

The Lawyers Weekly – Focus on Corporate Commercial Law
October 12, 2007

Time To Re-Examine Demand Promissory Note Precedents

Rarely does a case require commercial lawyers to review and revise a frequently used precedent such as the demand promissory note. *Hare v. Hare* is such a case.

In December 2006 the Ontario Court of Appeal provided a clear, if somewhat controversial answer to the following question: At what point does a demand promissory note become unenforceable due to the running of a limitation period? In many instances, the answer in Ontario is two years from the date the note is issued. This result comes as an unwelcome surprise to many lawyers and their clients.

In decisions under s. 45(1)(g) of the former *Limitations Act* (the “former Act”) the courts determined an action on a demand note was barred unless commenced within six years of issuance. When commercial lawyers reported on transactions involving a demand note, they should have warned their clients that the note could become statute-barréd within six years of issuance. I suspect that seldom happened. This failure to warn may be due in part to the intuitive and commercially reasonable view of most commercial lawyers that the limitation period for a demand note wouldn’t start to run until there’s default following a demand for payment. This view was wrong.

The *Limitations Act, 2002* (the “new Act”) establishes a 2-year limitation period for most claims but commencement of the limitation period is tied to discoverability. Under the former Act commencement was tied to when a cause of action arose. In *Hare v. Hare* the court had to determine if time starts to run when a demand note is issued, as determined under the former Act, or if the concept of discoverability in the new Act can be construed as altering the common law.

In a 2 to 1 decision, the Court held the new Act did not change the common law. The limitation period for a demand note starts to run when the note is issued and not, as some commentators had hoped, (and as found by dissenting Justice Juriansz), at the time of default following a demand.

For banks and other institutional lenders the decision may not be of concern. The Court confirmed that any payment of interest, or partial payment of principal, is an acknowledgment of debt, which restarts the limitation period. In other contexts, such as estate planning, loans to related parties, and private companies, demand notes are used to evidence a loan. No interest or principal is paid for years. In those situations two years is very short.

In *Hare v. Hare* a mother loaned her son \$150,000 in February 1997 and received a promissory payable on demand with interest. The son made one interest payment in October 1998. In November 2004 the mother issued a demand. When the son failed to pay she commenced an action in February 2005. The Court had to determine when the claim was discovered. The majority held there was nothing to be discovered because “the law is well settled that a lender has the right to immediate repayment of such [demand] loans”.

Discovery occurs when the note is issued. Under the transitional provisions of the new *Act*, the 6-year limitation period of the former *Act* applied. It had expired in October 2004, six years from the last payment of interest but several months before the mother’s claim was issued. Her action was statute-barred. The decision was not appealed despite a strong dissent. For demand notes issued after January 1, 2004 the transitional rules do not apply. The basic limitation period is two years.

The Business Law Section of the Ontario Bar Association wrote to the Attorney General requesting an amendment to provide the 2-year limitation period not start until there is a default following a demand. There has been no indication an amendment will be enacted.

Practitioners need to consider revising their demand promissory note precedents. Additional reporting may be required to alert clients to the 2-year limitation period. Section 22 of the new *Act* permits parties to vary or exclude limitation periods in a non-consumer context. A note could stipulate that the 2-year limitation period will not start until there is default following a demand.

Another approach is a promissory note payable 10 or 15 days after demand. The Court emphasized that a lender under a demand note is entitled to require immediate payment. If there is a waiting period after demand, a lender cannot require payment until the waiting period has expired. There is something to be discovered and it cannot be discovered until the end of the waiting period.

Acknowledgments of liability under s. 13 of the new *Act* restart limitation periods. The acknowledgment must be in writing and signed by the person making it or its agent.

Everyone using demand promissory notes needs to be aware of the decision in *Hare v. Hare*. There are a number of ways to deal with the result but those who are unaware, or who do nothing, are at risk.

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