NEW LIMITATION PERIODS — CONTRACTING IN ONTARIO

As of January 1, 2004, the limitation period in Ontario for breach of contract changed from six years to two years.[1] The new limitation period begins to run on the day on which the claim was discovered. In effect, the new law deems a person to have discovered a claim on the day on which a reasonable person first ought to have known of the claim. The new limitation period applies "despite any agreement to vary or exclude it".[2] This new law significantly affects business transactions under Ontario law, and puts Ontario out of step with the other common law provinces in Canada,[3] New York (and other U.S. states) and England. This article describes one of the principal consequences of the new law for business people,[4] and advocates that the law be amended to enhance Ontario's reputation as a province that is favourable for business investment.[5]

Before this new law was enacted, persons contracting under Ontario law could choose for themselves the time period within which claims for breach of contract can be pursued. For example, a typical agreement for the purchase and sale of a business would contain representations and warranties by the vendor in favour of the purchaser, and would provide that claims for breach of those representations and warranties must be pursued within a specific period

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1. See the Limitations Act, 2002, S.O. 2002, c. 24. The Act changes the limitation period to two years for tort and many other types of claims.
2. Section 22.
3. Article 2925 of the Civil Code of Québec, S.Q. 1991, c. 64, provides for a three-year limitation period. Article 2884 provides that "[n]o prescriptive period other than that provided by law may be agreed upon" and corresponds to s. 22 of the new Ontario law. See also Article 2930, which was considered by the Supreme Court of Canada in *Doré v. Verdun (City)*, discussed below. Alberta has a provision corresponding to s. 22, but its proclamation was rescinded, so that law is not currently in force.
4. This article does not address the application of the new law in other areas that are important to business transactions, including the application of the new law to demand promissory notes or other obligations payable on demand — see s. 15(6)(c) — and to "tolling agreements" under which parties suspend the operation of limitation periods while they attempt to resolve a dispute between them.
5. Much of the substance of this article is derived from discussions with lawyers at other Bay Street law firms beginning in the fall of 2003 through January 2004.

following closing. This time period would be open for negotiation between the vendor and the purchaser; but it is common to see a vendor and purchaser agree that most claims must be brought within 18 months or two years of closing. It is also common for a vendor and purchaser to agree that claims for breach of tax and environmental representations and warranties could be pursued within a longer period than would apply for other breaches.

These negotiated time periods will often be inconsistent with the limitation period specified under the new law. For example, a provision stating that claims for breach of representations and warranties must be brought within 18 months of closing is obviously shorter than the two-year period specified under the new law. Even if the parties choose a two-year period from closing, that time frame may be inconsistent with the new law, which provides that the two-year period begins to run from the date of discovery (which would typically occur after closing). If the parties choose a period longer than two years from the date of closing, that period could expire before or after the date that is two years from the date of discovery, and thus also be inconsistent with the new law.

Because s. 22 provides that the new limitation period applies "despite any agreement to vary or exclude it", it is not clear whether any attempts to avoid the new limitation period will succeed. Having said that, in the context of an agreement of purchase and sale, many practicing lawyers believe that the limitation period prescribed by the new law can be shortened, in effect, by including the following provisions in the agreement:

(1) a statement that the representations and warranties will survive for only a specified period of time following closing, *e.g.* 18 months;
(2) an indemnity by each party giving the representations and warranties;
(3) a statement that there will be no entitlement to indemnification unless notice of the claim for indemnity is given within the specified survival period; and
(4) a statement that the only recourse for damages for breach of the representation and warranty is under the indemnity, with the intention that all other remedies for damages are excluded.

This drafting technique[6] is not new, and was used in many agreements of purchase and sale before the new law came into force. Lawyers in practice theorize that this method of drafting ought to be enforceable despite the new law because the parties have chosen to limit the substantive right for breach of the representation and warranty, rather than to limit the time period within which an action must be commenced. In other words, the person relying on the representations and warranties is only entitled to claim indemnification if notice of the claim for indemnity is given within the specified survival period. There is no cause of action of action for indemnity if notice of the claim is given outside that period; and there is no other remedy in damages apart from the indemnity. By way of comparison, contracting parties are completely free to exclude wholly or partially the amount or remoteness of damages for breach of a representation and warranty, *e.g.* by limiting the quantum of liability to a specified amount or by excluding consequential damages. Contracting parties are completely free to provide that the only remedy in damages relating to a breach of representation and warranty is the remedy provided by the indemnity provisions of the agreement. Similarly, contracting parties ought to be completely free to specify that only certain types of claims are entitled to indemnification, *i.e.* only those claims for which notice is given during the survival period. Section 22 should not be interpreted as derogating from that freedom.

As to lengthening the period within which claims for breach of representations and warranties may be commenced, it is less clear that an agreement with that effect will be enforceable. In the context of agreements of purchase and sale, lawyers in practice are attempting to lengthen the limitation period by use of the indemnity mechanism described above. In this context, those lawyers theorize that the failure to pay losses under the terms of the indemnity gives rise to the cause of action, and it is only at that time — not at the time a breach of a representation and warranty is discovered — that the two-year statutory limitation period begins to run. To bolster this

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6. This is not the only drafting technique being discussed in practice to shorten the period within which claims can be pursued. Another technique is a covenant not to sue in respect of claims discovered or notified outside the specified survival period. Yet another technique is to shorten the discoverability period, on the theory that s. 22 does not address discoverability, and only precludes a variation or exclusion of the limitation period. As of early February 2004, I have not yet seen any examples of these two additional techniques being used in practice.

position, some lawyers are drafting agreements of purchase and sale to provide an indemnity in respect of those matters where a longer period is sought (*e.g.* a tax indemnity or an environmental indemnity), but omitting any related representation and warranty. They theorize that the absence of any representation and warranty as to a particular matter supports the view that the breach first occurs when a demand is made under the indemnity and the obligation to indemnify is not honoured. While this approach is attractive and may succeed, it gives rise to the question as to whether the obligation created is truly an indemnity for the purpose of applying the limitation period.

Obviously it is possible that a court could view these drafting techniques as an attempt to do indirectly what cannot be accomplished directly under the new law, in the face of s. 22. Viewed in that light, a court might apply the limitation periods under the new law despite the provisions of the agreement.

There is almost no relevant jurisprudence addressing this type of issue. The most relevant decision is *Doré v. Verdun (City)*.[7] In *Doré*, the Supreme Court of Canada considered the effect of Article 2930 of the Civil Code of Québec, which provides that notwithstanding any stipulation to the contrary, the Civil Code's three-year prescriptive period in respect of bodily injury cannot be hindered.[8] The court held that Article 2930 had precedence over the Cities and Towns Act (Québec) which provided that, within 15 days of an accident, notice be given that an action seeking reparation for bodily injury is to be brought against a municipality, failing which the municipality cannot be found liable.

The decision in *Doré* does not assist the interpretation of s. 22 because it is distinguishable in at least three important respects. First, the court in *Doré* identified a strong legislative policy in the Civil Code which guided its interpretation of Article 2930 — "namely to ensure that fair compensation is provided for bodily injury, which is a form of interference with a person's integrity".[9] Obviously, completely different policy considerations are at play

7. [1997] 2 S.C.R. 862, 150 D.L.R. (4th) 385. I thank Eric Gertner of McCarthy Tétrault LLP for bringing this case to my attention.
8. Article 2930 provides that "[n]otwithstanding any stipulation to the contrary, where an action is founded on the obligation to make reparation for bodily injury caused to another, the requirement that notice be given prior to the bringing of the action or that proceedings be instituted within a period not exceeding three years does not hinder a prescriptive period provided for by this Book".
9. *Supra*, footnote 7, at para. 30.

where two parties to a commercial agreement choose to limit the nature and extent of the contractual obligations created between them by stipulating that the representations and warranties (or an obligation to indemnify for breach of those representations and warranties) will survive only for a specified period of time. In that case, there is no valid policy reason to preclude the parties' choice. Second, unlike s. 22 of the new Ontario law, Article 2930 of the Civil Code specifically addresses the legislative technique, which the Cities and Towns Act used to extinguish tort claims, *i.e.* the Civil Code specifically refers to any "requirement that notice be given prior to the bringing of the action". Third, the main issue considered by the court in *Doré* was whether Article 2930 of the Civil Code overrode another statute in the province — not whether the parties could by contract agree to a temporal limitation on their contractual liability to each other.

Recognizing the uncertainty associated with these drafting techniques, lawyers in practice are looking for other solutions to provide certainty to their clients on this issue.[10] The most practical solution is to make use of that part of the new law which, in effect, provides that the new limitation periods do not apply to agreements governed by foreign law.[11] Since the laws of the other common law provinces[12] and the laws of New York and England do not contain any provision corresponding to s. 22 of the new law, some lawyers are advising their clients to choose one of those jurisdictions' laws to govern their contracts where the transaction has some significant connection to that jurisdiction. In fact, some business people are heeding that advice in practice and choosing the laws of another jurisdiction to govern their significant commercial agreements.[13]

10. It is possible that providing for arbitration may allow the parties to choose their own limitation periods; but the law in this area is unclear; see ss. 3 and 52(1) of the Arbitration Act, 1991, S.O. 1991, c. 17, and consider whether s. 22 precludes a contrary agreement in the context of an arbitration clause. The situation under the International Commercial Arbitration Act, R.S.O. 1990, c. I.9, is even less clear because it does not contain provisions comparable to ss. 3 and 52(1).
11. Section 23 states "[f]or the purpose of applying the rules regarding conflict of laws, the limitations law of Ontario or any other jurisdiction is substantive law".
12. As noted above, Alberta has a provision corresponding to s. 22, but its proclamation was rescinded so that law is not currently in force. The Alberta Law Reform Institute has been asked to review that provision and to make recommendations.
13. If parties choose a foreign law to govern their agreement solely for the purpose of avoiding the new Ontario limitation periods, an Ontario court or a foreign court might not respect that choice of law, especially if there is no connection to that jurisdiction apart from the choice of laws.

As a further consequence of the uncertainty associated with these drafting techniques, where share or asset purchase agreements are governed by Ontario law, lawyers are also qualifying their legal opinions about the enforceability of some of those agreements. In particular, the enforceability concern arises where the agreement directly or indirectly shortens or extends the period within which each party can pursue claims under the agreement. Here is an example of the type of qualification now appearing in practice:

> Enforceability of the Purchase Agreement will be subject to the Limitations Act, 2002 (Ontario), and we express no opinion as to whether a court may find a provision of the Purchase Agreement to be unenforceable as an attempt to vary or exclude a limitation period under that Act.

Recognizing these uncertainties, I ask myself, "Does section 22 represent a good policy choice for commercial transactions governed by Ontario law?". I think not. There is no sound policy reason to preclude business parties from defining the nature and extent of their contractual obligations, including the period within which those claims against one another can be pursued. For the most part, business parties want certainty in the application of the law to their commercial dealings. They want to know that the claims under their significant commercial agreements will be asserted within a finite and reasonably short period of time. They want to move forward with their business lives, without the possibility of litigation hanging over their heads. Business people contracting with other business people ought to be free to choose the time periods within which they can pursue claims against each other. In practice, business people are surprised to learn that Ontario law now may preclude that type of agreement; this part of the new law does nothing to enhance Ontario's reputation with business people abroad.

I am not alone in voicing these concerns. Over an extended period of time prior to the new law coming into force, the Ontario Bar Association, the Advocates Society and others lobbied the Ontario government to amend s. 22 or to suspend its operation. The former Ontario government was not receptive to those changes, and the current Attorney General of Ontario wrote to the Ontario Bar Association in December 2003 to say that his government was unwilling, at that time, to amend the new law or to delay its coming into force. However, the Attorney General also wrote that his Ministry would be monitoring the effect of the new law, and would consider proposals to amend the new law if future

developments indicate that amendments are necessary. In my view, those "future developments" have occurred; business people are choosing systems of law other than Ontario's to govern significant commercial agreements, solely to avoid the new law. The Ontario government should immediately amend s. 22 to provide that it does not apply outside consumer contracts.[14]

This amendment would restore this aspect of Ontario law to its state before January 1, 2004. This amendment would also bring Ontario law back into conformity with the rest of the common law provinces in Canada, and with the world's leading systems of commercial law — New York and England. This amendment is not difficult to understand, nor is it controversial. In summary, the Ontario government should amend s. 22 to clearly allow business people to choose the limitation periods they want to apply to claims between them under commercial agreements.

R. John Cameron*

14. As for consumer contracts, I am not sure that s. 22 does a service to consumers, but I leave that question for study by the Ontario government or others.

* Partner, Torys LLP.