
CANADA / JUDGMENT

Eha v. Genge

2006 BCSC 1249

COURT

Supreme Court of British Columbia

DECIDED

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2006 BCSC 1249 Eha v. Genge

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation:

Eha v. Genge,

2006 BCSC 1249

Date: 20060816

Docket: S055474

Registry: Vancouver

Between:

Karl Eha and Susan Eha

Plaintiffs

And

Dwight Genge

Defendant

Before: The Honourable Mr. Justice Goepel

Reasons for Judgment

Counsel for the Plaintiffs:

A. Morrison

Appearing on his own behalf:

D. Genge

Date and Place of Trial:

July 25 to 28, 2006

Vancouver, B.C.

INTRODUCTION

- [1] Karl Eha made a series of loans to Dwight Genge at an interest rate of 10% per month. Mr. Genge has not repaid the loans. Mr. Eha concedes the interest constitutes a "criminal rate" of interest as defined in s. 347 of the Criminal Code, R.S.C. 1985, c. C-46. The main issue is whether public policy renders the loans unenforceable.

BACKGROUND

- [2] Mr. Eha has been a money lender for more than thirty years. He first worked as a pawn broker in the 1960's. He presently operates a small jewellery and loan business.
- [3] Mr. Genge has been involved in the pawn broking industry since 1991 when he began working at a pawn shop operated by his parents. In late 1996, or early 1997, he opened Montego Bay Jewellery and Loans ("Montego Bay"), a pawn shop in Maple Ridge, British Columbia. He is a past director of the B.C. Pawn Brokers Association.
- [4] Considerable evidence was led concerning the practise of pawn brokers. Pawn brokers make loans secured by their customer's goods. The goods are generally worth much more than the amount advanced. Typically interest is charged on the loans at 10% to 20% per month. If the goods are not redeemed within a specified period, they become property of the pawn shop and are then sold.
- [5] Mr. Eha and Mr. Genge met in 2003. They often discussed the pawn broker business in general and Mr. Genge's business, Montego Bay, in particular. When they first met Mr. Genge was turning away lucrative business because of a lack of funds.
- [6] In mid-2003, Mr. Eha agreed to supply Mr. Genge with additional funds that could be lent to Montego Bay customers. The money would be secured by the pawned goods. If the goods were redeemed, Mr. Eha and Mr. Genge shared the interest paid on the loan. If the goods were sold, they would divide the net proceeds between them.
- [7] The first transaction that Mr. Eha financed involved a 1953 Harley Davidson motorcycle. Mr. Eha advanced \$4,000 to Mr. Genge who in turn lent the money to the Montego Bay customer at an interest rate of 20% per month. When the customer defaulted on the loan, the Harley Davidson was sold for just less than \$19,000. After expenses the profit on the transaction was approximately \$12,000. An issue in this action is whether Mr. Eha paid Mr. Genge his share of that profit.

- [8] Subsequent to the Harley Davidson matter Mr. Eha financed several additional transactions that allowed Mr. Genge to provide loans to customers of Montego Bay. All of the loans required the customers to pay high interest rates, typically between 15% and 20% per month.
- [9] On ten occasions between June 14, 2004, and September 9, 2004, Mr. Eha lent money to Mr. Genge. All the transactions were in cash. All the loans were at an interest rate of 10% per month. The particulars of the loans are as follows:

June 14, 2004

\$3,000

July 3, 2004

\$2,000

July 7, 2004

\$2,000

July 13, 2004

\$3,000

July 24, 2004

\$2,000

July 27, 2004

\$1,000

August 5, 2004

\$6,000

September 7, 2004

\$3,000

September 9, 2004

\$10,000

Total

\$32,000

- [10] The particulars of each loan were set out in Mr. Eha's day timer. Although the day timer notes indicate that certain of the loans were for a maximum of three months, in his notes Mr. Eha calculated interest in relation to all loans through to March 2005.

- [11] The funds were for Mr. Genge's own account, not to be loaned to specific Montego Bay customers. Mr. Genge used the funds, at least in part, to finance the operations of Montego Bay. Before borrowing the money from Mr. Eha, Mr. Genge had attempted unsuccessfully to borrow funds from a conventional lender.
- [12] Mr. Eha testified it was Mr. Genge who suggested an interest rate of 10% per month. Mr. Genge testified he did not have a specific recollection of his conversations with Mr. Eha about the interest rate. He says, however, that he knew Mr. Eha never lent money at less than 10% per month so he did not believe that the interest rate was negotiable.
- [13] Mr. Genge testified that he learned in 2001 or 2002, while a director of the B.C. Pawn Brokers Association, that loans involving interest rates of more than 60% per annum were illegal. He says this was common knowledge among pawn brokers. He knew the interest rate being charged by Mr. Eha was illegal.
- [14] Mr. Eha testified that for thirty years he has been lending money at between 10% and 20% interest per month. He was aware that there were laws governing the amount of interest that could be charged. He testified that he did not believe those laws applied to short term loans of the kind he made. He says he did not intend to charge an illegal interest rate and that if he had known the rate was illegal, he would have either lowered the interest rate or would not have lent the money at all.
- [15] On September 13, 2004, Mr. Eha commenced work at Montego Bay at a salary of \$50 a day. Mr. Genge asked him to work at the shop because of his knowledge of the pawn broker business and to supervise his staff, many of whom were inexperienced. Mr. Eha says he started work at Montego Bay at least in part to keep an eye on the business because of the money he had lent to Mr. Genge.
- [16] While employed at Montego Bay, Mr. Eha, with Mr. Genge's consent, set up and sold his own jewellery. Mr. Genge alleges that Mr. Eha was to pay him 20% of his jewellery sales. Mr. Eha denies any such agreement. In his counter-claim Mr. Genge seeks an accounting of Mr. Eha's jewellery sales.
- [17] In January 2005, Mr. Genge advised Mr. Eha that he could no longer afford to pay him \$50 a day to work at Montego Bay. Mr. Eha continued to work there until July 26, 2005. While at Montego Bay, in addition to selling his own jewellery, Mr. Eha also made some loans on his own account to Montego Bay customers.
- [18] As time went on Mr. Eha became increasingly concerned about Mr. Genge's failure to repay the money he had borrowed. On numerous occasions, he or his wife asked Mr. Genge to repay the loan. There is no evidence that they threatened Mr. Genge.

- [19] The Ehas provided Mr. Genge with spreadsheets setting out the amounts he owed and credits to which he was entitled. Interest on the loans was \$3,200 a month. On December 31, 2004, Mr. Genge promised to pay \$2,000 a month towards the loans. This was less than the monthly interest. Ultimately, in spite of Mr. Genge's promise only \$1,000 was repaid.
- [20] On October 6, 2005, Mr. Eha demanded in writing full payment of all loans and interest. This action was started the following day.

POSITION OF THE PARTIES

- [21] In his opening statement, plaintiff's counsel advised Mr. and Mrs. Eha sought judgment against Mr. Genge in the amount of \$32,000 plus interest at a rate of 10% per month. The amount claimed was \$99,061.63, which took into account certain credits arising from the loan transactions with Montego Bay customers.
- [22] In his closing, counsel acknowledged that the interest rate exceeded the legal limit set out in the Criminal Code. He submitted that in the circumstances of this case, the loan should not be declared void ab initio. Instead, the court should notionally sever the interest provision and order Mr. Genge to repay the loan at interest at a rate of 60% per year. This would lead to a judgment in the sum of \$61,849.13. Alternatively, counsel submits that at a minimum Mr. Eha should be repaid the principal amount of the loan together with interest as mandated by the Court Order Interest Act, R.S.B.C., 1996, c. 79.
- [23] In support of his submission counsel notes that Mr. Genge knew the interest rate was illegal. He also notes that Mr. Genge used the loans at least in part to support the operations of Montego Bay which knowingly lent money at rates in excess of the Criminal Code. He says that the Criminal Code provisions are aimed at loan sharks and that a loan shark is not simply someone who lends money at a high rate of interest, but rather a person who uses threats, extortion or violence to have the loan repaid. He says there is no evidence that the Ehas have ever used threats of violence to collect money owing to them and that they have never been involved in organized crime.
- [24] In calculating the amount due, Mr. Eha has credited Mr. Genge with \$7,100.87. This represents amounts payable to Mr. Genge on transactions in which Mr. Eha advanced funds that were then loaned to Montego Bay customers. In his counter-claim Mr. Genge alleges that Mr. Eha has failed to account for all profits earned from lending money to Montego Bay customers.
- [25] Mr. Eha submits that he has fully accounted for those loan transactions in which money was lent to customers of Montego Bay. He denies any agreement to pay Mr. Genge a portion of his jewellery sales. He submits that the counter-claim should be dismissed.

- [26] Mr. Genge does not deny borrowing money from Mr. Eha. He says the plaintiffs have failed to account to him in relation to various business transactions that took place while the loans were outstanding. He says Mr. Eha was to pay him 20% of all jewellery sales. He seeks an accounting.
- [27] Mr. Genge's statement of defence did not allege that the loan agreement was unenforceable or void ab initio as being contrary to public policy. After this issue was raised by the court Mr. Genge took the position the loans were not enforceable.

FINDINGS OF FACT

- [28] Before turning to the legal issues involved in this litigation, it is first necessary to make certain findings of fact. I find that Mr. Eha lent \$32,000 to Mr. Genge at the stated interest rate of 10% per month, double the legal limit. While Mr. Genge knew the interest rate was illegal, I accept his evidence that the interest rate was not negotiable. Mr. Eha had been lending money for some thirty years at interest rates of 10% a month. Mr. Eha would not have lent the money at a lesser rate.
- [29] Mr. Eha is an experienced businessman who has been making loans for thirty years. I do not accept his evidence that he did not know that the loans were at an illegal rate of interest. The legality of pawn shop loans was a subject well understood by those in the business. He and Mr. Genge had discussed the viability of a particular pawn shop that made loans at the legal rate of 5% a month. I find that Mr. Eha knew that the rate of interest he charged Mr. Genge was in excess of that allowed under the Criminal Code.
- [30] I accept Mr. Eha's evidence that there was no agreement that he would pay Mr. Genge 20% of his jewellery sales while employed at Montego Bay. Such an agreement is inconsistent with Mr. Genge's agreement to pay him \$50 a day. Mr. Eha would not have agreed to pay 20% of his jewellery sales to Mr. Genge. Mr. Eha was already selling jewellery prior to commencing employment at Montego Bay and there is no reason why he would agree to share the income from those sales with Mr. Genge.
- [31] I also accept Mr. Eha's evidence that he has fully accounted to Mr. Genge for the various transactions in which monies were advanced to Montego Bay customers. In particular, I find that Mr. Eha paid Mr. Genge \$6,000, being his share of the Harley Davidson loan transaction. That transaction completed in November 2003. If Mr. Genge had not received his share of those proceeds, I am certain that the relationship between himself and Mr. Eha would have deteriorated long before June 2004, when Mr. Genge commenced his personal borrowings.
- [32] Given these findings, there is no basis for Mr. Genge's counter-claim. It is dismissed.

ENFORCABILITY OF THE LOANS

- [33] The pertinent provisions of s. 347 of the Criminal Code are:

347(1) Notwithstanding any Act of Parliament, every one who

- (a) enters into an agreement or arrangement to receive interest at a criminal rate, or
- (b) receives a payment or partial payment of interest at a criminal rate,

is guilty of

- (c) an indictable offence and liable to imprisonment for a term not exceeding five years, or
 - (d) an offence punishable on summary conviction and is liable to a fine not exceeding twenty-five thousand dollars or to imprisonment for a term not exceeding six months or to both.
- (2) In this section,

"credit advanced" means the aggregate of the money and the monetary value of any goods, services or benefits actually advanced or to be advanced under an agreement or arrangement ...;

"criminal rate" means an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds sixty per cent on the credit advanced under an agreement or arrangement;

[34] In *Transport North American Express Inc. v. New Solutions Financial Corp.*, [2004] 1 S.C.R. 249, the Supreme Court of Canada concluded that the traditional rule that contracts in violation of statutory enactments are void ab initio, is not the approach that courts should necessarily take in cases involving a breach of s. 347 of the Criminal Code. The Supreme Court directed that in cases in which s. 347 had been violated trial judges should provide remedies that were tailored to the contractual context involved. Arbour J. summarized the majority view at ¶ 6:

A spectrum of remedies is available to judges in dealing with contracts that violate s. 347 of the Code. The remedial discretion this spectrum affords is necessary to cope with the various contexts in which s. 347 illegality can arise. At one end of the spectrum are contracts so objectionable that their illegality will taint the entire contract. For example, exploitive loan-sharking arrangements and contracts that have a criminal object should be declared void ab initio. At the other end of the spectrum are contracts that, although they do contravene a statutory enactment, are otherwise unobjectionable. Contracts of this nature will often attract the application of the doctrine of severance. The agreement in this case is an example of such a contract. In each case, the determination of where along the spectrum a given case lies, and the remedial consequences flowing there from, will hinge on a careful consideration of the specific contractual context and the illegality involved.

[35] Arbour J. discussed in greater detail the spectrum of remedies at ¶ 31:

I also agree with the view of Rosenberg J.A. at the Court of Appeal in the present case, at para. 33, that severance lies along a spectrum of available remedies. Depending on the circumstances, the court may exercise its discretion to find the whole agreement unenforceable or sever only the provision(s) that put the effective interest rate over 60 percent:

[A] judge has discretion to apply the doctrine of severance to an agreement that offends the criminal interest rate provisions of the Code. This discretion gives rise to a spectrum of available remedies. Where the loan transaction resembles a traditional loan sharking arrangement, the court may refuse to apply the doctrine of severance and hold the entire loan agreement unenforceable, including the obligation to repay the principal. While this remedy leaves the borrower with a windfall, this result may be justified in some cases by the need to denounce such usurious practices. See *C.A.P.S. International Inc. v. Kotello*, [2002] M.J. No. 205 [(QL)] (Q.B.). At the other end of the spectrum, in the case of a good faith commercial transaction where the equities favour the lender and severance does not undermine the policy of the legislation, the court may sever only those provisions of the loan agreement that put the effective interest rate over 60 per cent, leaving intact the borrower's obligation to repay the principal and pay some interest. See e.g., *Milani*, supra. Closer to the centre of the spectrum lies a case like *Terracan* [*Capital Corp. v. Pine Projects Ltd.* (1993), 100 D.L.R. (4th) 431(B.C.C.A.)], where the court severed all the interest provisions but upheld the debtor's obligation to repay the principal. [Emphasis added.]

This statement of the remedial discretion of a judge in a case involving a violation of s. 347 of the Code takes into account the seriousness of the illegality involved in any given case, the identity and nature of the parties and the broader contractual context.

[36] In *Transport* the court noted with approval the approach taken in *William E. Thomson Associates Inc. v. Carpenter* (1989), 69 O.R. (2d) 545 (C.A.) where Blair J.A. identified four considerations relevant to the determination of whether public policy ought to allow an otherwise illegal agreement to be partially enforced rather than being declared void ab initio. Those considerations are:

1. whether the purpose or policy of s. 347 would be subverted by severance;
2. whether the parties entered into the agreement for an illegal purpose or with an evil intention;
3. the relative bargaining positions of the parties and their conduct in reaching the agreement;
4. the potential for the debtor to enjoy an unjustified windfall.

[37] In *Transport*, the Supreme Court of Canada acknowledged that loan sharking arrangements are so objectionable that they should be declared void ab initio. The *New Oxford Dictionary of English* defines loan shark as a "money lender who charges extremely high rates of interest, typically under illegal conditions." I adopt that definition. The definition makes no reference to how loans are collected and, in my view, the presence or absence of a threat of violence is not determinative of where on the spectrum of remedies a transaction rests.

- [38] In *Kotello v. Dimerman*, 2006 MBCA 77, the Manitoba Court of Appeal was faced with a loan that had a rate of interest of 20% per month or 240% per annum. The loan had arisen in the context of a pawn broking transaction. The court concluded that the rate of interest was so incredibly high that it fell within the type of contract which is so objectionable that illegality taints the entire contract and that to allow notional severance would subvert the purpose of s. 347 of the Criminal Code.
- [39] I have reached a similar conclusion in this case. The interest rate on the loans was 120% per annum, twice the legal limit. This was not an isolated transaction. It was repeated on ten occasions. The loans were not negotiated by equals. Mr. Genge could not borrow money from a conventional lender so he turned to Mr. Eha who was only too glad to advance the monies, as long as it was repaid at a criminal rate of interest. That Mr. Eha did not threaten or use extortion to enforce repayment does not entitle him to the court's assistance. I appreciate that if Mr. Genge chooses not to voluntarily repay the principal he will have a windfall and be unjustly enriched. The equities between the parties are secondary to the public policy concerns raised by these transactions. The policy objective of s. 347 is to protect the public from usurious loans. To enforce these loans would undermine that policy. In the circumstances of this case, the need to denounce the usurious lending practises of Mr. Eha leads me to declare that these loan agreements are void ab initio.

[40] The claim and counter-claim are both dismissed.

[41] There will be no order for costs.

"R.B.T. Goepel, J."

The Honourable Mr. Justice R.B.T. Goepel

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