Volume 8 | Issue 2 Article 6

1962

Corporations - Sale of Voting Majority of Stock Coupled with Promise of Seriatim Resignation of a Majority of Directors Not Invalid as a Matter of Law

Frank Cross

sional enactment under the commerce clause was deemed valid although its effect was to abrogate a previously consented to compact between Virginia and Kentucky. Therefore, even if Congress could not technically withdraw its consent to a compact under the compact clause, it would seem that it could so regulate the external operations of any instrumentality created to execute the compact that the effect would be to annul the compact. If then Congress has the right through the interstate commerce clause to legislate in an area concerning the Port Authority, it has the power to investigate to this extent.[29] The investigation may extend to any matter pertinent to the question under inquiry.[30] Here, again, the problem is presented of balancing Congress' right to regulate interstate commerce and those rights reserved to the states by the Tenth Amendment.

In the present case, the circuit court avoided the important constitutional issue involved, but noted the "gravity of passing upon even only one of the constitutional questions posed by this case." However, it would seem that the issue will be soon decided. The role of interstate compacts is now much different than it was when the earliest decisions regarding interstate compacts were decided. In cases involving boundary disputes,[31] it is not hard to see why the Court was willing to imply that consent was irrevocable. In the case of an Authority whose operations could conflict with other Congressional powers, it would seem that some other standard must be found by the courts.

Nicholas C. Bozzi

James M. Salony

CORPORATIONS — SALE OF VOTING MAJORITY OF STOCK COUPLED WITH PROMISE OF SERIATIM RESIGNATION OF A MAJORITY OF DIRECTORS NOT INVALID AS A MATTER OF LAW.

Essex Universal Corporation v. Yates (2d Cir. 1962)

The defendant, Herbert J. Yates, a California resident, was president and chairman of the board of directors of Republic Pictures Corporation, a New York corporation having at the time relevant to this suit, 2,004,190 shares of common stock outstanding. In August of 1957, negotiations began between Yates and Joseph Harris, the president of Essex Universal Corporation (plaintiff), for the purchase of stock in Republic. A contract was signed whereby Yates agreed "to sell or cause to be sold" at least 500,000

---

declared the bridge to be a lawful structure. In holding the legislation valid the Court said: "Otherwise Congress and two states would possess the power to modify and alter the Constitution itself."

29. See *supra* note 15.
30. See *supra* note 20.
31. Poole v. Fleegar, *supra* note 5; Rhode Island v. Massachusetts, *supra* note 6.

and not more than 600,000 shares of Republic stock. The price was set at eight dollars a share, two dollars above the current market price on the New York Stock Exchange. Three dollars per share was to be paid at the closing and the remainder in twenty-four equal monthly installments. All the shares were to be transferred on the closing date but Yates was to retain the certificates endorsed in blank by Essex as security for full payment. In addition to other provisions, the following paragraphs were contained in the contract:

> 6. Resignations
>
> Upon and as a condition to the closing of this transaction if requested by Buyer at least ten (10) days prior to the date of the closing:
>
> (a) Seller will deliver to Buyer the resignations of the majority of the directors of Republic.
>
> (b) Seller will cause a special meeting of the board of directors of Republic to be held, legally convened, pursuant to law and the by-laws of Republic, and simultaneously with the acceptance of the directors' resignations set forth in paragraph 6 (a) immediately preceding will cause nominees of Buyer to be elected directors of Republic in place of the resigned directors.

Before the date of closing, Yates notified Harris that he would deliver 566,223 shares, or 28.3 per cent, of the Republic stock then outstanding. Harris then formally requested Yates to arrange for the replacement of a majority of the Republic directors with Essex nominees pursuant to paragraph 6 of the contract. This was to be accomplished by having eight of the fourteen directors resign seriatim, being in turn replaced by an Essex nominee who would be elected by the others as was provided in the corporate by-laws. But, when Harris tendered the full amount, Yates refused to close the deal. Essex began an action in the New York Supreme Court which was removed to the federal district court on diversity grounds. That court granted summary judgment in favor of Yates, on the ground that the provision in the contract providing for the immediate transfer of control of the board of directors was illegal per se. On appeal, the appellate court reversed, *holding* that a contract provision for the immediate transfer of control of a corporation, coupled with the sale of stock representing a voting majority, was not invalid as a matter of law. *Essex Universal Corp. v. Yates,* 305 F.2d 572 (2d Cir. 1962).

It is well settled that corporation stock is personal property.[1] Like any other property, it can be sold, mortgaged, pledged, and taxed.[2] The

1. Hawley v. City of Malden, 232 U.S. 1, 34 S. Ct. 201 (1914); Hall & Farley v. Alabama Terminal and Improvement Co., 173 Ala. 398, 56 So. 235 (1911); Banker's Trust Co. v. McCloy, 109 Ark. 160, 159 S.W. 705 (1913); Kirkland v. Levin, 63 Cal. App. 589, 219 Pac. 455 (1923); Talcott v. Mastin, 20 Colo. App. 488, 79 Pac. 973 (1905); Colt v. Ives, 31 Conn. 25 (1862); Bryan v. Bullock, 84 Fla. 179, 93 So. 182 (1922); Hightenier v. Ansley, 126 Ga. 8, 54 S.E. 939 (1906); Herbert v. Simson, 220 Mass. 480, 108 N.E. 65 (1915); Morris v. Hussong Dyeing Mach. Co., 81 N.J. Eq. 256, 86 Atl. 1026 (1913); In re Jones, 172 N.Y. 575, 65 N.E. 570 (1902); Appeal of Callery, 272 Pa. 255, 116 Atl. 222 (1922).

2. 11 FLETCHER CYC. CORP. § 5096 (1958).

fact that a shareholder owns a majority number of the shares in a corporation generally does not affect his right to sell at any time and for any price.[3] It should be remembered that a shareholder retains this right even though he may also be a corporate director or officer.[4] The sale of a corporate office alone by the holder of that office,[5] or another officer, or any agreement by an officer to use his influence to procure an office or to retain an office for a third party is void as contrary to public policy.[6] This same control, however, can be passed legally by the transfer of controlling shares.

Although great latitude is and must be given a shareholder in the disposition of his stock,[7] a majority shareholder is in a more difficult position than one holding only a few shares. Because the sale of a majority or a controlling bloc of shares results in the transfer of control of the corporation, a fiduciary duty has been imposed upon the seller,[8] a breach of which will result in liability for damages and for any profit received.[9] Most cases imposing such liability are so-called "looting" cases. For example, in *Gerdes v. Reynolds*,[10] defendants were officers and directors of the company and together owned a majority of the common stock. Upon selling their shares, the defendants resigned their positions and elected in their stead designees of the purchaser. Thereafter, the assets of the corporation were wasted and an action was brought against the defendant sellers. The court laid down the rule that,

> . . . officers and directors of a corporation, and under some circumstances and for some purposes the majority stockholders, whether one or many, stand in a fiduciary relation to the corporation and to the minority stockholders, and must observe the high standards of diligence, good faith, and loyalty required of all fiduciaries.[11]

The defendants were found to have violated their fiduciary duty by not having conducted a proper investigation of the motives of the purchasers. Such an investigation would have revealed that the sole purpose of the

---

3. Tyron v. Smith, 191 Ore. 172, 229 P.2d 251 (1951); Roosevelt v. Hamblin, 199 Mass. 127, 85 N.E. 98 (1908); Levy v. American Beverage Corp., 265 App. Div. 208, 38 N.Y.S. 2d 517 (1942).

4. 3 FLETCHER CYC. CORP., § 900 (1958).

5. Porter v. Healy, 244 Pa. 427, 91 Atl. 428 (1914); RESTATEMENT, TRUSTS § 203, *comment a* (1935); Comment, 70 HARV. L. REV. 986, 992 (1956).

6. West v. Camden, 135 U.S. 507, 10 S. Ct. 838 (1890); Mansfield v. Lang, 293 Mass. 386, 200 N.E. 110 (1936); Sutz v. Michel, 148 Minn. 80, 181 N.W. 102 (1921); Kountze v. Flannigan, 64 Hun. 635, 19 N.Y. Supp. 33 (1892); In re Allied Fruit and Extract Co. Inc., 243 App. Div. 52, 276 N.Y. Supp. 153 (1934); Ballantine v. Ferretti, 28 N.Y.S. 2d 668, 678-680 (Sup. Ct. 1941). *Cf.* Annot., 12 A.L.R. 1060 (1921).

7. See Searles v. Bar Harbor Banking and Trust Company, 128 Me. 34, 145 Atl. 391 (1929). For an exhaustive survey of the law regarding the restrictive sale of corporate stock, *cf.*, Annot., 65 A.L.R. 1154 (1929).

8. Levy v. American Beverage Corp., *supra* note 3 at 216, 38 N.Y.S. 2d at 525; HENN, CORPORATIONS § 242 (1961).

9. HENN, *op. cit. supra* note 8; 3 FLETCHER CYC. CORP., § 900, pp. 307-08.

10. 28 N.Y.S. 2d 622 (Sup. Ct. 1941).

11. *Id.* at 650.

purchase was to gain control of the corporate assets. The defendants were held accountable for the resulting damages.[12]

In addition to the award of consequential damages, any profit that can be distinguished above the market value of the stock sold is given to the corporation to be distributed among the minority shareholders, placed in the corporate treasury or deposited in trust for the minority shareholders.[13] The reason generally propounded for this action is that a sale of power or office, absent a sale of stock, is the sale of a "corporate asset" belonging only to the corporation and not to the individual officers or shareholders. This so-called "corporate asset" theory was formally advanced by Berle and Means in 1932.[14] They believed that premiums paid for a controlling interest were for power and not for stock; since the former was corporate property, any premium or profit exacted therefrom belonged to the corporation. Evidence of such a theory can be traced to *Bosworth v. Allen,*[15] decided in 1901. The defendants, officers and directors of a corporation, conspired with several purchasers to transfer the control of the corporation and its assets to the latter and to sell their capital stock in the corporation. The sale price exceeded the withdrawal value of the stock by $1,168.53. When the purchasers proceeded to mismanage the corporation and waste its assets, the court held the defendants in violation of their trust and assessed damages. In dealing with the $1,168.53, the court said:

> The amount . . . paid to them for official action, was money obtained pursuant to the same conspiracy by virtue of their office as directors, for which they must account as part of the assets of the corporation . . . and the law, in order to protect the corporation, treats it as its property, and, therefore money which it is entitled to recover from all the defendants.[16]

However, in cases where there has been no fraud, bad faith or injury to the corporation, a profit above the market price has been held the property of the seller and his rightful yield from the increased value of the stock as a controlling bloc.[17]

12. See also Insuranshares Corp. v. Northern Fiscal Corp. Ltd., 35 F. Supp. 22 (E.D. Pa. 1940); Dale v. Thomas H. Temple Co., 208 S.W. 2d 344 (Tenn. 1948), where the court held the defendant liable for the misappropriation of corporate assets.

13. Gerdes v. Reynolds, *supra* note 10. See also Heinman v. Marshall, 117 Mo. 546, 92 S.W. 1131 (1906), where a premium exacted for the sale of a corporate office, itself, was awarded to the association. Accord, Porter v. Healy, 244 Pa. 427, 91 Atl. 428 (Pa. 1914), 3 FLETCHER CYC. CORP. § 900 at p. 307 (1958); HENN, *op. cit. supra* note 8 at 385; Perleman v. Feldmann, 219 F.2d 173 (2d Cir. 1955), *cert. denied,* 349 U.S. 952, 75 S. Ct. 880 (1955); Stanton v. Hample, 272 F.2d 424 (9th Cir. 1921), where the award included the excess received from the sale of the shares.

14. BERLE & MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 244 (1932).

15. 168 N.Y. 157, 61 N.E. 163 (1901).

16. *Id.* at 167, 61 N.E. at 165. For a more recent case dealing with this issue, see Perleman v. Feldmann, 219 F.2d 173 (2d Cir. 1955), *cert. denied,* 349 U.S. 952, 75 S. Ct. 880 (1955).

17. Stanton v. Schenk, 140 Misc. 621, 251 N.Y. Supp. 221 (1931); Roosevelt v. Hamblin, 199 Mass. 127, 85 N.E. 98 (1908); Roby v. Dunnett, 88 F.2d 68 (10th Cir. 1937), *cert. denied,* 301 U.S. 706, 57 S. Ct. 940 (1937); Benson v. Braun, 155

An acceleration clause such as the one in the *Essex* case was upheld as early as 1880 when Judge Earl, in *Barnes v. Brown*,[18] found in favor of the seller:

> There is no proof that in obtaining the resignation of the plaintiff and other directors, and in filling the vacancies, any fraud or wrong was intended upon the corporation or any of its stockholders, or that any of the stockholders at any time objected to what was done in this respect. It was simply the mode of transferring the control of the corporation to those who by the policy of the law ought to have it, and I am unable to see how any policy of the law was violated, or in what way, upon the evidence, any wrong was thereby done to anyone.[19]

This case can be distinguished, however, on the basis that the sale was for over fifty per cent of the stock outstanding. In *San Remo Copper Mining Co. v. Moneuse*,[20] a similar stipulation was upheld, but the stock involved was sufficient to give absolute control. Although like provisions have appeared in many cases, fraud or looting was also usually involved, and the courts have preferred to rest their decisions on these grounds rather than determining the validity of the acceleration clause.[21] In short, it would seem that the presence or absence of fraud, bad faith, etc. has been the determining factor in cases where controlling shares were sold at a premium.

The court in *Essex* has taken a firm stand in this area where only a paucity of cases are to be found. It has established that the purchaser of a majority voting bloc, which is, however, only a minority of the shares outstanding, can, by virtue of his purchase, take immediate control of the corporation. Further, a separate stipulation to this effect in the contract of sale is neither invalid per se nor necessarily contrary to public policy. It is interesting to compare the *Essex* case with *Insuranshares Corp. v. Northern Fiscal Corp.*,[22] where a minority of outstanding shares was transferred which, like *Essex*, represented a voting majority. The initial step of the sale was to have the incumbent directors resign seriatim to be replaced by nominees of the purchaser. The court in this case found the transfer of control to be the primary purpose of the sale and the transfer of stock merely secondary. But here, again, the purchasers were looters, and the sellers had constructive knowledge of this from the price received for the stock the amount paid was over two hundred per cent of the market price and almost one hundred per cent above book value). The court reached a result opposite to that in *Essex*.

N.Y.S. 2d 622 (1956), where the court indicated in dicta that a different result would have been reached had fraud been found or had the evidence revealed that the defendants should have foreseen looting.

18. 80 N.Y. (11 Hun.) 527 (1880).

19. *Id.* at 537.

20. 149 App. Div. 26, 133 N.Y. Supp. 509 (1912).

21. Perlman v. Feldmann, *supra* note 16; Ballantine v. Ferretti, 28 N.Y.S. 2d 668 (Sup. Ct. 1941).

22. *Supra* note 12.

Chief Justice Lumbard, in writing the opinion in *Essex,* concluded that the contract for the sale of stock and the provision for the resignations were inseparable, that the latter was incident to the former and that the Essex corporation was acquiring a voting majority of the shares. He found no indication of fraud, bad faith, or illegality in the making of the contract nor that there would be any looting of the corporation or its assets.[23] He reasoned that Essex had the power to control, that this power could be exercised immediately, and, therefore, the clause providing for this exercise was also valid.[24]

Many courts have reasoned that since one similar to the present purchaser would exercise his control powers at the first election, the acceleration is merely an acceptance of the inevitable. However, Judge Friendly, concurring in the instant case, viewed a mass seriatim resignation of a board of directors as a violation of the trust placed in them by their electors. A full majority of the board was replaced without regard to the shareholder. He suggested not that Essex should be denied its right to control, but that it should assume this control only after a special election pursuant to the purchase (unless such election would be "mere formality — i.e.: when the seller owned more than fifty per cent of the stock").

There is little difficulty either when the sale involves more than fifty per cent of the outstanding stock or when it concerns a small number of shares lacking voting control. There is only a problem when a substantial minority is sold which purportedly gives the purchaser a voting control. Depending on the size and ownership of the corporation, this could range anywhere from about fifteen per cent to as high as forty nine percent. In electing directors, shareholders must expect that certain of those elected will resign and be replaced by the remainder of the board. But, when the resignations involve eight of fourteen directors and control passes into the hands of a stranger, the shareholder's vote has been nullified. Of course, in the transfer of absolute control, the shareholder has no recourse; and, in the case of a substantial minority, any recourse will probably be of little avail. For even if the shareholders could unite to oust the purchaser at the next election, in cases where this would be necessary, it would probably already be too late. On the other hand, from the purchaser's point of view, the seriatim resignation eliminates the cost of soliciting proxies in the event of a special election. Further, an open election might arouse the desire of a third group to gain control, thus throwing open the doors for a costly and often bitter proxy fight which the purchaser would probably have small chance of losing anyhow. A special election would avoid this situation and would also serve to acquaint the shareholder with the new

23. This factor Justice Lumbard used to distinguish this case from all the preceding cases which had reached the opposite conclusion.

24. "Given this principle that it is permissible for a seller thus to choose to facilitate immediate transfer of management control, I can see no objection to a contractual provision requiring him to do so as a condition of the sale." Essex Universal Corp. v. Yates, 305 F.2d 572, 577 (2d Cir. 1962).

control group and give him an opportunity, by his vote, to prevent possible harm where he otherwise would be unable to do so.

Allowing immediate transfer would also give the purchaser an opportunity to acquaint himself with his new job and enable him to continue and advance the corporation immediately. Further, it can be readily understood that the directors of the corporation who represent the seller, knowing that their principal has relinquished his interest and that their terms will definitely end at the next election, might tend to grow lax in corporate matters. It would be difficult to conscientiously advance the interests of an employer, realizing that the benefits will be shared by others only. Optimistically, the buyer's directors would take office with interest and enthusiasm.

These problems can be resolved, of course, by insuring the good faith of the purchaser before the sale. While the *Essex* case may have removed the first obstacle blocking a procedure which could advance and profit a corporation, it has failed to provide the necessary checks to insure a legitimate transfer of control without fraud, conspiracy, or looting.

Perhaps requiring the prospective seller of a controlling bloc to submit his proposal of sale to a special investigating committee of the corporation would aid in preventing a bad faith purchaser from steadily attaining a position in which he could cause extensive damage. Such a procedure would benefit the corporation, yet not impinge on the right of a stockholder to sell when and to whom he pleases. Further, it would both protect the corporation in cases of a sale of absolute control and save the purchaser of a substantial minority, whose voting control would be almost certain to prevail, from incurring the costs of a special election. However, where the minority shareholder's power is doubtful, a special election should be held. Unfortunately, the practical application of such an investigating committee is questionable. It is highly possible that a large shareholder could easily control such a measure.

Alternatively, an efficient means of notice to the minority shareholders prior to the sale may provide an answer. Since a minority shareholder's most effective weapon against a contemplated sale of control which the shareholder deems invalid is a restraining injunction, a means should be available whereby minority shareholders would receive notice and certain disclosures to enable them to voice their objections effectively. How should such a publication be made and how much need be revealed? Would the possibility of forcing the majority shareholder into litigation before he is able to sell be too great a restraint on his freedom to dispose of his property? Similar problems will arise regardless of the means of prevention or investigation, but the necessity for some protective methods remains. With proper checking available, immediate transfer of control can be executed, as indeed it should in situations like *Essex,* and the best interests of the corporation will be protected.

Albert P. Massey, Jr.

FEDERAL TORT CLAIMS ACT — VETERANS HOSPITAL CONSIDERED CHARITABLE INSTITUTION AND IMMUNE FROM LIABILITY.

White v. United States (E.D. Va. 1962).

Plaintiff, administrator of decedent's estate, commenced an action against the United States in a federal district court under the Federal Tort Claims Act.[1] The complaint alleged negligent treatment of the deceased by the defendant's employees who was, at the time of his death, a patient in a United States mental institution. The evidence showed that the patients at the institution had been classified into three groups with respect to their liberty of movement: some were completely confined, others semi-restricted, and the remainder completely unrestricted. Just prior to his death, the deceased had been transferred from the partial to the unrestricted category and was thus allowed to come and go as he pleased. Shortly thereafter, his dead body was found crushed by a railroad train near the hospital grounds.[2] At the trial, one of the hospital doctors testified that on the morning of the occurrence the deceased had complained of nervousness and apprehension and that, although he had administered a tranquilizing drug to the decedent, the doctor had not thought that the situation warranted putting the patient on observational status. The plaintiff contended that the decision to reclassify the deceased was a violation of the hospital's duty to provide proper care for his safety. The defendant denied its employees' negligence and pleaded affirmatively that its actions were protected by charitable immunity and also that the decision was a discretionary one, exempt by a special provision of the Federal Tort Claims Act.[3] The district court *held* that in an action against a federal hospital under the Federal Tort Claims Act, the defense of charitable immunity was valid and that, under the assumed facts, the alleged acts of negligence involved discretionary decisions which were precluded from compensation under the Act. *White v. United States,* 205 F. Supp. 662 (E.D. Va. 1962).

At common law, the King could do no wrong. This theory, incorporated into our jurisprudence as sovereign immunity, presented an adamant bulwark against the claims of individuals for redress of injuries inflicted on them by the government. Some relief was granted through the passing of private bills by Congress but this process was too cumbersome and often extremely unjust. In 1946, the Congress of the United States adopted the Federal Tort Claims Act which waived the immunity traditionally afforded

1. 60 Stat. 842 (1946), 28 U.S.C. § 1346(b) (1958).

2. It is not clear whether the death occurred on the hospital grounds or whether it resulted from an accident or suicide. Deceased had exhibited suicidal tendencies in the past and had been committed to a mental institution on three separate occasions.

3. 60 Stat. 842 (1946), 28 U.S.C. § 2680(a) (1958): "The provisions of this chapter and § 1346(b) of this title shall not apply to— Any claim . . . based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of . . . an employee of the Government, whether or not the discretion involved be abused."

the federal government and rendered it liable as if it were a private person.[4] The Act contains certain exceptions which are specifically set forth but, in the absence of such an express provision, there has been a tendency on the part of many courts to read the waiver of immunity liberally. In considering this question,[5] the United States Supreme Court has displayed a preference for Judge Cardozo's statement in *Anderson v. John Hayes Construction Co.*:[6]

> . . . the exemption of the sovereign from suit involves hardship enough where consent has been withheld. We are not to add to its rigor by refinement of construction where consent has been announced.

In *Indian Towing Co. v. United States,*[7] the Supreme Court of the United States again gave force to the Cardozo interpretation by rejecting the government's contention that the legislative intent was that the federal government should not be visited with liability for actions that had no "private person" counterpart. The case arose on a claim for damages resulting when a barge was destroyed because of the failure of defendant's employees to properly maintain a lighthouse which had been established on the Mississippi River. The Court held that the government had not been obliged to undertake the maintenance of the lighthouse, but once it decided to act it had a duty to keep the light in working order.

Although the defendant failed to argue the defense of charitable immunity, the district court considered the point and concluded that the Veterans Administration hospital qualified as a charitable institution under Virginia law and was therefore immune from liability save for the negligent selection of its employees.[8] This finding is contrary to the decisions of other federal courts that have considered the issue and have held that the immunity afforded charitable institutions cannot be claimed by the federal government when it performs comparable acts. The decisions appear to rest on two distinct bases. The first line of authority is illustrated by the case of *Grigalaukas v. United States,*[9] which was an action to recover damages resulting from the negligent treatment of an enlisted man's daughter by an Army doctor in an Army hospital in Kansas. Since the action was brought in a federal district court in Massachusetts, the court

4. 60 Stat. 842 (1946), 28 U.S.C. § 1346(b) (1958): "Subject to the provisions of chapter 171 of this title the district courts . . . shall have exclusive jurisdiction of civil actions on claims against the United States . . . for . . . personal injury or death caused by the negligent or wrongful act or omission of any employee of the government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred."

5. United States v. Aetna Casualty & Surety Co., 338 U.S. 366, 383, 70 S. Ct. 207, 216 (1949).

6. 243 N.Y. 140, 147, 153 N.E. 28, 29-30 (1926).

7. 350 U.S. 61, 76 S. Ct. 122 (1955).

8. *Cf.* Weston's Adm'rx. v. Hospital of St. Vincent of Paul, 131 Va. 587, 107 S.E. 785 (1921); Walker v. Memorial Hospital, 187 Va. 5, 45 S.E.2d 898 (1948); Memorial Hospital v. Oakes, 200 Va. 878, 108 S.E.2d 388 (1959).

9. 103 F. Supp. 543 (D. Mass. 1951), *aff'd* 195 F.2d 494 (1st Cir. 1952).

applied the law of Kansas[10] which granted to hospitals charitable immunity from liability for the torts of their employees. After discussing the characteristics of charitable institutions and the valid reasons for making them immune from liability, the court stated that the Army hospital derived its funds not from charity but from public monies. While it did not receive a monetary profit, as such, the court reasoned that a benefit did inure to the government by reason of the favorable light cast on the armed forces by such a service. Further, the existence of such medical care was found to be an important factor in inducing military enlistments. The court concluded that no one who receives treatment in an Army hospital is the recipient of charity. It is interesting to note that there is dictum in this case that indicates that if Judge McCarthy had found that the Kansas definition of a charitable institution applied to the Army hospital he would have held the government immune from liability. Such a decision would have had the effect of aligning that court with the court in the present case.

However, there is another line of cases which deny the defense of charitable immunity. In the words of the court in *Perucki v. United States*:[11]

> The defendant contends that this case is analogous to those in which a charitable institution is the defendant. The Pennsylvania decisions consistently held that the rule of respondeat superior does not apply in the case of injuries occasioned by the negligence of agents or servants of charitable institutions. The rationale which applies to these decisions does not apply to the United States.

The rationale for this decision is more explicitly set forth by the court in *Tessier v. United States*[12] where the same contention was also advanced by the government. That court declared:

> This is a waiver of tort immunity. It would be illogical to read back into the statute an immunity which has been granted to local charities, presumably for the pragmatic purpose of extending the charitable dollar to the greatest good of the greatest number, comparable in many respects to ordinary governmental immunity.

The last cited case seems to be most consistent with the apparent legislative intent of the Act. The government originally had a perfect immunity. Congress saw fit to alter that situation by making the government liable to the same extent that a private individual would be under similar circumstances according to the law of the place where the act or omission

10. This was done in accordance with the provisions of § 1346(b) quoted *supra* note 4.

11. 76 F. Supp. 34, 35 (W.D. Pa. 1948). The district court in the present decision, in discussing this case, stated that although a contrary opinion was reached it was not authority for cases brought under the Federal Tort Claims Act since it was decided prior to the adoption of the Act. A reference to the case, however, discloses that it was brought under the provisions of the Act and was decided on the precise point in issue.

12. 164 F. Supp. 779 (D. Mass. 1958).

occurred.[13] It is understandable that the legislature did not want to impose liability upon the federal government where a private person would not be liable nor to a greater extent than that person. It is submitted, therefore, that when a federal court looks to the law of the place where the act or omission occurred it should do so in the light of ascertaining whether a *private individual* would be liable under the circumstances and not whether the actor whom the government most closely resembles would be liable. Suppose, for example, "A", an employee of the federal government, while working on a public works project, negligently drove a truck into "B". Suppose, further, that "X", where the act occurred, provided redress in such a circumstance where the actor was a private individual but had not waived its sovereign immunity for torts committed by its agents. If the court likens the federal government to the individual actor, liability would be imposed. But if the court looks to see if the actor most resembling the federal government would be liable, i.e., the state, it would find the latter protected by sovereign immunity; hence, neither would the national government be liable. Had the court in the instant case looked to the law of the state to see if a private individual would be liable for negligence, instead of trying to discover whether the actor that the federal government most resembled would be liable (here, a charitable institution), the court would have better given effect to the objective which the legislature had sought to achieve.

The most troublesome of the explicit exceptions to liability under the Federal Tort Claims Act is the one set forth in § 2680(a).[14] Most of the cases involving its construction have been concerned with the issue of where the line should be drawn separating exempt discretionary functions from those which are actionable because of the lack of discretion involved. Of course, every voluntary action contains at least some degree of discretion. But the legislators certainly did not wish to exempt every act resulting from a choice of alternatives. On the other hand, the Federal Tort Claims Act was not meant to be a device whereby the courts could review the high level functions of the executive or the Congress, itself. Although a precise test would be easier to apply, the courts, as yet, have unearthed no adequate touchstone.[15] The cases treating with this point are in conflict. To refuse treatment to a serviceman's wife, after assurance was given that an Army ambulance had been dispatched, was held to be discretionary,[16] while the decision not to install a handrail on a government post office was not.[17] The decision to release a mental patient who stole a car and injured

13. *Supra* note 4; 28 U.S.C. § 2674: "The United States shall be liable . . . in the same manner and to the same extent as a private individual under like circumstances. . . ."

14. *Supra* note 3.

15. For a collection of the cases dealing with the discretionary function *cf.* Annot., 6 L. Ed. 2d 1422 (1962).

16. Denny v. United States, 171 F.2d 365 (5th Cir. 1948).

17. American Exchange Bank v. United States, 257 F.2d 938 (7th Cir. 1958).