

IN THE COURT OF APPEALS OF IOWA

No. 9-565 / 09-0224
Filed August 19, 2009

CARY LUMLEY,
Plaintiff-Appellant,

vs.

**ADVANCED DATA-COMM, INC.,
MICHAEL J. BUDDE as President of
ADVANCED DATA-COMM, INC., and
WS LIVE, L.L.C., a Foreign Limited Liability Company,**
Defendants-Appellees.

Appeal from the Iowa District Court for Dubuque County, Lawrence Fautsch, Judge.

Cary Lumley appeals from the district court's order granting WS Live's motion for summary judgment. **AFFIRMED.**

Angela C. Simon, David L. Hammer, and Susan M. Hess of Hammer, Simon & Jensen, Dubuque, for appellant.

Darin Harmon, Dubuque, for appellees Advanced Data-Comm, Inc. and Michael Budde.

Les V. Reddick of Kane, Norby & Reddick, P.C., Dubuque, for appellee WS Live, L.L.C.

Considered by Vogel, P.J., and Potterfield and Mansfield, JJ.

POTTERFIELD, J.**I. Background Facts and Proceedings**

Michael Budde founded Advanced Data-Comm, Inc. (ADCI) and was its president and CEO. Cary Lumley began working for ADCI in 1999 and worked there through October of 2006. On May 1, 2005, Lumley and Budde signed a change of control agreement that provided certain benefits and assurances, including severance payments, to Lumley in the event of a change of ownership in the company. The change of control agreement provided that ADCI agreed not to sell its assets unless: (1) the entity acquiring the assets agreed to assume all duties and obligations of ADCI; or (2) ADCI established a reserve for amounts payable under the agreement.

In the fall of 2006, WS Live, L.L.C. signed a purchase agreement to purchase the assets of ADCI. WS Live then operated under the fictitious name Advanced Data-Comm (ADC). WS Live was managed by Kim Houlne, who was its president and chief operating officer, and Tim Houlne, who was its CEO. Lumley's employment did not continue with ADC. After Lumley's employment ended, WS Live did not honor the terms of the change of control agreement, arguing it did not assume responsibility for the liabilities of ADCI. In addition, ADCI had not established a reserve as contemplated by the change of control agreement, so Lumley did not receive the benefits for which she had contracted. Lumley filed suit against WS Live, alleging breach of the change of control agreement for WS Live's failure to pay Lumley after demand was made.¹

¹ Lumley also filed suit against ADCI and Michael Budde, but these suits are not at issue on appeal.

On October 31, 2008, WS Live filed a motion for summary judgment, asserting it was under no obligation to honor the change of control agreement. On December 11, 2008, Lumley filed a resistance to summary judgment, arguing Iowa case law allowed the imposition of successor liability in this case. On January 8, 2009, the district court granted WS Live's motion for summary judgment, finding successor liability did not apply to WS Live because of the change of management and ownership. Lumley appeals, arguing there is a question of disputed fact as to whether WS Live is a mere continuation of ADCI and is therefore liable for ADCI's debts and liabilities. Lumley also asserts WS Live is liable because the transaction between ADCI and WS Live was fraudulent.

II. Standard of Review

We review the granting of a summary judgment motion for correction of errors at law. *In re Estate of Renwanz*, 561 N.W.2d 43, 44 (Iowa 1997). Summary judgment is appropriate when the record demonstrates that there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. *Id.* We review the evidence in the light most favorable to the nonmoving party. *Id.* When a motion for summary judgment is made and supported, the nonmoving party must set forth specific evidentiary facts showing existence of a genuine issue of material fact and may not rest on mere allegations or denial of pleadings. Iowa. R. Civ. P. 1.981(5).

III. Summary Judgment

As a general rule, a corporation that purchases the assets of another corporation assumes no liability for the transferring corporation's debts and liabilities. Exceptions arise only in four

circumstances: (1) the buyer agrees to be held liable; (2) the two corporations consolidate or merge; (3) the buyer is a “mere continuation” of the seller; or (4) the transaction amounts to fraud.

Pancratz v. Monsanto Co., 547 N.W.2d 198, 200 (Iowa 1996) (citations omitted).

Lumley asserts the mere continuation and fraud exceptions apply, imposing liability on WS Live for ADCI’s debts and liabilities, including the change of control agreement.

A. Mere Continuation

The Iowa Supreme Court discussed the mere continuation exception in great detail in *Pancratz*, 547 N.W.2d at 200-02. The traditional approach to the mere continuation exception focuses on the continuation of corporate management and ownership between the predecessor and successor corporations. *Id.* at 201. However, a more expansive approach adopted by some courts focuses on the continuity of the business operation, which includes continuity of factors such as employees, business location, trade name, and products. *Id.* The *Pancratz* court found Iowa case law followed the traditional approach, stating, “In determining whether a successor corporation is liable under the mere continuation exception, this court has consistently looked for a continuity of management and ownership.” *Id.* The supreme court in *Pancratz* declined to adopt the expanded approach, finding public policy was best served by the traditional approach. *Id.* Thus, in our analysis, we must follow the traditional approach to the mere continuation exception.

In determining whether a successor is a mere continuation of its predecessor under the traditional approach, we must look for a “common identity of the officers, directors and stockholders in the selling and purchasing of

corporations.” *Id.* The uncontroverted facts show there was no common ownership between ADCI and WS Live. “We have never applied the mere continuation exception where the buying and selling corporations had different owners.” *Id.*

However, it is undisputed that Budde became the general manager and vice president of WS Live while it operated under the name of Advanced Data-Comm and was therefore involved at some level in the management of both companies. The *Pancratz* court considered a similar situation, where the president and CEO of the successor corporation had served in a management position in the predecessor corporation. 547 N.W.2d at 202. In finding the mere continuation exception did not apply, the *Pancratz* court noted that a two-year hiatus existed between that individual’s management of the predecessor corporation and the purchase by the successor. *Id.* Though we do not have a similar hiatus in this case, we find Budde’s role in ADC does not invoke the mere continuation exception for three reasons.

First, the Iowa Supreme Court has established that employees of an insolvent corporation may become involved in a new corporation without the successor corporation becoming liable for its predecessor’s debts or obligations. *Nelson v. Pampered Beef-Midwest, Inc.*, 298 N.W.2d 281, 286 (Iowa 1980) (quoting *Allen v. N. Des Moines Methodist Episcopal Church*, 127 Iowa 96, 98, 102 N.W. 808, 809 (1905) (“[M]embers or some of the members of an insolvent or dormant corporation may organize a new corporation for the promotion of the same purposes to which the old one is dedicated without becoming chargeable with its debts or obligations”)). “The fact that the new organization

embraces the old membership is immaterial, and in itself affords no reason why it should be held liable for the debts of the old corporation.” *Allen*, 127 Iowa at 99, 102 N.W. at 809. The *Allen* court noted that such transactions are closely monitored to prevent fraud, but the presence of common members between a company and its successor is not, standing alone, reason “to charge the successor with the debts or delinquencies of the party succeeded.” *Id.* at 99, 102 N.W. at 809-10.

Second, the evidence presented on summary judgment does not demonstrate that ADCI or WS Live collaborated in a sham transaction to avoid ADCI’s debt and/or liabilities. WS Live purchased ADCI in a legitimate arm’s-length business transaction. See *Pancratz*, 547 N.W.2d at 202 (finding the mere continuation exception did not apply where, among other things, “the record reveals no hint of a sham transfer. The substantial purchase price evidences an arm’s-length transaction”). Iowa courts have applied the mere continuation exception in the past where a company changed only its form, or inserted relatives as sham owners and directors. See, e.g., *C. Mac Chambers Co. v. Iowa Tae Kwon Do Acad., Inc.*, 412 N.W.2d 593, 597 (Iowa 1987) (finding a mere continuation in the business after the father-owner gave his shares in the new corporation to his son but remained in charge of the business); *Arthur Elevator Co. v. Grove*, 236 N.W.2d 383, 393 (Iowa 1975) (finding the mere continuation exception applied where a partnership transformed itself into a corporation but otherwise “continued its business in the same manner”). In contrast, this record supports a finding that the transfer between ADCI and WS Live was legitimate.

Further, WS Live produced uncontroverted evidence that the Houlnes were actively involved in the business of the successor corporation. Lumley tendered no proof that the Houlnes operated as mere figureheads while Budde continued to run the business. See *Grand Labs., Inc. v. Midcon Labs of Iowa*, 32 F.3d 1277, 1285-86 (8th Cir. 1994) (applying Iowa law and finding that where the cofounder of the original corporation became the key employee of the successor corporation, the successor corporation was not a mere continuation of its predecessor because new directors and officers were actively involved in running the successor business and were not mere figureheads).

Third, the evidence shows Budde's role changed after the sale of ADCI, as the Houlnes took over the management of ADC. Budde was the president and CEO of ADCI. The Houlnes were not involved in the management of ADCI. The facts included in Kim Houlne's undisputed affidavit are that she is the president and chief operating officer of WS Live. Tim Houlne is the CEO of WS Live. Kim Houlne states in her affidavit that she and Tim Houlne took over the management of ADCI, replacing Budde. Houlne's affidavit states the leadership of the company changed and the successor company is different in both management style and business intent. Budde stated at his deposition that his duties after the sale of ADCI were not substantially the same as they had been before the sale. Budde stated that before the sale he was "responsible for everything," whereas after the sale the accounting, human resources, programming, and information technology departments no longer reported to him. Budde further explained that his decision-making duties decreased at ADC,

as he was no longer in charge of establishing and negotiating contracts with potential clients.

The evidence establishes that there is a marked difference between the management of ADCI and WS Live. See *Nelson*, 298 N.W.2d at 286 (Iowa 1980) (finding the mere continuation exception did not apply when there was a marked difference between transferor and transferee). “[T]he controlling factor is whether the transferor continues to own and control the new corporation.” *Grundmeyer v. Weyerhaeuser Co.*, 649 N.W.2d 744, 752 (Iowa 2002). Though Budde was involved in the management of both ADCI and WS Live, he did not continue to own or control the successor corporation. Thus, his participation in the management of both companies, by itself, does not generate a fact question as to whether there was a continuity of management as a whole. Because the undisputed facts demonstrate that WS Live and ADCI operated under different ownership and substantially different management, we find the mere continuation exception does not apply. “The [mere continuation] exception has no application without proof of continuity of management and ownership between the predecessor and successor corporations.” *Pancratz*, 547 N.W.2d at 201.

Lumley asserts WS Live is a mere continuation of ADCI by virtue of continuity of name, address, phone number, logo, billing, marketing, and employees. However, these factors are irrelevant when evaluating the mere continuation exception under the traditional standard. See *id.* at 202 (“Other common factors urged by Monsanto (same employees, same location, same trade name) are irrelevant when evaluating the mere continuation exception under the traditional standard.”). Further, that WS Live carried on the same

business operations as ADCI does not necessitate a finding that WS Live was a mere continuation of ADCI. *Nelson*, 298 N.W.2d at 287 (“There must be something more than a mere succession in business to charge the successor with the debts or delinquencies of the party succeeded.”).

B. Fraud

Lumley also asserts employees were led to believe ADC was the same company as ADCI and therefore the fraud exception to the general rule of successor nonliability applies². The elements of fraud are: (1) representation, (2) falsity, (3) materiality, (4) scienter, (5) intent to deceive, (6) reliance, (7) resulting injury and damage. *Wilden Clinic, Inc. v. City of Des Moines*, 229 N.W.2d 286, 292 (Iowa 1975). We agree with the district court that there is no fact question as to whether WS Live’s purchase of ADCI was fraudulent. Lumley does not present evidence that WS Live or ADCI intended to deceive employees through false representation. Budde sent an email to all ADCI employees informing them of discussions with WS Live regarding the purchase of ADCI. Budde further stated ADCI accepted WS Live’s offer to purchase the company. A press release also clearly stated, “WORKING SOLUTIONS™ COMPLETES PURCHASE OF ADVANCED DATA-COMM” There is no indication that WS Live or ADCI made any false representations. WS Live and ADCI announced both publicly and privately to employees that WS Live had purchased ADCI, and Lumley presents no evidence to the contrary. Lumley does not present a fact

² WS Live contends Lumley did not preserve this issue for appeal. We find this issue was properly raised before the district court. The district court found WS Live’s purchase of ADCI was not fraudulent.

question as to whether the transaction between ADCI and WS Live was fraudulent.

AFFIRMED.