IN THE COURT OF APPEALS OF IOWA

No. 6-221 / 05-0308
Filed June 14, 2006

PAUL L. DENNISON and JOYCE E. DENNISON,
Plaintiffs-Appellees/Cross-Appellants,

vs.

MEDIACOMM, INC., a/k/a MEDIACOMM, INC.,
Defendant-Appellant/Cross-Appellee,

U.S. BANK, N.A., successor in interest to
FIRSTAR BANK, N.A., f/k/a FIRSTAR BANK IOWA,
N.A., successor in interest to FIRSTAR BANK MT. PLEASANT,
and JOHN KUHENS,
Defendant-Appellee,
And
DIXIE BURKHART,
Defendant-Cross-Appellee.

Appeal from the Iowa District Court for Henry County, Mary Ann Brown, Judge.

A minority shareholder appeals the district court's ruling in a corporation's derivative action for breaches of fiduciary duties. Secured creditors cross-appeal. **AFFIRMED.**

Michael L. Noyes and Stacey Hawke of Lane & Waterman, L.L.P., Davenport, for appellant Burkhart.

Paul D. Burns, Vernon Squires, and Kevin C. Papp of Bradley & Riley, P.C., Cedar Rapids, for plaintiffs-appellees/cross-appellants.

John Kuhens, Mr. Pleasant, pro se.

Heard by Vogel, P.J., and Zimmer and Vaitheswaran, JJ.

VAITHESWARAN, J.

This appeal raises several issues arising from a creditor's attempt to enforce a security interest against a corporation and the corporation's derivative lawsuit alleging breaches of fiduciary duty. We affirm.

I. Background Facts and Proceedings

Paul and Joyce Dennison owned a radio station in Mt. Pleasant, Iowa, known as KILJ. They agreed to sell their stock in the station to a corporation called MediaComm. They further agreed to finance the transaction. MediaComm pledged its shares of KILJ stock as collateral for the loan.

In mid-2003, MediaComm began defaulting on its $11,119.55 monthly payments to the Dennisons. The Dennisons sent the company notices of default which were not cured. In August 2003 the majority shareholder and director of MediaComm, John Kuhens, took action to have the KILJ stock transferred to the Dennisons. That action was rescinded after MediaComm's attorney advised Kuhens that it violated statutory requirements. MediaComm remained in default on its loan payments to the Dennisons.

Towards the end of the year, Kuhens retained Paul Dennison to generate advertising revenue for MediaComm. The stated hope was that this revenue would be sufficient to cover MediaComm's outstanding expenses. In return for his services, Dennison was to receive $3000 per month plus a twenty percent commission, with the payments going to a management company formed for this purpose. From January through August 9, 2004, the management company received approximately $61,000.

Meanwhile, Dixie Burkhart, a minority shareholder of MediaComm, personally paid the Dennisons $88,000 to cure MediaComm's pre-2004 defaults. The company again defaulted in January 2004.

Following this default, the Dennisons sent MediaComm a notice of right to cure dated January 27, 2004. The notice specified two defaults: (1) MediaComm's failure to make the $11,119.55 loan payment due on January 25, 2004, and (2) MediaComm's payment of more than $25,000 to Burkhart in October and November 2003. MediaComm did not cure these claimed defaults.

The Dennisons sued MediaComm and others for foreclosure of their security interest in the KILJ stock and for execution against the collateral. Burkhart filed an answer and counterclaim on behalf of MediaComm in a derivative capacity. She alleged that MediaComm had sufficient funds to cure the default. She also alleged that Kuhens, with the knowledge and approval of the Dennisons, purposely refused to cure the default. Kuhens's motivation, in her view, was to allow the Dennisons to reacquire ownership of the KILJ stock and release him from a personal guaranty he made when the stock transaction was financed.

The Dennisons countersued Burkhart. They alleged she intentionally interfered with the performance of a contract. They requested an order requiring her to pay their attorney fees.

In a preliminary ruling, the district court concluded the Dennisons were entitled to repossess the KILJ stock, but also concluded repossession might cause MediaComm irreparable harm. The court enjoined the stock transfer, subject to the posting of a bond by Burkhart and MediaComm. The bond was not posted and the stock was released to the Dennisons. They subsequently acquired ownership of the stock at a foreclosure sale.

The case proceeded to trial. In a final ruling, the district court (1) rejected Burkhart's primary claim that Kuhens engaged in self-dealing by agreeing to turn over the KILJ stock to the Dennisons; (2) rejected additional contentions that (a) Kuhens breached a fiduciary duty to the corporation by retaining Dennison to sell advertising for the radio station and (b) Dennison aided and abetted this violation; (3) found Kuhens breached a fiduciary duty by paying personal legal fees with corporate assets and by failing to collect rent payments from KILJ; (4) concluded Kuhens incurred liability by allowing $22,000 of MediaComm money to be turned over to the Dennisons at the time they reacquired the KILJ stock; (5) denied the Dennisons' request for attorney fees from Burkhart based on their claim of intentional interference with the performance of a contract; and (6) declined to rescind the foreclosure sale.

Burkhart appealed and the Dennisons cross-appealed. Our review of the issues raised on appeal is de novo. Iowa R. App. P. 6.4.

II. Mootness, Estoppel, Lack of Prejudice

As a preliminary matter, the Dennisons maintain that Burkhart cannot now complain about the transfer and disposition of the KILJ stock "because the transfer occurred only after she failed to exercise her right to enjoin it." They assert that the doctrines of mootness, estoppel, and lack of prejudice foreclose the relief Burkhart is now seeking on appeal. Assuming without deciding that the Dennisons were required to preserve error on this argument and that error was indeed preserved, we find the argument unpersuasive.

A court action on a request for a temporary injunction "does not deprive the parties of the right to a trial on the merits of their petition seeking or resisting a permanent injunction, nor is it an adjudication for or against such right." *PIC USA v. North Carolina Farm P'ship*, 672 N.W.2d 718, 724 (Iowa 2003). A party may appeal as a matter of right from a ruling on a request for a permanent injunction. *Id.* at 723 (citation omitted).

In its final ruling, the district court denied Burkhart's request for rescission of the foreclosure sale. Burkhart challenges that aspect of the ruling on appeal. She has a right to do so, notwithstanding her failure to post a bond that would have prevented the sale. Accordingly, we proceed to the merits.

III. Claimed Breach of Fiduciary Duty in the January 2004 Default

Corporate directors owe a fiduciary duty to the corporation. *Cookies Food Prods., Inc. v. Lakes Warehouse Distrib., Inc.*, 430 N.W.2d 447, 451 (Iowa 1988). This duty includes a duty of care and a duty of loyalty. *Id.* "The duty of care requires each director to perform the duties of a director . . . in good faith, in a manner such director reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances." *Id.* (quoting Iowa Code § 496A.34). *See also* Iowa Code §§ 490.830(1), 490.831(1), (2) (2003). The duty of loyalty "derives from 'the prohibition against self-dealing that inheres in the fiduciary relationship.'" *Id*. at 452 (quoting *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264 (2d Cir. 1984)).

Burkhart first takes issue with Kuhens's 2003 action approving the transfer of KILJ stock to the Dennisons. She recites several procedural improprieties associated with this agreement. She acknowledges the agreement was rescinded, but contends it is evidence of a "cumulative scheme" to return the stock to the Dennisons.

We are not persuaded by this contention. As the district court found, the key event that triggered the stock transfer was not Kuhens's action in 2003 but MediaComm's default on its loan payment in January 2004. Burkhart does not dispute that this default occurred and that it was not cured. The stock purchase agreement authorized the release of the KILJ stock to the Dennisons "after a Default under the Loan or Security Agreement." Similarly, the loan agreement specified that the Dennisons could "compel the delivery of the pledged Stock" or could "proceed to sell the pledged Stock or . . . foreclose on the pledged Stock and other pledged assets to obtain payment." It is clear, therefore, that the Dennisons were entitled to the stock based on the 2004 default. *Cf. Irons v. Cmty. State Bank*, 461 N.W.2d 849, 853 (Iowa Ct. App. 1990) ("There existed no binding contract that the bank would continue to loan the Irons money year after year at the Irons' convenience.").

Anticipating this conclusion, Burkhart argues "the fact that the ultimate disposition of the assets may have legally been permissible through the foreclosure of the Dennisons' security interest and not through a voluntary transfer will not change the analysis." She maintains Kuhens "drained the corporation of cash, gave the corporation's creditors control of the corporation's only income source, neglected to collect rents due to the corporation, and refused to cure the corporation's default on its loan," all in violation of his duty of care to MediaComm. She also maintains that Kuhens's unwillingness to cure the default was motivated by his interest in absolving himself of liability under his personal guaranty agreement, which amounted to a breach of his duty of loyalty to MediaComm.

We will begin with the January 2004 default and Burkhart's contention that Kuhens violated his duty of care to the corporation by permitting the default. There is no question Kuhens elected not to cure that default. The record reveals, however, that this action was taken in good faith. *See* Iowa Code §§ 490.830(1)(a), 490.831(1)(b)(1); 6 Matthew Doré, Iowa Practice: Business Organizations § 28:6(2)(b), at 93 (2006) (hereinafter Doré) (stating good faith "is generally understood as an honest intention on the part of the director to act in the corporation's best interests"). Kuhens testified that MediaComm struggled for years to keep operations afloat. The company was forced to borrow additional funds from Paul Dennison in 2001 and 2002. By 2003, MediaComm had defaulted on several monthly loan payments. Foreclosure was forestalled only through Burkhart's injection of non-MediaComm funds.

MediaComm's only revenue came from radio advertising through its wholly owned subsidiary, KILJ. In January 2004, that amount totaled $29,391.67.[1] Expenses totaled $25,423.44, without the $11,119.55 loan payment to the Dennisons, leaving $4365.23 in net income. This sum was obviously insufficient to make the January payment.

[1] KILJ also generated $397 of finance charge income.

It is true that Kuhens could have made the payment by deferring the payment of other expenses. He testified he did not pursue this course because he believed the other expenses, including electricity and telephone bills, music licenses, a copy machine lease and staff salaries, were more critical. This decision showed an "honest intention" to "act in the corporation's best interests." Doré § 28:6(2)(b), at 93. MediaComm needed to have KILJ operational in order to generate revenue, and all the paid expenses furthered that goal. As Kuhens stated, "[a]ll the effort I gave was to keep the radio station going as well as it could," "[r]egardless" of who owned it.

In concluding that Kuhens acted in good faith with respect to the January 2004 default, we have considered the fact that KILJ generated enough revenue in February 2004 to fund the January loan payment within the thirty days specified in the notice of right to cure. Specifically, $38,210.81 came in from radio advertising and total expenses were $18,502.84, without the $11,119.55 loan payment, leaving $20,039.05 in net income, together with the $4365.23 from January 2004. This sum would have been sufficient to keep MediaComm going for two additional months. However, the company's long-term prospects were bleak. As Kuhens stated, the company had been failing for some time and "putting an end to it would be the appropriate thing to do." Notably, the loan agreement contemplated that MediaComm might be "unwilling" to cure a default and prescribed a remedy for such unwillingness: delivery and sale of the pledged stock. We conclude Kuhens did not breach a duty of care to MediaComm by permitting the company to default on its loan payment in January 2004.

We turn to Burkhart's contention that Kuhens permitted the January 2004 default to absolve himself of personal liability under the guaranty agreement, in violation of his duty of loyalty to MediaComm. There is no question that, under the personal guaranty agreement, Kuhens was liable for the entire outstanding loan balance in the event of a default. The agreement specified he would "absolutely and unconditionally" guarantee "prompt payment." *See Preferred Inv. Co. v. Westbrook*, 174 N.W.2d 391, 395 (Iowa 1970) ("If defendant's guarantee is one of payment, the obligation is an absolute undertaking with the imposition of liability on the guarantor immediately upon default of the principal debtor."); *Brenton Bank and Trust Co., Clarion v. Beisner*, 268 N.W.2d 196, 198 (Iowa 1978) ("[T]he Bank's possession of other collateral would not relieve Schutt or his personal representative on the guaranty."). Because the guaranty was unconditional, any attempts by Kuhens to get out from under it would have been futile. The Dennisons had the legal right to pursue him for the MediaComm debt, whether or not he agreed to release the collateral. *Id.*

The fact that the Dennisons knew Kuhens's financial condition and elected not to pursue that remedy is immaterial. Given the terms of the guaranty agreement, they could have changed their minds at any time. Indeed, the contemporaneous loan agreement stated the Dennisons would first enforce their security interest by disposing of the collateral and would hold Kuhens liable if a stock sale proved "insufficient to cover the outstanding contract balance."

As it turned out, the Dennisons bid $1.1 million for the stock, which was the "aggregate consideration" for the KILJ shares under the stock purchase agreement and the total amount owing under the loan agreement. Accordingly, MediaComm was not charged with a deficiency and Kuhens's liability under the guaranty agreement was extinguished. But, at the time that Kuhens made the decision to default on the January 2004 loan payment, he was still legally liable for payment of the loan balance and the precise consequences of his decision were still in question. For this reason, we conclude Kuhens did not breach his duty of loyalty to MediaComm by permitting the company to default on its January 2004 loan payment to the Dennisons.

We next address Burkhart's contention that Kuhens violated his duty of care to MediaComm by executing the compensation agreement with Paul Dennison. In her view, this agreement allowed Dennison to gain control of the radio station and was additional evidence of his "improper and illegal acts."

There is some evidence to support Burkhart's contention that Paul Dennison entered into the agreement to gain control over the radio station's finances before he formally acquired it. However, the compensation agreement Kuhens executed with Paul Dennison inured to the benefit of MediaComm as well as the Dennisons. *Cookies Food Prod., Inc.*, 430 N.W.2d at 454. Both Kuhens and Dennison testified that Dennison was retained to generate advertising revenue that could, in turn, be used to repay creditors. Dennison did just that, increasing revenues in January and February 2004 over the same period in 2003. He did so without auctioning off advertising, as Burkhart had done in previous years. While Burkhart criticizes his refusal to conduct an auction, Dennison and Kuhens testified that more revenue was generated by soliciting advertisers directly than by having them bid on advertising at an auction. For this reason, we agree with the district court that Kuhens did not breach his duty of care to MediaComm by retaining Dennison to generate advertising revenue for KILJ. As for the amount of Dennison's compensation for this service, we cannot conclude that it was so excessive as to amount to an independent breach of a fiduciary duty.

Finally, we turn to Burkhart's argument that Kuhens "drained the corporation of cash" and "neglected to collect rents due to the corporation." These are both post-default issues that do not directly bear on MediaComm's decision to default on its January 2004 loan payment.

We conclude Kuhens did not breach any fiduciary duties in connection with the January 2004 default. We further conclude that the Dennisons did not aid and abet the breach of any fiduciary duties in connection with that default. We find it unnecessary to address the Dennisons' contention that Burkhart also defaulted by withdrawing funds belonging to MediaComm in October and November of 2003.[2]

IV. Other Breaches of Fiduciary Duties

The district court concluded that Kuhens breached his fiduciary duties to MediaComm in several respects not directly related to the January 2004 default. For example, the district court noted that Kuhens paid personal legal fees with MediaComm funds, did not charge rent to KILJ, and acted improperly in

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[2] We note that officers and directors of an insolvent corporation owe a fiduciary duty to creditors as well as shareholders. *State v. Exline Fuel Co.,* 224 Iowa 466, 470-71, 276 N.W. 41, 43 (1937). Burkhart was a director of MediaComm at the time she withdrew funds from MediaComm. Given our conclusion that the stock transfer was justified based on the January 2004 default, we need not decide whether MediaComm was insolvent at the time of Burkhart's withdrawal and whether a fiduciary duty was triggered not to appropriate funds for her benefit at the expense of MediaComm's creditors. *See* 15A William Meade Fletcher, *Fletcher Cyclopedia of the Law of Private Corporations* § 7428, at 179 (perm. ed. rev. vol. 2000).

connection with certain rescinded actions in 2003. We agree with the Dennisons that these acts did not bear on the January 2004 default. We further agree that there is no evidence the Dennisons aided and abetted in these actions.

V. Cross-Appeal

A. Damage Award against the Dennisons

When the Dennisons acquired the KILJ stock at the foreclosure sale, the radio station's bank account contained $22,098. The district court found that this money was MediaComm's. The court further found Kuhens liable for allowing the money to pass to the Dennisons. The court entered judgment against the Dennisons and in favor of MediaComm in the amount of $22,098.

The Dennisons contend this aspect of the court's ruling was inequitable. First, they argue that this relief was never requested by Burkhart. We reject this contention. Whether pled or not, the issue was clearly tried by consent. Iowa R. Civ. P. 1.457 ("When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings."). Therefore, we proceed to the merits.

The Dennisons next argue that "at least part of the money represented financial obligations looking backward, which were properly the responsibility of MediaComm, not the Dennisons." They cite Iowa Code section 554.9207(2)(a), which provides that, with certain exceptions not applicable here, "reasonable expenses . . . incurred in the custody, preservation, use, or operation of the collateral are chargeable to the debtor and are secured by the collateral." Their argument presupposes that the Dennisons had an obligation to preserve the value of the stock in addition to the stock certificates. Some jurisdictions have rejected this premise. *See, e.g., Marriott Employees' Federal Credit Union v. Harris*, 897 S.W.2d 723, 728 (Tenn. Ct. App. 1994) (holding "duty of reasonable care when applied to stock pledged as collateral refers to the physical possession of the stock certificates"). The Dennisons preserved the physical stock certificates by entrusting them to an escrow agent until June 2004. When they acquired the stock pursuant to the court's temporary ruling, Kuhens continued to run the radio station and manage the bank accounts. Therefore, the Dennisons' receipt of more than $22,000 in a KILJ account cannot be justified on the ground that it was being used by the Dennisons to preserve the collateral between June and August 2004.

We also are not persuaded by the Dennisons' contention that expenses in August 2004 were paid using only funds that "entered the account" after the foreclosure sale. The undisputed evidence shows that the KILJ account ending in 74 contained $20,025.80 as of July 29, 2004. The Dennisons presented no evidence that these funds were exhausted as of August 9, 2004 when they acquired the KILJ stock at the foreclosure sale. Indeed, Paul Dennison conceded that there was money in the KILJ account at the time of the purchase. He testified, "that money was there because there was a payroll due that day, the 20th or the 10th of the month, and another payroll, so it was just money." It was clear, therefore, that MediaComm money was used to pay KILJ and other expenses after KILJ was formally acquired by the Dennisons.

Finally, we are not persuaded by the Dennisons' suggestion that they are entitled to these funds by virtue of Burkhart's withdrawal of more than $25,000 in 2003. This is simply an attempt to justify one claimed wrong with another. *Burke* *v. Reiter*, 241 Iowa 807, 817, 42 N.W.2d 907, 913 (1950) ("Two wrongs do not make a right.").

The district court acted equitably in concluding the balance in the KILJ was MediaComm's money rather than KILJ's and in entering judgment against the Dennisons for that amount.

B. Attorney Fees

The Dennisons contend "Burkhart is liable to [them] for interfering with their efforts to repossess the KILJ stock." They argue the district court acted inequitably in rejecting the claim and in failing to hold Burkhart accountable for their attorney fees.

Persons may be subject to liability for intentional interference with contract if they cause the performance of a contract with a third-party "to be more expensive or burdensome." *Ezzone v. Riccardi*, 525 N.W.2d 388, 393 (Iowa 1994) (quoting Restatement (Second) of Torts § 766A (1979)). The problem here is that Burkhart and the "third-party" with whom the Dennisons contracted are one and the same. Burkhart filed an answer and a counterclaim to the Dennisons' lawsuit as a minority shareholder of MediaComm. She did so in a derivative capacity "for the benefit of Defendant MediaComm." *See Whalen v. Connelly*, 545 N.W.2d 284, 292 (Iowa 1996). MediaComm cannot be a party to the contract and also have tortiously interfered with the Dennisons' performance of the contract. *See Harbit v. Voss Petroleum, Inc.*, 553 N.W.2d 329, 331 (Iowa 1996) ("[T]he tort of malicious interference with a contract can only be committed by a third party, not a party to that contract."); *Grahek v. Voluntary Hosp. Co-op. Ass'n of Iowa, Inc.*, 473 N.W.2d 31, 35 (Iowa 1991).

The Dennisons fall back on an exception to this rule for employer-employee relationships. *See Hunter v. Bd. of Trustees*, 481 N.W.2d 510, 518 (Iowa 1992); *Bossuyt v. Osage Farmers Nat. Bank*, 360 N.W.2d 769, 778-79 (Iowa 1985). It is unclear how this exception assists them. The Dennisons claimed Burkhart interfered with their right to recover the KILJ stock. This claim has nothing to do with Burkhart's status as an employee of MediaComm.

We agree with the district court that the Dennisons cannot invoke the tort of intentional interference with contract against Burkhart.

VI. Disposition

We affirm the considered ruling of the district court in its entirety.

AFFIRMED.