LENDING MONEY REPAYABLE “ON DEMAND”: BEWARE PRESCRIPTION!

“…prescription started its deadly trudge on the day the loan at issue in these proceedings was advanced” (extract from judgment below)

You will know that most debts prescribe (become unclaimable) after 3 years, so as a creditor you need to know exactly when it starts running. From that moment on, the clock is ticking…

A recent Constitutional Court case highlights one particular instance where prescription kicks in a lot earlier than you might think – namely, in the case of the “on demand” loan.

What “on demand” really means

Lending money to someone on an “on demand” basis means that the loan need only be repaid to you when you actually “demand” it from the debtor.

It’s a common way of making loans, particularly to family members and between related businesses, and you may think that because no fixed date for repayment is set, prescription never starts to run. Not, at least, unless and until you actually decide to call the loan in – perhaps in a week, or 5 years, or 50 years, whenever you want.

Not so! With an “on demand” loan - unless you agree otherwise - the loan is automatically “due and payable” on the day you advance the loan. The loan has, says our law, been due to you from Day 1 and all that “on demand” means is that you can call for repayment of that loan whenever you like. Prescription therefore starts “its deadly trudge” on the day you make the loan, not on the day you eventually call it in.

That’s a subtle distinction that might not sound that logical at first blush, but bear with us and we’ll have a look at what the Constitutional Court said about this. (Don’t worry if what follows seems complicated – it is! You can if you like just skip to the “practical” bit at the end).

On the “never-never” or not?

Company A lent Company B an amount of R3.05m on condition that it would be “due and repayable to the Lender within 30 days from the date of delivery of the Lender’s written demand”.

6 years later Company A demanded repayment and a year after that it applied for Company B’s liquidation on the basis of its inability to repay the amount then owing of R4.6m. The High Court dismissed the liquidation application, upholding B’s defence that the loan had prescribed.

The Supreme Court of Appeal agreed and so did the Constitutional Court, holding that -

A contractual debt becomes due as set out in the contract, and when no due date is specified, it “is generally due immediately on conclusion of the contract”.

Where however there is a “clear and unequivocal intention” that the creditor is entitled to determine the time for performance and that the debt becomes due only when demand has been made as agreed, prescription will only start running on that date.

On the facts (and the Court’s interpretation of this particular contract), A’s right to claim payment had arisen immediately on making the loan, A was “able to trigger repayment of the loan from [B] anytime” (at which stage B would have 30 days to pay), and therefore the claim had prescribed.

So company A is down R4.6m, plus no doubt a lot of interest and some serious legal costs (a journey through the High Court, Supreme Court of Appeal and Constitutional Court is for neither the faint-hearted nor the shallow-pocketed!).

The Court pointed out that sometimes, such as in cases of family members making loans to each other, it is clear that the loan is on a “never-never” basis and that the debt “won’t be due, in any sense, legal, technical or practical, until you say, ‘Please won’t you pay back’.” But with most commercial loan agreements, prescription starts to run immediately once the money is paid over unless the parties specifically agree otherwise.

The practical issue - not losing your money

Don’t worry if you find all that complicated – the Court itself was split 6-5 on whether the debt had prescribed or not – but the important thing is the practical issue of you not losing your money to prescription.

Here’s what you do - if you decide not to specify a repayment date but rather to make the loan repayable “on demand”, do specify exactly what you mean by that.