No cases have been found which discuss 344(c) and (d)[21] but it would seem not difficult to follow these provisions.

Paragraph (e) was added to Rule 344 by Court Order of December 12, 1945, and became effective February 1, 1946.[22] Only two cases have been found which point out failure to comply with this provision.[23] In each the omission was failure to supply the citation of the Iowa cases in the North Western Reporter.

Actions in equity are triable de novo; Rule 344(a)(3) provides for a statement of the propositions relied on for reversal in such cases. This statement of propositions corresponds to the statement of errors relied on in a law appeal. 344(a)(4)(Second) calls for separately numbered or lettered brief points substantially conforming to the statement of propositions and stating without argument the grounds of complaint of the ruling and citing authorities supporting each point. The appeal of an equity action in effect alleges that the decision itself is error. The propositions relied on for reversal explain why the decision is in error, in much the same way as the brief points in a law appeal explain why an individual error assigned is being criticized. Thus it would seem there is no purpose in adding brief points in a division of the brief which deals with a given proposition. In other words, a "proposition" in an equity appeal serves as a brief point and at the same time roughly corresponds to a single statement of error. However, the court has called attention to failure to insert brief points following a statement of a proposition in an equity appeal,[24] indicating that the court expects a literal compliance with the Rule in this respect.

The court has said that it has not felt called upon to say at just what point a civil appeal will be dismissed for failure to comply with Rule 344.[25] It has also said that, although the parties have not complied with the rule, it prefers to decide the case on the merits so far as possible.[26] Some minor errors in attempting to follow Rule 344 are to be expected, and will probably be tolerated, but every effort should be made to keep these errors

---

[21] IOWA CODE R.C.P. 344 (1950):

"(c) Argument of any error which relates to the sufficiency of the evidence to sustain a ruling on any point shall supply full references to the pages and lines of the record, unless such evidence is fully stated, with such references, in the statement of facts.

(d) Appellee's brief and appellant's reply shall follow the above outline as nearly as may be, but without unnecessary repetition."

[22] See note 5 *supra*.

[23] Betz v. Sioux City, 239 Iowa 95, 105, 30 N.W.2d 778, 783 (1948); Riemenschneider v. Riemenschneider, 239 Iowa 617, 634, 30 N.W.2d 769, 777 (1948).

[24] Bennett v. Bowers, 238 Iowa 702, 704, 28 N.W.2d 618, 619 (1947).

[25] Agans v. General Mills, Inc., 242 Iowa 978, 980, 48 N.W.2d 242, 243 (1951).

[26] Patterson v. Wuestenberg, 239 Iowa 658, 663, 32 N.W.2d 209, 212 (1948); Agans v. General Mills, Inc., 242 Iowa 978, 980, 48 N.W.2d 242, 243 (1951).

at a minimum. There is good reason to believe that the court will tire of issuing warnings. The result will be that cases will be dismissed and counsel responsible for the carelessness which caused the dismissal will have to answer to his client. As the court itself has pointed out, "substantial compliance . . . is the litigant's only safe course."[27]

---

[27] Patterson v. Wuestenberg, 239 Iowa 658, 664, 32 N.W.2d 209, 212 (1948).

UNREALIZED APPRECIATION AND CORPORATE DIVIDENDS

Under Iowa law a solvent corporation may not pay a dividend "which would diminish the amount of its capital stock".[1] If it has no surplus or current profits, may it pay a dividend justified solely by increase in value of property it is retaining for its own use?

To point up the problem more sharply, let us assume that the directors of a hypothetical corporation, The Johnson Company, are faced with the following situation. Their company five years ago was near insolvency and its capital was greatly impaired. Careful management has eliminated most of the impairment, but as there has been no surplus, shareholders have been without dividends for some years. The directors believe that some shareholders no longer are willing to wait for a return on their investment and fear that if these should attempt to unload their stock, that action might have an adverse effect on the corporation's credit position and undesirable consequences might follow. A dividend now would quiet the unrest, and as future prospects seem good they believe it would also permit further restoration of capital and enable the corporation eventually to build up a surplus. The firm's principal fixed assets, its land and factory buildings, were acquired in the mid-1930's at a very low figure, and if sold today at their current market value the resulting profit would not only make up remaining capital impairment but would result in a surplus sufficient to cover a dividend in the amount which appears necessary. May the directors legally declare that dividend under these circumstances?

Statutory restrictions on dividend declaration are of two main types, one prohibiting dividends which impair capital, the

---

[1] IOWA CODE § 491.41 (1950).

other prohibiting dividends except from surplus or profits.[2] However, courts generally have referred to the two types as synonymous and only occasionally have recognized distinctions.[3] In determining whether dividends have been paid from surplus or profits, the accounting concept of profits — that profits are not to be recognized until "realized" — has been applied to define "surplus" and "profits". There is good foundation for this position which ignores the existence of unrealized appreciation.[4] If the same accounting concept is appropriate for determining value of assets, as well as existence of profits, unrealized appreciation should not be a factor in applying the capital-impairment restriction. Capital would be impaired if the assets, recorded according to accepted accounting principles, were less than liabilities plus the par or stated value of the outstanding stock. Nearly all assets would be valued at cost (or possibly market, if lower) or cost less "depreciation". Such valuation is unlikely to reflect the market value of the entire corporate property at any time, and for this reason, after the New York dividend restriction was changed from the surplus type to the capital-impairment type, there was uncertainty as to whether unrealized appreciation could be considered in declaring dividends.[5] The uncertainty was removed by the two decisions in *Randall v. Bailey*,[6] which held that under the capital-impairment test the dividend was lawful when the directors had exercised an informed judgment as to the value of the company properties and had found that value to be much greater than the cost of the properties as shown on the company's books. These decisions in effect would require the revaluation of corporate assets each time a dividend is declared, if the directors wish to be certain that capital is not impaired or will not be by the dividend payment.

On the basis of prior decisions and interpretations of the Iowa statute, would the Iowa court reach a result different from that in *Randall v. Bailey*? The decisions available are not concerned with the propriety of recognizing unrealized appreciation, and, despite a few isolated comments in somewhat related cases, the question appears still to be open.

It should be noted that Iowa Code §491.41 lays down three tests for liability for improperly declared dividends: (1) insolvency, (2) capital impairment, and (3) payment of dividends

---

[2] Weiner and Bonbright, *Theory of Anglo-American Dividend Law: Surplus and Profits*, 30 Col. L. Rev. 330 (1930); STEVENS, CORPORATIONS § 100 (2d ed. 1949).

[3] Weiner and Bonbright, *supra* note 2, at 331.

[4] *Id.* at 334.

[5] *Id.* at 343; 2 BONBRIGHT, VALUATION OF PROPERTY 924 (1937). See Comment, 50 Yale L.J. 306 (1940).

[6] N.Y.S.2d 173 (Sup. Ct. 1940), *aff'd*, 262 App. Div. 844, 29 N.Y.S.2nd 512 (1st Dep't 1941), 288 N.Y. 280, 43 N.E.2d 43 (1942); 54 HARV. L. REV. 505 (1941); 10 U. OF CHI. L. REV. 350 (1943); 89 U. OF PA. L. REV. 822 (1941); 50 YALE L.J. 306 (1940).

which leaves insufficient funds to meet corporate liabilities. The language of the statute is somewhat ambiguous, but a possible literal interpretation of it is that the innocent recipient of an improper dividend must return what he has received only if the third restriction has been violated. This is the view of the Iowa court, which has excused shareholders from returning dividends made when capital was impaired, or dividends which resulted in impairment of capital.[7]

In *Miller v. Bradish*[8] the court was asked to require a shareholder to return a dividend paid at a time when the corporation had a small deficit. The court stated: ". . . [W]as the dividend lawful at the time it was paid? We think it was."[9] As the court was concerned only with the liability of the innocent shareholder, it may not have intended to imply that, as to directors or officers who know the circumstances and participate in the dividend declaration, such dividend necessarily would be lawful.

No case questioning the validity of a dividend under the capital impairment test has come to the Iowa Supreme Court. There is a presumption, according to several decisions, that any dividend is based upon earnings,[10] and several quotations from other jurisdictions, appearing in the opinion in *Sexton v. C. L. Percival Co.*,[11] suggest that realized profits are necessary for dividends. The court in the *Sexton* case was concerned solely with the owership of a stock dividend, and other language in the case suggests that that type of dividend, at least, may be based upon unrealized appreciation. In fact, in a previous instance involving ownership of a stock dividend, the dividend clearly had been based upon unrealized appreciation but the court made no criticism of this fact.[12]

The word "dividend" normally is interpreted to mean only a money or property dividend rather than one in the corporation's stock.[13] Therefore, recognition that stock dividends may have their source in unrealized appreciation does not necessarily carry with it the implication that cash dividends justified by such source would be proper under the Iowa "capital-impairment" test.

There is one consideration ignored in *Randall v. Bailey* which may be important. One justification for requiring realized profits is that they have taken place and can be determined with substantial certainty. Recognition of unrealized appreciation may be justified on the ground that, should the corporation be forced

---

[7] Bates v. Brooks, 222 Iowa 1128, 270 N.W. 867, 109 A.L.R. 1371 (1937); Miller v. Bradish, 69 Iowa 278, 28 N.W. 594 (1886).
[8] 69 Iowa 278, 28 N.W. 594 (1886).
[9] *Id.* at 282, 28 N.W. at 596.
[10] Sexton v. C. L. Percival Co., 189 Iowa 586, 177 N.W. 83 (1920); Kalbach v. Clark, 133 Iowa 215, 110 N.W. 599 (1907).
[11] 189 Iowa 586, 177 N.W. 83 (1920).
[12] Kalbach v. Clark, 133 Iowa 215, 110 N.W. 599 (1907).
[13] Sexton v. C. L. Percival Co., 189 Iowa 586, 177 N.W. 83 (1920).

to sell that asset, there is a good probability that a profit will then be realized. As it is likely that such a profit will be subject to a substantial income tax, courts which permit revaluation under the capital-impairment test may insist that the potential income tax liability resulting from a sale of the appreciated items be considered in the overall revaluation.

The way clearly is open for the Iowa court to treat a dividend as not in violation of the law, if made when capital is impaired according to an "accounting" valuation but is not according to an informed current valuation. If the directors of The Johnson Company declare a stock dividend, under the circumstances suggested above, they run little risk. If a cash dividend be declared, the risk of personal liability on their part is much greater unless their faith in the future proves justified. However, there is a good possibility that where the directors have exercised an informed judgment as to the value of the company properties and have determined that that valuation exceeds those liabilities which should be recognized plus the corporation's capital, such cash dividend does not violate the capital-impairment test set forth in §491.41.[14]

---

[14] Comment, 50 YALE L.J. 306 (1940) suggests that *Randall v. Bailey* is a precedent for construction of a number of state statutes applying the capital-impairment test, including Iowa in its listing of such states.

DIRECTED VERDICTS AND RULE 104

Before the adoption of the Iowa Rules of Civil Procedure in 1943 failure to state a cause of action could, under certain circumstances, be initially raised by a motion for a directed verdict. This situation occurred where the plaintiff had omitted to plead a necessary element and his proof covered only his allegations,[1] or affirmatively showed that his defectively alleged cause was not amendable.[2] Where, however, evidence of the omitted allegation had been presented during the trial, an initial objection to a defective petition by a motion for a directed verdict would not raise that issue, and, if not followed by a motion in arrest of judgment, was deemed to be waived.[3]

The Rules raised the question whether the motion for a directed verdict, or, in fact, anything but the motion to dismiss or answer, may be initially employed to raise the issue of failure to state a cause of action. The problem stems from Rule 104:[4]

> "Every defense in law or fact to any pleading must be asserted in the pleading responsive thereto, if one is required, or if none is required, then at the trial, except that:
>
> ". . .
>
> "(b) Failure to state a claim on which any relief can be granted, may be raised by motion to dismiss such claim, filed before answer."

This Rule seems susceptible to two interpretations: (1) that the defendant cannot raise the "defense in law" that the plaintiff does not have a cause of action by methods such as a motion for a directed verdict or motion for judgment notwithstanding the verdict unless he has given notice thereof in his answer or by motion to dismiss filed before answer, or (2) that in connection with Rule 110[5] the defendant may, as under the former practice, move for a directed verdict without first giving notice thereof by answer or motion to dismiss. In other words, Rule 104 may mean either that the motion to dismiss is the only method of raising the defense, or that the objection is an exception to the requirement that "every defense in law or fact be asserted . . ." in the responsive pleading.

The matter seems a simple one on principle. The Rules permit it to be raised before trial by either answer or motion

---

[1] See, *e.g.*, Smith v. Burlington, C.R. & N. Ry., 59 Iowa 73, 12 N.W. 763 (1882).

[2] Pierson v. Independent School Dist., 106 Iowa 695, 77 N.W. 494 (1898); Seaton & Spaan v. Hinneman, 50 Iowa 395 (1879).

[3] Baehr-Shive Realty Co. v. Stoner-McCray System, 221 Iowa 1186, 268 N.W. 53 (1936); *see* Howerton v. Augustine, 130 Iowa 389, 393, 106 N.W. 941, 942 (1906).

[4] IOWA CODE R.C.P. 104 (1950). All subsequent text references to the Rules of Civil Procedure refer to IOWA CODE (1950).

[5] Rule 110 provides that no pleading shall be held sufficient for failure to move to strike or dismiss it.