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Applying the Rule in *Foss v Harbottle* to Limited Partnerships

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Case Commented On: *Asher Place Senior Residency Limited Partnership v Balcom*, 2021 BCCA 162 (CanLII)

In *Asher Place Senior Residency Limited Partnership v Balcom*, 2021 BCCA 162 (CanLII), the issue was whether a common law derivative action may be brought on behalf and in the name of a limited partnership against the partnership's general partner based on alleged wrongs committed by the general partner in its conduct of the business of the limited partnership (at para 1). The Court of Appeal found that procedurally and substantively, it is possible.

General Context

The rule in *Foss v Harbottle* (1843), 2 Hare 461, 67 ER 189 (UK Ch), is the basic common law rule that only a person who has suffered a wrong may bring a cause of action with respect to that wrong. Applied to corporate law, that means that a corporation, which is a separate legal entity, is the proper party to bring actions for wrongs done to it, and shareholders, being separate from the corporation, do not have personal causes of action when the corporation has been harmed. This rule is the assertion of what is commonly known as the *Salomon* principle, that the corporation is a legal entity distinct from its shareholders (*Salomon v A Salomon & Co Ltd*, [1896] UKHL 1, [1897] AC 22). (There is some overlap between the derivative action and the oppression remedy, which complainants can use when they have been personally harmed, but that discussion is beyond the scope of this post.)

In the context of how corporations are structured, this rule can be problematic, as those controlling the corporation (and deciding whether the corporation would bring a legal action) may be the ones harming it and would therefore be unlikely to bring an action against themselves on behalf of the corporation. The common law exception to the rule in *Foss v Harbottle* allows the commencement of a legal action where the impugned act constitutes a fraud on the minority. (Although there are four known exceptions to the rule in *Foss v Harbottle*, only one is a true exception. See Christopher C Nicholls, *Corporate Law* (Toronto: Emond Montgomery Publishing Limited, 2005) at 397.) Now, both the rule in *Foss v Harbottle* and the exception are outdated references more than anything else, as complainants, typically minority shareholders but not exclusively, can bring a statutory derivative action in the name and on behalf of the corporation against the wrongdoers. Complainants must obtain leave to commence a derivative action (*Business Corporations Act*, RSA 2000, c B-9, s 240).

Asher Place

This brings us to the issue in *Asher Place*. Corporations can utilize the statutory derivative action, but a partnership, unlike a corporation, is not a separate legal entity, and is not formed under corporate statutes. This leads to the two-fold issue in *Asher Place*, which dealt with a limited partnership: 1) does the rule in *Foss v Harbottle* apply to partnerships, and 2) can a partnership bring a common law derivative action?

A limited partnership consists of one or more partners who manage or control the firm's affairs and are liable for the debts and obligations of the firm (a general partner), and one or more partners whose liability is limited and who do not participate in management of the firm (a limited partner) (see RC I'Anson Banks, *Lindley & Banks on Partnership*, 18th ed (London: Sweet & Maxwell, 2002) at 28-01). A limited partnership acts through its general partner; limited partners, unlike general partners, cannot bind the partnership (*Partnership Act*, RSA 2000, c P-3, ss 58, 65).

In *Asher Place*, the Court of Appeal found that Rule 20-1(1) of the *Supreme Court Civil Rules*, BC Reg 168/2009, procedurally allows the action to proceed. The Rule, which exists to avoid a multiplicity of actions, applies to both ordinary and limited partnerships and allows partnerships to sue and be sued in their own names. It states,

> Two or more persons claiming to be entitled, or alleged to be liable, as partners may sue or be sued in the name of the firm in which they were partners at the time when the alleged right or liability arose.

The court relied on *Watson v Imperial Financial Services Ltd* (1994), 88 BCLR (2d) 88, CanLII 3293 (BCCA) for the substantive analysis. In *Watson*, individual limited partners advanced derivative claims on behalf of the limited partnership against a bank, alleging that it had participated in a breach of fiduciary duty committed by the general partner. In allowing the claims to proceed, the court adopted the rule in *Foss v Harbottle*, maintaining that it applied even though a partnership is not a legal entity. The court said, "[t]he basis of the application of the rule in *Foss v Harbottle* is that the harm or damage is done to the partnership itself and whatever loss or damage the individual members of it suffer is as a consequence of and incidental to the fact that they are members of the partnership" (at para 24). In short, in spite of a partnership not being a legal entity, the cause of action belongs to the partnership and not to the individual partners.

This principle is not new. In *Edwards v Halliwell*, [1950] 2 All ER 1064 (CA), the English Court of Appeal said that the application of the rule in *Foss v Harbottle* is not limited to corporations, maintaining, "[T]he proper plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is prima facie the company or the association of persons itself" (at 1066). In fact, the origin of the rule in *Foss v Harbottle* can be traced to early decisions in the law of partnership (see AJ Boyle, *Minority Shareholders' Remedies* (Cambridge: Cambridge University Press, 2002) at 2).

This principle can be found in other Canadian jurisdictions. In *Allen v Platinum Rouge Valley Inc*, [1998] OJ No 2834, 43 BLR (2d) 62 (Ont Ct J (Gen Div)), another case that considered whether the rule in *Foss v Harbottle* applied to limited partnerships, Justice Marc Rosenberg found that the

limited partnership could bring the claim since the duty to act in the best interests of the partnership was owed to the partnership. In *Quikjets Inc v Q Private Jets Limited Partnership*, 2015 ABQB 702 (CanLII), the court determined that the *Watson* and *Allen* decisions required it to consider against whom the alleged wrongs were committed (at para 35). And in *0738827 B.C. Ltd v CPI Crown Properties International Corp*, 2013 ABQB 499 (CanLII), the defendants referenced *Watson* to assert that the harm was done to the partnership itself, but due to a limited partnership agreement specifying that the general partner owed a duty to limited partners, the court declined to apply the principle and found instead that the general partner was contractually obliged to each of the limited partners, not to the partnership (at paras 57-59).

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