Old Case, New Gloss: The Ontario Court of Appeal Clarifies the Rule in *Foss v Harbottle*

July 10, 2020

By Greg Richards

The recent decision of the Ontario Court of Appeal in *Tran v Bloorston Farms Ltd.*, 2020 ONCA 440, provides a helpful explanation and clarification of the rule in *Foss v Harbottle* (1843), 67 ER 189 (UKHL). The decision shows that there are circumstances in which a shareholder may have a cause of action to claim for a loss, including a diminution in the value of their shareholding, where the company has suffered loss but has no cause of action. The rule will not bar the shareholder's claim.

Background

The appellant, Bloorston Farms Ltd. ("**Bloorston**"), argued that the rule in *Foss v Harbottle* should have been applied to deny the claim of the respondent, Sang Thi Tran ("**Sang**"), for the diminution in the value of her shares in her wholly-owned company, 1835068 Ontario Ltd. ("**183**"). The shares lost value because Bloorston terminated Sang's lease for premises in which 183 had been operating its restaurant business.

The lease of the premises named Sang as the tenant, and the lease was never assigned to 183. Bloorston became Sang's landlord when it purchased the building containing the leased premises. Shortly thereafter, Bloorston emailed an architect's certificate to Sang alleging that the leased premises were larger than what was specified in an earlier agreement made with the previous landlord. Bloorston demanded increased payments based on the larger area.

Through her lawyer, Sang disputed the increases. She stated that she would continue to pay the usual amount rather than paying the higher rent demanded, and sent a cheque to Bloorston calculated in accordance with past practice. Bloorston cashed the cheque but nevertheless changed the locks and terminated the tenancy. As a result, 183's restaurant business stopped operating.

Sang sued Bloorston for the return of her deposit and damages. 183 was later added as a plaintiff. Bloorston counterclaimed against Sang for lost rent and other losses relating to Sang's failure to pay the increased rental amounts.

The motion judge found that the termination of the lease caused both the restaurant to close and Sang's shares in 183 to become worthless. He rejected Bloorston's argument that Sang was not entitled to damages based on such loss in share value because of the rule in *Foss v Harbottle*. The motion judge granted summary judgment in favour of Sang and dismissed Bloorston's counterclaim.

The Court of Appeal's Decision

In dismissing Bloorston's appeal, the Ontario Court of Appeal noted that the rule in *Foss v Harbottle* is well entrenched in Canadian law. The rule stipulates that a shareholder – even a controlling or sole shareholder – does not have a personal cause of action for a

wrong done to the corporation. Although a wrong done to the corporation often results in a diminution in the value of the corporation's shares, and thereby harms the shareholders of the corporation, they personally have no right of action against the wrongdoer.

The Court identified two reasons for the rule. First, as separate legal entities, corporations, not their shareholders, are liable for corporate acts and, conversely, are entitled to sue for wrongs committed against them. Second, the rule prevents the multiplicity of actions that would result if a shareholder could sue whenever a wrong was done to a corporation resulting in harm to the company and a diminution in the value of the company's shares.

But the scope of the rule is limited. The rule prevents shareholders from bringing individual claims only if the wrong was committed against the company. The Court identified two circumstances in which the rule's limits are manifested:

(1) Both the company and its shareholders may have causes of action arising from the same or overlapping facts. In such circumstances, the rule in *Foss v Harbottle* will not impair either claim. For example, based on the various duties that a corporate director owes, both a corporation and its shareholders may have separate causes of action against a director who makes misrepresentations to induce the acquisition of shares. However, in any given fact situation, a careful analysis is required to determine whether a corporation and its shareholders both have valid claims. The outcome of such analysis will inevitably turn on the factual details. As the Court noted, cases may "fall on either side of the line" (para. 37).

(2) The second limit to the rule that the Court identified is when only the shareholder has a cause of action. The Court noted that this was the situation in the case before it. Only the shareholder, Sang, had a cause of action. Her company, 183, had no cause of action. On these facts, the rule in *Foss v Harbottle* would appear to have no application.

Nevertheless, Bloorston argued that the rule still applied to preclude Sang's claim. As summarized by the Court (para. 42), Bloorston's argument was "essentially that the rule applies because the claim is for diminution in share value, even though the predicate to the rule, a shareholder claim for a wrong done to the corporation, is absent."

To address this argument, the Court reviewed the relevant Canadian jurisprudence, as well as a decision of the House of Lords in *Johnson v. Gore Wood & Co*., [2001] 1 All ER 481. The Court specifically considered "the second proposition in *Johnson*" which Bloorston contended the motions judge had erred in adopting.

The Court rejected Bloorston's argument. On behalf of the Court, Zarnett, J.A. stated that the second proposition in *Johnson* should be treated as good law in Ontario and formulated the principle as follows (para. 63):

Where the wrong was not committed against the corporation and the corporation therefore has no cause of action, the rule in *Foss v. Harbottle* does not prevent a shareholder who has her own cause of action from suing for any damages properly recoverable under that cause of action, including, in appropriate cases, loss or diminution of share value.

The Court cautioned that a shareholder claiming diminution in share value would still need to meet all the requirements of proof, causation, foreseeability, and quantification, as is the case with any other head of damages.

For its part, Bloorston further contended that, indeed, diminution in share value was not a reasonably foreseeable consequence of the termination of Sang's lease. It also alleged that the motion judge had made errors in quantifying Sang's damages. Upon analysis, the Court of Appeal found no merit in these arguments and dismissed Bloorston's appeal.

Conclusion

The rule in *Foss v Harbottle* is a bedrock principle of corporate law. The decision of the Court of Appeal in *Tran v Bloorston Farms Ltd.* provides a helpful clarification. The rule does not preclude a shareholder from claiming for a diminution in the value of their shares where the shareholder has been wronged but the corporation, while it may have suffered a loss, suffered no wrong and therefore has no cause of action.

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

For more information or inquiries:

Greg Richards

Toronto
416-947-5031

Email:
grichards@weirfoulds.com

WeirFoulds LLP

www.weirfoulds.com

Toronto Office
4100 – 66 Wellington Street West
PO Box 35, TD Bank Tower
Toronto, ON M5K 1B7

Tel: 416.365.1110
Fax: 416.365.1876

Oakville Office
1525 Cornwall Road, Suite 10
Oakville, ON L6J 0B2

Tel: 905.829.8600
Fax: 905.829.2035