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# Can Shareholders Sue Personally for Losses in Company Share Value?

By Marco P. Falco

Since 1843, a corporation has been treated as a distinct legal entity from its shareholders. The practical effect of what is known as the rule *Foss v. Harbottle* (1843), 67 E.R. 189 (U.K.H.L.) is that only the corporation, not its shareholders, may start a lawsuit for wrongs done to it.

There are exceptions, such as "derivative actions". But even in those cases, the shareholders are simply bringing the derivative action "on behalf of" the corporation. The lawsuit still belongs to the company.

So what happens when there is harm done to a shareholder personally resulting from a loss in the company's share value? Does the shareholder have a personal cause of action? Under a strict *Foss v. Harbottle* analysis, the answer is no.

But a recent decision of the Ontario Court of Appeal, *Tran v. Bloorston Farms Ltd.,* 2020 ONCA 440, now adopts an important exception to *Foss v. Harbottle*.

*Bloorston Farms* establishes that a shareholder can bring a claim for the diminution in share value to the company where only the shareholder, not the company, has a right to sue the defendant.

### A Restaurant Goes Under. Who Sues?

*Bloorston Farm* involved the breach of a restaurant lease. The corporation, of which Sang was the sole shareholder, operated a restaurant on the premises. Sang was the only listed tenant on the lease.

In 2014, the defendant became Sang's landlord when it purchased the building in which the restaurant operated. The defendant landlord then demanded increased payments of rent from the tenant. Sang disputed the changes to the restaurant's rent and continued paying the rent she was already paying. The landlord ultimately terminated Sang's tenancy and the corporation's restaurant business ceased operations.

Sang brought an action against the landlord for breach of the lease for locking her and the corporation out of the premises. The corporation was also a plaintiff to the action, though it was not a party to the lease.

Part of Sang's claim involved an action for the loss of her share value as the sole shareholder of the corporation.

The landlord brought a motion for summary judgment, arguing that Sang, as a shareholder, could not personally claim the loss of the value of her shares when the corporation became worthless following the restaurant closure. The landlord relied on the rule from *Foss v. Harbottle*, arguing that only a corporation could bring an action for the harm done to it.

The motion judge rejected the landlord's position. The Court held that there was an exception to the rule in *Foss v. Harbottle* where a company suffers a loss, but has no cause of action to recover the loss. In that case, the shareholder can sue for the loss of share value.

Here, the corporation was not a tenant under the lease and therefore only Sang could bring an action for the diminution in share value. In the end, the motion judge awarded Sang damages of $140,614 for the loss of her share value.

The Ontario Court of Appeal upheld the motion judge's ruling.

### *The Exceptions to Foss v. Harbottle*

The Court of Appeal began its analysis with a review of *Foss v. Harbottle*. As stated, this rule provides that a shareholder of a corporation does not have a personal right to sue for wrong done to the corporation: *see Hercules Management Ltd. v. Young,* [1997] 2 S.C.R. 165.

The policy underlying the rule in *Foss v. Harbottle* is as follows: (i) the corporation, as a discrete legal personality, is liable for the corporation's acts, not its shareholders. Therefore, the company, not its shareholders, has the right to sue for wrongs done to it; and (ii) absent the rule, a shareholder would always be able to sue for wrongs done to the corporation which indirectly cause harm to the shareholder.

However, the Court of Appeal recognized that the rule has its limits and that there are two recognized exceptions to it:

i. where both the shareholder and the company have separate and distinct causes of action against the defendant. In this scenario, the "same or overlapping facts" amount to actionable wrongs done to the corporation and the shareholder. This may occur, in the Court's view, where a shareholder and a corporation have causes of action against the director for misrepresenting the share value of the company;

ii. where only the shareholder has a cause of action for which the corporation can't sue.

This exception is known as the "Second Proposition" from *Johnson v. Gore Wood & Co.,* [2001] B.C.C. 820 (U.K.H.L.).

It is the exception adopted by the Court of Appeal in *Bloorston Farms*:

Here, the corporation has no cause of action whatsoever. Only the shareholder, Sang, has a cause of action. Since the rule in *Foss v. Harbottle* applies only to prevent a shareholder from suing for a wrong done to the corporation, the question is whether the rule has any application when the corporation has no cause of action and the shareholder, who does have a cause of action, makes a claim for diminution of share value.

### Where Only the Shareholder Can Sue

The "Second Proposition" from *Johnson* was articulated by the House of Lords as follows:

Where a company suffers loss but has no cause of action to sue to recover that loss, the shareholder in

the company may sue in respect of it (if the shareholder has a cause of action to do so), even though the loss is a diminution in the value of the shareholding…

After reviewing previous cases in Ontario and British Columbia, including *Meditrust Healthcare Inc. v. Shoppers Drug Mart* (2002), 220 D.L.R. (4th) 611 (Ont. C.A.) and *Robak Industries Ltd. v. Gardner*, 2007 BCCA 61, the Court of Appeal in *Bloorston Farms* held that the Second Proposition from *Johnson* "fits consistently into a legal framework that is otherwise consistent with Ontario law".

In the Court's view, the Second Proposition "should be treated as good law in Ontario".

The Court offered three rationales for adopting the Second Proposition:

i. allowing a shareholder action for loss of share value where the corporation does not have a cause of action "respects the separate legal identity of the corporation. The shareholder is pursuing her own cause of action, not a cause of action that belongs to a separate legal person (the corporation)";

ii. there is no risk of a multiplicity of proceedings. The company does not have a cause of action, so only the shareholder can make the claim; and

iii. the claim for a loss in share value is "not simply a claim for loss that is reflective of the loss suffered by the corporation (for which the corporation, and only the corporation, can sue)". The claim for "diminution in share value results from a [shareholder's] relationship with the wrongdoer that is independent of any relationship the corporation had with the wrongdoer".

The Court cautioned, however, that its ruling was not intended to open the floodgates and that the plaintiff still had to prove the necessary elements for a loss in share value:

This does not, of course, mean that in every such case damages for diminution of share value should be allowed. A claim for this head of damages is subject to all the same requirements of proof, causation, foreseeability, and quantification as a claim for any head of damages flowing from the wrong that grounds the shareholder's cause of action…

Applying the principles above, the Court in *Bloorston Farms* held that the corporation had no contractual relationship under the lease with the landlord. Only Sang did. Accordingly, the Second Proposition applied. Sang was entitled to damages for the loss of her share value.

## A Necessary Step in Ontario Corporate Law

*Bloorston Farms* represents a necessary step in the evolution of Ontario common law. Recognizing the Second Proposition as an exception to *Foss v. Harbottle* aligns Ontario corporate law with other common law jurisdictions.

The Court was careful to cast the Second Proposition as a narrow, limited means of awarding compensation to shareholders for losses in share value that are otherwise unrecoverable by the company.

Of course, *Bloorston Farms* is a textbook example of the Second Proposition come to life. The case involved a breach of contract to which the corporation was not a party and under which the corporation had no right to sue.

What remains to be seen are the Second Proposition's conceptual boundaries. Where it is questionable whether a corporation has a right to pursue an action for losses in share value, the Second Proposition may very well not apply.

# Author

**Marco P. Falco**
Partner

**Tel:** 416 777 5421
mfalco@torkinmanes.com

Marco is a partner in the Litigation Department at Torkin Manes. He provides written advocacy for a wide range of civil disputes, including commercial litigation and administrative law. He specializes in applications for judicial review and civil appeals.