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Marine Loan Agreements – Commercially Absurd Repayment Terms

Loans between people and companies in the marine industry are common and frequently relied on when obtaining a loan through a commercial lender such as a bank is not possible or timely. These loans tend to be much less formal than bank loans, frequently papered by only a letter, emails or handwritten notes between the lender and borrower. Sometimes they are not papered at all and are only verbal agreements. Often these loans are made between parties who have ongoing business together, where the profitability of the lender's own business relies on the borrower's business staying afloat, so the lender has an interest in funding the borrower out of an immediate cash flow crisis. Revenue streams not being entirely predictable, lenders and borrowers can make repayment of such loans dependent on the happening of a future event, such as: "I will repay the $100,000 you lent me to repair my main engine out of money from my towing contracts once the tug is running". Such loans are called "contingent loan obligations" because the obligation to pay is contingent, or dependent, on the occurrence of another event. The question arises, however, what happens to the obligation to repay if the future event never happens?

A Sooke Marina Case:

One would assume this is a question frequently addressed by the courts, but a recent B.C. Supreme Court case involving a Sooke B.C. marina developer and a marine construction contractor is one of only a few B.C. cases to have considered this issue. In that case the marine contractor was hired to install a marina at an approximate cost of $520,000. The developer made progress payments of about $235,000 to the contractor, but fell behind in payments. The contractor continued to work on the marina, expecting to get paid once the developer received new financing, and because the contractor did not want a refusal to work to jeopardize the possibility of getting further work from the developer. Payment to the contractor was delayed, and the contractor ran short of cash to pay for materials and labour, so an investor who had an interest in the development lent the contractor $234,000 to fund the contractor's overhead to allow work to continue. The lender and the contractor signed two brief handwritten loan agreements (the $235,000 was paid in two chunks) stating "*Lender agrees to loan the borrower [$234,000] at zero percent interest to be paid back from the monies received from the [development company]*". Some months later, before paying the contractor any of the $285,000 remaining owed for the work done, the development company was put into foreclosure by a commercial lender and the development was sold to new investors. The contractor had not registered a lien against the marina, and had not started a court action to recover the money owed, so found it impossible to recover the money owed by the insolvent developer. The investor who had lent the contractor money while the contractor waited to be paid by the developer, now sued the contractor for repayment of the $234,000 loan. The contractor replied they did not have to repay the loan because the loan agreement said "*to be paid back from the money received from the [development company]*", and the development company never paid the contractor.

A "Reasonable Period" Required for Repayment

The court summarized the issue between the investor and the marine contractor as: "*where a loan is made contingent on the occurrence of a specified event and that event does not occur, can the borrower nevertheless be obligated to repay the loan*?". The court referred to the B.C. case of *Berry v. Page (1989)* where a verbal loan agreement provided the loan was to be repaid when the borrower sold family property on Gabriola Island. Seven years after the loan was made, the property had still not been sold and the lender commenced a court action to recover the money. The Court of Appeal found the obligation to repay the loan was absolute (must occur at some point), and implied an obligation that the loan was to be repaid within a reasonable period of time. The court in *Berry v. Page* referred to an American case (*Nunez v. Dautel*) where the repayment of a debt was to occur "*as soon as the crop could be sold, or the money could be raised from any other source*". In that case the court decided, as there was no time specified within which the crop was to be sold, or the money otherwise raised, the law required that one or the other should be done within a reasonable time. The court in the Sooke marina case also referred to an Alberta decision (*Brunie v. Royal Bank*) that stated "*the law will, I think, [add as a term] to an agreement for the repayment of a loan contingent upon the happening of an event which may never occur that if it does not happen within a reasonable time then the money shall become due and payable after the expiration of such reasonable time, unless it is very clear that the intention of the parties is that the liability is conditional only upon the happening of the particular event*".

Avoiding Commercially Absurd Interpretations of a Contract

In the Sooke marina case the lender, of course, argued the loan agreement was *very clear* the loan had to be repaid whether the developer paid the contractor or not. Not surprisingly, the contractor argued the loan agreement was *very clear* the loan did not have to paid except out of money it received from the developer, which it never did. In resolving these positions, the court considered five principles of interpreting contracts commonly relied on by Canadian Courts (see *Western Mariner, August 2011 Legal Net - "Who Forgot the Cotter Pin? - Interpreting Marine Contracts*"), emphasizing the fifth principle, that the words of contract will not be interpreted literally if it would result in an "*unbusinesslike outcome or a commercial absurdity*". In applying this principle the court concluded that on all of the evidence the parties expected the developer would pay the contractor and that the contractor would pay the investor, and to conclude the contractor would not have to repay the loan if they did not receive money from the developer was not what the parties had intended as it would be unbusinesslike and be commercially absurd. Undoubtedly, the contractor, who was ordered to repay the $234,000 within one year of the initial demand for repayment (what the judge found was a "reasonable period of time"), disagreed.

In closing, there are several lessons that readers can take from this case. Unless the loan agreement is painfully clear that a debt never has to be repaid unless an event occurs, loans which are payable on an event occurring still have to be repaid within a reasonable period of time, whether the event has occurred or not. What will be a reasonable period of time for repayment depends on when the parties expected the event to occur. When the loan amount is anything more than minimal, the requirement that the contract be "very clear" in order to excuse repayment of the debt likely justifies retaining a lawyer to prepare the agreement. This way, if anything does go wrong, the lawyer may be responsible.

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