As to the capacity of the judgment creditor to become a bona fide purchaser it seems safe to conclude that *Butterfield v. Walsh* has, by implication, overruled *Vannice v. Bergen* and placed the purchasing creditor on a parity with strangers. This position seems most desirable.[28] It has been attacked as failing to recognize that one of the requirements for the bona fide purchaser status is the passing of a valuable consideration[29] and that the satisfaction of an existing debt fails to meet this requirement. This point has not been discussed, as such, in the Iowa cases,[30] but it is submitted that the surrender of the legal rights represented by the judgment does constitute a valuable consideration. The judgment is more than a mere debt, it is a lien. Although the creditor may set aside the satisfaction, he has lost all rights acquired by notice through his lien as to strangers who intervene between the satisfaction and its setting aside.

Protecting the judgment creditor as a bona fide purchaser is desirable for two reasons: (1) It increases the efficacy of the judgment lien; (2) It leads to higher bidding at the sale, a result which benefits the judgment debtor. Both of these aims are surely in the public interest.

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[28] See GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 19 (rev'd ed. 1940); RESTATEMENT, RESTITUTION § 173, comment *k*, (1937); RESTATEMENT, TRUSTS § 309, comment *b*, (1935); Note, 35 Geo. L. J. 376 (1947).

[29] For complete discussion of the bona fide purchaser doctrine, see AMES, LECTURES ON LEGAL HISTORY 253 (1913). On the question of satisfaction of the judgment as valuable consideration, see Riley v. Martinelli, 97 Cal. 575, 32 Pac. 579 (1893).

[30] Although the Butterfield case discussed consideration it was not as a requirement for the bona fide purchaser doctrine. In Halloway v. Platner, 20 Iowa 121, 123-124 (1865), the court said: "But when a creditor merges his judgment into a title, without actual or constructive notice of prior equities, he becomes a purchaser, within the meaning of section 1211 of the Revision [Iowa Code § 1211 (1851)] and is entitled to equal protection, in the absence of equitable circumstances, . . . with any other subsequent *bona fide* purchaser."

ELIMINATION OF ACCRUED DIVIDENDS ON CUMULATIVE PREFERRED STOCK

In the recent case of *Sherman v. Pepin Pickling Co.*,[1] the Minnesota Supreme Court held that under the Minnesota statutes[2] a corporation has the power to amend its articles of incorporation and thereby cancel accrued but undeclared dividends on preferred stock. The Iowa court has not been confronted with this problem. It is not improbable that a similar manipulation of corporate finances will bring this problem before the Iowa lawyer.

The economic and historical background of the problem may be briefly summarized. The depression of the 1930's was characterized by the insolvency of many business organizations. A significant number which did not collapse barely managed to survive.[3] For almost ten years, thousands of corporations operated without profit, depleting their assets in order to continue operation. Many corporations had outstanding cumulative preferred stock on which no dividends had been paid for several years. The accrued unpaid dividends in some cases amount to 85% of the par value of the stock.[4]

In 1940, the boom due to war preparation began to affect the nation. For the first time in ten years, some corporations were given the opportunity to operate at a profit. For many, a capital revitalization was needed. However, the heavy accruals on preferred stock stifled any desires for outsiders to invest in new capital issues. Consequently, the main problem confronting many corporations was the elimination of the burdensome arrearages. If an organization could free itself from the burden of paying accrued undeclared[5] dividends, new resources of investment might be available, profit might be earned and the common shareholder[6] might again receive dividends.[7]

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[1] 230 Minn. 87, 41 N.W. 2d 571 (1950); Note, 35 Minn. L. Rev. 90 (1950).

[2] MINN. STATS. § 300.45 and 300.54, (1949).

[3] See 2 DEWING, THE FINANCIAL POLICY OF CORPORATIONS, p. 1246 et. seq. (1941).

[4] See Hottenstein v. York Ice Machinery Co., 136 F.2d 944 (3rd Cir. 1943).

[5] The declaration of a dividend creates a debtor-creditor relationship between the corporation and the stockholder. King v. Patterson & H. R.R.Co., 29 N.J.L. 82 (1861); STEVENS, CORPORATIONS § 101 (2d ed. 1949). An undeclared dividend creates no such relationship. Arstein v. Robert Reis & Co., 77 N.Y.S. 2d 303 (N.Y. Sup. Ct. 1948); Patterson v. Durham Hosiery Mills, 214 N.C. 806, 200 S.E. 906 (1939).

[6] Corporate management is generally controlled by the common stockholders. See Dodd, *Fair and Equitable Recapitalizations*, 55 Harv. L. Rev. 780, 784 (1942).

[7] See 2 DEWING, *op. cit. supra* note 3, at 1246-1249. For a complete summary of the legal problems involved, see Becht, *Alteration of Accrued Dividends*, 49 Mich. L. Rev. 363-394 and 565-594 (1951).

From the beginning, the principle barrier against the elimination of accrued dividends was the constitutional limitation against taking property without due process of law,[8] and the restriction against states impairing the obligation of contracts.[9] In *Keller v. Wilson*,[10] an attempt to reclassify outstanding stock by an amendment to the corporation charter, thereby cancelling accruals on preferred stock was held invalid. The court said that the right to accrued dividends, though undeclared, was a "fixed and vested right." This concept subsequently found support in several other states.[11]

While the vested rights theory still holds prominence in many jurisdictions, it has been repudiated, within the last few years, in several states.[12] In these states, the courts have held that stockholders' rights are not vested, but merely contractual, and are therefore subject to the state's reserved power to amend, alter, or repeal a corporation's charter.[13] There appears to be a trend in recent years favoring the latter view.[14]

Even in states which do not recognize the vested rights theory, a corporation cannot, by mere charter amendment, terminate the preferred shareholders' rights to accumulated dividends unless there is sufficient statutory authorization.[15] A few states have

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[8] U.S. CONST. AMEND. XIV, § 1. This is also provided in many state constitutions. E.g. IOWA CONST. Art. I, § 21.

[9] U.S. CONST. Art. I, § 10. This is also provided in many state constitutions. E.g. IOWA CONST. Art. I, § 9.

[10] 21 Del. Ch. 391, 190 Atl. 115 (1936).

[11] Dunn v. Wilson & Co., 51 F. Supp 655 (D. Del. 1943); Wessel v. Guantanamo Sugar Co., 135 N.J.Eq. 271, 35 A.2d 215 (1944); Lonsdale Securities Corp. v. International Mercantile Marine Co., 101 N.J.Eq. 554, 139 Atl. 50 (1927); Wiedersum v. Atlantic Cement Products, Inc., 261 App. Div. 305, 25 N.Y.S.2d 496 (1941); Clark v. Henrietta Mills, 219 N.C. 1, 12 S.E.2d 682 (1941); Patterson v. Durham Hosiery Mills, 214 N.C. 806, 200 S.E. 906 (1939); Schaffner v. Standard Boiler & Plate Iron Co., 150 Ohio St. 454, 83 N.E.2d 192 (1948); Wheatley v. A.I. Root Co., 147 Ohio St. 127, 69 N.E.2d 187 (1946); Harbine v. Dayton Malleable Iron Co., 61 Ohio App. 1, 22 N.E.2d 281 (1949). Cf. Weckler v. Valley City Mill. Co., 93 F. Supp 444 (W.D. Mich. 1950).

[12] Hottenstein v. York Ice Machinery Co., 136 F.2d 944 (3rd Cir. 1943); McQuillen v. National Cash Register Co., 27 F.Supp. 639 (D. Md. 1939); Western Foundry Co. v. Wicker, 403 Ill. 260, 85 N.E.2d 722 (1949); Dratz v. Occidental Hotel Co., 325 Mich. 699, 39 N.W.2d 341 (1949); Sherman v. Pepin Pickling Co., 230 Minn. 87, 41 N.W.2d 571 (1950); McNulty v. W. & J. Sloane, 184 Misc. Rep. 835, 54 N.Y.S.2d 277 (1945); Davison v. Parke, Austin & Lipscomb, Inc., 285 N.Y. 500, 35 N.E.2d 618 (1941).

[13] This is generally provided by state constitution or by statute. E.g. IOWA CONST. Art. VIII, § 12, and IOWA CODE § 491.39 (1950).

[14] See STEVENS, CORPORATIONS § 127 (2d ed. 1949); Becht, *Alteration of Accrued Dividends*, 49 Mich. L. Rev. 565, 594 (1951); Comment, 57 Harv. L. Rev. 894 (1944).

[15] Romer v. Porcelain Products, Inc., 23 Del. Ch. 52, 2 A.2d 75 (1938); Morris v. American Public Utilities Co., 14 Del. Ch. 136, 122 Atl. 696 (1923); Janes v. Washburn Co., 94 N.E.2d 479 (Mass. 1950); Davison v. Parke, Austin & Lipscomb, Inc., 285 N.Y. 500, 35 N.E.2d 618 (1941); Harbine v. Dayton Malleable Iron Co., 61 Ohio App. 1, 22 N.E.2d 281 (1939).

enacted statutes which authorize corporations to cancel accrued dividends outright.[16] In other states, statutes authorizing corporations to change *terms*,[17] of the outstanding stock, or to change *preferences*[18] have been judicially interpreted to permit elimination of accrued dividends by charter amendment.[19] However, statutes granting corporations the mere power to reclassify stock, and to make charter amendments, have generally been held insufficient.[20]

In Iowa, the only statutory coverage of the power to amend articles of incorporation is found in § 491.20 of the Iowa Code (1950), which states that, "Amendments to articles of incorporation making changes in any of the provisions of the articles may be made at any annual meeting of the stockholders. . . ." This is undoubtedly insufficient to authorize cancellation of accrued dividends.[21] Whether subsequent action by the legislature, authorizing corporations to cancel accrued dividends would be valid is a question answerable only by the Supreme Court of Iowa. The court will have to determine whether Iowa will be one of the states following the vested rights doctrine.

In two previous cases, the Iowa court indicated that it would not follow the vested rights doctrine, but that it would uphold such a statute under the reserved power of the state.[22] In *St. John v. Iowa Business Men's Building & Loan Ass'n.*,[23] the court held that since the state had the power to place conditions on the corporation's right to continue in business, and could en-

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16 CALIF. CODE, CORPS § 3601 (Deering, 1947); N.J. REV. STATS. § 14-11-1 (1937); N.Y. STOCK CORP. LAW § 36; OHIO GEN. CODE §§ 8623-14, 8623-15, and 8623-72 (Pages, 1939); VA. CODE ANN., SUPP. § 3780 (1940).

17 McQuillen v. National Cash Register Co., 27 F. Supp. 639 (D. Md. 1939).

18 Western Foundry Co. v. Wicker, 403 Ill. 260, 85 N.E.2d 722 (1949); Sherman v. Pepin Pickling Co., 230 Minn. 87, 41 N.W.2d 571 (1950). *Contra*: Morris v. American Public Utiltities Co., 14 Del. Ch. 136, 122 Atl. 696 (1923); Keller v. Wilson & Co., 21 Del. Ch. 391, 190 Atl. 115 (1936); Janes v. Washburn Co., 94 N.E.2d 479 (Mass., 1950); Davison v. Parke, Austin & Lipscomb, Inc., 285 N.Y. 500, 35 N.E.2d 618 (1941). See 63 Harv. L. Rev. 529 (1950).

19 Generally, where a state has authorized charter amendments as in notes 16, 17 and 18, there is a requirement that the proposed amendment be approved by a specified majority of each class of stockholders. E.g. DEL. GEN. CORP. LAW § 26 (Requires simple majority); CALIF. CODE, CORPORATIONS § 3634 (Deering, 1947) (Requires ⅔); ILL. REV. STATS § 157.53 (1949) (Requires ⅔); N.Y. STOCK CORP. LAW §§ 35-39 (Requires ⅔).

20 Morris v. American Public Utilities Co., 14 Del. Ch. 136, 122 Atl. 696 (1923); Davison v. Parke, Austin & Lipscomb, Inc., 285 N.Y. 500, 35 N.E. 2d 618 (1941); Wiedersum v. Atlantic Cement Products, Inc., 261 App. Div. 305, 25 N.Y.S.2d 496 (1941); Clark v. Henrietta Mills, 219 N.C. 1, 12 S.E.2d 682 (1941); Schaffner v. Standard Boiler & Plate Iron Co., 150 Ohio St. 454, 83 N.E.2d 192 (1948); Vulcan Co. v. Westheimer & Co., 14 Ohio App. 274, 34 N.E.2d 278 (1938). *But cf*: Western Foundry Co. v. Wicker, 403 Ill. 260, 85 N.E.2d 722 (1949).

21 See note 20 *supra*.

22 See note 13 *supra*.

23 136 Iowa 448, 113 N.W. 863 (1907).

force such conditions by revoking its privileges for noncompliance, the fact that the contract between the corporation and its stockholders would be changed if the corporation complied with such conditions did not make the statute unconstitutional as impairing the obligation of contracts. In *Wall v. Bankers' Life Co.*,[24] it was held that under the reserved power to amend or repeal corporation charters, a statute changing the corporate form from an assessment insurance company to a legal reserve insurance company was not unconstitutional. The members of the company had argued that they had a contract for, or vested rights demanding, the perpetual existence of the insurance corporation as a mutual assessment institution. However, the court concluded, "Rather than impairing the obligation (of contracts) and interfering with vested rights, the amendatory statute . . . was in conformity with the statutory and constitutional provisions[25] which became a part of (the articles of incorporation)."[26]

There are two methods, in addition to the charter amendment, which have been used for the purpose of eliminating accrued dividends. The first is that of merging or consolidating two corporations, and thereby eliminating claims against the old corporation for undeclared dividends.[27] In Delaware, a corporation may thus eliminate accrued dividends by consolidating with its wholly owned subsidiary,[28] though that subsidiary may have been organized for the sole purpose of enacting the consolidation.[29] Cancellation of accrued dividends by merger or consolidation has

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[24] 208 Iowa 1053, 223 N.W. 257 (1929).

[25] See note 13 *supra*.

[26] Cf. Ops. Att'y Gen. (Iowa, 1922) p. 260 "(Constitution Art. 8 § 12, and § 491.39 of the Iowa Code, 1950) undoubtedly gave the legislature the full power to control the organization and operation of all corporations seeking to operate within the state of Iowa, and for that reason, the legislature would have the right to change laws with reference to organization of corporations even though such change might in effect abrogate or impair contracts existing between such corporation and other persons."

[27] Langfelder v. Universal Laboratories, Inc., 163 F.2d 804 (3rd Cir. 1947); Hottenstein v. York Ice Machinery Co., 136 F.2d 944 (3rd Cir. 1943); Hubbard v. Jones & Laughlin Steel Corp., 42 F. Supp. 432 (W.D. Pa. 1941); Havender v. Federal United Corp., 24 Del. Ch. 318, 11 A.2d 331 (1940); Dratz v. Occidental Hotel Co., 325 Mich. 699, 39 N.W.2d 341 (1949); In re Janssen Dairy Corp., 2 N.J. Super. 580, 64 A.2d 652 (1949); Windhurst v. Central Leather Co., 101 N.J.Eq. 543, 138 Atl. 772 (1927); Anderson v. International Minerals & Chemical Corp., 295 N.Y. 343, 67 N.E.2d 573 (1946); Anderson v. Cleveland-Cliffs Iron Co., 87 N.E.2d 384, (Ohio Ct. of Comm. Pl. 1948); Comment, 47 Mich. L. Rev. 81 (1948).

[28] Havender v. Federal United Corp., 24 Del. Ch. 318, 11 A.2d 331 (1940).

[29] Hottenstin v. York Ice Machinery Corp., 136 F.2d 944 (3rd Cir. 1943). *Accord*: Dratz v. Occidental Hotel Co., 325 Mich. 699, 39 N.W.2d 431 (1949). *But cf*: Weckler v. Valley City Mill. Co., 93 F. Supp. 444 (W.D.Mich. 1950).

been allowed in some states which have not permitted the same result by charter amendment.[30]

The Fifty-second General Assembly on March 20, 1947, enacted Iowa's first merger statute.[31] In light of the many decisions in other states which have allowed cancellation of accrued dividends by merger or consolidation, there can be little doubt that the right to accrued dividends on cumulative preferred stock issued after the enactment date may be defeated under the merger statute. It has not yet been decided whether such merger statutes may be given retroactive effect.[32]

The second method is that of introducing a new issue of prior preference stock, and allowing the preferred shareholders to exchange their old shares with accrued dividends for the new issue. The plan is not compulsory, and the shareholder may keep his old stock. However, he will no longer have first call on dividends. This method has been held valid almost universally,[33] even in some states which have not allowed cancellation of accruals by charter amendment.[34] There seems to be no indication that the Iowa Court would hold contrary to the weight of authority.

In applying any of the preceding methods of recapitalization, there are two related factors worth considering. First, the plan used must not be unfair or inequitable.[35] Various judicial interpretations have ranged from the New Jersey concept requiring that the plan actually be fair and equitable,[36] to the Pennsylvania sham that a plan is not unfair if approved by the required majority

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[30] Havender v. Federal United Corp., 24 Del. Ch. 318, 11 A.2d 331 (1940); In re Janssen Dairy Corp., 2 N.J.Super. 580, 64 A.2d 652 (1949); Anderson v. Cleveland-Cliffs Iron Co., 87 N.E.2d 384 (Ohio Ct. of Comm. Pl. 1948). See Comment, *Accrued Dividends in Delaware Corporations—From Vested Rights to Mirage*, 57 Harv. L. Rev. 894 (1944).

[31] IOWA CODE §§ 491.101 et. seq. (1950).

[32] In the cases in note 27 *supra*, and in other cases where the elimination of accrued dividends was permitted by merger, the merger statute was in effect before the dividends in question were issued. Again, as in the charter amendment method, the Supreme Court of Iowa would have to decide whether "vested rights" would be impaired by retroactive application.

[33] Barrett v. Denver Tramway Corp., 146 F.2d 701 (3rd Cir. 1944); Harr v. Pioneer Mechanical Corp., 65 F.2d 332 (2d Cir. 1933); Blumenthal v. Di Giorgio Fruit Corp., 30 Cal. App. 11, 85 P.2d 580 (1938); Shanik v. White Sewing Machine Co., 25 Del. Ch. 371, 19 A.2d 831 (1941); Longson v. Beaux-Arts Apartments, Inc., 290 N.Y. 845, 50 N.E.2d 240 (1943); Johnson v. Lambrecht, 133 Ohio St. 567, 15 N.E.2d 127 (1938). *Contra*: Patterson v. Durham Hosiery Mills, 214 N.C. 806, 200 S.E. 906 (1939).

[34] Shanik v. White Sewing Machine Corp., 25 Del. Ch. 371, 19 A.2d 831 (1941); Longson v. Beaux-Arts Apartments, Inc., 290 N.Y. 845, 50 N.E.2d 240 (1943); Johnson v. Lambrecht, 133 Ohio St. 567, 15 N.E.2d 127 (1938).

[35] See Dodd, *Fair and Equitable Recapitalizations*, 55 Harv. L.Rev. 780 (1942); Meck, *Accrued Dividends on Cumulative Preferred Stocks: The Legal Doctrine*, 55 Harv. L. Rev. 71 (1941).

[36] Wessel v. Guantanamo Sugar Co., 135 N.J.Eq. 271, 35 A.2d 215 (1944).

of stockholders.[37] In the recent case of *State ex rel. Weede v. Bechtel,*[38] a plan of reclassification was held invalid for the sole reason that it was inequitable to the preferred shareholders.[39] On the basis of this decision, the Iowa court should follow the New Jersey concept and refuse to uphold any scheme of reclassification or reorganization which is not fair and equitable.

Second, a remedy is provided by statute in many states for shareholders dissenting from the plan of reclassification or reorganization. Such statutes permit a dissenting shareholder to require the corporation to pay him, in cash, the fair appraisal value of his stock at the time of amendment,[40] or merger.[41] In Iowa, this remedy is provided only in the latter situation.[42]

Conclusion

The methods of recapitalization open to an Iowa corporation are limited. At the present time, an attempt to eliminate accumulated preferred dividends by a mere charter amendment would be declared invalid. A similar financial manipulation probably can be achieved by merging two corporations, or by issuing prior preferred stock. What cannot be done directly can be accomplished by a mere change of form.

In any recapitalization plan, the relative value of all classes of stock would have to be accounted for in issuing new shares. No class of stockholders would have to submit to an unfair scheme. In the case of a merger, any member of a dissenting minority could demand and receive, in cash, a fairly appraised value of his old shares. The methods available, though somewhat cumbersome, assure equitable consideration of all stockholders.

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[37] Hubbard v. Jones & Laughlin Steel Corp., 42 F. Supp. 432 (W.D. Pa. 1941). *Accord*: Western Foundry Co. v. Wicker, 403 Ill. 260, 85 N.E.2d 722 (1949); Franzblau v. Capital Securities Co., 2 N.J. Super. 517, 64 A.2d 644 (1949). *Cf.* Barrett v. Denver Tramway Corp., 146 F.2d 701 (3rd Cir. 1945); Porges v. Vadsco Sales Corp., 27 Del. Ch. 127, 32 A.2d 148 (1943). See Comment, 44 Ill. L. Rev. 389 (1949).

[38] 239 Iowa 1298, 31 N.W.2d 853 (1948).

[39] The net assets of the corporation were several million dollars less than the value of the preferred stock plus accumulated dividends, therefore the common stock was practically worthless. The plan called for a new issue of stock in exchange for all old issues, with the common shareholders being allowed to share with the preferred shareholders in approximately a one to six ratio. The court held that since the old common stock was worthless, the common shareholders should have no interest in the new issue.

[40] N.Y. Stock Corp. Law § 21; Ohio Gen. Code § 8623-15 (Pages, 1939).

[41] Del. Gen. Corp. Law § 61; N.Y. Stock Corp. Law § 87; Ohio Gen. Code § 72 (Pages, 1939). The appraisal remedy is provided in considerably more states for merger than for mere charter amendment. Note, 89 U. of Pa. L. Rev. 789 (1949).

[42] Iowa Code § 491.112 (1950). See Note, 34 Iowa L. Rev. 67 (1949).

DURATION OF RESTRICTIVE COVENANTS

In a 1948 decision of the Supreme Court of Pennsylvania,[1] the plaintiffs invoked a unique argument to support their contention that a restrictive covenant against the use of the property for commercial purposes should be enforced by injunction despite the fact that it was no longer necessary to preserve the residential character of the community because of changes in the condition of the neighborhood. The plaintiffs, trustees of an estate, had conveyed parts of an original tract of farm land by deeds, all of which contained similar restrictions confining the use of the land to residential purposes. A definite change in the predominant character of the neighborhood from residential to commercial had taken place by reason of the natural demands of concentrated population. The trustees claimed that the restrictions in the deeds still remained of value to them in that enforcement would enable them to retain control of the potential commercial uses of the land, which in turn would enhance the value of the remaining property. Therefore, they sought to enjoin a subsequent grantee of a restricted lot from erecting store buildings in violation of the restriction.

The Pennsylvania court, in denying the relief sought, held that the trustees could not avoid the effect of the rule that equity does not enforce long-continued business restrictions which have become useless from the standpoint of practical utility. The restrictions were intended to prevent intrusion of business pursuits in a residential district, and because of the predominant change in the character of the neighborhood, the enforcement of this intention would no longer practical.[2]

With the growth of cities, the determination of home owners to secure desirable surroundings led to the practice of limiting neighborhoods to development for residential purposes. Problems arise because of two conflicting desires: on the one hand, the desire of home owners to limit land to residential purposes; on the other, the abhorrencé of courts as a matter of public policy of restrictions on the future use and alienability of land. Each controversy must be decided on the equities of the particular case. The test to be applied is whether the conditions in the neighborhood have so predominantly changed as to render the purpose and intention of the restrictive covenants unnecessary from a practical point of view.

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[1] Price v. Anderson, 358 Pa. 209, 56 A.2d 215, 2 A.L.R.2d 593 (1948).

[2] *Cf.* Taylor Improvement Ass'n v. Detroit Trust Co., 283 Mich. 304, 278 N.W. 75 (1938); Barton v. Moline Properties, 121 Fla. 686, 164 So. 551, 103 A.L.R. 725 (1935); Brown v. Huber, 80 Ohio St. 183, 88 N.E. 322, 28 L.R.A. (N.S.) 705 (1909). See 4 POMEROY, EQUITY 3971, 3972 (4th ed. 1919).