

CANADA / JUDGMENT

## Kilroy v. A OK Payday Loans Inc.

2007 BCCA 231

COURT

British Columbia Court of Appeal

DECIDED

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2007 BCCA 231 Kilroy v. A OK Payday Loans Inc.

COURT OF APPEAL FOR BRITISH COLUMBIA

Citation:

Kilroy v. A OK Payday Loans Inc.,

2007 BCCA 231

Date: 20070425

Docket: CA034406

Between:

Doris Kilroy

Respondent

(Plaintiff)

And

A OK Payday Loans Inc.

Appellant

(Defendant)

Before:

The Honourable Madam Justice Prowse

The Honourable Mr. Justice Mackenzie

The Honourable Madam Justice Saunders

W. Branch and

L. Brasil

Counsel for the Appellant

P. Bennett and

M. Munteer

Counsel for the Respondent

Place and Date of Hearing:

Vancouver, British Columbia

March 21, 2007

Place and Date of Judgment:

Vancouver, British Columbia

April 25, 2007

Written Reasons by:

The Honourable Mr. Justice Mackenzie

Concurred in by:

The Honourable Madam Justice Prowse

The Honourable Madam Justice Saunders

Reasons for Judgment of the Honourable Mr. Justice Mackenzie:

## Introduction

- [1] This is an appeal from the decision of a summary trial judge under Rule 18A answering certain common issues previously certified in a "payday loan" class action. Her reasons may be found at 2006 BCSC 1213. The learned judge concluded that processing and late fees charged by the appellant A OK Payday Loans Inc. ("A OK") constitute interest under s. 347 of the Criminal Code, which defines criminal interest "as [an] annual rate of interest that exceeds sixty per cent." She decided that A OK has been unjustly enriched to the extent that the charges are criminal interest in excess of the 60 per cent maximum rate set by s. 347. She also found the charges in excess of the 60 per cent rate were in breach of provincial consumer trade practice legislation.
- [2] A OK submits that the learned judge erred in finding the processing and late payment fees were interest for the purposes of s. 347 and that the court was in a position to determine the issue of unjust enrichment at a summary trial. A OK also submits that the learned judge erred in finding a violation of the provincial statutes.

## The Facts and the Judge's Determination of the Common Issues

- [3] The basic facts, summarized by the summary trial judge, are not in dispute. A OK has been making short-term loans of small amounts from three business locations in British Columbia. These "payday loans" were for amounts generally between \$100 and \$500 and advanced under standard form loan agreements. The term of the loan would be for 15 days or until the borrower's next payday, whichever came first. Interest was charged for a two week period at 21 per cent per annum, together with a processing fee of 19 per cent or more of the principal sum advanced ("the Processing Fees").
- [4] In order to obtain a loan, each borrower was required to provide A OK with a signed cheque for the total amount of the sum advanced, the interest charged, and the Processing Fees. A OK held the cheque as security and used it to obtain repayment if the borrower did not exercise an option to repay the loan by other means, such as cash payment or a debit transaction. If the borrower failed to repay the loan and the cheque was not honoured, the standard agreement required the borrower to pay a further fee of \$75 ("the Late Fee").
- [5] The summary trial judge accepted expert evidence from the plaintiff's actuary which she summarized as follows:
- [7] Expert actuarial evidence provided by Mr. Karp, F.S.A., F.C.I.A., establishes that:
- (a) the maximum ratio of return a lender may receive on the principal amount advanced for 15 days, without receiving a return of greater than 60%, is a ratio of 1.1019503 on the principal advanced, which amounts to 1.95% of the principal advanced; and
  - (b) a return of 19% of the principal advanced will result in an effective annual rate of interest in excess of 60% if the loan is repaid within 135 days of the loan advance, regardless of how many payments are made in repayment of that loan advance.
- [6] The class as defined for certification was limited to borrowers whose charges exceeded a 60 per cent annual rate as calculated by the actuary.
- [7] The plaintiff applied to have certain common issues determined by a summary trial proceeding under Rule 18A. The learned judge agreed to a summary determination and concluded:
- [72] The common issues in the class proceeding are determined as follows:
- (a) Do the Processing Fees charged by A OK constitute interest as defined by and for the purpose of s. 347 of the Criminal Code, either in whole or in part?

Answer: Yes.

- (b) If the answer to (a) is yes, then do the Late Fees charged by A OK also constitute interest as defined by and for the purpose of s. 347 of the Criminal Code, either in whole or in part?

Answer Yes.

- (c) If the answer to (a) is yes, do the standard form agreements pursuant to which the Processing Fees have been collected from Class members constitute agreements or arrangements to receive interest at a criminal rate, contrary to s. 347(1)(a) of the Criminal Code?

Answer: Yes.

- (d) If the answer to (a) or (b) is yes, then has the collection by A OK of those fees from Class members in relation to their Class Loans resulted in the payment by Class members to, and the receipt by A OK of, interest at a criminal rate, contrary to s. 347(1)(b) of the Criminal Code?

Answer: Yes.

- (e) If the answer to (d) is yes, then has A OK been unjustly enriched by the collection of those Fees?

Answer: Yes.

- (g) If the answer to (c) or (d) is yes, then does the provision by A OK of the Class Loans to Class members on terms that offend s. 347 of the Criminal Code, or the receipt by A OK of interest at a criminal rate in respect of those Class Loans, constitute unconscionable acts or practices within the meaning of s. 4 of the Trade Practice Act, R.S.B.C. 1996, c. 457, and s. 8 of the Business Practices and Consumer Protection Act, S.B.C. 2004, c. 2, irrespective of whether the factors set out in s. 3(a) through (d) of those sections are present?

Answer: Yes.

## The Interest Issue

- [8] The first issue is whether the judge erred in finding that the Processing Fees and Late Fees were interest for the purposes of s. 347 of the Code. A OK contends that it operates legitimate store-front businesses that provide services to a wide and varied clientele, and is far removed from the loan sharking activity that was the object of the enactment of s. 347. The processing fee covers the real administrative cost of processing, staff and facilities and the Late Fee only applies in the event of default, not on the making of the loan itself.
- [9] A OK tendered part of a 2002 report for the Public Interest Advocacy Centre titled Fringe Lending and "Alternative" Banking: The Consumer Experience that outlined the payday loan clientele. It found that:

Payday loan users tend to be somewhat older than cheque-cashing customers are. They are attracted to payday loans because of the confidentiality aspects and because the loans are highly structured forms of short term cash. These individuals are inclined to be debt-averse, especially open-ended debt like credit card cash advances. They obviously pay a lot for short-term loans, but they tend to calculate the cost in dollar terms that make the cost seem more palatable or, just as likely, don't consider the cost. A portion of the market rolls over these loans and therefore pay

very high total [Annual Percentage Rate's] for their cash.

Although the overall levels of debt for these customers, by their reckoning, is "about average", about 20 per cent of the market is at significant risk of running into debt problems through roll-over behaviour, which is a similar percent of the market that uses both cheque-cashing and payday loan products. Our estimate is that around 350 thousand Canadians use payday loans.

- [10] The report also found that payday loan customers, together with pawnshop and cheque cashing service customers collectively designated as Alternative Financial Services or AFS, had a basic lack of financial literacy and did not know how much the loan was costing them, particularly as an annualized percentage cost related to the amount of the loan. These borrowers tended to place more weight on the confidentiality of the service and an "atmosphere [that] was friendly and welcoming." Some had an aversion to conventional banking institutions.
- [11] The record indicates that payday loan providers fill a niche for a substantial number of financially unsophisticated short-term borrowers, and A OK is typical of these businesses. There is no evidence that the Processing Fees do not reflect actual expenses (plus a profit margin) of the business or that the Late Fee is unrelated to the costs of default. The question then is whether these commercial aspects take A OK outside the purview of s. 347, or at least influence the determination whether the processing and late fees are "interest" for the purpose of the section.
- [12] "Interest" for the purposes of s. 347 is a defined term. The definition in s. 347(2) reads:
- "interest" means the aggregate of all charges and expenses, whether in the form of a fee, fine, penalty, commission or other similar charge or expense or in any other form, paid or payable for the advancing of credit under an agreement or arrangement, by or on behalf of the person to whom the credit is or is to be advanced, irrespective of the person to whom any such charges and expenses are or are to be paid or payable, but does not include any repayment of credit advanced or any insurance charge, official fee, overdraft charge, required deposit balance or, in the case of a mortgage transaction, any amount required to be paid on account of property taxes
- [Emphasis added.]
- [13] A OK submits that "interest" as defined in s. 347 is limited to charges "for the advancing of credit" and neither the processing fee nor the Late Fee was charged for that purpose. It contends that the processing fee is charged for the administrative cost of preparing the legal documentation and operating the business facilities for the benefit of all borrowers, irrespective of whether any particular loan is accepted or rejected. A OK relies on *Helo Enterprises Ltd. v. Standard Trust Co. (In liquidation of)*, 39 B.C.A.C. 61, aff'd [1996] 1 S.C.R. 183. The issue in *Helo* involved the s. 347 interest status of a broker's fee payable by a borrower for arranging a mortgage. The loan agreement provided that the lender would pay the broker and obtain reimbursement from the borrower. Southin J.A. concluded that the broker's fee was not interest because it was not a charge or expense "paid or payable for the

advancing of credit." She noted that the borrower had independently retained the services of the broker and negotiated the fee in the services agreement. The broker was not an agent of the lender and the lender had not selected the broker for the borrower. Those facts distinguish Helo from the case at bar where the Processing Fees are charged by A OK for part of its services.

- [14] The question of interest within s. 347 was addressed by the Supreme Court of Canada in *Garland v. Consumers' Gas Company Limited*, [1998] 3 S.C.R. 112 ("Garland No. 1"), and *Garland v. Consumers' Gas Company Limited*, [2004] 1 S.C.R. 629 ("Garland No. 2"). Both appeals involved the same late payment charge levied by Consumers' Gas, with regulatory approval, on overdue accounts. Actuarial evidence determined that the charge exceeded the criminal rate of 60 per cent for customers who paid within 37 days of the due date. The plaintiff sought certification of class proceedings on behalf of those customers to recover the payments. The majority of the court in *Garland No. 1* held that the late payment charge was interest within s. 347. Major J. observed at paragraph 27 that "interest" as defined in s. 347 "is an extremely comprehensive term, encompassing many types of fixed payments which would not be considered interest proper at common law or under general accounting principles." Later he added:
- [24] The scope of the language in s. 347 is extremely broad. Interest is defined, with the exception of six specific items, as the aggregate of all charges and expenses, in any form, that are paid or payable for the advancing of credit under an agreement or arrangement. The definition of credit is similarly expansive. It includes the aggregate of the money and the monetary value of any goods, services or benefits advanced under an agreement or arrangement, minus any fees, commissions or similar charges incurred by the creditor.
- [15] A OK submits that these passages must be read in the light of the Supreme Court's later judgment in *Transport North American Express Inc. v. New Solutions Financial Corp.*, [2004] 1 S.C.R. 249, where Arbour J., for the majority, referred to criticism by Professor Jacob Ziegel of the hasty passage of s. 347 by Parliament in 1980 and observed:
- [43] Since it is very difficult to identify the policy objective behind s. 347 of the Code beyond the prevention of loan-sharking, violations of the section that clearly do not involve loan-sharking should be approached cautiously, keeping in mind that there is no need to deter, through the criminal law, effective interest rates of up to 60 percent per year.
- [16] The issue in *Transport North* was the extent of severance of interest provisions under a credit agreement. The Ontario Court of Appeal had blue penciled the interest provisions of the agreement resulting in an effective interest rate of 30.8 per cent. The majority of the Supreme Court, noting that the credit agreement was a commercial arrangement negotiated by sophisticated parties with the benefit of independent legal advice, rejected the "blue-pencil" technique and applied "notional severance", reading down the offending interest rate so the contract provided for the maximum legal rate of interest permitted by s. 347 of the Code--60 per cent. The particular issue in *Transport North* does not arise here as the

respondent agrees that only interest over 60 per cent is in issue. At paragraph 43 Arbour J. approved the proposition stated in Garland No. 1 that s. 347 was designed to have a much wider reach than loan-sharking and "in fact the section has most often been applied to commercial transactions which bear no relation to traditional loan-sharking arrangements."

- [17] In *William E. Thomson Associates Inc. v. Carpenter* (1989), 69 O.R. (2d) 545 (C.A.), a facility fee stated to be charged for services and expenses in connection with a loan was determined to be interest for the purposes of the criminal interest provision of the Code, then s. 305.1. I do not think that there is any significant difference between the facility fee in Thompson and the Processing Fees here. Trial courts have consistently applied s. 347 to various charges levied by payday loan companies. The cases include: *Affordable Payday Loans v. Harrison*, 2002 ABPC 104, [2002] A.J. 824 (QL); *Dean's Cash Connection Ltd. v. Nelson-Wiger*, 2001 ABPC 44, [2001] A.J. No. 246 (QL); *Cash Store (Advanced Finance Co.) v. Lajoie*, 2002 ABPC 96, [2002] A.J. No. 780 (QL); *Direct Advances (Spruce) Ltd. v. Halgren*, 2003 ABPC 136, [2003] A.J. No. 951 (QL); *C.A.P.S. International Inc. v. Kotello*, 2002 MBQB 142, [2002] M.J. No. 205 (QL); *Affordable Payday Loans v. Beaudette*, [2004] O.J. No. 3235 (QL) (S.C.J.); *Affordable Payday Loans v. Firth*, [2005] O.J. No. 1232 (QL) (C.J.); *Stop 'N' Cash 1450 v. Box*, [2005] O.J. No. 1233 (QL) (C.J.); and *R. v. Marsy*, 2006 ABPC 371, [2006] A.J. No. 1685 (QL).
- [18] I am satisfied that the learned judge did not err in her conclusion that the Processing Fees are sufficiently connected to the loans to be a charge payable or paid for the advancing of credit, and that they are "interest" as defined by s. 347 of the Code, and as interpreted in Garland No. 1.
- [19] The Late Fee may be closer to the line, as the fee is payable only on default and not in connection with the initial extension of credit. The standard loan agreement states: "[T]here will be a \$75 service charge for any of the following: NSF cheque, default cheque, stop payment, funds not cleared, account closed or an account not paid, in full (for any reason), by the due date." A OK tries to certify the borrower's cheque in the event of default and financial institutions typically charge A OK between \$15 and \$25 if the cheque can be certified. Approximately 45 per cent of A OK's customers default on their loans. A OK employees have a discretion to waive the \$75 fee in some circumstances but the fee is charged to defaulting customers in most cases.
- [20] The learned judge relied on the reference to "penalty" in the definition of interest in s. 347 in support of her conclusion that the Late Fee was included interest as defined. She noted that the Late Fee was not merely the recovery of a disbursement. The fact that a Late Fee could be avoided by prompt payment did not prevent the late payment penalty charged by Consumers' Gas on overdue accounts from being determined to be interest in Garland No. 1. The Late Fee here and the late payment penalty in Garland No. 1 were both one-time charges on overdue payments. In my view, Garland No. 1 is conclusive on the issue and the learned judge was correct in deciding that the Late Fee was interest.

## Juristic Reason

- [21] In *Garland No. 2*, Iacobucci J. summarized the well known three-part test for a claim in unjust enrichment. There must be a benefit to the defendant, a corresponding deprivation of the plaintiff, and the absence of a juristic reason for the benefit. Benefit and corresponding detriment are not questioned. The appellant submits that juristic reason remains an open question and the learned judge erred in concluding that A OK had been unjustly enriched before allowing it to explore the individual circumstances of class members on discovery.
- [22] In *Transport North*, Arbour J. identified certain factors as relevant to the question whether an otherwise illegal agreement should be partially enforced rather than being declared void ab initio. Inferentially, the same factors bear on issues of juristic reason and unjust enrichment. Those factors, found at paragraph 42, 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.
- [23] The appellant submits that some class members may be sufficiently sophisticated borrowers as to be aware of the potential illegality. This knowledge could be linked particularly to any class members who borrowed from A OK after the payday loan litigation involving various lenders was publicized. The appellant relies on *Lefavre v. Green*, 2002 ABPC 40, [2002] A.J. No. 362 (QL) and *Buda v. Plyplatis*, [2004] O.J. No. 5175 (QL) (S.C.J.) to support the argument for non-recovery on unjust enrichment principles. In both cases, the plaintiffs were denied recovery of monies paid to the defendants in pyramid schemes. In each case the court concluded that the plaintiffs were aware that the scheme was illegal and that they were equally complicit with the defendants in their pursuit to make a profit. In the case at bar there is no similar equality of position. A OK was engaged in a commercial enterprise that offered standard form loans to small borrowers who had to take the loans on A OK's terms or not at all. I am prepared to accept that there was no conduct of an oppressive or unconscionable character on the part of A OK beyond the breach of s. 347. However, A OK was the dominant party and I am satisfied that it had the responsibility to comply with the s. 347 "criminal rate" limits. The section is framed to impose the responsibility on the lender and not on the borrower. Even if some borrowers were aware that there might be an illegal interest problem in the loans I do not think that the knowledge could change the relative bargaining position of the parties significantly to tip the balance against recovery.
- [24] *Garland No. 2* supports recovery. Consumers' Gas was required to make a refund of the portion of the late payment penalty in excess of the criminal interest limit, notwithstanding that the penalty had been approved by its regulator and it had been included in the revenue

requirement approved for recovery from customers. Consumers' Gas was not receiving a windfall profit. The appellant contends that Garland No. 2 was decided at a pre-certification stage of a prospective class action and claims of other potential class members were not in issue. The reasons in Garland No. 2 do not suggest that there would be any distinction made between the individual plaintiff and other customers who paid the late penalty and would form a class. I do not think that Garland No. 2 can be distinguished on that ground.

- [25] Finally the appellant relies on the decision in *Bon Street Developments Ltd. v. Terracan Capital Corp.*, 76 B.C.L.R. (2d) 90, [1992] B.C.J. No. 2729 (QL) (S.C.), where a borrower failed to recover interest paid to its lender at an illegal rate. *Bon Street* pre-dates both Garland No. 1 and Garland No. 2 and the decision may be questionable in the light of those later authorities. In any event, *Bon Street* involved a negotiated commercial agreement between sophisticated parties with the benefit of legal advice. I do not think it has any parallel to the standard form agreement unilaterally imposed on the borrowers here. This Court observed that the resolution of the juristic reason issues should not require individual assessment in another payday loan case, *Bodnar v. The Cash Store Inc.*, 2006 BCCA 260 at para. 17. In my view, the learned judge did not err in rejecting the submission that individual assessment was necessary.

### The Unconscionable Trade Practice Issue

- [26] The learned judge concluded that loans to class members at a criminal interest rate were "unconscionable acts or practices" within s. 4 of the Trade Practice Act, R.S.B.C. 1996, c. 457 ("TPA"), and s. 8 of the Business Practices and Consumer Protection Act, S.B.C. 2004, c. 2 ("BPCPA"). BPCPA s. 8 replaced TPA s. 4 as of 4 July 2004 and claims of class members are on both sides of the transition. There is no significant difference between the statutes so far as the issues here are concerned and it is sufficient to refer only to the definition of an unconscionable act or practice in s. 8 of the BPCPA (formerly s. 4 of the TPA):

8(1) An unconscionable act or practice by a supplier may occur before, during or after the consumer transaction.

- (2) In determining whether an act or practice is unconscionable, a court must consider all of the surrounding circumstances of which the supplier knew or ought to have known.
- (3) Without limiting subsection (2), the circumstances that the court must consider include the following:
  - (a) that the supplier subjected the consumer or guarantor to undue pressure to enter into the consumer transaction;
  - (b) that the supplier took advantage of the consumer or guarantor's inability or incapacity to reasonably protect his or her own interest because of the consumer or guarantor's physical or mental infirmity, ignorance, illiteracy, age or inability to understand the character, nature or language of the consumer transaction, or any other matter related to the transaction;

- (c) that, at the time the consumer transaction was entered into, the total price grossly exceeded the total price at which similar subjects of similar consumer transactions were readily obtainable by similar consumers;
- (d) that, at the time the consumer transaction was entered into, there was no reasonable probability of full payment of the total price by the consumer;
- (e) that the terms or conditions on, or subject to, which the consumer entered into the consumer transaction were so harsh or adverse to the consumer as to be inequitable;
- (f) a prescribed circumstance.

A OK does not dispute that it is a "supplier" and its loans are "consumer transactions" for the purposes of s. 8.

[27] The learned judge concluded that contravention of s. 347 of the Code was sufficient for the loans, as consumer transactions, to contain an unconscionable act or practice in breach of the BPCPA and TPA. A OK argues that the unconscionability provisions of the BPCPA and the TPA were intended to codify the equitable doctrine of unconscionability, citing *Drost J. in Watson v. Cull*, [1992] B.C.J. No. 2339 (QL) (S.C.):

While in the [Trade Practice Act, R.S.B.C. 1979, c. 406] the words "unconscionable" and "transaction" have become uncoupled, and the statute speaks of an "unconscionable act or practice" in relation to a "consumer transaction", my reading of the Act, including the examples set out in s. 4(2), satisfies me that s. 4 is an attempt on the part of the Legislature to codify the equitable doctrine of unconscionability.

A OK contends that s. 347 of the Code essentially creates a strict liability offence and contravention of that provision is not per se unconscionable. It submits that at a minimum it is entitled to discover individual class members on the circumstances referred to in s. 8(3)(a) to (d) of the BPCPA to support a defence that A OK did not engage in conduct that would offend those criteria. The respondent's position is that the class does not rely on any s. 8(3)(a) to (d) circumstances to demonstrate unconscionability. The respondent argues contravention of s. 347 is conclusive that the terms of the transaction were so harsh or adverse to the consumer as to be inequitable within s. 8(3)(e). On this theory individual circumstances of particular class members become irrelevant and there are no grounds for discovery of individual class members on unconscionability issues.

[28] This issue was considered in the context of class certification in *Bodnar*, at paragraphs 13 and 14. *Bodnar* concluded that for the purposes of s. 8(3)(e), the question whether the terms of the loans were so harsh or adverse as to be inequitable could be determined as a general proposition without canvassing individual circumstances. The learned judge applied *Bodnar* and concluded that individual assessments were unnecessary. Accordingly there was no need to canvass individual circumstances on discovery. She went on to conclude that illegality under s. 347 of the Code could be equated with unconscionability under s. 8 of the BPCPA, relying on the statement of Lambert J.A. in *Harry v. Kreutziger* (1978), 9 B.C.L.R. 166

at p. 178 (C.A.) that: "In my opinion, it is appropriate to seek guidance as to community standards of commercial morality from legislation that embodies those standards in law." I agree that interest charged at a rate determined to be illegal under the criminal law is unconscionable for the purposes of the BCBPA and the TPA, in the context of standard form consumer transactions. I would reject that ground of appeal.

## Conclusion

[29] I am not persuaded that the learned judge made any reviewable error in determining that the common issues were appropriate for disposition under Rule 18A . Nor do I not think that there has been any error of law demonstrated in the answers given by her to the common issues. Accordingly, I would dismiss the appeal.

"The Honourable Mr. Justice Mackenzie"

I AGREE:

"The Honourable Madam Justice Prowse"

I AGREE:

"The Honourable Madam Justice Saunders"

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