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A Matter of "*Interest*"

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By

In a decision that raised concerns for lenders earlier this year, the Superior Court of Justice held, in *Solar Power Network Inc. v. ClearFlow Energy Finance Corp.*[1], that the provision of a formula for determining the equivalent annual rate of interest applicable to a loan was insufficient for purposes of complying with the *Interest Act*.[2] Lenders will be relieved to hear that this decision has now been reversed on appeal. The Court of Appeal addressed a number of points raised on appeal.[3] However, we have limited our review to the main issue regarding the interpretation and application of s.4 of the *Interest Act*.

Background:

ClearFlow Energy Finance Corp. ("**ClearFlow**") had made various loans to Solar Power Network Inc. ("**Solar Power**"). Amounts payable in respect of the loans included the following:

(a) a base rate of interest of 12% per annum, compounded and calculated monthly, and 24% per annum in the event of a default;

(b) an administration fee of either 1.81% or 3.55%, charged when the loan is advanced and, if not paid off prior to expiry of the term, each time the loan is renewed; and

(c) a discount fee of 0.003% of the principal amount of the loan payable on the due date of the loan and every day thereafter until the loan is repaid.[4]

The loan agreement in question included the following formula to calculate the annual rate – a provision which lenders will have likely seen before in various iterations:

"Interest and Fee Calculations, Maximum Interest Rate

Unless otherwise stated, in this Agreement if reference is made to a rate of interest, discount rate, fee or other amount 'per annum' or a similar expression is used, such interest, fee or other amount shall be calculated on the basis of a year of 365 or 366 days, as the case may be. If the amount of any interest, fee or other amount is determined or expressed on the basis of a period of less than one year of 365 or 366 days, as the case may be, the equivalent yearly rate is equal to the rate so determined or expressed, divided by the number of days in the said period, and multiplied by the actual number of days in that calendar year."[5]

Solar Power, which eventually defaulted under its loan arrangement with ClearFlow, disputed the amount payable by it to ClearFlow on the basis that certain fees charged by ClearFlow were, in fact, interest charges and that because these interest charges were not expressed as an equivalent annual rate of interest, they failed to comply with s.4 of the *Interest Act*.[6] As a result, Solar Power argued that, pursuant to the terms of s.4 of the *Interest Act*, the maximum rate of interest payable on the loans should be limited to 5.0% per

annum.[7] Note that s.4 of the *Interest Act*provides as follows:

"Except as to mortgages on real property or hypothecs on immovable, whenever interest is, by the terms of any written or printed contract, whether under seal or not, made payable at a rate or percentage per day, week, month, or at any rate or percentage for any period less than a year, no interest exceeding the rate or percentage of five per cent per annum shall be chargeable, payable or recoverable on any part of the principal money unless the contract contains an express statement of the yearly rate or percentage of interest to which the other rate or percentage is equivalent."[8]

At the hearing, the application judge held that the administration fee did not constitute interest within the meaning of s.4 of the *Interest Act*, given that it did not have the hallmarks of interest. The administration fee was not compensation for the use of money, it was not tied to the principal amount of the loans, and it did not accrue or recur during the term of the loans.[9] Unlike the administration fee, however, the application judge found that the discount fee did constitute interest and, as such, the terms of s.4 of the *Interest Act* would apply. [10] ClearFlow took the position that the loan agreement provided a formula for calculating an annualized rate and that, accordingly, the discount fee complied with the provisions of s.4 of the *Interest Act*. Unfortunately for ClearFlow, the application judge was of the view that the formula fell short of satisfying the requirements of s.4 in not providing for an express, annualized statement of interest.[11]

As a consequence, the application judge found that s.4 of the Interest Act applied with the result that all interest on the loans, including the base rate, was limited to no more than 5%.[12]

Appeal:

On appeal, the Ontario Court of Appeal found no reason to interfere with the application judge's findings as to the characterization of the administration fee as a fee and the discount fee as constituting interest.[13] Given that the discount fee was viewed to be interest, the court proceeded to determine whether or not s.4 of the *Interest Act* was contravened.

The Court of Appeal was of the view that s.4 must be interpreted in light of modern commercial reality. The court noted that it is common commercial practice for commercial loans to provide an annualizing formula for the purpose of calculating interest and that a number of prior cases have found that such formulas satisfied the provisions of s.4 of the *Interest Act*, including formulas that are tied to variable rates or some standard external to the loan agreement. Accordingly, the Court of Appeal determined that the mathematical formula provided for in the loan agreement between Solar Power and ClearFlow served to establish a rate that satisfied the requirements of s.4 of the *Interest Act*.[14]

As such, no violation of s.4 was found to have occurred and interest (including the base rates of interest), at the rates negotiated between the parties and as set out in the loan agreement, was restored.[15]

Lenders will, no doubt, be relieved to see that the Court of Appeal elected to interpret s.4 of the *Interest Act* in a commercially reasonable manner and pleased that the court's decision now clarifies the uncertainty that resulted from the earlier, lower court's decision.

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[1]*Solar Power Network Inc. v. ClearFlow Energy Finance Corp*, 2018 ONSC 7286 [*Solar Power ONSC*].

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

[3]*Solar Power Network Inc. v. ClearFlow Energy Finance Corp*, 2018 ONCA 727 [*Solar Power*].

[4]*Solar Power ONSC*, at para. 11.

[5]*Solar Power ONSC*, at para. 48.

[6]*Solar Power ONSC*, at para. 5.

[7]*Solar Power ONSC*, at para. 6.

[8]*Interest Act*, s. 4.

[9]*Solar Power ONSC*, at paras. 36-39.

[10]*Solar Power ONSC*, at para 40.

[11]*Solar Power ONSC*, at para 63.

[12]*Solar Power ONSC*, at para. 105.

[13]*Solar Power*, at paras. 35-36, 41.

[14]*Solar Power*,at para. 53.

[15]*Solar Power*, at paras. 83-84.

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