Privy Council Appeal No. 22 of 1991

Imperial Life Assurance Company of Canada *Appellant*

v.

Efficient Distributors Limited *Respondent*

FROM

THE COURT OF APPEAL OF THE BAHAMAS

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 9TH MARCH 1992

Present at the hearing:-

LORD KEITH OF KINKEL
LORD ROSKILL
LORD TEMPLEMAN
LORD JAUNCEY OF TULLICHETTLE
LORD LOWRY

*[Delivered by **Lord Keith of Kinkel**]*

This appeal from the Court of Appeal of The Bahamas raises an issue concerning the true construction of section 3 of the Rate of Interest Act 1948. The relevant provisions of that Act are these:-

Section 3

"The rate of interest which may be charged by any person on any loan of money made after the commencement of this Act shall not directly or indirectly exceed twenty per centum per annum simple interest on loans of more than £25, or thirty per centum per annum simple interest on loans of twenty-five pounds or any less amount irrespective of the date fixed for repayment of the said loan."

Section 4

"Any contract, promissory note, bill of exchange, cheque, receipt or any other document entered into after the commencement of this Act, whereby a rate of interest higher than that authorized by section 3 purports to be payable either expressly or by implication in respect of any loan, shall be absolutely null and void, and no proceedings shall be entertained in any Court either for the recovery of the loan or of any interest thereon."

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Section 7

> "Any person who contravenes or attempts to contravene any of the provisions of this Act shall be guilty of an offence, and shall be liable on summary conviction to a fine of £100 or six months imprisonment or to both."

Put shortly, the question is whether, on a proper construction of section 3, it is contravened by a provision in a mortgage deed to the effect that, if the borrower fails to pay any instalment of interest within 14 days after the due date, the interest in arrear is to be capitalised by way of compound interest and added to the principal to form one aggregate sum, by reason that, in the event of the borrower defaulting on his interest payments over a protracted period, the total amount of interest which he would eventually be liable to pay on the original principal sum lent plus accumulated arrears of interest, would amount to a higher percentage of that principal sum than is permitted by the section.

The Chief Justice and a majority of the Court of Appeal of The Bahamas (Henry P. and Melville J.A., Smith J.A. dissenting) answered this question in the affirmative.

The facts of the case are these:

By an Indenture of Mortgage dated 16th May 1983 the respondent mortgaged certain property to the appellant as security for a loan of $95,000, repayable over 20 years by monthly instalments of combined principal and interest of $1026.93 commencing on 1st July 1983. The rate of interest on the loan was stated to be 12% per annum payable semi-annually. Clauses 6 and 7 of the Indenture gave the borrower an option to redeem the mortgage prematurely on payment of a sum equivalent to interest for a certain period. Clause 4(6) provided:-

> "If any instalment of Principal and interest payable hereunder shall not be paid within fourteen (14) days after the date appointed for payment thereof then as from such last mentioned date but without prejudice to the Lender's other rights under the covenants herein contained interest in arrear shall be capitalised by way of compound interest and added to the Principal to form one aggregate sum."

Clause 5(1) provided that in the event *inter alia* that two of the monthly instalments provided for should be in arrear the lender might by notice in writing call in the principal sum. By letter to the respondent dated 27th January 1987 the appellant stated that the respondent was in arrear to the extent of three monthly instalments and gave notice of calling in the principal sum.

On 22nd July 1988 the appellant issued an originating summons claiming payment by the respondent of all monies due under the Indenture of Mortgage, and various other remedies. On 2nd March 1989 the respondent took out a summons for the striking out of the appellant's originating summons on the ground *inter alia* that the Indenture of Mortgage was null and void by virtue of sections 3 and 4 of the Act of 1948. The matter came before Chief Justice Telford Georges, who on 25th July 1989 made an order declaring that the mortgage was null and void and dismissing the appellant's originating summons. The appellant appealed, but on 20th September 1990 the Court of Appeal by a majority affirmed the order of the Chief Justice. The appellant now appeals to Her Majesty in Council.

The respondent led evidence before the Chief Justice to the effect that if the borrower failed to pay any instalments of principal and interest at all over a period of $5\frac{1}{2}$ years a rate of interest of 12% compounded annually would result in an interest charge which calculated as a percentage of the sum originally advanced would exceed 20%. The Chief Justice and the majority of the Court of Appeal took the view that the mere existence of the possibility of this happening had the result that section 3 of the Act of 1948 was contravened by the mortgage.

In this case the rate of interest payable on the sum of $95,000 originally advanced did not directly exceed 20% per annum - it was only 12% per annum. Did it do so indirectly? The answer to this depends on whether or not the interest element in any monthly instalment in respect of which the borrower was in default, and which by virtue of Clause 4(6) of the mortgage fell to be capitalised and added to the principal sum, is properly to be regarded as a further advance, itself bearing interest at 12% per annum.

In *Paton v. I.R.C.* [1938] A.C. 341 the question to be decided was whether, in a situation where a bank had advanced a sum of money at interest and had debited the borrower's account with interest on the advance half-yearly, carrying forward the accumulated amount, the borrower properly fell to be treated as having paid the half-yearly interest so as to be entitled to recover from the Inland Revenue income tax on the amounts in question. The House of Lords held that he was not. In the course of making their decision the House considered the legal effect of the banker taking half-yearly rests and carrying forward the accumulated balance. Lord Atkin, at page 350 quoted with approval from the opinion of Lord Justice-Clerk Inglis in *Reddie v. Williamson* (1863) 1 Macph. 228, at page 237, including in particular this passage:-

"The privilege of a banker to balance the account at the end of the year, and accumulate the interest with the principal, is founded on this plain ground of equity, that the interest ought then to be paid, and, because it is not paid, the debtor becomes thenceforth debtor in the amount, as a principal sum itself bearing interest."

Lord Atkin continued:-

"As I understand this judgment the Lord Justice-Clerk, so far from saying that the interest is paid or is deemed to be paid, is saying that it is unpaid, and, because unpaid, the customer becomes debtor in the account as a principal sum."

So the position as regards yearly or half-yearly rests taken by the custom of bankers is that unpaid interest becomes part of the principal sum owing by the borrower. In the present case the respondent was by the terms of the mortgage specifically obliged to pay each monthly instalment, including the interest element in it, as and when it fell due. Unpaid interest became a principal sum owing in addition to the principal sum originally lent, and as such carrying its own interest charge. With each instalment in respect of which default is made the total amount of interest payable increases, but that does not mean that there is any variation in the rate of interest chargeable on the original loan. That rate is not increased directly or indirectly but remains what it always was, namely 12%.

It is noteworthy that the Act of 1948, differing in this respect from the now repealed British Moneylenders Act 1927, does not specifically strike at agreements for compound interest. Section 7 of the latter Act did, however, contain a proviso expressly saving provisions in a moneylending contract entitling the moneylender to charge simple interest upon any sum payable by way of interest in respect of which the borrower was in default. It is possible to envisage cases where a rate of interest exceeding the maximum permitted by section 3 of the Act of 1948 could indirectly become payable under an agreement providing for compound interest, for example where the loan is for a fixed period with rests and interest is not payable till the end of the period. But that would be a case where compound interest is forced on the borrower and is clearly distinguishable from the case where interest is capitalised only upon default by the borrower.

Their Lordships conclude that sections 3 and 4 of the Act of 1948 do not, upon a proper construction, strike at the capitalisation of unpaid interest upon default by the borrower. It thus becomes unnecessary to give any consideration to the Rate of Interest (Amendment) Act 1990 which appears to have been designed to reverse retrospectively the effect of the decision of the Court of Appeal in the present case

and which is the subject of constitutional proceedings in The Bahamas.

Their Lordships will humbly advise Her Majesty that the appeal should be allowed, that paragraphs 3 and 4 of the order of the Chief Justice dated 25th July 1989 should be set aside, and that the respondent's summons dated 2nd March 1989 should be dismissed. The respondent must pay the appellant's costs of the hearings before the Chief Justice and the Court of Appeal and before this Board.