate schemes of entitlements, and the regulatory lawyers suppressed the implications of their radical challenge to nineteenth-century legal order." However, since the 20th century has seen the "productive disintegration" of these barriers, accounts that maintain they are separate are no longer representative. Rather, "legal systems are in a process of transition from the dominance of traditional private law regulation to one where welfarist regulation increasingly provides the basic discourse of the legal regulation of contracts" (*ibid*).

180 Smith, *supra* note 9 at 249.

181 *Ibid* at 254–55.

182 Smith does not discuss what should happen in cases where parties to a contract did not know they were contravening these rules (*ibid*).

branches of the legal system on the matter of morality. Illegality is a private law doctrine and judges are, unsurprisingly, tempted to modulate it to bring their support to contract parties who they believe deserve the assistance of the law. While Smith's position is coherent, it no longer reflects the law: the doctrine of illegality is being softened, mostly for cases of regulation where the illegal act does not appear morally reprehensible.[183] With the rise in the sheer number of statutes, "[t]he courts are increasingly faced with actions arising out of heavily regulated relationships, in which their ability to deploy the traditional common law tests is necessarily coloured by the need to engage with the aims, goals, and policies underlying the relevant regulations."[184] In the cases discussed in this paper, the courts chose to assert a competing authority over the "regulation" of high interest loan contracts between sophisticated parties, assigning it certain aims and goals, and giving themselves a power to rewrite contracts that seem to come from the realm of regulation rather than private law. There are reasons to believe this was a good thing: TT Arvind and Joanna Gray have argued, for instance, that regulatory efforts benefit from the input of private law judges, who are exposed daily to "the needs and perspectives of end-users and of the broader polity" and capable of developing "broad standards of conduct" to supplement regulatory rules.[185] Furthermore, judges who are willing to work out the points of contact, for instance by adapting the doctrine of illegality, are working to ensure that private law remains relevant and useful.[186] One can only imagine how little faith the general public

183 See pages 10–11 of this article for the new approach to illegality.

184 TT Arvind & Joanna Gray, "The Limits of Technocracy: Private Law's Future in the Regulatory State" in Kit Barker, Karen Fairweather & Ross Grantham, eds, *Private Law in the 21st Century* (Oxford: Hart Publishing, 2017) 237 at 237.

185 *Ibid* at 247–49. Hugh Collins also considers the former to be one of the comparative advantages of private law over regulation at Collins, *supra* note 178 ("private law in its application learns from its environment about the effects of its rules on the subjects of regulation. This observation then permits the recursive process of further refinement of the legal rules in order to modify their effects" at 55). In the cases described here, judges did indeed consider the consequences of regulation on parties and concentrated on the behaviour of borrowers and lenders rather than the mere rate of interest. Where the legislature offered an outcome-oriented rule, they substituted a grid of analysis that focused on parties and whether their behaviour was reasonable in the circumstances.

186 Arvind and Gray note that private law's role has been diminished (Arvind & Gray, *supra* note 184 at 238). They are not the only ones to note this. Jeannie Paterson and Elise Bant warn that unless it allows itself to be "influenced by the changing expectations of market conduct evidenced by consumer protection legislation… [c]ontract law risks becoming increasingly isolated from many forms of market transactions" (see Jeannie Paterson & Elise Bant, "Contract and the Challenge of Consumer Protection Legislation" in TT Arvind & Jenny Steele, eds, *Contract Law and the Legislature* (Oxford: Hart Publishing, 2020) 79 at 81–82).

would have in the obligatory force of contracts if cases like *St John* were decided differently.[187]

Smith's interpretation also asks too little of judges by ignoring the public nature of courts. Although illegality is a private law doctrine, it is born to no small extent of necessity. It cannot and should not be thought of as an extension of promissory morality, if this means judges believe they can modulate it as they wish, without regard for the need for some coherence within the legal system. Allowing lenders to systematically obtain as much as they could without technically being in violation of the law is not coherent with the spirit of section 347. While the judges cited here have not followed Smith's invitation to defer entirely to Parliament on this matter, they have followed the gist of the analysis, which invites them to consider the doctrine of illegality entirely from the point of view of private law, as if "the demands of private law and corrective justice [were] unique, morally prior to, and rightly unaffected by the various systems that supplement … it."[188]

In the cases discussed here, it would have been best for common law courts to either void the contracts or sever all the obligations to repay interest. Only this would have recognized the seriousness of a criminal prohibition. The second-best solution would have been for courts to embrace the regulation-like powers they had given themselves and impose commercially appropriate rates of under 60% per annum on parties whose contracts violated section 347, perhaps inviting submissions on the matter to guide their decisions. In other words, courts should have continued asserting the superiority of their understanding of commercial lending practices, which is what justified setting aside Parliament's initiative to limit contractual freedom. The courts should have ensured that 60% interest per annum remained the upper limit, rather than one of the default options, to make their own regulatory scheme coherent with the spirit of section 347, the provision that justified its existence. By refusing to either fully defer to

187 John Gava & Janey Greene object to Hugh Collins' theory in part because they believe it fails to recognize that contract law can aspire to do more than facilitate market exchange (see John Gava & Janey Greene, "Do We Need a Hybrid Law of Contract? Why Collins is Wrong and Why it Matters" (2004) 63:3 Cambridge LJ 605 at 612). While this is a perfectly appropriate response, I believe that this example shows how important it is that contract law *at least* serves to facilitate market exchange, meaning, that it is still used by some people to achieve something. Refusing to adapt the doctrine of illegality for the age of statute to preserve the common law's ability, for instance, to uphold the ideals of human freedom and autonomy, is not worth doing if it means that contract law has become a theoretical text expressing an unachievable ideal that is seldom, if ever, used to resolve disputes. The law is, at least in part, a public service.

188 Barker, "Complex System", *supra* note 4 at 5.

Parliament or fully participate in justifying the limits they themselves imposed on the freedom of contracts, courts have contributed to making the law less normatively coherent.

This second-best solution would have required openly abandoning private law's facilitative character, which is what many theorists argue makes it different from regulation.[189] Private law is said to be facilitative because parties are only held to the obligations they have chosen for themselves, not obligations that were chosen by legislatures or judges.[190] For many theorists, this feature is what ensures that private law is "private," and that it concerns only "the directness of the connection between the parties" and the obligations that flow directly from it.[191] It is also seen as the source of freedom of contract. Parliament's intervention limited the courts' ability to simply facilitate certain transactions, as judges might have preferred to do. Rather than deferring to criminal law (either by voiding contracts or severing the obligation to pay interest on the loan), the courts modified contracts, imposing obligations that neither of the parties had bargained for. They made private law directive rather than facilitative, so that lenders could benefit from the security of contract law to achieve their aims, even if they achieved something somewhat different than what they had bargained for.

However, courts then made sure to specify that their remedial powers and their ability to dictate the contents of contracts were limited, perhaps to protect the facilitative character of private law. This preserved the ability of lenders to turn to courts to force borrowers to repay their debts and some

189 See a comparison of private law and regulation in Anthony Ogus, *Regulation: Legal Form and Economic Theory* (Oxford: Hart Publishing, 2004) at 2. As I explain in section 4.2, the fact that judges have many options to pick between under the current state of the law makes it difficult to claim that they are merely imposing on parties obligations they have chosen for themselves.

190 For Ogus, this means that the private law is also "decentralized" (*ibid*). Since "obligations are incurred voluntarily," they are created by a myriad of actors, whereas under regulation "the state plays a fundamental role in the formulation…of the law" (*ibid*). However, the word captures the features of private law named by theorists as well. Weinrib writes, "private law is a domain of prohibitions against misfeasance, rather than of positive commands promoting particular substantive ends against a background of nonfeasance" (see Weinrib, *supra* note 7 at 207). Contract law then protects specifically against the misfeasance of breaching one's promise, most likely. Zipursky's version of the claim is that "some forms of adjudication in private law may be distinctive, and distinctively non-public in their orientation" because "the recognition of a power need not be premised on a view as to the appropriateness of the plaintiff exercising that power, or of the outcome of the exercise of that power" (Zipursky, *supra* note 7 at 653–54).

191 To take Ernest Weinrib's version of what the private character of private law entails, see Weinrib, *supra* note 7 at 10–11.

interest, although not the interest they had asked for. However, it did so in a haphazard way which signals that courts are not selecting the commercially appropriate rate—not truly being directive. The fact that *Forjay* might have been decided to support the rationale given in *Shafron* to marginalize notional severance supports that hypothesis: if courts claimed an ability to determine commercially appropriate interest rates, they might also be able to craft reasonable covenants in restraint of trade, and then private law might have become directive in even more cases. This retreat, however, is only partial. Even after *Forjay*, the law remains somewhat directive.

In addition to making the law more coherent, this second-best solution would have given courts and scholars a chance to better understand what freedom of contract might mean when it is no longer simply an extension of the facilitative character of private law. This last sentence might appear nonsensical to some: freedom of contract has no meaning beyond this one. Yet, it does seem as though these doctrinal changes were meant to protect something like freedom of contract for sophisticated parties. Judges appeared to prefer this ersatz freedom by which lenders are told to expect a new, lower, unconsented interest rate to the alternative of denying lenders the assistance of the law. The common law is replete with cases where courts are forced to pick between vindicating a perhaps less-robust view of freedom of contract or refusing to enforce a contract altogether, to the detriment of a party. In cases of covenants in restraint of trade, the blue-pencil rule is what determines, with great arbitrariness, which it will be, and legal actors seem generally satisfied with this solution. Whether this arbitrariness and the final stage of the jurisprudential evolution presented here ultimately serve to ensure that private law can claim it is only facilitative, is a question for another day. However, in cases that involve boilerplate contracts and the version of unconscionability that is meant to protect adherents who have little to no ability to shape the obligations they will be held to,[192] this ersatz freedom might be the best adherents can hope for—in the same way that a revised interest rate was the best lenders could hope for in the cases discussed in this paper.[193] It might have been good for courts and scholars to get used to vindicating this ersatz freedom fully, without hiding behind the limitations of remedial tools.

192 See Marcus Moore, "The Flaws of Magic Bullet Theory: Retraining Unconscionability to Discretely Target Different Contexts of Unfairness in Contracts" (2022) 45:2 Dal LJ 551.

193 Unsophisticated parties might have a more legitimate claim to the assistance of courts than the parties discussed here, who benefited from the services of attorneys.