

IN THE COURT OF APPEALS OF IOWA

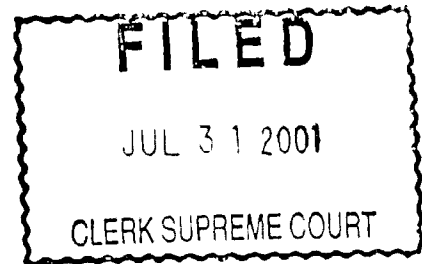
No. 1-241 / 99-1807

Filed July 31, 2001

JOHN F. KELLY and DENIS M. KELLY,
Individually and as Successor Trustee of the
Ann M. Kelly Trust,
Plaintiffs-Appellants,

vs.

ENGLEHART CORPORATION, LEWIS M. ANDREWS,
PAULA S. EOFF, JANE ANNE HARRIS and
DOUGLAS M. KRATZ,
Defendants-Appellees.



Appeal from the Iowa District Court for Webster County, Kurt L. Wilke,
Judge.

The plaintiffs, minority shareholders of a corporation that merged with the
defendant corporation, appeal from district court rulings denying them recovery
on their claims of breach of fiduciary duty and self-dealing claims and awarding
the defendants attorney fees. **AFFIRMED.**

Denis M. Kelly, Plano, Texas, for appellants.

Michael L. Noyes of Lane & Waterman, Davenport, for appellees.

Heard by Mahan, P.J., and Miller and Vaitheswaran, JJ.

VAITHESWARAN, J.

Minority shareholders of Sieg-Fort Dodge Company, Inc. sued majority shareholder Sieg Company, Inc. and the directors of Sieg-Fort Dodge, alleging multiple breaches of fiduciary duty. The district court dismissed all the claims on summary judgment or directed verdict. We affirm.

I. Background Facts and Proceedings

Sieg, an Iowa Corporation, distributed auto parts. It had a number of subsidiaries, including Sieg-Fort Dodge. Sieg-Fort Dodge and other subsidiaries of the company ultimately merged with Sieg. After the merger, Sieg changed its name to Englehart Corporation.¹

The Kellys were minority shareholders of Sieg-Fort Dodge and of other subsidiaries of Sieg. Following the merger, they dissented to the price Sieg offered to pay them for their shares. In response, Sieg filed two appraisal actions to determine the fair value of the Kellys' stock. The first related to the Kellys' shares in two subsidiaries not at issue here. *Sieg Co. v. Kelly*, 512 N.W.2d 275 (Iowa 1994). The second addressed the fair value of their shares in Sieg-Fort Dodge. *Sieg Co. v. Kelly*, 568 N.W.2d 794 (Iowa 1997). In the second case, the Kellys argued that incidents of pre-merger mismanagement by the directors of Sieg and Sieg-Fort Dodge should bear on the fair value of their shares and should result in a share price of \$184.59 rather than the \$22.60 share price set by Sieg. The Iowa Supreme Court rejected this contention, stating:

If the Kellys believe the officers and directors of Sieg and Sieg-Fort Dodge are responsible for premerger mismanagement and breach of fiduciary duty resulting in harm to Sieg-Fort Dodge, then those claims must be presented in a separate action; they are not

¹ We will refer to the parent as Sieg throughout this opinion.

appropriately considered in an appraisal action under chapter 490.
(Citations omitted).

Sieg Co., 568 N.W.2d at 802.² The court affirmed the district court's valuation of the Kellys' stock at \$62.67 per share. *Id.* at 808.

The Kellys then filed a separate lawsuit against Sieg and the directors³ of Sieg-Fort Dodge, raising twenty-two claims of pre-merger mismanagement and other breaches of fiduciary duty. The defendants moved for summary judgment. The district court granted the motion on fifteen of the twenty-two claims. The remaining seven proceeded to trial.

At trial, the Kellys introduced twelve exhibits in support of their claims, then rested. The defendants moved for a directed verdict, citing a "complete lack of showing of any evidence indicating any kind of self-dealing." However, they agreed to present their evidence before the court ruled, to accommodate witnesses and to afford the district court additional time to consider their motion.

² As discussed in Part IV, A, the parties dispute whether the causes of action the Iowa supreme Court authorized the Kellys to file are direct or derivative. There is some authority from other jurisdictions to suggest shareholders in a corporation that subsequently merges have no standing to file derivative actions. See *Scattergood v. Perelman*, 945 F.2d 618, 626 (3d Cir. 1991); *Grace Brothers, Ltd. v. Farley Industries, Inc.*, 264 Ga. 817, 450 S.E.2d 814, 816 (Ga. 1994); see also 19 Am. Jur. 2d *Corporations* § 2335 (1985); Cf. 19 Am. Jur. 2d *Corporations* § 2328 (noting divergence of opinion as to effect of merger on rights of shareholders to bring derivative action); 18A Am. Jur. 2d *Corporations* § 814 (stating dissenting shareholder to merger ceases to have any rights of shareholder except right to be paid fair value and consequently such shareholder cannot maintain a derivative action on behalf of merged corporation or an action for money damages); 19 Am. Jur. 2d *Corporations* § 2401 (stating preferable for shareholder in a predecessor corporation to file representative rather than derivative action so recovery would be received by shareholders rather than corporation). We need not resolve this issue because the defendants appear to have conceded that the court's statement in *Sieg II* gave the Kellys authority to file a derivative action. Indeed, they argue strenuously that this is a derivative action entitling them to fees and costs rather than a direct action where such relief would be unavailable.

³ In an amendment to their petition, the Kellys named Lewis M. Andrews, Paula S. Eoff, Jane Ann Harris and Douglas M. Kratz as defendants.

Following the close of all the evidence, the district court sustained the defendants' motion for directed verdict.

The Kellys appealed "the Order of the trial court entered October 13, 1999, granting Defendants' Motion for Directed Verdict." Meanwhile, defense attorneys sought statutorily authorized attorney fees. The district court granted their request as to the fifteen claims that were dismissed before trial and awarded a total of \$27,704.93 in fees and costs. The Kellys separately appealed this ruling. Both appeals are considered here.

II. Summary Judgment Ruling

A. Sufficiency of Notice of Appeal. At the outset, the defendants argue this court lacks jurisdiction to consider the Kellys' challenge to the district court's summary judgment ruling because the Kellys did not appeal it.

Iowa Rule of Appellate Procedure 6(a) requires an appealing party to specify "the decree, judgment, order or part thereof appealed from." The Kellys clearly did not specify they were appealing the summary judgment ruling as well as the directed verdict ruling. However, notices of appeal are to be liberally construed to preserve the right of review and consideration of the merits. *Iowa Dep't of Human Services ex. rel. Greenhaw v. Stewart*, 579 N.W.2d 321, 323 (Iowa 1998). Accordingly, our courts have required only substantial compliance with Rule 6(a). *Blink v. McNabb*, 287 N.W.2d 596, 598 (Iowa 1980); *Citizens First Nat. Bank of Storm Lake v. Turin*, 431 N.W.2d 185, 188 (Iowa Ct. App. 1988). If one can infer from the notice of appeal an intent to appeal from the judgment and the appellee has not been misled, the appeal will be entertained. *Blink*, 287 N.W.2d at 598-99.

Given the course of the district court proceedings, we believe defense counsel could discern the Kellys' intent to appeal both rulings and were not misled by the omission in the notice of appeal. See *McBride v. City of Sioux City*, 444 N.W.2d 85, 88 (Iowa 1989); *Miller v. Wellman Dynamics Corp.*, 419 N.W.2d 380, 382 (Iowa 1988); *Turin*, 431 N.W.2d at 188; but see *Jensen v. State*, 312 N.W.2d 581, 582 (Iowa 1981) (rejecting appeal notice which did not specify appeal was from denial of motion to correct sentence).

The defendants nevertheless urge us to find that, even if they were not misled by the Kellys' omission, they were prejudiced. They point to the cost of having to defend the district court's partial summary judgment ruling on appeal and the burden of having to deal with what they characterize as a frivolous lawsuit. Were we to accept their cost argument, a finding of prejudice would be automatic in virtually every case. As for the burden of defending frivolous litigation, we believe the statutory right to attorney fees set forth in Iowa Code section 490.740(4) addresses this issue.

Given the presence of an intent to appeal the summary judgment ruling and the absence of a showing the defendants were misled or prejudiced, we will proceed to the merits.

B. Standard of Review. We review the summary judgment ruling for errors of law. *Whalen v. Connelly*, 621 N.W.2d 681, 684-5 (Iowa 2000). Summary judgment is appropriate if the entire record including pleadings, discovery, and affidavits on file shows there is no genuine issue of material fact such that the moving party is entitled to judgment as a matter of law. *Id.*

C. Discussion. As noted, the district court dismissed fifteen of the Kellys' twenty-two claims on summary judgment. We will address these claims and, for purposes of clarity, will refer parenthetically to the claims as they appear in the petition.

1. No accounting of borrowed funds. (Paragraph 15(b)). The Kellys allege the defendants borrowed substantial sums of money from Sieg-Fort Dodge without providing security for these loans. The district court concluded this claim was barred by the applicable statute of limitations.

The five-year limitations period set forth in Iowa Code section 614.1(4) applies to shareholder derivative actions.⁴ *Des Moines Bank & Trust Co. v. George M. Bechtel & Co.*, 243 Iowa 1007, 1086, 51 N.W.2d 174, 219 (1952).⁵ That limitation period is subject to a discovery rule which provides:

In actions for relief on the ground of fraud or mistake, and those for trespass to property, the cause of action shall not be deemed to have accrued until the fraud, mistake, or trespass complained of shall have been discovered by the party aggrieved.

Iowa Code section 614.4.

The defendants maintain that the limitations period began to run when the Kellys received "actual notice" of the facts underlying the claims they asserted,

⁴ See discussion in Part IV below concerning distinction between derivative and direct actions.

⁵ In *Rowen v. Le Mars Mutual Ins. Co. of Iowa*, 282 N.W.2d 639, 646 (Iowa 1979) our court questioned the applicability of a five year statute of limitations to a policyholder derivative action founded partially on written contracts. However, our highest court resolved the issue in *Rieff v. Evans*, ___ N.W.2d ___ (Iowa 2001), holding the five year period applied to a policyholder derivative action even though the action was partially premised on a written contract. We need not here decide whether certain of the Kellys claims are indeed founded on written contract and should be subject to a ten rather than a five year limitations period, as this issue was neither raised by the Kellys nor addressed by the district court. See *State v. Jefferson*, 574 N.W.2d 268, 278 (Iowa 1997).

which, they contend, was more than five years before they filed this action. The Kellys respond that the statute of limitations defense is inapplicable to a fiduciary action such as this where the challenge is to the absence of full disclosure. They essentially claim we should apply a "fraudulent concealment exception" to the statute of limitations defense. See *Rieff v. Evans*, ___ N.W.2d ___, ___ (Iowa 2001); *Rowen v. Le Mars Mut. Ins. Co. of Iowa*, 282 N.W.2d 639, 647 (Iowa 1979); 51 Am Jur. 2d *Limitation of Actions* § 185.

Assuming without deciding that the Kellys were the "party aggrieved" within the meaning of Iowa Code section 614.4⁶, they had knowledge of the claimed fraud more than five years before this action was filed, as did the corporation. The Kellys acknowledge that, as early as 1989, they apprised the corporation of their concerns about a \$300,000 promissory note, which, they agree was the subject of their paragraph 15(b) claim. It is undisputed they did not file their lawsuit within five years of that time. Therefore, this claim would be time-barred unless we adopt the Kelly's argument that defendants who fraudulently conceal material facts cannot assert a statute of limitations defense.

Fraudulent concealment may toll the applicable statute of limitations. *Rieff*, ___ N.W.2d at ___; *Pride v. Peterson*, 173 N.W.2d 549, 555 (Iowa 1970).⁷

⁶ The "party aggrieved" within the meaning of Iowa Code § 614.4 is not the minority shareholder but the corporation, and the statute of limitations does not begin to run until the corporation discovers the fraud. *Rieff*, ___ N.W.2d at ___, Cf. *Des Moines Bank & Trust Co.*, 243 Iowa at 1086, 51 N.W.2d at 219.

⁷ This doctrine is analogous to the doctrine of adverse domination, a doctrine that tolls statutes of limitation for claims by corporations against their officers, directors, lawyers and accountants while the corporation is controlled by those acting against its interests. See *Resolution Trust Corp. v. Grant*, 901 P.2d 807, 811 (Okla. 1995). Notably, application of this doctrine "presupposes that there has not been notice sufficient to apprise an interested party of the facts needed to bring about a suit." *Id.* at 814 n.24. Here, there was such notice.

Where a fiduciary relationship exists, affirmative concealment is not necessary.

Id. Silence in the face of a duty to disclose may be sufficient. *Id.*

To toll the statute of limitations on the basis of fraudulent concealment, the Kellys needed to furnish evidence that Sieg breached a duty of disclosure to the minority shareholders with respect to the \$300,000 it borrowed from Sieg-Fort Dodge. They did not do so. In sworn answers to interrogatories attached to the defendants' motion for summary judgment, the Kellys admitted they were advised in 1989 by the chairman of the board of Sieg that the loan referenced in paragraph 15(b) of the petition had no security. This answer conclusively establishes that Sieg did not breach its duty of disclosure to the Kellys with respect to the loan. Accordingly, the fraudulent concealment doctrine does not operate to toll the five-year statute of limitation and the claim is time-barred.

2. Failure to Provide Fiduciary Accounting (Paragraphs 4(b), 4(c), 4(d)). These paragraphs of the petition allege the directors "failed to investigate and provide a fiduciary accounting" of 1) the administration of former board member Thomas Rudbeck; 2) the financial history of Sieg-Fort Dodge; and 3) intercompany financial transactions between Sieg and Sieg-Fort Dodge. The district court concluded these claims were time-barred as well.

According to correspondence between Sieg and the Kellys, a board member apprised the Kellys in 1989 that Sieg was looking into establishing a special litigation committee to investigate possible breaches of fiduciary duty by Rudbeck. The correspondence also made mention of the Kellys' concerns with the financial dealings of Sieg and its subsidiaries. In response, the chairman of the board made the books and records of Sieg and Sieg-Fort Dodge available to

the Kellys and assured them "no raid of affiliates will occur" in the event of a corporate reorganization. Therefore, the parties had notice of all three claims in 1989. Because the lawsuit raising these claims was not filed within five years of these disclosures, the claims are time-barred.

3. Failure to provide accounting of legal proceeding (Paragraph 15(n)). The Kellys contend the defendants did not provide an accounting of a legal proceeding Sieg filed against former officer Rudbeck. The district court granted summary judgment for the defendants on statute of limitations and other grounds. As the Kellys' concerns about the Rudbeck administration were raised in 1989 correspondence with Sieg, we agree with the district court that the claim is time-barred.

4. Failure to Pay Interest (Paragraph 15(c)). The Kellys allege that the defendants failed to pay interest on the money borrowed from Sieg-Fort Dodge. The defendants' motion for summary judgment contained an affidavit from Sieg's accountant refuting this claim. Specifically, the accountant attested that interest on the loans were either accrued on Sieg-Fort Dodge's books or paid. The Kellys' resistance does not contain facts controverting this affidavit. Therefore, they failed to generate a genuine issue of material fact that would have precluded summary judgment on this claim. See Iowa R. Civ. P. 237(e); *Gilbride v. Trunnelle*, 620 N.W.2d 244, 250 (Iowa 2000).

5. Violation of Preemptive Stock Rights (Paragraph 15(g)). The Kellys allege that the defendants issued new common stock of Sieg-Fort Dodge without notice to them and in violation of their preemptive stock rights. The district court agreed with the defendants' contention that the Kellys had no preemptive stock

rights under Iowa Code section 490.1704(1)(b) because this was a stock-for-stock transaction.

Preemptive rights "guarantee existing shareholders the first opportunity to buy new or unissued shares of stock in proportion to the number of shares they already possess before such shares can be offered to third parties or the public at large." C. Dana Waterman III and Edmund H. Carroll, Jr., *The Iowa Business Corporation Act: Corporate Governance Through the Articles of Incorporation and Bylaws*, 40 Drake L. Rev. 805, 832 (1991). These rights give existing stockholders a means of maintaining their relative equity position in a corporation when new shares of stock are issued. 18A Am. Jur. 2d *Corporations* § 525.

In 1989, the Iowa legislature changed the law on preemptive rights. Since that time, shareholders have not had a preemptive right to acquire unissued corporate shares unless the articles of incorporation so provide. Iowa Code § 490.630(1). However, the new law provided for a transitional period extending until December 31, 1992 during which shareholders of corporations formed under the old act would retain preemptive rights even if the articles of incorporation did not provide for them. Iowa Code § 490.1704; 40 Drake L. Rev. n. 267.

The sole evidence the Kellys relied on to support this claim was the fact that the number of outstanding shares of Sieg-Fort Dodge increased from 15,835 in 1989 to 27,798 in 1994. They asserted that because they were not given the first opportunity to buy these additional shares, their preemptive stock rights were violated. The defendants refuted this assertion by establishing through Sieg's accountant that the increase in outstanding shares resulted from stock-for-stock transfers in 1989 and 1991 for which no preemptive rights existed.

Like the district court, we agree with the defendants' position. By its terms, Iowa Code section 490.1704(1)(b) does not afford preemptive rights "[t]o acquire any shares sold otherwise than for cash", unless otherwise provided for in the articles of incorporation. The Kellys did not point to any portion of Sieg-Fort Dodge's articles of incorporation that would override this provision. Therefore, they did not generate an issue of material fact. See Iowa R. Civ. P. 237(e); *Cf.* 18A Am. Jur. 2d *Corporations* § 540 (noting plaintiffs have burden of proving they were denied preemptive right under statute or articles of incorporation). The district court did not err in granting summary judgment on this claim.

6. Failure to obtain independent appraisal. (Paragraphs 15(j), (k), 4(e), 4(f)). The Kellys allege the defendants failed to obtain an independent appraisal of the value of the Sieg-Fort Dodge stock and the salability of the company prior to the merger. The district court agreed with the defendants that they were under no legal obligation to conduct an independent appraisal prior to the merger. We agree with the district court.

Iowa Code chapter 490 contains detailed provisions on mergers. See Iowa Code §§ 490.1101-1110. Nothing in these provisions requires a parent corporation to obtain an independent appraisal of its subsidiary as a prelude to merger with the subsidiary. See also *Tanzer v. International General Indus., Inc.*, 402 A.2d 382, 391 (Del. Ch. 1979) (accepting testimony of officers and directors and report as prima facie evidence of value of subsidiary). Accordingly, the defendants were entitled to summary judgment on these claims.

7. Post-merger sale of assets (Paragraphs 15(l), 15(m), 4(g), 4(h)).

The Kellys allege the defendants failed to provide a fiduciary accounting of assets sold after the merger. The district court concluded these claims were raised and litigated in the prior appraisal action and, accordingly, the prior findings were preclusive on the Kellys in this action.

Issue preclusion is a doctrine that prevents a party to a prior action from relitigating issues finally resolved in that action. *Dettman v. Kruckenberg*, 613 N.W.2d 238, 244 (Iowa 2000). Issue preclusion applies if

(1) the issue determined in the prior action is identical to the present issue; (2) the issue was raised and litigated in the prior action; (3) the issue was material and relevant to the disposition in the prior action; and (4) the determination made of the issue in the prior action was necessary and essential to that resulting judgment.

Id. (quoting *American Family Mut. Ins. Co. v. Allied Mut. Ins. Co.*, 562 N.W.2d 159, 163-64 (Iowa 1997)).

We are not convinced that the defendants have established an identity of issues. The question in *Sieg I* was the effect of a post-merger sale of assets on the fair value of the Kellys' Sieg-Fort Dodge stock. The question here is whether the defendants appropriately accounted to the Kellys for the post-merger sale proceeds. Because the issues are distinct, the issue preclusion doctrine does not apply.

However, we believe summary judgment was appropriately granted on these claims for a different reason. See *O'Malley v. Gundermann*, 618 N.W.2d 286, 293 (Iowa 2000) (we may affirm on any basis appearing in the record even if not one relied on by the district court). Assuming without deciding that the Kellys

had standing to challenge post-merger actions,⁸ their exhibits contain no evidence relating to post-merger transactions. Accordingly, they failed to satisfy their burden of proof, and the district court did not err in directing a verdict on this claim.

III. Directed Verdict Ruling

The Kellys also challenge the district court order granting the defendants' motion for directed verdict on the seven remaining claims in their petition. We review this ruling on error. *Dettman*, 613 N.W.2d at 250. A defendant is entitled to a directed verdict where no substantial evidence exists to sustain a plaintiff's claim. *Godar v. Edwards*, 588 N.W.2d 701, 705 (Iowa 1999). Each of the remaining claims assert breaches of fiduciary duty.

A. Fiduciary Standards

Iowa Code section 490.830 requires directors to discharge their duties:

- (a) in good faith.
- (b) with the care an ordinarily prudent person in a like position would exercise under similar circumstances.
- (c) in a manner the director reasonably believes to be in the best interests of the corporation.

These obligations represent a fiduciary duty to a company and its shareholders.

Cookies Food Products, Inc. v. Lakes Warehouse Distributing, Inc., 430 N.W.2d

⁸ Citing Iowa Code section 491.740, the defendants argue that the Kellys were not shareholders in Sieg and, therefore, could not challenge post-merger conduct. This argument is consistent with the nature of derivative actions, which are actions brought by stockholders to remedy a wrong against the corporation. 19A Am. Jur. 2d *Corporations* § 2243; accord *Engstrand v. West Des Moines State Bank*, 516 N.W.2d 797, 799 (Iowa 1994). Additionally, Iowa Code section 491.110(5) states that a surviving corporation shall take over claims "existing or action or proceeding *pending* by or against any of such corporations" (emphasis added), again suggesting shareholders in the predecessor do not have standing to raise post-merger claims. We find it unnecessary to decide this question.

447, 451 (Iowa 1988). They include two types of duties: (1) a duty of care and (2) a duty of loyalty. *Id.*

Generally, the decisions of directors are presumed to be informed, made in good faith, and believed to be made in the best interests of the company. *Id.* at 453. This presumption is known as the business judgment rule. *Id.* In light of this presumption, the burden of proving a violation of a duty of care rests with the plaintiff. *Id.* However, where a party challenges a director's duty of loyalty, the burden is bifurcated. *Id.* The plaintiff initially has the burden of establishing a director engaged in self-dealing. *Id.* "When self-dealing is demonstrated, 'the duty of loyalty supersedes the duty of care, and the burden shifts to the director to prove that the transaction was fair and reasonable to the corporation.'" *Id.* (citing *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264 (2d Cir. 1984)). Self-dealing occurs when the parent corporation, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary, to the exclusion of, and detriment to, the minority stockholders. See *Solomon v. Armstrong*, 747 A.2d 1098, 1112 n. 35 (Del. Ch. 1999).

We believe all the claims that went to trial implicated Sieg's duty of loyalty rather than its duty of care. Therefore, the bifurcated burden applied. With respect to each claim, the Kellys were required to make a prima facie showing of self-dealing in order to shift the burden to Sieg. We will now determine whether they did so.

B. Discussion

1. Common Board Membership (Paragraph 15(a)). The Kellys allege Sieg used its power to set up common boards of directors between Sieg and Sieg-Fort Dodge in order to avoid dissenting director votes and notice to minority stockholders of Sieg's self-dealing. To support this claim, the Kellys introduced answers to interrogatories from Sieg Chairman Douglas Kratz that established common membership on the boards of Sieg and Sieg-Fort Dodge between 1989 and 1994. The Kellys argued before the district court that this common membership permitted Sieg to set the price it would pay for Sieg-Fort Dodge. This, they asserted, amounted to self-dealing. The district court disagreed, finding "[s]ome of the Board members of Sieg Company were also Board members of Sieg-Fort Dodge Company as plaintiffs complain, but the purpose was to integrate to benefit all shareholders and the common Board actually enhanced sales in Fort Dodge."

It is undisputed that the boards of Sieg and Sieg-Fort Dodge shared common directors. However, the modern rule is that common membership alone does not render a transaction voidable, in the absence of a showing of unfairness or bad faith. See 16 Fletcher Cyc. Corp. § 962 (Perm. Ed 2000). Iowa follows this rule. See *Rumery v. Standard Seed Tester Co.*, 194 Iowa 325, 326, 189 N.W. 667, 669 (1922); Cf. *Tschirgi v. Merchants Nat. Bank of Cedar Rapids*, 253 Iowa 682, 693, 113 N.W.2d 226, 232, (1962) (noting agreement by majority of stockholders to combine votes not unlawful in absence of showing of intent to defraud or to secure private benefit at expense of corporation); *State of Tennessee ex. rel. Washington Indus., Inc. v. Shacklett*, 512 S.W.2d 284, 287

(Tenn. 1974) (parent corporation holding majority common stock in its subsidiary could vote that stock to elect subsidiary's board of directors even though five directors of parent would be on subsidiary's board); *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 721 (Del. 1971) (holding dividend declaration by subsidiary at direction of parent not self-dealing).

We are not convinced the Kellys established unfairness or bad faith. It is true the board of Sieg-Fort Dodge voted on a price to offer shareholders upon the merger of the subsidiary with the parent. We also know from the parties' prior appraisal action that the share price Sieg initially offered was too low. *Sieg*, 568 N.W.2d at 806. However, we are bound by the Iowa Supreme Court's holding that "Sieg had a factual and legal basis for its fair value determination, and made a good faith effort to honestly assess the fair value of the dissenters' shares." *Id.* Additionally, even if we were not bound by this statement, the Kellys presented no evidence in this proceeding to refute it. Accordingly, they failed in their burden of proof. We find no error in the district court's dismissal of this claim.

2. Dissipation and Encumbrance of Assets (Paragraphs 15(d), (e), (f)).

The Kellys allege that Sieg: 1) sold income-producing assets of Sieg-Fort Dodge and converted the proceeds to its own use without full consideration; 2) sold debt-free assets of Sieg-Fort Dodge and replaced them with leased assets; and 3) mortgaged debt-free assets of Sieg-Fort Dodge, converting the proceeds to its own use without full consideration. In support of these contentions, the Kellys introduced financial statements that they claimed, showed Sieg-Fort Dodge did not owe Sieg anything in 1989 but, by the time of the merger, owed Sieg 5.6 million dollars. They maintained this debt diluted the value of their stock by

seventy-five percent. The defendants responded that transfers between parent and subsidiary do not alone constitute self-dealing.

We conclude the Kellys did not meet their burden of showing self-dealing. First, although in answers to interrogatories they identified the assets in question as A T & T stock, vehicles, computer equipment, and real estate, they introduced no evidence at trial to show how Sieg encumbered or converted these assets. Second, they failed to show how any sales or encumbrances enured to the benefit of Sieg and to their detriment. See *Sinclair*, 280 A.2d at 720.

What the Kellys did establish was a general downturn in the business operations of Sieg-Fort Dodge beginning in 1990 and continuing through 1993. The valuation report they proffered noted Sieg-Fort Dodge had experienced operating losses for each year since 1990. The report noted that Sieg-Fort Dodge's debt to equity ratio increased each year from 1990 through 1993. The report also showed its operations were financed through advances from Sieg and another subsidiary, reducing total equity to less than \$900,000 and reducing gross profits.

Without more, however, these facts do not show self-dealing. Cf. *Holi-Res, Inc. v. Treloar*, 217 N.W.2d 517, 526 (Iowa 1974) (describing "flagrantly wrongful" acts, omissions and concealments by shareholder of closely held corporation). According to the valuation report, Sieg was also experiencing financial problems during much of this period. The authors of the report attributed these problems in part to a high level of operating expenses. An offering memorandum disseminated prior to the merger disclosed senior management's view that a merger would "reduce duplicative and expensive

administrative functions in accounting and record-keeping systems." In light of this evidence contained in the Kellys' own exhibits and the absence of any evidence suggesting Sieg increased Sieg-Fort Dodge's debt load to benefit itself, we agree with the district court that Sieg was entitled to a directed verdict on these claims.

3. Management Fees (Paragraph 15(h)). The Kellys next allege that Sieg charged Sieg-Fort Dodge management fees "designed to eliminate the profit of the Sieg-Fort Dodge Company, Inc." The valuation report introduced by the Kellys does support the Kellys' contention that the management fees were high and contributed to the high operating costs of Sieg-Fort Dodge. However, the report further notes Sieg did not charge interest on intercompany loans, as it was entitled to do. The report found, "the total amount of management fees paid to Company by Fort Dodge was \$12,221 less than would have been paid if a pro rata share of expenses and interest expenses on intercompany loans would have been paid to the parent." The report concluded that in 1993 and 1994, "management fees were substantially less than what otherwise would have been paid by Fort Dodge if pro rata sharing of costs and intercompany interest expense was implemented." In light of these statements contained in the Kellys' own evidence, we conclude the district court was correct in directing verdict in favor of the defendants on this claim.

4. Transfer of Inferior Assets (Paragraph 15(i)). The Kellys also allege Sieg transferred assets of inferior quality to Sieg-Fort Dodge to depress the earning power of the subsidiary. We can find no evidence to support this claim among the exhibits introduced by the Kellys. Accordingly, we conclude the

district court correctly granted the defendants' motion for directed verdict as to this claim.

5. Absence of Accounting (Paragraph 4(a)). Finally, the Kellys allege the directors failed to "investigate and provide a fiduciary accounting of the administration of Madis Sulg, Chairman of the Board," of Sieg and Sieg-Fort Dodge. To the contrary, the minutes of testimony introduced by the Kellys show that the board authorized an investigation into a multimillion dollar unreported loss. The minutes further disclose that, soon after the loss was discovered, Sulg was dismissed and director Kratz was hired. In light of this evidence, the district court did not err in directing a verdict for the defendants.

IV. Attorney Fees

Iowa Code section 490.740(4) authorizes the defendants in a derivative proceeding to recover reasonable expenses from the plaintiff, including attorney fees if the court finds the proceeding was commenced without reasonable cause. Pursuant to this provision, the district court awarded Sieg the costs and attorney fees it incurred in defending the fifteen claims disposed of on summary judgment. The Kellys challenge this award. Our review of statutory fee awards is for abuse of discretion. *Sieg*, 568 N.W.2d at 807.

A. Are the Claims Derivative? As a preliminary matter, the Kellys contend Iowa Code section 490.740(4) does not apply because their claims are direct, not derivative. The defendants respond that the Kellys' allegations are derivative because "all allegations are owned by the corporation and for the benefit of all shareholders."

Derivative actions are ones in which shareholders allege that corporate directors harmed the corporation by their acts or omissions, such that the corporation experienced a loss. *Weltzin v. Nail*, 618 N.W.2d 293, 295 (Iowa 2000); see also *Whalen*, 593 N.W.2d at 152 (stating derivative action is challenge to board's managerial power). They are distinct from direct actions where a plaintiff complains of a loss separate from that of other shareholders or alleges a special duty owed to the shareholder distinct from duties owed to the corporation. *Ezzone v. Riccardi*, 525 N.W.2d 388, 394-5 (Iowa 1994); *Cunningham*, 332 N.W.2d at 883.

In determining whether a claim is direct or derivative, we examine the nature of the claimed wrong. 16 Fletcher Cyc. Corp. § 5908 (Perm. Ed. 2000). We look to "the body of the complaint, not to the plaintiff's designation or stated intention." See *Kramer v. Western Pacific Indus., Inc.*, 546 A.2d 348, 352 (Del. 1988). Suits charging mismanagement that depresses the value of stock are derivative in nature. *Id.* at 353. In contrast, suits directly attacking the fairness or validity of a merger are direct. *Id.* at 354; accord *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243, 1245 (Del. 1999). It is often difficult to discern the difference. *Parnes*, 722 A.2d. at 1245.

Given the abuse of discretion standard under which we review the court's ruling on this issue, we need not parse the language of the Kellys' petition to determine whether each claim is direct or derivative. Instead, we need only determine whether the court applied an improper standard, failed to follow established legal rules, or based the decision on a record devoid of facts to support the decision. See *Edson v. Chambers*, 519 N.W.2d 832, 834 (Iowa Ct.

App. 1994). The district court concluded "Plaintiff's assertions that the defendants wasted corporate assets and breached their fiduciary duty to the stockholders are clearly claims vested with the corporation and derivative in nature." We find no abuse of discretion in this ruling.

B. Demand. The Kellys next argue the district court should not have required them to make a demand on Sieg before filing suit. As the district court did not find this question dispositive on the attorney fee issue, we need not address it.

C. Reasonable Cause. The final issue to be addressed under Iowa Code section 490.704(4) is whether the proceeding was commenced without reasonable cause. The court noted that the defendants apprised the Kellys before the litigation commenced of many of the defenses they intended to raise and of their intent to seek statutory attorney fees. The court also summarized the defenses that were in fact raised in their motion for summary judgment and the court's reasons for granting the motion as to fifteen of the claims. The court then concluded:

Because Plaintiffs went forward with these claims, with knowledge of the affirmative defenses asserted by Defendants, and because Plaintiffs could have determined that reasonable cause did not exist to commence a derivative action on these claims, Plaintiffs bear the burden of Defendant's attorney fees as apportioned on these claims.

The court declined to find the remaining seven claims were unreasonably commenced, having earlier gleaned sufficient evidence to allow them to proceed to trial. After articulating its reasons for and against an award of fees, the court

apportioned the fees and costs attributable to the fifteen claims dismissed on summary judgment. We find no abuse of discretion in this ruling.

The Kellys raise additional issues that we find unnecessary to decide. We affirm the district court's summary judgment and directed verdict rulings.

AFFIRMED.