INTEREST AND BONUS PAYMENTS IN THE LAW OF MORTGAGES *

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Two recent cases, one in Nova Scotia[1] and the other in Alberta,[2] have dealt with the problem of bonuses attached to mortgages of real property. In each case, the mortgagee (or his assignee) was unsuccessful in his attempt to fasten a bonus to the mortgage. As the bonus was eliminated in both cases, it would appear efficacious at this juncture in the development of the law to spend a little time on what will almost certainly prove to be a most topical subject.

The background of rates of interest and bonus payments as they apply to mortgages of real property is somewhat tangled due in large measure to the conditions and philosophies extant at the time of the cases in point. The farthest back one needs go is to the period in English legal history of the usury laws and their subsequent repeal.[3] There is little doubt that such a change as was effected by repeal was reflected in large measure in the enhanced power of the Chancery Court to deal with agreements between individuals which resulted in oppression or unfair advantage. This increased jurisdiction in the Chancery Court gave rise to equitable decisions controlling to a limited extent the rates of interest and bonus payments.[4] Certainly the leading case on the point, *Kreglinger v. New Patagonia Co.*,[5] decided the route to be taken by future courts faced with inordinate rates of interest and bonuses. In Lord Parker's words:

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1 *Longley v. Barbrick* (1962), 36 D.L.R. (2d) 672.

2 *Stephen Investments Ltd. v. LeBlanc* (1963), 37 D.L.R. (2d) 346.

3 By (1854), 17 and 18 Vict., c. 90.

4 As to excessive interest rates, see *Croft v. Graham* (1863), 2 DeG. & S. 155; 46 E.R. 334 and *Earl of Aylesford v. Morris* (1873), L.R. 8 Ch. App. 484 and as to bonus payments see *Barrett v. Hartley* (1866), L.R. 2 Eq. 789, in particular, at p. 795. Further reference might also be had to Smith, "Validity of Bonuses in Mortgages" (1927), 5 Can. Bar Rev. 161, at p. 163.

5 [1914] A.C. 25.

> In every case in which a stipulation by a mortgagee for a collateral advantage has, since the repeal of the usury laws, been held invalid, the stipulation has been open to objection either (1) because it was unconscionable, or (2) because it was in the nature of a penal clause clogging the equity arising on failure to exercise a contractual right to redeem, or (3) because it was in the nature of a condition repugnant as well to the contractual as to the equitable right.[6]

It is not difficult to conclude that the advent of high interest rates and large bonuses which followed hard on the heels of the repeal of the usury laws was soon to meet the confining influence of the equitable jurisdiction of the Court of Chancery and have thereafter a continued struggle for existence. The use of the words "oppressive" and "unconscionable" enables any court to encompass whatever actions the court wishes to envelop. It puts such discretionary power in a court then as to effect the standard thought desirable at any given time in the lending field. These standards obviously change as social conditions generally change and as particular fact situations at any time demand. One example from this jurisdiction will illustrate.[7]

The mortgagor (in 1902) borrowed £3,500 from the mortgagee on security of a property valued at only £2,500 for the purpose of operating a salt spring. The mortgagor was to repay £6,000 in cash and, as well, transfer to the mortgagee some £5,000 in paid-up shares of a company to be formed to operate the salt works. On a claim by the mortgagor that this repayment provision amounted to a clog on redemption and that it should therefore be relieved against, the court refused to comply with the request and held that "The difference between the sum loaned and the sum secured . . . does seem large . . . but no such defence [as oppression or surprise] was set up here . . ."[8] In thus ordering the bonus paid the court agreed that no inequity under these facts existed. This type of decision, allowing large bonuses and high rates of interest, may be seen in other jurisdictions as well.[9]

It is not difficult to see that a plateau was reached following repeal of the usury laws where there were no precise limits on the rate of interest or on the amount of the bonus. There was the

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6 *Ibid.*, at pp. 54-55.

7 *Buchanan v. Harvie* (1904), 3 N.B. Eq. 61.

8 *Ibid.*, at p. 67.

9 "A contract for payment to the mortgagee of a bonus in addition to the sum advanced is valid if the bonus is reasonable and the contract was freely entered into by the mortgagor." Halsbury's *Laws of England*, 3rd ed., vol. 27, p. 238.

ever present threat of an equitable remedy in the mortgagor based on oppressive treatment but this was rarely used as witness the New Brunswick case outlined above.

The next progression in the story of the bonus and the interest rate moves to the passage in Parliament of the Interest Act.[10] It would appear that this statute should have little if any bearing on matters of bonus or excessive rates of interest and thus little significance in this paper for the Act is definitely not a usury statute. It provides expressly that "any person may stipulate for, allow and exact . . . any rate of interest or discount that is agreed upon".[11] The real problem arises because of a further section in this statute on which a number of courts have dwelt in dealing with interest and bonus payments. It will be recalled that under the most familiar section of the Act, section 6, that if the mortgage is to be amortized by one of three methods, viz., blended payments of principal and interest, stipulated repayments or on the sinking fund plan, then no interest at all can be recovered by the mortgagee unless the mortgage contains a statement showing the principal amount and the rate of interest claimed.

A number of cases have arisen involving a promise by the mortgagor to repay not only the principal and interest but to pay a bonus as well and the courts have had to concern themselves with the effect of section 6 on such provisions. The burden of such cases is placed directly on the fact that the bonus sometimes makes it very difficult to determine exactly what the rate of interest is on the principal sum actually advanced.

In *Singer v. Goldhar*,[12] the mortgagee advanced the sum of $3,500 and the mortgagor covenanted to repay a total sum of $4,700 in monthly instalments. No mention was made of interest. The Ontario Court of Appeal held that the Interest Act applied and that as section 6 was not complied with (as no rate of interest was stated) no interest whatsoever was recoverable. While the mortgagor was informed as to the *amount* of bonus (or interest) he was paying he was not informed as to the *rate* of interest. The important function of this case in the jurisprudence of this facet of the law of mortgages is that it is a case which involves a method of repayment consonant with the Interest Act and brings into play therefore the exacting rules of that statute. Just how important this delineation is can readily be seen from the two major cases in this area which follow.

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10 R.S.C., 1952, c. 156.
11 *Ibid.*, s. 2.
12 (1924), 55 O.L.R. 267.

In *London Loan and Savings Co. v. Meagher*,[13] the mortgagee advanced $30,000 to the mortgagor and received in return the latter's cheque for $3,000. This was admittedly a bonus for the granting of the loan. The face of the mortgage deed disclosed that the rate of interest was 7½% and this to be applicable to the entire $30,000. The mortgagor argued that as all that had really been advanced was $27,000 and as the 7½% was stated to be on the $30,000, a true rate of interest was not being expressed as required by the Interest Act. The Supreme Court of Canada was able to evade the real issue which is present here however by deciding that the method of repayment in this mortgage was not one of those three outlined in section 6 and therefore no requirement of a stated, correct rate was present. *Singer v. Goldhar* was distinguished on this basis and accordingly no decision could at this stage be made on the still pervasive question of the validity of a mortgage which had a bonus and interest provision and did come within the Interest Act by reason of the mortgage repayment procedure.

The latest case in this trilogy, *Asconi Building Corp. v. Vocisano*,[14] also before the Supreme Court of Canada, dealt with two mortgages with face values considerably in excess ($5,000) of the amounts actually advanced. The $2,500 not advanced on each mortgage was agreed to represent interest of $1,500 and a bonus of $1,000. The mortgagor again proposed to the court that he should pay no part of the $2,500 on either mortgage as section 6 was not complied with in that no interest rate had been established or stated in the deed. Again the court decided in favour of the mortgagee in holding that this was not a section 6 case, not being an amortization plan identical with one of the three there outlined.

A consideration of these three cases may lead one to the conclusion that if the mortgagor promises to repay the principal sum together with interest at stated intervals (the most common method of repayment today, blended payments) and also promises to pay a bonus, then the interest rate must be stated exactly so as to cover all the surplus over the principal. It may be submitted that while no interest or bonus could be recovered if no rate was stipulated (in the light of the wording of section 6), if a rate is expressly set forth but it covers only the actual interest and not the bonus then the bonus itself is not recoverable but the interest

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13 [1930] 2 D.L.R. 849.
14 [1948] 1 D.L.R. 794.

is. Section 7 of the Interest Act may lead one to this conclusion.[15] An Ontario case apparently buttresses this view.[16] The correlative of this conclusion however is as important as the conclusion itself. It is this: if the method of amortization is not one of the three as in section 6, then no rate of interest at all need be stated and so far as the Interest Act is concerned any amount of bonus and any rate of interest can be charged, separately or in conjunction with each other.

With these two conclusions in mind an approach should then be made to Mr. Justice Coffin's decision in the recent Nova Scotia case of *Longley v. Barbrick*.[17] The facts of this case provide a somewhat sad tale. Beatrice Barbrick telephoned a realtor in Halifax, Town and Country, and requested a loan of $2,500. Mr. Hickey at Town and Country remarked that he thought that could be arranged and agreed to call her back. This he did, and said that the manager had consented to grant her a loan of $2,500 at an interest rate of 8% for 96 months. She later signed a mortgage in a lawyer's office, not having read it, for $5,000. She signed, as well, a collateral agreement in the same terms. The mortgage was then assigned to Mr. Longley for $3,170. It should be mentioned that this was a first mortgage on a valuable piece of property. Mr. Justice Coffin is presented squarely with the problem of determining the validity of a mortgage which has an interest rate of 8% of $5,000, a bonus of 100% leaving a cash advance of $2,500. At last a case in which there is a bonus, a rate of interest stated *and* a method of repayment falling within and therefore calling into play the Interest Act.

The choice of the method of handling this problem is extremely interesting. Mr. Justice Coffin, in his usual painstaking way, first concluded that the provisions of the Interest Act applied to this mortgage because of the method of repayment and then went on to say that as there was here a collateral agreement for bonus this set off the bonus as something distinct from either principal or interest. On the basis of the reasoning of the courts in both *Meagher* and *Asconi*, the bonus was valid under the Interest Act. In other words, in Coffin, J.'s mind, so long as the bonus is set out separately, the interest rate applying to the princi-

15 "Whenever the rate of interest shown in such statement is less than the rate of interest that would be chargeable by virtue of any other provision, calculation or stipulation in the mortgage, no greater rate of interest shall be chargeable, payable or recoverable, on the principal money advanced, than the rate shown in such statement."

16 *Rogers v. Labour* (1929), 36 O.W.N. 316. Noted in (1929), 7 Can. Bar Rev. 555.

17 (1962), 36 D.L.R. (2d) 672.

pal sum being stated correctly under the Act, all the interest is recoverable. It seems reasonable to accept this argument when one realizes that the spirit of the Interest Act is being complied with in that the borrower is being apprised exactly of what this money is costing him. He knows the rate, the principal to which this rate applies, and the full amount of the bonus.

It follows clearly therefore that one can do one of two things to extract a bonus successfully in the mortgage business. First, be sure the method of repayment is such that no application of the Interest Act is possible (as in *Meagher* and *Asconi*) or second, if the mortgage is to be repaid on say a blended basis, and thus the Interest Act provisions are to be superimposed on the transaction, segregate the bonus clearly so that it cannot be construed as interest[18] and if all other aspects are above-board all will be well.

It is because all other aspects were not above-board in the *Longley* case that it must be pursued further. It is obvious from the beginning of Mr. Justice Coffin's judgment that he was bothered a great deal with the size of the bonus.[19] After considering the judgments in the *New Patagonia* decision and the writings of Dean Falconbridge on the issue, Mr. Justice Coffin was able to conclude that while "the agreement could be upheld"[20] under the Interest Act, it must be struck under the equitable rules already laid down as "unfair and unconscionable".[21] The fact that the amount of the bonus was "entirely out of proportion" to the amount actually advanced provided the convincing manner of decision. This was not speculative property and no risk of security was involved. The mortgage was reduced to $2,500 bearing interest on that sum at 8%.[22] It bears repeating that the size of the bonus alone was the factor which convinced Mr. Justice Coffin.

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18 In *Attorney-General for Ontario v. Barfried Enterprises Ltd.* (1963), 42 D.L.R. (2d) 137, the Supreme Court of Canada reinforced the *Meagher* and *Asconi* decisions respecting bonus. It is stated, at p. 146: "It is now established that in considering s. 6 of the Interest Act, a bonus is not interest and the fact that interest may be payable on a total sum which includes a bonus does not involve an infringement of the Act."

19 "It is not usual to have a bonus of such tremendous amount, particularly in the case of a first mortgage." *Ibid.*, at p. 676.

20 *Ibid.*, at p. 683.

21 *Ibid.*

22 The plea of *non est factum* was also accepted by Mr. Justice Coffin as a reason for reaching such a decision.

In the light of this last statement above, it is interesting to look at a case even more recent than this arising in Alberta. In *Stephen Investments Ltd. v. LeBlanc,*[23] the Supreme Court of Alberta declared "In order that the defendant succeed in setting aside an agreement on the ground that it is unconscionable it is essential that he establish the existence of a relationship between himself and the plaintiff which places him in a servient position to the plaintiff".[24] It is clear that the Supreme Courts of Alberta and Nova Scotia are saying vastly different things about the problem of large bonuses in mortgages. It is obvious that under the Alberta test, the decision in *Longley v. Barbrick* would have been that there was no oppression as the parties dealt always at complete arms length. As it turned out in Alberta, the court had to dismiss the defence based on oppression as the defendant was "a bright and intelligent young man, who was not without experience in everyday transactions".[25] This latter case involved a bonus of 50% and while this is only one-half of that in the Nova Scotia case, it remains an extremely large price to pay for the use of money.

As the *Stephen Investments* case turned out, the mortgagor achieved relief through another means which thus provides a further point of departure for this paper. This turns on an application of another federal statute, The Small Loans Act.[26] It will be remembered that under this statute, a loan (including a mortgage on real property) made by a money-lender (which includes one who does money-lending as a business or holds himself out as so doing) which is of the amount of $1,500 or less must bear interest at a rate not to exceed that stipulated under the Act. In other words, as to loans of a maximum value of $1,500, this is a usury statute.

Under the facts of the *Stephen Investments* case the amount of the face value of the loan was $2,250 although only $1,500 was actually advanced. It is, of course, important for future applications of the statute to realize that this court was able to come to the conclusion that the $1,500 figure mentioned in the statute is satisfied so long as the amount actually advanced is not in excess of this figure. The total indebtedness has no relation therefore to the question of applicability of the statute; only the amount of the actual loan after the interest and bonus are scraped away.[27]

23 (1963), 37 D.L.R. (2d) 346.
24 *Ibid.*, at p. 349.
25 *Ibid.*
26 R.S.C., 1952, c. 251; as amended by (1956), 4-5 Eliz. II, c. 46.
27 Not only will the court reform the deed but the power is given it to find the lender guilty of an offence and levy a maximum fine of $1,000 or to a term of imprisonment of one year maximum, or both: section 3(1).

While no New Brunswick court has as yet been faced with a modern set of facts on a bonus question (or for that matter an extremely high rate of interest question), it is abundantly clear that if the amount of the loan fits the requirements of The Small Loans Act then this Act will work its way into this side of the lending field in New Brunswick. So far as mortgages on real property are concerned this will be largely felt in the second mortgage business. One then who makes a practice of such loans is going to have to be careful to abide by this federal statute as regards both rates of interest and bonus.

In respect to loans in this province in excess of $1,500, and say then the majority of mortgage loans, or certainly the majority of first mortgage loans, no decision is as yet available on the treatment to be accorded high rates of interest (which perhaps is not as important in the light of today's availability of money) and bonus payments.

With respect to these matters, some prognosis can be effectively made. It is clearly possible that two possible routes may be taken. The first is to channel all these questions directly into the courts and have them dealt with on a "dog-law" basis. That is, when the question of the legality of a bonus payment arises out of a concrete fact situation, let the court seized of the case then choose to adopt the reasoning of Mr. Justice Coffin and declare the high bonus figures inequitable in a generally non-speculative transaction; or, allow such court to partake of the decision from Alberta and declare such to be valid so long as no oppression can be proven arising from the relationship of the parties. This course does have the advantage of injecting an element of flexibility into the course of justice which is always to be desired but it has as a corollary the usual companion of flexibility, the loss of predictability. An *ex post facto* explanation can never be satisfactory of course to a client who has relied on the advice of his counsellor.

The second route that may be chosen is the legislative approach. A New Brunswick statute, similar to that now in force in Ontario,[28] and approved as to constitutionality recently by the Supreme Court of Canada,[29] is one statutory solution. While this no doubt has some efficacy in Ontario, it is apparent that the wording of the statute does not accomplish fully what some might

28 The Unconscionable Transactions Relief Act, R.S.O., 1960, c. 410. Similar legislation exists in other provinces or is being actively considered by them. It seems that the decision of the Supreme Court of Canada on the Ontario statute has had a catalyzing effect.

29 In *Attorney-General for Ontario v. Barfried Enterprises Ltd.* (1963), 42 D.L.R. (2d) 137.

desire in that it is only a quasi-usury statute. That is, it gives wide discretionary powers to a court to re-open a mortgage transaction and study its terms from a base composed of equitable principles made up in themselves of the concepts of harshness and matters of an unconscionable nature. It would appear therefore that this is legislation largely declaratory of the common law principles outlined above. The sanction of the legislature is of course a force to be reckoned with.

In conclusion, one should state that the course of the law in this area obviously depends to a large degree on one's point of view. The writer would prefer therefore to merely restate the alternatives: a bonus payment or a high rate of interest will provide a possible crutch for a mortgagor who deems himself badly used if he can convince the court today that the transaction is inequitable either because it is harsh and oppressive (and thus inequitable) due to the amount of money involved in the bonus or the high rate of interest (thus adopting the reasoning of Coffin, J., in *Longley v. Barbrick*) or because the borrower was oppressed due to the relative positions of the parties (under the Alberta thesis). This plea will be necessary of course only if the amount of the loan exceeds $1,500.

As regards the future, the writer further ventures the opinion that if legislation is thought necessary to bring complete protection for the mortgagor to fruition then two alternatives are as well present here: the first is to adopt a statute similar to the Ontario Unconscionable Transactions Relief Act and the second is to adopt a statute which is somewhat more definitive in that it establishes rates of interest (or total charges) similar in kind to the Small Loans Act. It would appear that the latter course, so far as legislation is concerned, is preferable in that the former is merely repetitive of the possible picture at common law. The constitutionality of such precise measures remains in doubt however as the ruling of the Supreme Court does not appear so wide as to allow a definite procedure.