The Supreme Court of Canada’s recent decision in Canada (Attorney General) v. Fairmont Hotels Inc. narrows the scope of the doctrine of rectification, and clarifies where it will and will not be applied. In order for the doctrine of rectification to apply, parties must agree upon, and document, a specific plan that the parties intend to implement to achieve their projected results. The Supreme Court’s decision in Fairmont is significant, as it may have important implications on not only the drafting of financing agreements, but also the drafting of trust deeds and testamentary documents.

Factual background

The facts of this case deal with foreign exchange tax liability triggered by a financing arrangement. In 2002 and 2003 Fairmont Hotels Inc. entered into a complex financing arrangement with Legacy Hotels REIT, a Canadian real estate investment trust in which Fairmont owned a minority interest. Because the financing was in U.S. currency, Fairmont’s participation in the financing arrangement exposed it to a potential foreign exchange tax liability. In order to ensure foreign exchange tax neutrality, Fairmont entered into reciprocal loan agreements with Legacy through Fairmont’s subsidiaries, FHIW Hotel Investments (Canada) Inc. and FHIS Hotel Investments (Canada) Inc.

In 2006, Fairmont’s goal of foreign exchange tax neutrality was frustrated when Fairmont was acquired by Kingdom Hotels International and Colony Capital LLC. Fairmont, Kingdom Hotels and Colony Capital agreed on a “modified” plan which allowed Fairmont to hedge against its exposure to prospective foreign exchange tax liability. However, the plan did not protect Fairmont’s subsidiaries from such exposure.

In 2007, Legacy asked Fairmont to terminate the reciprocal loan arrangements so as to allow for the sale of the hotels. On the incorrect assumption that the matter of the subsidiaries’ foreign exchange tax neutrality had been resolved, Fairmont complied with Legacy’s request by redeeming its shares in its subsidiaries via resolutions passed by the directors of FHIW and FHIS. These share redemptions resulted in an unanticipated tax liability, which was discovered only after the Canada Revenue Agency audited the 2007 tax returns of FHIW and FHIS, and questioned Fairmont on those returns.
Fairmont and its subsidiaries then sought to correct this unanticipated tax liability by asking the court to rectify the 2007 resolutions passed by the directors of FHIW and FHIS. They sought to do this by converting Fairmont’s share redemption into a loan whereby FHIW and FHIS would loan to Fairmont the same amount that they paid to Fairmont for the share redemption.

The chambers judge allowed Fairmont’s application for rectification. Relying on the decision of the Ontario Court of Appeal in *Juliar v Canada (Attorney General)*, the chambers judge held that since 2002, Fairmont had intended that its financing arrangement be tax neutral.

The Ontario Court of Appeal affirmed the decision of the chambers judge, holding that Fairmont had intended that its financing arrangement would be carried out on a tax neutral basis.

The Supreme Court of Canada allowed the Attorney General’s appeal, holding that the parties’ mutual intention of tax neutrality could not support a grant of rectification, as Fairmont and its subsidiaries failed to demonstrate any prior agreement allowing for the loan, whose terms were definite and ascertainable.

### The Doctrine of Rectification

In *Fairmont*, the Supreme Court clarified that rectification is an equitable remedy designed to correct errors in the recording of terms in written legal instruments. Parties may not use the doctrine of rectification to rewrite their legal instruments where their recording in an instrument has led to an undesirable or otherwise unexpected outcome. As the majority of the Supreme Court stated, “rectification is not equity’s version of a mulligan.”

Where the drafting error in question has resulted from a mistake common to both or all parties to the agreement, rectification is available upon the court being satisfied, on a balance of probabilities, that (1) there was a prior agreement whose terms are definite and ascertainable; (2) that the agreement was still in effect at the time the instrument was executed; (3) that the instrument fails to accurately record the agreement; and (4) that the instrument, if rectified, would carry out the parties’ prior agreement.

Parties seeking rectification must show not only putative error in the instrument, but must also demonstrate the way in which the instrument should be rectified in order to correctly record what the parties intended to do. While 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. In this manner, the Supreme Court clarified that a court “may not modify an instrument merely because a party discovered that its operation generated an adverse and unplanned tax liability.”

### Rectification in the context of wills and trusts

Although the Supreme Court did not expressly address the issue of rectification in the context of wills and trusts, the Court's decision in *Fairmont* could impact the rectification of trust deeds and testamentary instruments in future cases.

In *Fairmont*, the Supreme Court stated that the focus of the inquiry should be on “whether the originally intended mechanism was properly recorded, and not on whether it achieved the desired tax outcome or resulted in a party incurring an undesired or unexpected tax outcome.” The Court further clarified that a mere intention to obtain a fiscal objective is insufficient to ground a claim in rectification.

On the face of the decision, the Supreme Court’s reasons in *Fairmont* appear to be consistent with the current case law on the rectification of wills. In *Robinson Estate v Robinson*, the chambers judge held that “if no errors were made by the solicitor and the words in the will were reviewed and approved by the testator, rectification will not be available simply because the testator was mistaken about their legal effect.” This statement appears to be
consistent with the Supreme Court’s recent holding in Fairmont that parties may not use the doctrine of rectification to re-write their agreements where the instrument as originally drafted has resulted in an undesirable or otherwise unexpected outcome.

Nonetheless, the extent to which the Supreme Court’s circumscription of the scope of rectification in its decision in Fairmont will impact the rectification of wills and trusts in future cases is unclear.

**Drafting considerations in light of Fairmont**

The Supreme Court’s decision in Fairmont highlights the importance of precision and clarity in the drafting of legal instruments. It is arguable that the principles set out in Fairmont also extend to the drafting of wills and trust deeds.

In light of the decision in Fairmont, drafting solicitors should consider implementing the following practices in the drafting of trust deeds and testamentary documents:

1. Ensure that the client’s instructions and intentions, including any instructions related to tax planning and any anticipated tax liability, are carefully and thoroughly documented.

2. Set out a plan documenting not only the clients’ general intended result, but also a road map detailing how the party or parties specifically intend to arrive at the intended result. In light of the decision in Fairmont, the plan should outline how the result is to be achieved in definite and ascertainable terms.

3. Consider adding recitals to agreements to clearly set out the clients’ objectives, and how they plan to arrive at those objectives, in definite and ascertainable terms.

The Supreme Court’s decision in Fairmont is significant, as the remedy of rectification may not be as readily available as previously thought.

Footnotes


4. Fairmont at para. 38.

5. Fairmont at para. 3.


7. Fairmont at para. 22.
