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DEMAND PROMISSORY NOTES & ESTATES

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DEMAND PROMISSORY NOTES & ESTATES

(Promises Aren't Forever)

Craig Vander Zee (Hull & Hull LLP)[1]

OVERVIEW

When an adult child receives a significant sum of money from a parent during a parent's lifetime, the intentions of both the parent and child need to be determined and defined regarding the payment. The child may consider the payment a gift without conditions regardless of the parent's intention. The parent, on the other hand, may intend that the payment be either: (i) a gift, (ii) a loan to be repaid, or (iii) an advance on an inheritance to be taken into account in the division of the parent's estate. By canvassing the express intentions of the parent, in particular, misunderstandings can be avoided.[2]

When a parent considers such a payment to be a loan, it is frequently evidenced by way of a demand promissory note that the parent, and perhaps other members of the family, expects will be repaid in full. Depending on the particular circumstances, however, a parent might not follow up on the enforcement of the demand promissory note thinking that he or she can ask that the money be paid sometime in the future. It may be that an adult son or daughter may have started paying interest on the note but, for whatever reason, stopped paying interest.

However, the ability to enforce the payment of a demand promissory note does not last forever!

Historically, a demand loan has been held to mature as soon as it is delivered and where the loan is repayable on demand, the Limitations Act, R.S.O. 1990, c.L.15 ("the Former Act") applied to bar an action unless commenced within 6 years of the funds being advanced.

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2 For a commentary on issues that may arise with payments from a parent to an adult child, see "It's a Gift! It's a Loan! It's an Advancement!", written by Anne Werker, Hull & Hull LLP's Probater, Volume 9, Number 4, November 2005

Under Ontario's new *Limitations Act*, S.O. 2002, c.24 ("New Act"), which came into effect on January 1, 2004, the limitation period was reduced to two years. However, given the language of the New Act, it was arguably open to interpretation as to whether the law had changed in respect of demand promissory notes such that refusal to repay the loan now triggered the running of the limitation period.

The Ontario Court of Appeal's December 2006 decision in *Hare* v. *Hare,* [2007] 83 O.R. (3d) 766 deals with this very issue and the limitation periods applicable to the enforcement of a demand promissory note.

The following reviews the motion judge's decision[3] as well as the appellate decision in *Hare*, and discusses a number of considerations in dealing with demand promissory notes in the estate context, or otherwise.

HARE V. HARE

Background

In *Hare*, a parent (Mary Hare, the plaintiff) loaned her son (Brian Hare, the defendant) money in February 1997. By a promissory note dated February 10, 1997 the defendant promised to pay the plaintiff on demand, the sum of $150,000.00. The note indicated that the loan was payable on demand with interest calculated at the rate of prime plus 1.0% per annum.

The defendant last made an interest payment on October 26, 1998. No payment in respect of the note had been made since then. On November 10, 2004, the plaintiff made a demand for repayment. No payment was forthcoming. On February 17, 2005, she commenced an action for repayment of all sums due on account of the note.

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[3] [2006] O.J. No. 5502

Motion for Summary Judgment

The defendant moved successfully under Rule 20 of the *Rules of Civil Procedure* for summary judgment dismissing the claim.

Although the motion judge indicated that the plaintiff's argument was superficially attractive, he rejected the plaintiff's argument that the limitation period in the New Act applied to the claim as well as the plaintiff's argument that it was the refusal of the plaintiff's November 10, 2004 demand letter that constituted the act or omission that gave rise to the plaintiff's claim.

Applying the Former Act, the motion judge held that it was clear law that a demand note matures for all purposes as soon as it is delivered, and that in these circumstances, where the loan is repayable on demand, s. 45(1)(g) of the Former Act applied to bar an action unless it was commenced within 6 years of the funds being advanced.

In this case, the limitation period was started afresh by reason of the last payment on October 26, 1998. The action was not, however, commenced within six years of the funds being advanced, so it was barred by s. 45(1)(g)[4].

The plaintiff appealed.

Appeal

In a split decision (2-1), the majority of the Court of Appeal dismissed the appeal by the plaintiff. The divergence of the Court in this decision is particularly interesting.

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[4] The order of the motion Judge (Minden J.) arising from the motion for summary judgment was dated April 10, 2006. Minden J. referred to a number of cases in his decision. For ease of reference, the following is taken from Minden J.'s decision, "In my view, this situation is governed by clear and binding authorities, including the Ontario Court of Appeal's decision in Royal Bank v. Hogg (1929), [1930] 2 D.L.R. 488 (Ont. C.A.), and other cases to the effect that (p. 490) "a demand note matures for all purposes as soon as it is delivered." See also: Royal Bank v. Dwigans, [1933] 1 W.W.R. 672 (Alta. C.A.) at p. 675 & p. 677. In these circumstances, where the loan is repayable on demand, s. 45(1)(g) of the Limitations Act, R.S.O. 1990, CL.15 applies to bar an action unless commenced within 6 years of the funds being advanced; Wilkosz v. Amato, [1999] O.J. No. 1958 (Ont. S.C.J.), at paras. 49 and 50, and Spencer Investments Ltd. v. Hansford (1974), 48 D.L.R. (3d) 474 (Alta. T.D.), at para. 6. Here, the limitation period was started afresh by reason of the last payment: St. Hillaire et al. v. Kravacek et al. (1979), 26 O.R. (2d) 499 (Ont. C.A.). See also Montreal Trust Co. of Canada v. Vanness Estate, [2005] O.J. No. 594 (Ont. C.A.) at para. 2. Thus, the effective limitation period by which this action had to have commenced was October 26, 2004. Accordingly, this action commenced February 17, 2005 is statute barred."

Majority (E.E. Gillese J.A. and H.S. LaForme J.A.)

In short, aside from canvassing the applicable provisions of the Former Act and the New Act, the majority, agreed with the motion Judge and, reaffirmed that the law is well-settled that a lender has a right to immediate repayment of a demand promissory note. As there was no repayment period specified, the lender was entitled to require immediate repayment. The Court of Appeal rejected that appellant's submissions that the claim was "discovered" when her son refused the plaintiff's demand for payment on November 10, 2004.[5] The majority held that the former limitation period had expired and the plaintiff's/appellant's claim was statute-barred.

Among other things, the decision of the majority considered the following.

As the action was commenced on February 17, 2005, after the New Act came into force on January 1, 2004, in order to determine whether the appellant's claim was to be dealt with in accordance with the Former Act or the New Act, recourse was required to the transition provisions in s. 24 of the New Act.

Section 24(2) and 24(5) of the New Act state:

> 24(2) This section applies to claims based on acts or omissions that took place before the effective date and in respect of which no proceeding has been commenced before the effective date.
>
> ...
>
> 24(5) If the former limitation period did not expire before the effective date and if a limitation period under this Act would apply were the claim based on an act or omission that took place on or after the effective

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[5] Section 4 of the new *Limitations Act* creates a basic limitation period of two years following the discovery of a claim. It reads as follows:

> 4. Unless this Act provides otherwise, a proceeding shall not be commenced in respect of a claim after the second anniversary of the day on which the claim was *discovered*. (emphasis added)

The Court of Appeal held in *Hare* that none of the exceptions in s. 2 of the new *Limitations Act* apply to a demand promissory note so *prima facie* the appellant's claim (whether based on default after demand for repayment or the Note) would be subject to the two-year limitation period provided for by s. 4.

date, the following rules apply:

1. If the claim was not discovered before the effective date, this Act applies as if the act or omission had taken place on the effective date.
2. If the claim was discovered before the effective date, the former limitation period applies.

"Effective date" and "former limitation period" are defined in s. 24(1), which reads as follows:

24(1) In this section,

"effective date" means the day on which this Act comes into force; ("date de l'entrée en vigueur")
"former limitation period" means the limitation period that applied in respect of the claim before the coming into force of this Act. ("ancien delai de prescription")

The Court of Appeal noted that on a plain reading of s. 24(5), its rules apply if two conditions are met:

1. the former limitation period did not expire before January 1, 2004; and,
2. a limitation period under the new *Limitations Act* would apply if the claim were based on an act or omission that took place after January 1, 2004.

In determining whether the requirements of s. 24(2) had been met, the only issue was whether the appellant's claim was based on an act or omission that took place before the effective date.

The majority held that the act was the delivery of the note as extended by the making of an interest payment on October 26, 1998. As such, the requirements of s. 24(2) were met.

The Court of Appeal went on to conclude that s.24(5)(2) applied, as the claim had been discovered as of October 26, 1998.

The Court of Appeal acknowledged that the language of the New Act is very different from that of the Former Act noting that where the Former Act speaks of "action", the new legislation speaks of "claims". "Claim" is defined in s. 1 of the New Act as "a claim to remedy an injury, loss or damage that occurred as a result of an act or omission". [6]

Section 5 of the New Act ties the discovery of a claim to the notion of "injury, loss or damage". Section 5(1) reads as follows:

> 5(1) A claim is discovered on the earlier of,
>
> (a) the day on which the person with the claim first knew,
>
> (i) that the injury, loss or damage had occurred,
>
> (ii) that the injury, loss or damage was caused by or contributed to by an act or omission,
>
> (iii) that the act or omission was that of the person against whom the claim is made, and

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[6] Paragraph 29 of the Decision

(iv) that, having regard to the nature of the injury, loss or damage, a proceeding would be an appropriate means to seek to remedy it; and

(b) the day on which a reasonable person with the abilities and in the circumstances of the person with the claim first ought to have known of the matters referred to in clause (a).

In rejecting the appellant's argument, the Court found, among other things, that:

(i) in order to accede to the appellant's submission, one would need to accept that the legislature intended to change the law relating to demand notes by means of the New Act, a piece of legislation that is directed at limitation periods, not commercial law;

(ii) the appellant's interpretation, taken to its logical extreme, results in limitless liability. If a demand for repayment must be made before the limitation period would begin to run and no demand is made, the limitation period would never begin to run and the claim would exist in perpetuity; and

(iii) the alleged deficiency in the approach to limitation periods under the former legislation is that it failed to recognize that a person may not know of a cause of action at the time the limitation period commences. As such, the former approach could act to unfairly bar claims before potential plaintiffs had any knowledge of their causes of action. This concern does not arise in the case of demand promissory notes as the law is settled that a lender has the right to immediate repayment of such loans. There is nothing to be discovered by the lender before he or she becomes aware of their claim. They know of their claim immediately on receipt of the demand promissory note. [7]

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[7] The Court of Appeal noted in *Hare* that several commentators had suggested that the New Act should be interpreted as changing the law so that the limitation period would begin to run from the date of default of payment, as opposed to from the date of the promissory note. See, for example, Brian Bucknall, "The Limitations Act, 2002 and the Real Property Limitations Act: Some Notes on Interpretive Issues" (2004) 29 Advocates' Q. 1 at 19-21.

Costs

The Court of Appeal made no order as to costs indicating that (i) the case raised novel points of interpretation on which there is no existing judicial authority, and (ii) the issues are of broad significance and arise early in the life of the New Act.

Dissent (Juriansz J.A.)

It is certainly worth noting that Juriansz J.A., in his dissent, interpreted the New Act differently.

He states that (i) the general rule under the Former Act was the limitation period began to run on the date the cause of action accrued (section 45(1)(g) which applied to demand notes, stipulated that the action "shall be commenced... within six years after the cause of action arose", and (ii) section 4 (see footnote 5 above) of the New Act provides for a basic limitation of two years that begins to run, not when the cause of action arose, but on the day "on which the claim is discovered".

In considering section 5 of the New Act and the determination of this case, he noted that "it is neither necessary nor desirable to embark on an exhaustive consideration of the meaning of the "nature" of the injury, loss or damage. It is sufficient to say that the nature of the damage that flows from a freely advanced demand loan is latent or potential until the debtor defaults in making repayment. Until then, the creditor is in precisely the situation he or she expected to be in. The creditor has lent money to someone and expects that person to keep it until asked to repay it... It is only when the debtor fails to repay the money after a demand is made, that the creditor realizes the damage is not latent but actual. The creditor knows from the beginning that he or she is owed money, but only knows after the debtor has defaulted following a demand for repayment that he or she has a "bad debt"."[8]

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[8] Paragraph 83 of the Decision

He adds that a reasonable person who has extended a demand loan would know (i) from the common law that he or she was entitled to commence a legal action without first making a demand, (ii) a legal proceeding might not be necessary to collect the debt as the making of a demand may suffice, (iii) that commencing a legal action would be costly, and (iv) that the courts take a dim view of unnecessary litigation.

As a result of his analysis, Juriansz J.A. concluded:

"that the new Act applies, that the appellant did not discover her claim until following the demand for repayment made on November 10, 2004 and that the appellant's action was launched within the basic two-year limitation period which began on that day. Consequently, I would conclude that the motion judge erred in granting summary judgment. I would allow the appeal, set aside the summary judgment, and replace it with an order dismissing the respondent's motion for summary judgment."

Juriansz J.A. also notes that his finding would not be a departure from established commercial practice or common law rights.

IN THE ESTATE CONTEXT

Should either of the parent or the adult child, who has received the payment, die before the repayment of the demand loan, the estate trustee of the parent's or child's respective estate will become responsible for dealing with the demand loan and the potential enforcement of same.

Simply put, if the parent dies, his or her estate will be the creditor in respect of the loan, and the demand loan will be payable to the estate, unless the loan is forgiven in the parent's will, and/or is dealt with by way of a hotchpot clause, or some other agreement. If the child dies, his or her estate will be the debtor in respect of the loan and the loan will be payable by the estate, unless the loan is forgiven by the surviving parent.

Should the enforcement of demand loan be barred, by statute or otherwise, as a result of the conduct, that is an act or omission, of the estate trustee of the parent's estate, the

beneficiaries of that estate will no doubt hold the estate trustee accountable and liable for the loss and damages incurred as a consequence.

As such, the status of a demand loan granted by the parent must be considered by the estate trustee of the parent's estate.

With this in mind, the limitation periods applicable to claims in respect of a demand loan by or against an estate need to be considered.

As noted by Justin de Vries in his Article, "Understanding Limitation Periods" written in 2006, "pursuant to section 19 and the accompanying Schedule of the Act, limitation provisions in other Ontario legislation may be incorporated into the Act and will prevail over the basic two-year limitation period (plus discoverability). If a limitation period is not expressly incorporated, it will not be applicable and the basic two-year limitation period will apply. Relevant legislative provisions incorporated pursuant to s. 19 include:

Statute	**Section(s)**	**Limitation**
Estates Act	ss. 44(2), 45(2) and 47	Contesting claims against estate
Estates Administration Act	s. 17(5)	Distributing estate by court order
Family Law Act	s. 7(3)	Equalization claims
Succession Law Reform Act	s. 61	Dependant Support claims
Trustee Act	s. 38(3)	Actions by or against estate trustee

"

In dealing with the two-year limitation period under section 38(3) of the *Trustee Act*, the Ontario Court of Appeal held in *Waschkowski v. Hopkinson Estate (2000)*, 47 O.R. (3d) 370 that the discoverability principle did not apply and the two-year limitation period could not be extended.

It may very well be that a claim must be made by the estate trustee of the parent's estate on a demand loan well in advance of the second anniversary of the parent's

death depending upon the applicable limitation period attributable to the enforcement of the demand note.

It should be noted that an Attorney appointed pursuant to a Power of Attorney for Property granted by the parent or, alternatively, the adult child, might also have to consider the possible enforcement of a demand loan.

CONSIDERATIONS

During the parent's lifetime, the following considerations might be taken into account by and with the parent when a demand loan has been made by the parent to a child:

(i) ensure that at least interest payments are being made on the demand loan;

(ii) diarize the date for the expiry of the limitation period, assuming that no interest payments have been made;

(iii) have a new demand promissory note executed prior to the expiry of the limitation period, or, alternatively, enter into an agreement/acknowledgment in respect of the outstanding debt (there are potentially issues, however, with a forbearance agreement in respect of the limitation period which may render the forbearance agreement invalid or null and void);

(iv) whether the promissory note can be secured with collateral;

(v) make a demand for repayment of the loan well in advance of the expiry of the limitation period;

(vi) if in doubt, commence an action, by way of Notice of Action if need be, in advance of the possible limitation period; and

(vii) consider the loan in, and as a part of, the parent's estate plan.

The above considerations are not meant to be exhaustive.

A parent may wish to have a payment to an adult child dealt with as a loan during his or her lifetime so that, among other reasons, he or she can have access to the funds if and when necessary. However, the parent may wish to forgive the demand loan upon his or her death. In this circumstance, a provision in the Will may be made specifically forgiving the specific loan and/or any loan to this specific child that has been made.

The Will might also contain a hotchpot clause. A hotchpot calculation is a way of securing an equal division among siblings by a non-sequential increase of the estate by the amounts advanced to one or another child before death and a corresponding decrease in their respective entitlement. A hotchpot clause is included then where a parent does not intend that an *inter vivos* gift to a child or loan shall be duplicated with an equal entitlement to inherit from the estate.

For a comprehensive review of hotchpot clauses, see "Hotchpot Clauses – A Primer", a paper given by Corina Weigl at the 2001 Fourth Annual LSUC Estates and Trusts Forum.

It must be noted, however, that if a Will does contain a hotchpot clause but does not contain a provision to the effect that a loan to a child shall not be claimed as a debt, then the child who got the advance may still be liable to repay the estate. It may well be that if a discharge of the specific loan is not included in the Will that the estate may be insufficient to provide the other children with equal benefits, assuming the Will requires an equal distribution.

In her above noted paper, Ms. Weigl notes, in the context of bringing into account loans outstanding, a typical precedent for a Will as follows:

> "I declare that I have advanced by way of loan to my son, John, the amount of $x and this amount, together with any other sum that I may after the date of this my Will advance to him or for his benefit, or so much as may be owing to me at my death, shall not be charged or claimed as a debt owing to me from him or his representative, but every such claim, whether legally constituting a debt or not, with interest thereon from my death at the rate of x% per annum, but not any interest thereon prior to

> my death, shall be brought into account by way of hotchpot, in the division of the residue of my estate, as against my son, John and his wife and issue or other person or persons interested in his share of the residue of the estate."

Ms. Weigl then reviews various aspects of this clause in her paper. She notes turning to the words "advanced by way of loan" that "Loaned funds can be considered an advance if the testator so intends. In this situation the whole amount of the debt must be brought into hotchpot. This is so even if the debt is statute barred."[9]

In the end, as an estate trustee of the parent's estate, any and all documents, testamentary or otherwise, must be reviewed to determine, among other things, (i) the terms and status of the payment of the loan, (ii) whether the demand loan has been forgiven, and/or (iii) how the loan advanced is to be accounted for in respect of the parent's estate.

If the demand loan has not been forgiven and/or dealt with by way of a hotchpot clause, or other agreement, and is to be enforced, and there is any doubt as to the status of the demand loan, the estate trustee might, among other things, (i) consider certain of the above-noted considerations, (ii) need to commence a lawsuit, and/or (iii) bring an application seeking the opinion, advice or direction of the Court in respect of the issue regarding the demand loan.

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[9] Page 9-4 of the paper. The case referred to in Ms. Weigl's paper on this point is *Poole v. Poole* (1872) 7 Ch. 17.