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AUGUST 11, 2025

Tolling Agreements in Construction Contracts – A Practical Solution

Key Takeaway

Parties should consider including tolling agreements directly in their construction contracts.

Introduction

The pressure of a statutory limitation period often drives the commencement of litigation or arbitration before either party wishes to do so, and often before the issue is properly ripe for final dispute resolution.

This is particularly so in construction, where project durations generally exceed the basic 2-year limitation period and where it can be unclear as to when a claim is considered "discovered" and therefore when the limitation clock begins to run.[1]

As a result, parties often seek to negotiate tolling agreements during a project in order to avoid having to commence proceedings prematurely, i.e. before they are ready to do so or before it is in the best interests of all parties and the project to do so.

This article explores a little-used but perhaps more efficient approach – including tolling agreements directly within one's construction contract, obviating the need to commence an action prematurely to avoid losing their claim due to the *Limitations Act*.

Limitation Periods and Construction Projects

As with many legal issues, the question of when a limitation period begins to run and conclude is fact dependent.

The *Limitations Act* provides a basic limitation on a claimant's right to pursue a claim more than two years following the day on which a claim is "discovered".[2] Section 5 provides that 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,*

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[1] This article is predicated upon the Ontario *Limitations Act, 2002*. Similar statutes exist in other jurisdictions, although the limitation periods and specific rules and requirements may vary. Consult with your legal professional when seeking advice on the limitation period applicable to your specific case.

[2] *Limitations Act*, 2002, S.O. 2002, c. 24, Sched. B [*Limitations Act*].

> *(iii) that the act or omission was that of the person against whom the claim is made, and*
>
> *(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).*

The Supreme Court of Canada in *Grant Thornton LLP v New Brunswick* provided guidance to litigants with respect to the principle of discoverability, holding that a claim is discovered when a plaintiff has knowledge, actual or constructive, of the material facts upon which a plausible inference of liability on the defendant's part can be drawn.[3] A plaintiff does not need knowledge of all constituent elements of a claim to "discover" that claim.

Despite the legislature and court's efforts to simplify the analysis, much debate in litigation remains over this question and in construction the answer is often more complicated.

For example, in a case involving what might be considered a relatively simple dispute over unpaid invoices, the court in *1838120 Ontario Inc. v. Township of East Zorra-Tavistock*[4] noted that:

> *…the limitation period on an invoice, issued for having supplied goods and services in accordance with a contract, does not commence at the time the goods and services are supplied or at the time the invoice was issued and submitted to the payors. Instead, it commences after a "reasonable" period of time has passed for the invoice to be issued and a "reasonable" period of time has passed for the invoice to be paid. What is "reasonable" is context- and circumstance-dependent and follows the parties' contract and the parties' past practices with respect to when invoices were issued and submitted and when payments were made.*

In an Alberta case, *Suncor Energy Products Inc. v. Howe-Baker Engineers, Ltd.*,[5] the court considered a limitations defence in respect of Suncor's non-payment for Howe-Baker's alleged improper work. The court found that "…*it was not until Suncor made it clear to Howe-Baker that they were not going to pay the invoices that Howe-Baker "discovered" that it had a cause of action*."

Although not a construction case but still instructive, the Ontario Court of Appeal in *Apotex Inc. v Nordion (Canada) Inc*. highlighted how the limitation period for breach of contract does not necessarily run from the date of the breach, the party with the claim must also know that the damage occurred.[6]

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[3] *Grant Thornton LLP V New Brunswick*, 2021 SCC 31.
[4] *1838120 Ontario Inc. v. Township of East Zorra-Tavistock*, 2021 ONSC 3341.
[5] *Suncor Energy Products Inc. v. Howe-Baker Engineers, Ltd.*, 2010 ABQB 310.
[6] *Apotex Inc. v. Nordion (Canada) Inc.*, 2019 ONCA 23.

Often times in construction, a party is impacted, but the damage resulting from that impact does not materialize immediately. In law, "*damage*" and "*damages*" refer to two distinct concepts. The former refers to the injury that is inflicted by the breach of contract or tort, while the latter refers to the sum of money that is payable by way of compensation for that injury.[7] Only *some damage* has to occur in order to start the limitation period.[8] This principle is particularly impactful within the context of construction claims, where the damage may be known but the quantification of damages evolves over time, may be mitigated, and frequently crystallizes only upon project completion. Further, construction contracts often contain detailed processes and stepped dispute resolution clauses, which further muddy the water as to when a claim is "discovered" for the purposes of the *Limitations Act a*nd a legal proceeding is not always the initial and most appropriate means to remedy a dispute.

Impact of Stepped Dispute Resolution Clauses on Limitation Periods

Once a claim or dispute has materialized under a construction contract, there is often a stepped dispute resolution process which adds further complexity to the issue of limitations. For example, if the contract requires negotiations, followed by mediation, and only thereafter is a party entitled to commence an action or arbitration – how does this affect the basic limitations period under the *Limitations Act*?

In *PQ Licensing S.A. v LPQ Central Canada Inc*, the Ontario Court of Appeal affirmed an arbitrator's finding that a condition precedent to arbitration has the effect of suspending the running of the limitation period until the condition is fulfilled or if the party refuses to engage with the process.[9] In other words, the claim is not "discovered" for the purposes of the *Limitations Act* until the condition precedent is fulfilled.

Similarly, in *Maisonneuve v Clark*, the court followed the decision in *PQ* and refused to dismiss an application on the basis that it was time-barred because the dispute resolution clause required the parties to attempt resolution before proceeding to arbitration.[10] The court held that the two-year limitation period did not begin to run until it was clear that no informal resolution was possible.

At least in the case of contracts with mandatory stepped dispute resolution clauses that culminate in litigation or arbitration, the courts are moving towards a finding that a claim is "discovered" for the purposes of the *Limitations Act* only after the mandatory predecessor steps are fulfilled.

But, if you are a claimant, or representing a claimant, are you going to take the risk that a court or arbitral tribunal may find otherwise?

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[7] *Dass v. Kay*, 2021 ONCA 565.
[8] *Hamilton (City) v. Metcalfe & Mansfield Capital Corp.*, 2012 ONCA 156.
[9] *PQ Licensing S.A. v. LPQ Central Canada Inc.*, 2018 ONCA 331 [*PQ*].
[10] *Maisonneuve v Clark*, 2021 ONSC 1960.

Considered from a slightly different angle, are you going to take the risk that a court or arbitral tribunal might find that your client or the other client failed or refused to engage in the stepped dispute resolution process, triggering the "discovery" for the purposes of the *Limitations Act*?

You probably will not, and you will either (a) commence litigation or arbitration to preserve your claim or (b) seek to enter a tolling agreement.

Tolling Agreements

Section 22(3) of the *Limitations Act* allows parties to suspend or extend a limitation period by agreement, which are generally referred to as "tolling agreements". This allows parties to pause limitation periods to avoid the need to commence litigation or arbitration (as applicable).

Although typically entered into when a dispute is contemplated, there is no reason that the parties cannot agree in advance, in their construction contracts, to toll limitation periods.

The Case for Including Tolling Agreements in the Contract

Tolling agreements are particularly useful in construction projects for many reasons, including primarily (a) that formal disputes disrupt the relationship of the parties who must work together to successfully perform the project and (b) disputes often arise on construction projects before the damages are fully realized or crystalized, and while opportunities to mitigate may remain abundant.

The other unique aspect of construction projects that drive interest in tolling agreements is the fact that many construction disputes involve or have the potential to involve multiple parties. For example, a contractor may make a claim against the owner who would seek recovery from the designer. In another example, a subcontractor may make a claim against a contractor who would seek recovery from the owner, or perhaps from other subcontractors. As a result, disputes on construction projects have a tendency to snowball quickly, forcing parties to take positions and bring claims against other parties that they may otherwise wish to avoid during the course of construction.

With the proposed changes to the *Rules of Civil Procedure*[11] which contemplate the fast-tracking of litigation processes and the front-loading of costs, there is even more reason for potential litigants to toll their limitation periods until the dispute is appropriately ripe for dispute resolution, and the parties have exhausted opportunities for early settlement.

So, the question is, why wait until a potential dispute has arisen to negotiate a tolling agreement? Instead, the parties can include tolling agreements in their construction contracts and design agreements such that the limitation period does not begin to run until completion of the contract, substantial performance of the project, or otherwise.

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[11] Civil Rules Review, Ontario Superior Court of Justice website, at https://www.ontariocourts.ca/scj/areas-of-law/civil-court/civil-rules-review/.

In light of the prevalence of contractual dispute resolution processes that seek to resolve disputes before resorting to litigation or arbitration, there is no better way to ensure the proper functioning of that process than to remove the risk of expiration of a claim pursuant to the *Limitations Act*.

Therefore, at the drafting and negotiation stage of construction contracts, parties should strongly consider including a provision that tolls the basic limitation period under the *Limitations Act*, avoiding the need to commence actions or arbitrations before the parties are properly ready to do so.