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Blaneys on Business

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This newsletter is designed to bring news of changes to the law, new law, interesting deals and other matters of interest to our commercial clients and friends. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Corporate/Commercial group, Steve Popoff at 416.593.3972 or spopoff@blaney.com.

LIMITATION PERIOD FOR DEMAND OBLIGATIONS CONFIRMED TO BE TWO YEARS

Laura McLennan

The rules technically haven't changed, but lenders could be out of luck on demand notes which are more than two years old, as the Ontario Court of Appeal recently confirmed in *Hare v. Hare*.

Mary Hare loaned her son Brian $150,000 in February 1997. In return, Brian gave her a promissory note promising to pay $150,000 on demand and interest at the rate of prime plus 1% per year. Brian last made an interest payment in October 1998. In November 2004, Ms. Hare made demand for repayment. Brian made no payment of any kind and Ms. Hare started the action for recovery in February 2005. On a motion for summary judgment, the judge agreed with Brian's argument that the claim was barred by the *Limitations Act* and dismissed the claim. Ms. Hare appealed.

The Court of Appeal had to decide, first, whether the old *Limitations Act* (the "**Former Act**") or the new *Limitations Act, 2003* (the "**New Act**") applied to the action, and second, whether the action was statute-barred.

The rule under the Former Act is that the limitation period begins to run from the date the cause of action arises. For most claims, this limitation period was six (6) years. Since a creditor is entitled to sue on a demand note as soon as the note is given (without the necessity of demand being made), the cause of action arises, and the limitation period begins to run, on the date the note is given. Each time the debtor makes a payment or otherwise acknowledges the debt, the limitation period is restarted. For the purposes of the appeal, Ms. Hare conceded that her claim *arose* on the date the note was given.

The New Act creates both a "basic" limitation period of two (2) years and an "ultimate" limitation period of fifteen (15) years. If either period has expired the claim may not proceed.

The new basic limitation period, which applies to the majority of claims, begins to run on the date the cause of action is *discovered*. The New Act sets out the criteria for determining when a claim has been "discovered" as follows: the claim is discovered on the day on which the person with the claim first knew that (i) the injury, loss or damage ("damage") had occurred, (ii) the damage was caused by or contributed to by an act or omission, (iii) the act or omission was that of the person against whom the claim is made, and (iv) having regard to the nature of the damage, a proceeding would be an appropriate means to seek to remedy it.

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"The majority decision of Hare v. Hare confirms that creditors holding demand notes granted more than two years ago and on which no payment has been made in the last two years may find their actions for recovery barred by the Limitations Act, 2002."

Laura McLennan has just joined Blaneys' Corporate/Commercial group following the completion of her articles, and we are pleased to welcome her to the firm.

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The ultimate limitation period of 15 years created by the New Act begins to run on the "day on which the act or omission on which the claim is based took place", regardless of when the claim is discovered. In the case of default in performing a demand obligation, this day is defined, for the purposes of the ultimate limitation period only, to be the day "on which default occurs". "Default" is not defined by the New Act.

The New Act also has a number of complicated transition rules for dealing with those claims at various stages (for example, arisen but not yet discovered, discovered but no action commenced, etc.) when the New Act came into force and replaced the Former Act on January 1, 2004.

In the end, the outcome of the *Hare v. Hare* case turned on the Court's application of these transition rules and the determination of when Ms. Hare discovered her claim: if Ms. Hare had discovered her claim before January 1, 2004 then the six year limitation period under the Former Act would apply. If Ms. Hare did not discover her claim until after January 1, 2004, (say, when her demand for repayment was made), then the two year limitation period of the New Act would apply and would begin to run on January 1, 2004.

The majority of the Court held that Ms. Hare "discovered" her claim as soon as the note was given. The limitation period under the Former Act applied, but had expired, and so the claim was barred. Ms. Hare lost the appeal. The majority rejected Ms. Hare's argument that the legislature, through the incorporation of the discoverability principle into the New Act, clearly intended to change the old law such that the limitation period would begin to run from the date demand is made. In the Court's view, to hold that the limitation period does not begin to run until a demand for payment is made would result in indefinite liability, a result clearly not intended by the legislature.

Juriansz J.A., in dissent, was of the view that although the cause of action arose as soon as the note was given, the last of the four conditions necessary for a claim to be discovered – that the claimant know that a proceeding is an appropriate means to remedy the claim – could only be met once a demand for payment had been made and refused. Accordingly, Juriansz J.A. determined that the claim was not discovered until November 2004 and the limitation period had not expired.

The majority and minority decisions also diverged on the interpretation of the ultimate limitation period. The majority, seemingly ignoring the section of the New Act stating that the ultimate limitation period begins running from the day on which default occurs, held that the ultimate limitation period runs from the date the note is given. Once again, to the majority, to find otherwise would result in indefinite liability. Although not expressed in the *Hare* case, this interpretation leads to the conclusion that the limitation period for an action on a demand note will always expire two years after the making of the note, assuming no payments or acknowledgment by the debtor. The minority held that the ultimate limitation period runs from the date that demand for repayment is made, and found the potential for indefinite liability where no demand has been made to be both acceptable and intended by the legislature.

The bottom line? The case confirms that the New Act does not change the old law with respect to limitation periods for demand notes: the limitation period begins to run from the day

"In the wake of Enron, WorldCom and other corporate financial reporting scandals, securities regulators have been putting new rules into effect..."

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the note is issued, and will be restarted each time a payment is made or the debtor otherwise acknowledged the debt. What has changed, as of January 1, 2004, is the limitation period itself. It is now only two years instead of the more forgiving (at least to lenders) six years. The majority decision of *Hare v. Hare* confirms that creditors holding demand notes granted more than two years ago and on which no payment has been made in the last two years may find their actions for recovery barred by the *Limitations Act, 2002*.

Accordingly, lenders would be well advised to pull out their demand loan files and determine when the last payment or acknowledgment of the debt was made by the debtor, and to implement a policy of regular acknowledgments by debtors on their demand notes.

For new demand notes, there may be another solution. By virtue of recent amendments to the New Act the legislated basic limitation period may be suspended, extended, varied or excluded by an agreement between the parties made on or after October 19, 2006. The ultimate limitation period may be suspended, extended, varied, or excluded as long as the claim has been discovered at the time of the agreement. A provision within the demand note itself creating a longer limitation period, or prescribing when the basic limitation period begins to run, could reduce the risk of an action being barred and eliminate the hassle of bi-yearly acknowledgments. Some restrictions must be noted: only parties acting for *business purposes* and not for consumer (personal, family or household) purposes may shorten or exclude a legislated limitation period; individuals acting for consumer purposes are limited to agreements suspending or extending the legislated limitation period. ■

AUTHORITIES PUTTING FINISHING TOUCHES ON FINANCIAL REPORTING RULES

James Leech

In the wake of Enron, WorldCom and other corporate financial reporting scandals, securities regulators have been putting new rules into effect to improve the quality, reliability and transparency of financial reporting by public companies and restore public faith in capital markets.

The United States has enacted the *Sarbanes-Oxley Act 2002* (SOX). Under SOX, CEOs and CFOs must certify each periodic report containing financial and other disclosures that their companies file with the Securities and Exchange Commission. Further, management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting and for assessing the effectiveness of such internal controls over financial reporting (ICFR).

SOX also requires an independent auditor to attest to and report on management's internal control assessment. This is regarded as the most onerous provision of SOX. It has been sharply criticized within the business community.

Canada's capital markets are closely connected to the U.S. and are heavily affected by the real or perceived erosion of American investor confidence. As a result, the Canadian Securities Administrators (CSA) has taken measures here to address the issue of investor confidence and maintain the reputation of Canadian markets internationally. (The CSA is the national forum for the securities regulators of Canada's 13 provinces and territories.)

"...Canada's decision to not require auditor attestation of (internal controls over financial reporting) is a significant departure from the U.S. approach and could have lasting consequences."

Multilateral Instrument 52-109 (MI 52-109), which came into force in March, 2004, closely parallels the certification standards of SOX by requiring CEOs and CFOs of all reporting issuers in Canada, other than investment funds and U.S. inter-listed companies that already comply with SOX, to personally certify their issuers' annual and interim filings. These include issuers' information forms, financial statements, and management's discussion and analysis (MD&A). If something is found to be wrong in such filings, the CEO and CFO are personally liable for any misrepresentations.

CEOs and CFOs must also certify that they or their company have designed disclosure controls and procedures (DC&P) and a system of ICFR. Currently, they are obliged to assess and report on the effectiveness of the DC&P and disclose in their annual MD&A their conclusions about the effectiveness of the controls.

After much debate, the CSA decided last March not to proceed with any auditor attestation requirement. It did, however, signal its intention to have management evaluate and comment on the effectiveness of ICFR. Draft rules to this effect were expected to be released for comment in late 2006 to apply to financial years ending on or after December 31, 2007 at the earliest, but this had not happened as of the time of writing this article.

The CSA has provided no guidance on what form these controls will take. Management, therefore, has been left with the responsibility of determining how complex the controls should be. (This level of complexity may be a factor in determining whether an issuer sued under Ontario's new civil liability regime for deficient disclosure can rely on a due diligence defence.) It is hoped that the CSA will provide some guidance on how to design and implement the controls when they release the draft rules.

Canada's decision to *not* require auditor attestation of ICFR is a significant departure from the U.S. approach and could have lasting consequences. Supporters of the decision argue that it will benefit issuers by permitting them to design and implement controls that address their specific needs as opposed to the much more costly option of implementing controls to cover *all* risks in order to satisfy the auditors. Detractors, however, argue there is a real risk that the Canadian market will be perceived as lax on regulation and that this could raise the cost of capital for all domestic issuers.

Whatever the outcome, it is clear that the CSA has signalled its intention to find a made-in-Canada solution to internal control requirements, one that balances the costs and benefits associated with such requirements. The CSA has indicated that it will monitor the results of these requirements both at home and internationally, and consider whether in the future auditor involvement will be necessary to improve the quality and consistency of disclosure to investors. ■

Blaneys on Business is a publication of the Business Law Department of Blaney McMurtry LLP. The information contained in this newsletter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The information and views expressed are not intended to provide legal advice. For specific legal advice, please contact us.

We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Chris Jones at 416 593.7221 ext. 3030 or by email to cjones@blaney.com. Legal questions should be addressed to the specified author.

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