Can Shareholders Sue for Harm to their Company?

After 160 Years, *Foss v. Harbottle* Still Rules

By Albert S. Frank, LL.B.

When a company is harmed, this naturally affects the shareholders. The harm would undermine the value of their shares. Can the shareholders sue if the harm was contrary to law?

Foss v. Harbottle

Almost 160 years ago the case of ***Foss v. Harbottle*** said no, the shareholders cannot sue. That case has been followed ever since in Britain and Canada.

The issue recently came up again in the Court of Appeal for Ontario in the case of ***Meditrust Healthcare Inc. v. Shoppers Drug Mart***, (2002) 61 O.R. (3d) 786, where the Court said at page 790:

The rule in *Foss v. Harbottle* provides simply that a shareholder of a corporation – even a controlling shareholder or the sole shareholder – does not have a personal cause of action for a wrong done to the corporation. The rule respects a basic principle of corporate law: a corporation has a legal existence separate from that of its shareholders…. A shareholder cannot be sued for the liabilities of the corporation

and, equally, a shareholder cannot sue for the losses suffered by the corporation.

In the business law statutes of Canada and various provinces, a Court may give permission to a shareholder to sue on behalf of a company for the wrong done to the company. This is called a "derivative action." Note, though, that this requires the permission of the Court, which has the discretion to give or to refuse permission. Moreover, the shareholder would be suing on behalf of the company, for the benefit of the company rather than for the shareholder.

Meditrust Healthcare Inc.

In the above-mentioned case of ***Meditrust Healthcare Inc. v. Shoppers Drug Mart***, Meditrust was a company that owned a national mail-order pharmacy business. Because of regulatory and statutory requirements across Canada it had to operate through subsidiary companies and, in Quebec, through a licensee.

In 1997 Meditrust sued Shoppers Drug Mart and other defendants, saying that they had conspired, in various ways including through false advertising and a phoney letter from a fictitious society of pharmacists, to destroy Meditrust and to eliminate it as a competitor. The subsidiaries were never part of the lawsuit; they did not sue and there was no derivative action brought on their behalf.

Two years after starting the lawsuit Meditrust sold the subsidiaries. Meditrust then said that the main purpose of the litigation was to recover the difference between what the sale price would have been, but for the conduct of the defendants, and the actual sale price.

On a Motion for Summary Judgment the judge ruled that for the claims in question, any damages suffered by Meditrust were not suffered by it directly but were derivative of damages suffered by the subsidiaries. Accordingly, the rule in ***Foss v. Harbottle*** barred the claims. On appeal, as shall be seen below, the Court of Appeal largely agreed.

Single Economic Entity

On appeal, Meditrust asserted four bases for its right to sue, the first of which was that it and the subsidiaries were really a single economic entity. Meditrust completely controlled the subsidiaries.

According to the Court of Appeal, though:

> This submission shows the difference between economic reality and business reality…. And the rule in *Foss v. Harbottle* is a corporate law rule, not an economic rule. A parent company that owns all the shares of its subsidiaries may exercise complete and constant control over them. That control, however, does not clothe the parent with the right to sue for the subsidiaries.

Meditrust could not be sued for harm caused ***by*** the subsidiaries, and similarly could not sue for harm caused ***to*** them.

Principal and Agent

The second basis advanced by Meditrust was that it was the principal and the subsidiaries were its agents.

Where an agent enters into a contract for a principal, the principal can sue for a breach of that contract. Meditrust claimed that it could apply the same rule here, where it complained that the defendants committed various torts including conspiracy, intentional interference with contractual relations, unlawful infliction of economic harm, and injurious falsehood.

Meditrust lost this point. According to the Court "[the] law of principal and agent is concerned with contract and property, not with torts." Note that Meditrust was suing for various alleged torts, not because of any breach of contract.

Contractual Right to Sue

Meditrust also said that its security agreements with the subsidiaries gave it a basis to sue, but for various reasons lost on this point as well. One of the reasons was that although the agreements gave Meditrust rights upon a default by the subsidiaries, no default was alleged.

Suffered Damages Personally

Meditrust said that it suffered various losses independent from and not derivative of the damages suffered by the subsidiaries. The Court disagreed in all areas except its claim that harm was caused to its "goodwill":

Goodwill includes reputation, position in the business community, client base, the expectation of continued public patronage and like considerations.

It was possible that Meditrust had suffered such harm, and so this claim should proceed to trial.

Conspiracy Claim

Meditrust said that the conspiracy claim should also go to trial, but the Court agreed with the motions judge that ***Foss v. Harbottle*** applies to bar conspiracy claims just as it applies to bar other tort claims.

# # #

The above article first appeared in the April, 2003 issue of ***The Bottom Line.***

# # #

Research has NOT been done to see if this article is still good law. Also, this is general information that might not apply to your particular situation.

# # #

Albert S. Frank is a business and trial lawyer with over 30 years of experience.

Phone: 416 929 7202
Email: afrank@FrankLaw.ca
Web: www.FrankLaw.ca