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THE SUPREME COURT RECTIFIES A WRONG TURN IN CANADIAN LAW

INTRODUCTION

In *Canada (Attorney General) v Fairmont Hotels Inc*,[1] the Supreme Court of Canada (McLachlin CJ, Abella, Cromwell, Moldaver, Karakatsanis, Wagner, Gascon, Côté and Brown JJ) had the opportunity to consider the doctrine of rectification in Canadian law. The result of the decision is to correct a wrong turn in the Canadian law of rectification, returning it to a position of harmony with the approach taken in other common law jurisdictions.

FACTS

Fairmont Hotels Inc ("Fairmont"), a hotel management company, was involved in a financing arrangement which would allow Legacy Hotels REIT ("Legacy") to purchase two hotels in US currency. Fairmont's aim was to obtain the management contract for the two hotels. As the financing was conducted in US currency Fairmont would be exposed to foreign tax liability. In order to ensure tax neutrality, Fairmont (through its subsidiaries) entered into reciprocal loan agreements with Legacy (also in US currency) designed so that no foreign exchange gains or losses would be realised. Fairmont was later acquired, and the aim of tax neutrality was frustrated since the acquisition would cause Fairmont and its subsidiaries to realise a deemed foreign exchange loss (without a corresponding gain).

Fairmont and the acquiring companies therefore agreed on a 'modified plan' which allowed Fairmont to realise both its gains and losses, thereby fully hedging it against exposure to the tax liability. The plan to protect its subsidiaries in a similar way was deferred. In the following year Legacy asked Fairmont to terminate the financing arrangement to allow for the sale of the hotels. Fairmont accordingly unwound the reciprocal loan structure with a share redemption achieved by resolutions passed by the directors of its subsidiaries. This resulted in an unanticipated tax liability, discovered after an audit by the Canada Revenue Agency.

Fairmont sought rectification of the directors' resolutions to convert the share redemption into a loan, thereby avoiding the tax liability. Newbould J allowed rectification on the basis that the parties had an ongoing intention to unwind the reciprocal loan agreements on a tax-neutral basis.[2] The Court of Appeal (Simmons, Cronk and Blair JJA) upheld the decision at first instance, unanimously dismissing the appeal.[3]

DECISION

In the Supreme Court, two judgments were delivered. Brown J delivered the majority judgment (with which McLachlin CJ, Cromwell, Moldaver, Karakatsanis, Wagner and

1 2016 SCC 56.

2 *Fairmont Hotels Inc et al v A-G Canada* 2014 ONSC 7302.

3 *Fairmont Hotels Inc v Canada (Attorney General)* 2015 ONCA 441.

Gascon JJ agreed), allowing the appeal. Abella J (Côté J agreeing) delivered the dissenting judgment. The majority held that the courts below erred in allowing rectification of the agreement on the basis of the parties' common intention with respect to 'tax neutrality'. Brown J observed:

> Rectification is limited to cases where the agreement between the parties was not correctly recorded in the instrument that became the final expression of their agreement … It does not undo unanticipated effects of that agreement. While, therefore, a court may rectify an instrument which inaccurately records a party's agreement respecting what was to be done, it may not change the agreement in order to salvage what a party hoped to achieve.[4]

In reaching this conclusion, Brown J emphasised the need for a strict approach to rectification, limiting its application 'to cases where a written instrument has incorrectly recorded the parties' antecedent agreement', rather than cases concerned with mistakes in the making of the agreement.[5] His Honour stated that '[i]n short, rectification is unavailable where the basis for seeking it is that one or both of the parties wish to amend *not the instrument* recording their agreement, but *the agreement itself*'.[6]

In allowing the appeal, the majority overruled the decision of the Ontario Court of Appeal in *Juliar v Canada (Attorney General)*,[7] which had been applied by Newbould J and the Court of Appeal. In that case, shares in a family company were transferred by the owners to their daughter and her husband. The couple subsequently decided to transfer the shares to a holding company, and in exchange received promissory notes in the holding company. This led to an immediate and unanticipated tax liability.

The parties sought rectification of the transaction such that the couple would receive shares instead of promissory notes, the effect of which would have been to defer the tax liability. The Court of Appeal allowed rectification on the basis of the trial judge's finding that the parties 'had a common and continuing intention from the outset to transfer their half interest in the [family company] and to do so "on a basis which would not attract immediate liability for income tax on the transaction"'.[8]

Brown J noted several difficulties with this decision, commenting that it was 'indisputable that *Juliar* has relaxed the requirements for obtaining rectification'.[9] The mistake in *Juliar* was in the selection of the mechanism by which to effect the transfer, as opposed to an error in the recording of their agreement. As his Honour explained:

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4 2016 SCC 56 at [3].

5 2016 SCC 56 at [13].

6 2016 SCC 56 at [13].

7 (2000), 50 OR (3d) 728.

8 (2000), 50 OR (3d) 728 at [19].

9 2016 SCC 56 at [18].

> By granting the sought-after change of mechanism, the Court of Appeal in *Juliar* purported to "rectify" not merely the instrument recording the parties' antecedent agreement, but that agreement itself where it failed to achieve the desired result or produced an unanticipated adverse consequence — that is, where it was the product of an error in judgment.[10]

His Honour also disapproved of the Court's reliance in *Juliar* on the decision in *Re Slocock's Will Trusts*,[11] in which rectification was allowed in circumstances where it would secure a tax advantage. Brown J explained that rectification was granted in that case '*not* to secure that tax advantage, but on the strength of [the] finding that the deed … [failed] to record fully the terms of the parties' original agreement'.[12] It was noted that subsequent English authorities had 'made clear that a mere intention to obtain a fiscal objective is insufficient to ground a claim in rectification'.[13]

In sum, Brown J stated that *Juliar* was 'irreconcilable with this Court's jurisprudence and with the narrowly confined circumstances to which this Court has restricted the availability of rectification'.[14] His Honour also cited[15] the Court's direction in *Shell Canada Ltd v Canada*,[16] that a taxpayer should expect to be taxed 'based on what it actually did, not based on what it could have done'.[17]

DISSENTING OPINION

Abella J (with whom Côté J agreed) would have dismissed the appeal. Her Honour characterised rectification as 'an equitable remedy that seeks to prevent the unfairness that results from enforcing a mistake, including the unfairness inherent in unjust enrichment and windfalls'.[18] Her Honour saw the approach of Brown J as unduly narrowing the doctrine's scope. In particular, it was observed:

> A common, continuing, definite, and ascertainable intention to pursue a transaction in a tax-neutral manner has usually satisfied the threshold for granting rectification. The additional requirement that the parties clearly identify the precise mechanism by which they intended to achieve tax neutrality, and how that mechanism was mistakenly transcribed in a document, has the effect of raising the threshold and frustrating the purpose of the remedy.[19]

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10 2016 SCC 56 at [19].

11 [1979] 1 All ER 358.

12 2016 SCC 56 at [21].

13 2016 SCC 56 at [22].

14 2016 SCC 56 at [16].

15 2016 SCC 56 at [23].

16 [1999] 3 SCR 622.

17 [1999] 3 SCR 622 at [45].

18 2016 SCC 56 at [44].

19 2016 SCC 56 at [45].

An important feature of her Honour's conclusion was the assertion that the doctrine of rectification is based on notions of relief against unjust enrichment.[20] Accordingly, while recognising that rectification is often granted in the context of terms which have been *transcribed* incorrectly, it was noted that 'since unjust enrichment can also result from a mistake in *carrying out* the intention of the parties, the remedy is also available to correct errors in implementation'.[21]

The party that would have been unjustly enriched if rectification were not permitted was the Crown. The fact that the Crown was a third party to the transaction was seen as immaterial. As her Honour noted 'rectification can also prevent a third party who has not relied on the agreement from enforcing a mistake and receiving a windfall'.[22] In this case, to allow the Crown to profit from 'legitimate tax planning errors' would have (in her Honour's opinion) amounted to unjust enrichment.[23] This conclusion was not altered because it was the government that stood to benefit. As her Honour noted '[t]he tax department is not entitled to play "Gotcha" any more than any other third party who did not rely to its detriment on the mistake'.[24]

COMMENT

The decision in *Fairmont* brings Canadian law back into line with the approach taken to rectification in England and Australia, limiting the application of the doctrine to cases where the *document* incorrectly records the parties' intended agreement, and excluding its operation in cases where there is a mistake in the *agreement* itself. This reflects the traditional understanding of the equitable doctrine of rectification in that it is concerned with the correction of documents, and not agreements.[25] Rectification ensures that the document contains what the parties intended it to contain, and not that which it might have contained 'if they had been better informed'.[26]

The approach of the minority, on the other hand, would have allowed rectification to correct the *implementation* of the agreement, as distinct from the *recording* of the agreement. As we explain below, to allow rectification to undo unanticipated effects of an agreement would be to expand the doctrine well beyond its limits as developed in English and Australian law.

The starting point is that rectification will generally not be available where the document contains the words that the parties intended to use.[27] In cases of common mistake, the requirement of intention has 'traditionally been expressed in terms requiring that the

20 2016 SCC 56 at [63].

21 2016 SCC 56 at [66].

22 2016 SCC 56 at [68].

23 2016 SCC 56 at [70].

24 2016 SCC 56 at [84].

25 *Mackenzie v Coulson* (1869) LR 8 Eq 368 at 375.

26 *Townshend v Strangroom* (1801) 6 Ves 328 at 332.

instrument take a certain form, as distinct from a common understanding that it would have a certain effect'.[28] To this general rule a narrow exception has been developed where the parties deliberately chose to use particular words while operating under a common mistake as to the meaning of those words. The exception appears to be a part of both English and Australian law.[29]

In two English decisions, however, rectification has also been used to correct the intentional use of particular words on the basis that the parties were operating under a common mistake as to the *legal effect* of those words.[30] This exception is now well-established in English law.[31] In *Amp (UK) Plc v Barker*,[32] Collins J stated the principle thus:

> Consequently rectification may be available if the document contains the very wording that it was intended to contain, but it has in law or as a matter of true construction an effect or meaning different from that which was intended.[33]

The expanded exception has also been accepted in Australian law. In *Commissioner of Stamp Duties (NSW) v Carlenka Pty Ltd*,[34] Sheller JA referred to the relevant passage from *Re Butlin's Settlement Trusts* with approval.[35] It was applied by Gzell J in *Oates Properties Pty Ltd and Ors v Commissioner of State Revenue*,[36] and has been accepted by leading commentators.[37] It has not, however, escaped criticism.[38]

Whatever the merits of the exception where there is a common mistake as to the legal effect of the words chosen, the approach of the minority in *Fairmont* and the Court of Appeal in *Juliar* would have gone far beyond it. In both of those cases the mistake related to the mechanism chosen to effect the transaction. To permit rectification in such cases would allow

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27 *Frederick E Rose (London) Ltd v William H Pim Junior & Co Ltd* [1953] 2 QB 450 at 461; *Bacchus Marsh Concentrated Milk Co Ltd (in liq) v Joseph Nathan & Co Ltd* (1919) 26 CLR 410 at 451.

28 J W Carter, LexisNexis, *Carter on Contract* (at [22-440]).

29 *Re Butlin's Settlement Trusts* [1976] Ch 251, 250; *The Club Cape Schank Resort Co Ltd v Cape Country Club Pty Ltd* (2001) 3 VR 526 at 539-40 [39].

30 *Burroughes v Abbott* [1922] 1 Ch 86; *Jervis v Howle & Talke Colliery Co Ltd* [1937] Ch 67.

31 *Re Butlin's Settlement Trusts* [1976] Ch 251 at 250; *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 at 1122 [46]. See also J McGhee QC (ed), *Snell's Equity* (Sweet & Maxwell, 33rd ed, 2015) [16-016].

32 [2001] Pens LR 77.

33 [2001] Pens LR 77 at [70].

34 (1995) 41 NSWLR 329.

35 (1995) 41 NSWLR 329 at 336.

36 (2003) 53 ATR 308.

37 See, eg, I C F Spry, *Equitable Remedies* (LawBook Co, 8th ed, 2010) 612; J W Carter, LexisNexis, *Carter on Contract* (at [22-440]).

38 J D Heydon, M J Leeming and P G Turner, *Meagher, Gummow and Lehane's Equity Doctrines and Remedies* (LexisNexis Butterworths, 5th ed, 2015) [27-115].

the doctrine to operate whenever the parties failed to anticipate the consequences of structuring their transaction in a particular way. Far removed from the situation where the parties misunderstood the legal effect of a particular word or phrase, this would allow parties to rewrite and restructure their transactions simply to avoid undesirable consequences.

There is a distinction between rectification of a document which contains words used purposely, but mistakenly as to their effect, and rectification because an agreement produced unanticipated consequences. In *Carlenka* McLelland AJA explained:

> In this context "effect" means the legal and factual operation of the instrument according to its true construction, but does not include legal or factual consequences of the operation of the instrument of a more remote, or collateral, kind (for example, its liability to stamp duty).[39]

Admittedly, the distinction can be difficult to draw, as illustrated by the recent decision of the English Court of Appeal in *Day v Day*.[40] In that case, rectification was permitted of a transaction by which a mother had executed a conveyance of her home, declaring the property to be held by herself and her son as joint tenants. The evidence was that she had never intended to confer a beneficial interest in the property on her son. In permitting rectification, however, the Court was not altering the transaction to avoid an unintended consequence. Rather, the Court was correcting the document which had failed to accurately record Mrs Day's intention not to confer a beneficial interest in the property on her son.

As the majority in *Fairmont* acknowledged, allowing rectification in order to avoid unintended consequences (of the remoter kind, to use the expression of McLelland AJA) would amount to rectification not only of the document embodying the agreement but of the agreement itself. This would be expanding the doctrine well beyond its limits as recognised by other leading common law jurisdictions. In *Pitt v Holt*,[41] the United Kingdom Supreme Court had the opportunity to consider the circumstances in which equity will intervene in cases of voluntary dispositions made under a mistake. The following observation of Lord Walker is apposite:

> Rectification is a closely guarded remedy, strictly limited to some clearly-established disparity between the words of a legal document, and the intentions of the parties to it. *It is not concerned with consequences*.[42] (emphasis added)

The decision in *Fairmont* brings Canadian law into line with the orthodox understanding of rectification adopted in English and Australian law, embodied in Lord Nottingham LC's adage that 'the Chancery mends no man's bargain, though it sometimes mends his assurance'.[43] There is much to be said for such harmonization,[44] and the Supreme Court's decision is a welcome development. The decision also confirms that the approaches to

39 (1995) 41 NSWLR 329 at 345.

40 [2014] Ch 114.

41 [2013] 2 AC 108.

42 [2013] 2 AC 108 at 159 [131].

43 *Maynard v Moseley* (1673) 3 Swans 651 at 655.

rectification under Canadian common law and Quebec civil law have converged. The majority made reference to the decision *Jean Coutu Group (PJC) Inc v Canada (Attorney General)*,[45] a rectification case with a similar factual matrix that was decided according to the civil law, noting that 'on this question both equity and civil law are *ad idem*'.[46]

It is worth noting that the Canadian law of rectification may still differ from English and Australian law in at least one material respect. Historically, English law required that in order to obtain rectification of a document the parties would have to establish that there was a valid and enforceable prior agreement which had been incorrectly transcribed.[47] That requirement has now been abandoned in both English and Australian law, which only insist upon a common continuing intention, whether or not it amounts to an agreement.[48] As Gageler, Nettle and Gordon JJ of the High Court of Australia recently put it, the law only insists upon an '"agreement" between the parties in the sense that the parties had a "common intention"'.[49]

In *Fairmont*, the majority referred (at [30]) to the decision in *Performance Industries Ltd v Sylvan Lake Golf & Tennis Club Ltd*,[50] where the Supreme Court held that rectification 'is predicated on the existence of a prior oral contract whose terms are definite and ascertainable'.[51] Notwithstanding this, the majority in *Fairmont* accepted that 'rectification requires the parties to show an antecedent agreement *with respect to the term or terms* for which rectification is sought',[52] as opposed to a *complete* antecedent agreement. In this regard, *Fairmont* may signal the beginning of a departure from this requirement. However, without more, this should not be read as impliedly overruling the Court's earlier statements in *Performance Industries.* It remains to be seen whether Canadian law will adopt this approach.

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44 See, eg, *FHR European Ventures LLP v Cedar Capital Partners LLC* [2015] AC 250 at 273 [45]; *Hasler v Singtel Optus Pty Ltd* (2014) 87 NSWLR 609 at 626 [71].

45 2016 SCC 55.

46 2016 SCC 56 at [33].

47 See, eg, *Lovell & Christmas Ltd v Wall* (1911) 104 LT 85 at 88; *Frederick E Rose (London) Ltd v William H Pim Junior & Co Ltd* [1953] 2 QB 450 at 461.

48 *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 at 1123 [48]; *Swainland Builders Ltd v Freehold Properties Ltd* [2002] 2 EGLR 71 at 74 [33]; *Simic v New South Wales Land and Housing Corporation* (2016) 339 ALR 200 at 209 [32], 211 [41], 223 [103]; *Maralinga Pty Ltd v Major Enterprises Pty Ltd* (1973) 128 CLR 336 at 350-1; *Slee v Warke* (1949) 86 CLR 271 at 281.

49 *Simic v New South Wales Land and Housing Corporation* (2016) 339 ALR 200 at 223 [103].

50 [2002] 1 SCR 678.

51 [2002] 1 SCR 678 at [31].

52 2016 SCC 56 at [28] (emphasis added).