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Shareholders Do Not Have Standing To Bring an Individual Action Against Third Parties Who Have Damaged the Corporation: *Adair v. Wozniak*

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**SHAREHOLDERS DO NOT HAVE STANDING TO BRING AN
INDIVIDUAL ACTION AGAINST THIRD PARTIES WHO
HAVE DAMAGED THE CORPORATION:
ADAIR V. WOZNIAK**

Apart from the context of a derivative action, can a shareholder in a corporation sue individually for wrongful acts committed against the corporation by third parties? The general rule of corporate law states that a shareholder cannot attain standing for such a suit.¹ This rule is grounded on the theory that all shareholders should incur loss from third party wrongdoing in proportion to the amount of shares he or she holds, and likewise should proportionately benefit when the corporate entity wins an action.² In addition, courts are fearful that if this rule were not in force, then there would be a multiplicity of individual shareholder suits.³ Finally, the rule protects creditors' rights and allows the board of directors to decide how recovered damages should be used by the corporation.⁴ In *Adair v. Wozniak*,⁵ a case of first impression⁶, the Ohio Supreme Court followed this rule and by a six to one decision held that shareholders do not have an independent cause of action against a third party.

FACTS

The plaintiffs-appellees/cross-appellants (plaintiffs) were several shareholders in an Ohio close corporation, Houk Machine Co.⁷ The defendant-appellants/cross-appellees (defendants) were Thomas Wozniak, the corporation's accountant; William Monteith, a client of Wozniak's; and the First National Bank of Akron.⁸ In early 1981, Houk Machine was not able to meet a loan

¹Several jurisdictions adhere to this principle: *United States v. Palmer*, 578 F.2d 144 (5th Cir. 1978); *Scharmer v. Carrollton Manufacturing Co.*, 525 F.2d 95 (6th Cir. 1975); *Eden v. Miller*, 37 F.2d 8 (2nd Cir. 1930); *Continental Illinois Nat'l Bank & Trust Co. v. Stanley*, 585 F. Supp. 1385 (N.D. Ill. 1984); *Hikita v. Nichiro Gyogyo Kaisha, Ltd.*, 713 P.2d 1197 (Alaska 1986); *Cunningham v. Kartridg Pak Co.*, 332 N.W.2d 881 (Iowa 1983); *New Castle Siding Co. v. Wolfson*, 97 A.D. 2d 501, 468 N.Y.S.2d 20 (1983), *aff'd*, 63 N.Y.2d 782, 481 N.Y.S.2d 70, 470, N.E.2d 868 (1984), *reargument denied*, 64 N.Y.2d 755, 485 N.Y.S.2d 1031, 475 N.E.2d 472 (1984). *Adair v. Wozniak*, 23 Ohio St. 3d 174, 492 N.E.2d 426 (1986).

²*See, e.g., Cunningham*, 332 N.W.2d at 885.

³*See, e.g., E.K. Buck Retail Stores v. Harkert*, 157 Neb. 867, 899, 62 N.W.2d 288, 307 (1954).

⁴*See Hikita*, 713 P.2d at 1199.

⁵23 Ohio St. 3d 174, 492 N.E.2d 426 (1986).

⁶*Id.* at 178, 492 N.E.2d at 429. Other courts have applied Ohio law in finding no standing for individual causes of action: *Scharmer*, 525 F.2d at 100; *Hancock v. SLD Development*, No. WMS-81-25 (Ohio App. May 28, 1982) (available currently on LEXIS, States library, OH file); *North v. Wick*, 104 Ohio App. 332, 144 N.E.2d 132 (1957); *Lagos v. Weprin*, 6 O.B.R. 101 (Ohio C.P. Ct. June 16, 1983); *Barnes v. Executors of Swift*, 11 Ohio Dec. Reprint 321 (Sup. Ct. 1891).

⁷The Plaintiffs included Harold Adair, Clifford Houk and Jon Houk who were officers; Sylvester Houk, chairman of the board; and each one's respective spouse. *Adair*, 23 Ohio St. 3d at 175, 492 N.E.2d at 427. The corporation was a close corporation in part because it had less than 35 shareholders. *See* OHIO REV. CODE ANN. §1701.591 (Page 1985). Brief of Defendant, First National Bank of Akron, at 10-11, *Adair*.

⁸Appellees's Briefs at 2, *Adair*.

payment due its largest creditor and subsequently defaulted on that loan.⁹ When the corporation defaulted, the creditor filed an action, obtained a judgment and threatened to seize all the company's assets which had been pledged against the loan.¹⁰ In April of 1981, Wozniak told Jon Houk, a corporate officer, that Wozniak and Monteith would secure a loan from the First National Bank of Akron for \$121,000 to pay off the creditor.¹¹ Later that year Wozniak proposed to secure an additional loan of \$250,000 from First National in order to pay off the first loan and provide working capital for the corporation.¹² Wozniak and Monteith never secured the second loan, and Houk Machine subsequently filed for bankruptcy.¹³

As a result of the bankruptcy, plaintiffs brought an action alleging that the defendants had conspired to defraud the corporation of its personal property.¹⁴ The Summit County Court of Common Pleas found that the plaintiffs did not have standing to sue individually and granted the defendants' motions for summary judgment.¹⁵

The plaintiffs successfully appealed the summary judgment.¹⁶ Only defendants Monteith and First National Bank appealed to the Ohio Supreme Court.¹⁷ All of the plaintiffs from the original action subsequently filed a cross appeal.¹⁸

⁹The creditor was National Acceptance Corporation of America. Brief of Appellant William Monteith Sr., at 3, *Adair*.

¹⁰Although National Acceptance planned a liquidation sale of the corporate assets, Thomas Wozniak, Houk Machine's accountant, managed to get a brief reprieve from the creditor in order to find alternatives to either obtain financing or to generate the capital necessary to satisfy the judgment. *Id.* at 3.

¹¹The agreement terms involved a sale by Houk Machine of its equipment to Wozniak and Monteith for the stated \$121,000 amount, and the corporation would then lease the equipment back from Wozniak and Monteith. Appellees' Brief at 4, *Adair*.

¹²*Adair*, 23 Ohio St. 3d at 175, 492 N.E.2d at 427. Immediately before the \$250,000 loan was to be closed, Jon Houk was told by Wozniak to bring to the Bank three checks payable to him and Monteith for finder's fees for both loans. Appellees' Brief at 3, *Adair*.

¹³*Adair*, 23 Ohio St. 3d at 175, 492 N.E.2d at 427. The corporation could not meet the terms of the \$121,000 loan which included a monthly payment of \$1,400 in interest alone. In addition Wozniak's attorneys sent Houk Machine a letter giving Wozniak the option to reacquire the equipment within one month of paying off the First National Bank loans. Shortly thereafter, Wozniak resigned as accountant for Houk Machine. The final event which forced Houk Machine into bankruptcy was when another secured creditor, Wyandot Industries, obtained a judgment against the corporation and attempted to seize some machinery integral to the business; Houk Machine subsequently filed Chapter 11 on September 11, 1982 in order to continue operations. Brief of Appellant, William Monteith, Sr. at 4-5, *Adair*.

¹⁴The Plaintiffs alleged damages which included "loss of compensation, potential and real liability for personal guarantees of loans and corporate taxes, loss of loans to the company and mental anguish." *Adair*, 23 Ohio St. 3d at 176, 492 N.E.2d at 427.

¹⁵*Id.* The trial court granted the summary judgment because "the Plaintiffs as shareholders have no individual right of action separate and apart from the corporation for damage to the corporation . . ." *Adair v. Wozniak*, No. CV 83 8 2428, order and judgment entry at 2 (C.P. Ohio October 2, 1984).

¹⁶The appeals court reversed in favor of those Plaintiffs who had "personally guaranteed loans made to the Houk Co." [sic] because such guarantees can be a basis for a personal cause of action. The court affirmed the decision as to Harold Adair who had not made such guarantees. *Adair v. Wozniak*, C.A. No. 11923 (Ohio Ct. App. May 15, 1985).

¹⁷*Adair*, 23 Ohio St. 3d at 178, n. 3, 492 N.E.2d at 429, n. 3.

¹⁸The plaintiffs' reason for the cross appeal was that their "case either involves a substantial constitutional

LAW REGARDING SHAREHOLDER ACTIONS VS. THIRD PARTIES IN GENERAL

In general, corporations exist separately and distinctly from their respective shareholders.¹⁹ A shareholder cannot personally recover for an alleged wrong done to the corporation.²⁰ However, there is a well-recognized exception to this rule: a shareholder does have a cause of action if "the harm to the corporation also damaged the shareholder in his capacity as an individual rather than as a shareholder."²¹ Courts have basically interpreted this exception to mean either that the injury arose out of a special duty owed the shareholder,²² or the injury was separate and distinct from that suffered by the other shareholders.²³ These two concepts often overlap,²⁴ but the existence of either one will allow for an individual action.²⁵

A "special duty" exception could be a contractual obligation between the shareholder and a third party.²⁶ Another situation would be where the beneficiary of a trust has standing to sue the trustee individually for depreciation in the value of the trust assets, "even though the trustee is an officer of the corporation in which the trust holds stock and even though the action is based on the officer's breach of his corporate fiduciary duties," because the officer owes a special fiduciary duty to the trust beneficiary individually.²⁷ The rationale for allowing the shareholder standing when such a duty exists is that the shareholder has rights which extend beyond ownership in the corporation,

question or presents a case of public and great general interest." Plaintiffs-Appellees/Cross-Appellants' Notice of Cross Appeal, No. 85-1090, C.A. No. 11923.

¹⁹See, e.g., *Wolfson*, 97 A.D.2d at 504, 468 N.Y.S. at 21.

²⁰See, e.g., *Palmer*, 578 F.2d at 145-46.

²¹See, e.g., *North v. Wick*, 104 Ohio App. 332, 334, 144 N.E.2d 132, 133-34 (1957). It is curious that the Ohio Supreme Court did not cite *North* as authority for the individual damages exception discussed in *Adair*; one will note that no authority is cited in the paragraph discussing the exception in the opinion. Although *North* discussed the exception as dicta, it still could have been helpful in establishing some precedent; however, one can note that the *Adair* court cites no case authority whatsoever in the paragraph of the opinion which discusses the exception. *Adair*, 23 Ohio St. 3d at 176, 492 N.E.2d at 428.

²²See *Cunningham*, 332 N.W.2d at 883. Some cases which have interpreted the exception as arising out of a special duty include *Sherman v. British Leyland Motors, Ltd.*, 601 F.2d 429, 440 n. 13 (9th Cir. 1979); *Empire Life Insurance Co. v. Valdak Corp.*, 468 F.2d 330, 335 (5th Cir. 1972); *Stanley*, 585 F. Supp. at 1388; *Cunningham*, 332 N.W.2d at 883; *Weiss v. Northwest Acceptance Corp.*, 274 Or. 343, 348, 546 P.2d 1065, 1069 (1976).

²³See note 22. Some cases which have interpreted the exception to arise out of a separate and distinct injury include *Buschmann v. Professional Men's Ass'n*, 405 F.2d 659, 662-63 (7th Cir. 1969); *ITT Diversified Credit Corp. v. Kimmel*, 508 F. Supp. 140, 144 (N.D. Ill. 1981); *Alario v. Miller*, 354 So.2d 925, 926 (Fla. App. 1978); *Harkert*, 157 Neb. at 898-99, 62 N.W.2d at 307.

²⁴See *Hikita*, 713 P.2d at 1199. Note in *Hikita* that the Alaska Supreme Court partially overruled *Norman* which held a shareholder does not have standing to sue in the absence of a separate and distinct injury; the *Hikita* court found such injury is not necessary when a shareholder sues a fellow shareholder for breach of a shareholders' agreement. The breaching party here is arguably not a third party wrongdoer.

²⁵See, e.g., *Norman v. Nichiro Gyogyo Kaisha, Ltd.*, 645 P.2d 191 (Alaska 1982).

²⁶See *Buschmann*, 405 F.2d at 662.

²⁷12(B) W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §5921 (Rev. perm. ed. 1984). See *Massic v. Barth*, 634 S.W.2d 208 (Mo. App. 1982). The *Fletcher Cyclopedic* has been used as authority by nearly all of the courts' opinions cited in this article. It is also interesting that none of the cases cited in this note cite any secondary authorities except *Fletcher* and Annot., 167 A.L.R. 279 (1947), which has yet to

and it would be inequitable to ignore the rights of the individual.²⁸

This same rationale applies for the "separate and distinct injury" exception.²⁹ In this instance a shareholder must prove that his injuries are unique in comparison with fellow shareholders.³⁰ An example of such an injury would be the case of a corporate promoter who also owns shares and is damaged by a third party's act which also harms the corporation. The promoter probably formed the corporation to profit beyond the gains attainable by being only a shareholder and should be able to recover such "damages as he can prove . . . regardless of any cause of action the corporation may have against the defendant."³¹

PRE-*ADAIR* LAW IN OHIO REGARDING INDIVIDUAL SUITS

In light of this widely accepted rule and its exception, it is somewhat curious to find that Ohio had very little state case authority upon which the *Adair* court could base its decision.³² Therefore, the court grounded its decision on the case law of other jurisdictions, including most prominently, the Fifth Circuit Court of Appeals.³³ The court's citations of the Fifth Circuit authorities indicates faulty research since the proposition was set forth as recently as 1975 when the Sixth Circuit decided the Ohio case of *Scharmer v. Carrollton Manufacturing Co.*³⁴

Before *Scharmer* there were only a few Ohio cases which addressed this issue. The first case was *Ritchie v. McMullen*³⁵, which held that a shareholder does not have a right of action against third parties or directors who cause devaluation of corporate stock. *Ritchie* found such a wrong is only incidental to the wrong suffered by the corporation and effects all shareholders alike.³⁶

Later the Ohio Supreme Court decided *Zinn v. Baxter*.³⁷ The case involved an individual's right to bring an action against the corporate directorate.³⁸ The *Zinn* court held that a shareholder cannot maintain an individual

²⁸See, e.g., *Cunningham*, 332 N.W.2d at 883.

²⁹*Id.*

³⁰*Buschmann*, 405 F.2d at 662.

³¹*Eden*, 37 F.2d at 9-10, quoted in *Buschmann*, 405 F.2d at 661-62. The *Buschmann* case, which the plaintiffs in *Adair* used as authority, calls the *Eden* decision "the leading case which stands for the proposition that a stockholder's right to maintain a personal action against a third person" even if the corporation has a claim against the same wrong.

³²Neither the majority nor the dissent cited any Ohio cases in the opinion. *Adair*, 23 Ohio St. 3d at 176-78, 492 N.E.2d at 427-30.

³³*Id.* at 176, 492 N.E.2d at 428.

³⁴525 F.2d at 100. *Scharmer* originated in the Northern District, Eastern Division of Ohio. The *Scharmer* court stated that "under Ohio law shareholders have no individual right of action for damage to the corporation."

³⁵79 F. 522 (6th Cir. 1897), modifying 64 F.253 (6th Cir. 1894), cert. denied, 168 U.S. 710 (1897).

³⁶*Id.*

³⁷65 Ohio St. 341, 62 N.E. 327 (1901).

action in light of prevailing case law in other jurisdictions.³⁹ Although an action against the directors would not be technically the same as an action against an outside, third party, *Zinn* clearly states the general rule that a suit praying for damages based on wrongs to the corporation can only be brought as a derivative suit or by the corporation itself.⁴⁰

The case of *North v. Wick*⁴¹ is also important because it outlines the exception to the rule forbidding individual suits by stating that "if a shareholder suffers a special damage peculiar to himself and distinguishable in kind from that which he shares in the common injury then he may maintain a special action for his individual benefit, but not otherwise."⁴² The facts of *North* are similar to those of *Zinn*, but the *North* court was willing to recognize that an exception had finally developed in the law.

Since the *Scharmer* decision there has been at least one Ohio Court of Appeals case⁴³ and one Common Pleas case⁴⁴ which have decided the issue. Otherwise, it is apparent that the law in Ohio has not progressed very far in the area of individual shareholder standing to bring actions.

THE ADAIR DECISION

It follows that *Adair* stands as the benchmark Ohio decision regarding individual shareholder suits outside the derivative context. The syllabus of the *Adair* opinion states specifically that a ". . . plaintiff-shareholder does not have an independent cause of action where there is no showing that he has been injured in any capacity other than in common with all other shareholders as a consequence of the wrongful actions of a third party directed towards the corporation."⁴⁵

This holding means Ohio follows the accepted rule, and that state courts are to allow an exception to the rule forbidding individual shareholder suits if a shareholder can show that a *special duty* existed between him and the third party wrongdoer.⁴⁶ Thus, a shareholder cannot gain standing to sue if he lost money because a third party caused the stock to become devaluated or worthless; this is a risk all shareholders must face.⁴⁷ Also, if a shareholder guaranteed

³⁹*Id.*

⁴⁰*Id.* The *Zinn* court relied on the case law of several other jurisdictions, much like the *Adair* court does, see note 33.

⁴¹104 Ohio App. 332, 144 N.E.2d 132 (1957).

⁴²*Id.* at 334, 144 N.E.2d at 133.

⁴³See *Hancock*, No. WMS-81-25 (Ohio App. May 28, 1982) (currently available on LEXIS, States library, OH file).

⁴⁴*Lagos*, 6 O.B.R. 101 (Ohio C.P. Ct. June 16, 1983).

⁴⁵*Adair*, 23 Ohio St. 3d at 175, 492 N.E.2d at 427. This holding updates the *Ohio Jurisprudence* legal encyclopedia volume entitled "Business Relationships" at Sections 743, 744 and 745.

⁴⁶*Adair*, 23 Ohio St. 3d at 176, 492 N.E.2d at 428. The court cited several cases which adhere to the special duty interpretation of the exception. See note 23.

⁴⁷See, e.g., *Palmer*, 578 F.2d at 145-46.

a loan or had made any contributions beyond mere stock ownership, then that shareholder cannot gain individual standing unless the third party owed a direct duty to the shareholder.⁴⁸

This special duty exception interpretation by the *Adair* majority is more stringent against the shareholder than the separate and distinct injury exception.⁴⁹ The separate and distinct injury exception, for instance, probably would allow shareholders who guaranteed loans, but who were not in privity with third party wrongdoer to have standing to bring an individual action.⁵⁰

The lack of privity with the third party wrongdoer was the reason the *Adair* majority did not grant standing to the plaintiffs. The facts revealed that all the plaintiffs, except Mr. Houk, had guaranteed loans to the corporation at one time or another.⁵¹ These loans were separate from the transactions between the defendants and the corporation.⁵² Thus, when the corporation went bankrupt, the plaintiffs lost money on their loans, but the majority found that ". . . the injuries allegedly suffered by plaintiffs are not based on any independent contractual relationship plaintiffs had with defendants."⁵³ The majority went on to cite numerous cases which adhere specifically to the special duty exception to the rule.⁵⁴

By exclusively embracing the special duty interpretation, the majority has answered the question of whether Ohio should give more latitude to standing for shareholder suits with a resounding NO.

Conversely, Justice Douglas sided with the appeals court and dissented from the majority opinion by calling for the court to adopt both interpretations of the exception,⁵⁵ and allow the shareholder standing for an individual cause of action if either a special duty exists or a separate and distinct injury has occurred.⁵⁶ Douglas relied on *Buschmann v. Professional Men's Ass'n*,⁵⁷ a case

⁴⁸*Adair*, 23 Ohio St. 3d at 176, 492 N.E.2d at 428. The special duty requirement surfaces near the end of the opinion, but the syllabus of the opinion implies that the exception is allowed for a shareholder if he or she can prove an injury in "any capacity other than in common with all other shareholders . . ." The slight discrepancy within the opinion between text and syllabus may cause confusion to courts citing to this case. *Adair*, 23 Ohio St. 3d at 175, 492 N.E.2d at 427.

⁴⁹See note 24.

⁵⁰See, e.g., *Hikita*, 713 P.2d at 1199. The *Hikita* decision is liberal in that the Alaska Supreme Court allowed the exception even when the shareholder did not suffer a separate and distinct injury from the other shareholders. In that case there was a breach of a shareholder agreement which benefited the corporation. See note 26.

⁵¹*Adair*, 23 Ohio St., 3d at 177, 492 N.E.2d at 428.

⁵²*Id.* The loans the plaintiffs guaranteed were obtained by the corporation in 1972, nearly a decade before the loans involving the defendants were procured. Brief of Appellant, William Monteith Sr., at 6, *Adair*.

⁵³*Adair*, 23 Ohio St. 3d at 177, 492 N.E.2d at 428.

⁵⁴*Id.* at 177-78, 492 N.E.2d at 428. See note 47.

⁵⁵*Id.* at 178-79, 492 N.E.2d at 429-30. See notes 23 and 24.

⁵⁶*Id.*

⁵⁷405 F.2d 659 (7th Cir. 1969).

that the majority went through great pains to distinguish on the facts.⁵⁸ *Buschmann* involved a separate contractual duty that the defendant-third party owed the plaintiff-shareholder.⁵⁹ The *Buschmann* court found an individual cause of action, and even though that court did not specifically state that privity of contract between the shareholder and the third party was necessary for the exception to arise, the case authority and the implications flowing from the language of the opinion eliminate any other conclusion.⁶⁰ Justice Douglas seemed to have misinterpreted *Buschmann*.

Justice Douglas would have been more on point if he would have cited cases such as *E.K. Buck Retail Stores v. Harkert*.⁶¹ The *Harkert* court allowed for the separate and distinct injury exception, and did not imply that the plaintiff and defendant need be in privity in order to achieve standing for an individual action.⁶²

SIGNIFICANCE OF ALLOWING ONLY THE SPECIAL DUTY EXCEPTION

The *Adair* majority's narrow holding of the exception to the rule of not allowing a shareholder to have an individual cause of action is significant for at least two reasons: (1) the decision puts shareholders on notice that they may not always be able to personally recover damages for wrongs that a third party has committed against the corporation even if the shareholder had a considerable stake in that corporation beyond merely owning stock; and (2) the decision respects the United States Bankruptcy Courts' functions.

As to putting the shareholder on notice, the *Adair* majority in all likelihood has raised a red flag in front of shareholders who wish to guarantee loans or to make loans to a corporation. The guarantor/shareholder could stand to lose a great deal if the corporation folds and there is no privity between the wrongdoer and the guarantor/shareholder.⁶³ The lack of shareholder ability to make and guarantee loans may not be of much consequence to multibillion dollar corporations such as IBM and General Motors because of their massive lines of credit. However, a small corporation consisting of a few investors may need personal guarantees because the corporation itself has an inadequate line of credit. A shareholder making a personal, fiscal commitment beyond owning stock may be essential to keep the small corporation a going concern.⁶⁴ The

⁵⁸*Adair*, 23 Ohio St. 3d at 177, 492 N.E.2d at 428.

⁵⁹The contract was between an incorporator, Buschmann, and a medical finance company, Professional Men's Ass'n in consideration for stock and other security. *Buschmann*, 405 F.2d at 660-61.

⁶⁰*Id.* at 661-63. The Ninth District Court of Appeals concluded that the mere existence of any contractual obligation owed the shareholder allowed for standing without addressing the privity aspect of the *Buschmann* holding. *Adair*, C.A. No. 11923 (Ohio Ct. App. May 15, 1985). See note 17.

⁶¹157 Neb. 867, 898-900, 62 N.W.2d 288, 307 (1954).

⁶²*Id.*

⁶³See Brief of Cross-Appellants at 4. *Adair*.

⁶⁴*Id.*

Adair holding, therefore, can be manifestly unfair to the close corporation in Ohio because the decision would have a chilling effect on the oftentimes necessary personal financial contribution of the shareholders.⁶⁵

A possible alternative for a small corporation would be to draft a close corporation agreement which would include all shareholders.⁶⁶ If this agreement attempts "to treat the corporation as if it were a partnership" the shareholders might have an argument that as partners they have a right to recover whatever amount they contribute.⁶⁷ This amount might include capital beyond the value of the stock they own.⁶⁸ Such an agreement may or may not be an absolute shield for shareholders against the consequences of *Adair*. There is little case authority for such a proposition.

The *Adair* decision is also significant because of its respect for the U.S. Bankruptcy Code. The corporation in *Adair* filed for bankruptcy,⁶⁹ and the plaintiffs who guaranteed loans to the corporation are considered to be secured creditors with a valid claim against the bankrupt.⁷⁰ By restricting the exception to the rule against individual shareholder suits the Ohio Supreme Court has limited the guarantor/shareholder's remedy to a partial recovery from a bankruptcy disposition and has prohibited complete recovery against the alleged tortfeasors.⁷¹

The *Adair* decision is well-reasoned in terms of creditors' rights in that a shareholder who lacks privity with the party who has allegedly caused the corporation to go bankrupt cannot circumvent the U.S. Bankruptcy Court by bringing a civil suit.⁷² The decision maintains consistency in the laws regarding bankruptcy and creditors' rights.

In evaluating whether the *Adair* holding was a "good" decision, one must weigh the need for equitable treatment of large and small corporations (if such a need exists) against the need for respect for the bankruptcy laws. In making

⁶⁵*Id.* The Houk Machine Company was a family business, and the accompanying need for personal loan guarantees was evident.

⁶⁶OHIO REV. CODE ANN. §1701.591(F)(1) (Page 1985). Ohio instituted a close corporation act, which became effective in April of 1985. This law codified a great deal of common law in an attempt to accommodate close corporations. See O. JUR. 3d, *Business Relationships* §§ 5, 349 (1986).

⁶⁷OHIO REV. CODE ANN. § 1701.591(F)(1) (Page 1985). There is case authority stating that shareholders in a close corporation owe each other a fiduciary duty of good faith dealing. Whether this is an indication that such shareholders, when recognized as "partners," may be able to bring actions to recover their investments remains to be seen. See, e.g., *Donahue v. Rodd Electrotype Company of New England*, 367 Mass. 578, 328 N.E.2d 505 (1975).

⁶⁸*Donahue*, 367 Mass at 578, 328 N.E.2d at 505.

⁶⁹*Adair*, 23 Ohio St. 3d at 176, 492 N.E.2d at 427.

⁷⁰*Id.* It is interesting to note that there is a counterclaim pending in U.S. Bankruptcy Court for the Northern District of Ohio filed against the plaintiffs by the corporation based on the same transactions that were at issue in the Ohio Supreme Court. See *In re Houk Machine Co.*, Nos. 582-1512 & 583-0135. *Adair*, 23 Ohio St. 3d 178, 492 N.E.2d at 429.

⁷¹This was a main contention of the Defendant, First National Bank of Akron. Brief of Defendant-Appellant, First National Bank of Akron, at 10-11, *Adair*.

⁷²See e.g., *Hikita*, 713 P. 2d at 1199.

such an evaluation, it is important to remember that one rationale for the rule disallowing a shareholder action against a third party who harms the corporation is that the shareholder should suffer in proportion to the number of shares he owns. Accordingly, a creditor who either guaranteed a loan or loaned money should only be able to collect in proportion with the other creditors in Bankruptcy Court.⁷³

The Ohio Supreme Court was correct in limiting the exception to the special duty the defendant/third party owed the plaintiff/shareholder in privity because insuring that the bankruptcy dispositions are respected outweighs the need for giving shareholders the incentive to take an interest beyond stock ownership. In a capitalist economy investors are expected to take risks, and it is reasonable to expect shareholders to be accountable for their risks. In addition, aggrieved shareholders, such as the plaintiffs in *Adair*, have a remedy in bankruptcy court.⁷⁴

CONCLUSION

In *Adair* the Ohio Supreme Court has embraced the majority view that a shareholder does not have standing to bring an individual cause of action against a third party who harms the corporation. Additionally, the court limited the exceptions to the rule to allow shareholder standing if the shareholder is in privity with the third party.⁷⁵ The court chose its course by synthesizing case law from other jurisdictions and ignoring Ohio's rather piecemeal progeny of decisions.⁷⁶ The *Adair* court has sent a message to shareholders to be wary of financial involvement with a corporation beyond mere stock ownership.⁷⁷ This conservative decision may prove to be unfair to investors in close corporations, but does have the foresight to consider creditors' rights. Finally, *Adair* clearly defines shareholder standing in Ohio.

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⁷³See, e.g., *Cunningham*, 332 N.W.2d at 885.

⁷⁴Brief of Defendant-Appellant, First National Bank of Akron, *Adair*.

⁷⁵*Adair*, 23 Ohio St. 3d at 176-78, 492 N.E.2d at 428-29.

⁷⁶*Id.*

⁷⁷See Brief of Cross-Appellants at 4. *Adair*.

