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Damages—Income Taxes—Compensation Basis for Wrongful Death Act.—Cunningham v. Rederiet Vindeggen A/S

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plaintiff comes under great pressure to settle.²⁶ The great consumption of time in a derivative suit and the prospect of losing all if the case is litigated on the merits frequently leaves the plaintiff-shareholder with little choice but to settle. Recovery by corporations in New York court settlements amounts on the average to three per cent of the amount sued for.²⁷ The unrepresentative nature of derivative suits severely undercuts the theory of the majority's opinion in the noted case. Because the corporate interest must be represented, and because the ordinary derivative suit does not fulfill the task, the burden of sustaining the corporate welfare logically should devolve upon the director. By requiring the director to observe the standard of full and frank disclosure during litigation, derivative suits would be made more effective, because a director's ability to control litigation and to effect an outcome favorable to himself would be lessened considerably.

In summary, because of the lack of precedent bearing on this issue, the courts will have to weigh the two contrary viewpoints on the director's duties during derivative suits. Balanced against the threat to the finality of judgments is a desirable strengthening of the stockholder's position in derivative suits. Although imposition of this duty may not produce immediate compliance by wrongdoing directors, the remedies of stockholders will not be cut off by an adverse decision. If a director withholds material evidence of his wrongdoing, it will constitute a breach of duty and provide the stockholder with the procedural means of overturning an unjust decision favoring the wrongdoer. The adoption of this new duty seems clearly in line with the trend in case law toward a higher standard of loyalty of directors to their corporation and stockholders.

JOHN A. DONOVAN

Damages—Income Taxes—Compensation Basis for Wrongful Death Act.—*Cunningham v. Rederiet Vindeggen A/S*.¹—While unloading cargo, a longshoreman was killed by a falling hatch boom on defendant's vessel which was moored in New York territorial waters. His administratrix brought this admiralty action in the United States Court for the Southern District of New York² to recover her damages as the wife-beneficiary under the New York wrongful death act.³ Finding defendant's equipment unseaworthy, the trial court was required to compute fair and just compensation for the pecuniary injuries to the wife as a result of the wrongful death.

²⁶ Report of the SEC on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, 675-76 (1937), pt. 1.

²⁷ Hornstein, Legal Controls for Intracorporate Abuse—Present and Future, 41 Colum. L. Rev. 405, 426 (1941).

¹ 333 F.2d 308 (2d Cir. 1964).

² Although the longshoreman's widow did not qualify for the admiralty provisions of the Death on the High Seas Act, 41 Stat. 537 (1920), 46 U.S.C. §§ 761-68 (1958), admiralty in personam remedies which follow New York law were available on account of death within the territorial waters of that state. *The Tungus v. Skovgaard*, 358 U.S. 588 (1959); *Western Fuel Co. v. Garcia*, 257 U.S. 233 (1921).

³ N.Y. Decedent Estate Law §§ 130-35.

The court estimated the amount of decedent's future earnings, which were in the lower income range, and then deducted future federal and state income taxes. The only issues on appeal concerned the method of computation of damages, and the primary question was whether decedent's gross earnings or his net earnings after taxes should be the basis of compensation.⁴ On appeal, reversing and remanding for recomputation of damages, the Second Circuit HELD: In the absence of New York law to the contrary, the federal court should use the gross income measure of damages because of the speculative nature of any deduction for future income taxes.⁵

Historically, English law punished misconduct leading to personal injury because it threatened the maintenance of public order—the foremost governmental concern of an emerging society.⁶ Monetary penalties for crimes and torts alike satisfied compensatory, punitive, and vindictive instincts of the freemen and the king. A man's *wer*, the compensation for his life, was derived from his position in the social hierarchy, but the compensation for personal injury followed a graded schedule according to the degree of physical harm.⁷ Both death and personal injury were amendable by payment of the pre-ordained fines.⁸ When wilful homicide became punishable by death during the thirteenth century, neither *wer* nor compensation of any sort accrued to the kindred of the slain.⁹ Six centuries intervened before

⁴ The trial court also included in its award a sum designed to take into account the future income taxes of the widow on the income payable as a result of investment of the award.

⁵ The trial court decision was affirmed, however, with respect to all other questions raised by the parties, but the recomputation must omit the sum mentioned supra note 4.

⁶ 2 Pollock & Maitland, *The History of English Law* 449 (2d ed. 1898).

⁷ See Stephenson & Marcham, *Sources of English Constitutional History* 3-4 (1937), quoting the dooms of King Aethelberht (601-04):

If a man slays another, he shall pay as compensation (to the kindred) the ordinary wergeld . . . of 100s. . . .

Here follows in the doom an elaborate schedule of compensations for minor injuries: e.g., an ear, 12s.; an eye, 50s.; the chin-bone, 20s.; a front tooth, 6s.; a thumb, 20s.; a forefinger, 9s.; a fingernail, 1s.; a big toe, 10s.

King Alfred (871-904) perceived a standard of care and the possibility of accident in his wrongful death act:

A man carrying a spear should carry it level on his shoulder in order to be free from blame if another runs upon the point. If the point is three fingers or more above the butt (so as to bring the point to the level of a man's face), he will be liable to pay *wer* [to the kindred] in case of a fatal accident, and all the more if the point were in front (so that he could have seen the other's danger).

See 1 Pollock & Maitland, supra note 6, at 53-54.

⁸ But fines were often unpaid, because of their size. In lieu of the tariffs, the penalties included enslavement of the malefactor, his outlawry by society, or resort to blood-feud by kin of the injured. Earlier punishment to life and limb persisted for certain wrongs. See 1 Pollock & Maitland, supra note 6, at 46-49, and 2 Pollock & Maitland, supra note 6, at 456-62.

⁹ 2 Pollock & Maitland, supra note 6, at 459-60. How this rule became a part of the common law is the topic of Holdsworth, *The Origin of the Rule in Baker v. Bolton*, 32 L.Q. Rev. 431 (1916).

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Lord Campbell's Act¹⁰ in England and similar wrongful death acts¹¹ in the United States finally again provided for compensation to surviving kin. Thereafter, the statutory provisions and the compatible common law controlled these remedial actions.¹²

The New York wrongful death act, like similar acts in several states, awards "fair and just compensation for the pecuniary injuries, resulting from the decedent's death, to the person . . . for whose benefit the action is brought."¹³ Courts consider several variables in determining damages for pecuniary injuries¹⁴ under compensatory¹⁵ wrongful death acts. Chief among these variables are:¹⁶

- (1) decedent's lost potential earnings and pension benefits;
- (2) value of services, instruction and guidance to the beneficiary, had decedent lived;
- (3) decedent's potential income taxes, personal expenses and other self-directed expenditures;
- (4) estate taxes payable on the award;¹⁷
- (5) yield after beneficiary's taxes from the investment of the declining balance of the award;¹⁸ and
- (6) all litigation costs.

Several federal analogies to state wrongful death acts have led to damage actions in the federal courts. In some of these cases, fair and just compensation has been reached without a discussion of the income tax issue or each other variable, even though the award turned out to be vastly less than the product of decedent's past annual earnings and life expectancy.

¹⁰ 9 & 10 Vict., c. 93 (1846).

¹¹ New York Laws of 1847, ch. 450, was the first, according to Tiffany, *Death by Wrongful Act*, § 19 (2d ed. 1913).

¹² For instance, the common law principle of a single lump sum judgment presents to the courts the comprehensive problem of forecasting at once the amount of any continuing damage. Whether the principle satisfies plaintiff's needs for compensation as they occur is questioned in 2 Harper & James, *Torts* § 25.2 (1956).

¹³ N.Y. Decedent Estate Law § 132.

¹⁴ Some states allow recovery for beneficiary's lost companionship, affection and protection. See *Morris' Adm'rx v. Baltimore & O. R.R. Co.*, 107 W.Va. 97, 147 S.E. 547 (1929).

¹⁵ Some state statutes, for example, Mass. Gen. Laws Ann. ch. 229 (Supp. 1963), provide punitive damages instead of, or in addition to, compensatory damages.

¹⁶ For a more extensive set of variables than those corresponding to the facts and controlling death act present in the instant case, see Anderson, *A Model State Wrongful Death Act*, 1 Harv. J. Leg. 28 (1964).

¹⁷ Awards which go to the beneficiary without passing through decedent's estate are not subject to federal estate tax. Rev. Rul. 54-19, 1954-1 Cum. Bull. 179. *Quaere*, whether awards distributed through decedent's estate which are subject to claims of decedent's creditors are also free of federal estate tax.

¹⁸ The beneficiary is not liable for federal income tax on the award itself because the compensation is viewed as a return of capital "to restore [the recipient] . . . to substantially the same financial and economic status as she possessed prior to the death of her husband." I.T. 2420, VII-2 Cum. Bull. 123 (1928), cited in *United States v. Kaiser*, 363 U.S. 299, 319 (1960). See also the extensive discussion in *Morris & Nordstrom, Personal Injury Recoveries and the Federal Income Tax Law*, 46 A.B.A.J. 274 (1960).

Thus, in *Noel v. United Aircraft Corp.*,¹⁹ the hazards of decedent's new entrepreneurial venture and the uncertainties of his health and other contingencies caused the court to be silent about what annual compensation formed the basis of the award. Decedent's earnings in the five years immediately prior to death increased irregularly from \$35,000 to \$108,000, averaging \$70,000, but the award was consistent with an annual compensation of about \$42,000. Very simple facts also may spare a court the need to consider explicitly the income tax variable. For example, in *United States v. Smith*,²⁰ decedent's parents were compensated for money he had been sending them out of his earnings. The court computed an award by using just the highest past remittance, life expectancies and investment yield.

In *McWeeney v. New York, N.H. & H. R.R.*,²¹ where plaintiff, annually earning \$4,800, alleged permanent and total disability, the Second Circuit considered the tax variable and affirmed use of the gross income measure. *Stokes v. United States*,²² holding that income taxes were too speculative to consider in a personal injury action involving temporary and partial disability, was cited as controlling. The *McWeeney* court found the higher award resulting from the gross income rule to be fair, except possibly where high incomes are involved, because of failure to include anything in the award otherwise for inflation and plaintiff's attorneys' fees. Tax considerations were deemed improper to consider because of the uncertainties of tax law changes and the number of plaintiff's future dependents and because of the computational difficulties in maintaining consistency by crediting income taxes on yield from the award.²³

Although *Stokes* and *McWeeney* did not deal with compensation for death,²⁴ they governed a wrongful death action in *Montellier v. United States*,²⁵ where again use of the gross income measure was affirmed. Since *McWeeney* recognized a possible exception where high incomes are involved, the *Montellier* court declared:

It would not have been erroneous under the rule of *McWeeney* . . . for the trial judge to have made a deduction for income taxes, which would have amounted to a substantial sum in this case.

¹⁹ 219 F. Supp. 556 (D. Del. 1963). Controlling was the Death on the High Seas Act, 41 Stat. 537 (1920), 46 U.S.C. §§ 761-68 (1958).

²⁰ 220 F.2d 548 (5th Cir. 1955). Controlling was the Jones Act, 38 Stat. 1185 (1915), as amended, 46 U.S.C. § 688 (1958). Accord, *Lange v. United States*, 179 F. Supp. 777 (N.D.N.Y. 1960). Controlling was the Federal Tort Claims Act, 28 U.S.C. §§ 1346, 2671-80 (1958).

²¹ 282 F.2d 34 (2d Cir.), cert. denied, 364 U.S. 870 (1960). Controlling was the Federal Employers' Liability Act, 35 Stat. 65 (1908), as amended, 45 U.S.C. §§ 51-60 (1958).

²² 144 F.2d 82 (2d Cir. 1944).

²³ Compare, however, the clarity of the mathematical approach to the last problem via an adjustment in the discount rate in 22 Ohio St. L.J. 225, 227 (1961).

²⁴ Some of the uncertainties of compensation for disability are not relevant to compensation for death. See Wright, Foreword to Symposium on Damages for Personal Injuries, 19 Ohio St. L.J. 155, 157 (1958).

²⁵ 315 F.2d 180 (2d Cir. 1963). The Federal Tort Claims Act, 28 U.S.C. § 2674 (1958), provides a federal measure of compensatory damages where none are provided by the state's wrongful death act.

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However, [decendent's \$12,000 annual] earnings were not so clearly above the "middle reach of the income scale" that it was erroneous not to make such a deduction. As we indicated in *McWeeney*, no precise line can be drawn.²⁶

State courts which have considered the question in wrongful death or personal injury actions have also established the gross income measure, rather than the net, as supported by "the weight of authority."²⁷ Texas, for example, has excluded any mention of income taxes as a matter of "legal principle."²⁸ Pennsylvania has adopted the gross income measure because it is the "majority rule" and the product of "sound legal reasoning."²⁹

Floyd v. Fruit Indus. Inc.,³⁰ was the first decisive break from the gross income rule in this country.³¹ The Connecticut court treated the high income bracket of the decedent as a signal to recognize that the only usable earnings are those included in net income. *Floyd* held that the tax factor was no more uncertain, speculative or conjectural than many of the other variables which must be considered by the jury according to Connecticut precedent.³²

Oklahoma, in the wrongful death action of *Magnolia Petroleum Co. v. Sutton*,³³ has used the net income basis in order to avoid giving the plaintiff more than her husband would ever have contributed for her needs or wants. The decision determined the Oklahoma law which the court in *O'Connor v. United States*³⁴ was bound to apply in a death action under the Federal Tort Claims Act.³⁵ The authority was congenial as well as controlling, for the *O'Connor* court also felt that the compensatory nature of the right to damages under the Tort Claims Act required computation of decedent's future income after taxes. It was deemed unrealistic to suppose taxes will be discontinued or reduced substantially. The holding was clari-

²⁶ *Montellier v. United States*, supra note 25, at 186.

²⁷ *Jennings v. United States*, 178 F. Supp. 516, 532 (D. Md. 1959). The federal court determined that the gross income measure should be used in a wrongful death action which applied Maryland law under the Federal Tort Claims Act, 28 U.S.C. § 2674 (1958).

²⁸ *Texas Consol. Transp. Co. v. Eubanks*, 340 S.W.2d 830, 836 (Tex. Civ. App. 1960).

²⁹ *Girard Trust Corn Exch. Bank v. Philadelphia Transp. Co.*, 410 Pa. 530, 538, 190 A.2d 293, 298 (1963).

³⁰ 144 Conn. 659, 136 A.2d 918 (1957), construing the Connecticut wrongful death act, Conn. Gen. Stat. tit. 52 § 52-555 (1958). Exemplary damages up to the costs of litigation are permitted. *Chykirda v. Yanush*, 131 Conn. 565, 41 A.2d 449 (1945).

³¹ Just one year before, English precedent had been reversed and the net income measure used in a partial disability personal injury action where high income tax rates were involved. *British Transp. Comm. v. Gourley*, [1956] 2 Weekly L.R. 41 (H.L.). The net income measure is used in death actions; see, e.g., *Daniels v. Jones*, [1961] 1 Weekly L.R. 1103 (C.A.). In English actions plaintiffs receive a more liberal measure of costs than in this country. See *Goodhart, Costs*, 38 Yale L.J. 849 (1929).

³² *Floyd v. Fruit Indus. Inc.*, supra note 30, 144 Conn. 659, 672, 136 A.2d 918, 925. Cited was an earlier wrongful death action, *Sims v. Smith*, 115 Conn. 279, 161 Atl. 239 (1932).

³³ 208 Okla. 488, 257 P.2d 307 (1953), applying 12 Okla. Stat. 1053-54 (1951).

³⁴ 269 F.2d 578 (2d Cir. 1959).

³⁵ 28 U.S.C. §§ 1346, 2671-80 (1958).

fied in the instant case, however, and limited to an application of Oklahoma law.³⁶

In a rehearing which reduced the award of *Meehan v. Central R.R. Co.*,³⁷ the New Jersey wrongful death act³⁸ was found to be silent about deduction of income taxes. The net income measure was used and credit was given for taxes on the anticipated yield on the award. Decedent's gross earnings were \$11,500. Because of its failure to recognize that the use of net income in *O'Connor* was based on Oklahoma law rather than general compensatory principles, the reasoning in *Meehan* appears to have been rejected in the instant case.

In *Rogow v. United States*,³⁹ where decedent had annual income of \$23,600, the New York wrongful death act⁴⁰ was not found to be silent nor a barrier to the net income basis. The following definition of fair and just compensation under New York law was the authority for deducting taxes:

The main elements to be considered are the age of the decedent, his health, habits, qualities, expectation of life and expectation in life, earning ability, income, the prospect of increase of income, the number, age, sex, situation, and condition of those dependent on him for support, and his disposition to support them well or otherwise, and the like. . . . [T]he precise question is: What were the 'probable chances of pecuniary benefit from the continuance in life of the decedent worth under all circumstances?'⁴¹

Despite the apparent conflict with *Rogow's* reading of New York law, the instant case reaches a practical result which is more justly compensatory to the beneficiary in the eyes of the Second Circuit than if income taxes were deducted.⁴² The court emphasized that inflation and attorneys' fees—neither of which were included in the trial court's determination of the award—would be quite as real to the beneficiary as her freedom from taxes on the award. The court would perhaps have been a "bit more generous" to the beneficiary than the trier of fact.⁴³ The result sets off these variables against each other by leaving all of them out of the recomputation of damages.

The instant case illustrates that the choice between gross and net income measures is not always critical to the principle of compensation, if the courts regulate their view of other variables according to how they handle income

³⁶ *Supra* note 1, at 315.

³⁷ 181 F. Supp. 594 (S.D.N.Y. 1960).

³⁸ N.J.S.A. 2A: 31-1 to 2A: 31-6 (1952).

³⁹ 173 F. Supp. 547 (S.D.N.Y. 1959).

⁴⁰ N.Y. Decedent Estate Law §§ 130-35.

⁴¹ *Arnold v. State*, 163 App. Div. 253, 264, 148 N.Y.S. 479, 486 (1914). See also *Swanson v. United States*, 229 F. Supp. 217 (N.D. Cal. 1964), which analyzed California law analogously to use the net income measure where decedent's income was \$10,500.

⁴² In a future case like *Rogow* where state law does not expressly compel the use of the gross income measure at all levels of earnings, the *McWeeney* exception would seem to allow income taxes to be deducted, if the court finds income to be high enough.

⁴³ *Supra* note 1, at 312.

taxes. An unfortunate result of the emphasis in the Second Circuit on its qualified gross income rule, however, is the picture it may present of casual handling by the courts of other difficult and important compensatory variables when they are considered in combination with the income tax question.⁴⁴

SAMUEL E. SHAW II

Government Contracts—"Team" Projects—Prime Contractor's Relation to Subcontractor—Joint Enterprise.—*Air Technology Corp. v. General Elec. Co.*¹—In 1961 General Electric (GE) began preparing a proposal to the Air Force for the establishment of a nuclear detection system. Representatives of GE and Air Technology (AT), discussed the possibility of GE incorporating AT's design of the EM sensor subsystem² in a "team" proposal to the Air Force if AT could demonstrate that Air Force accuracy requirements had been met. For "team" membership, GE required that AT (1) justify to GE the scientific basis for its EM sensor design, (2) assist in preparing and presenting the proposal to the Air Force, and (3) submit, at GE's request, a properly priced proposal for the EM sensor subsystem. AT fulfilled its first requirement without imposing proprietary restrictions on the included data. At about this time, GE informed the Air Force that AT was a "team member" and subcontractor of GE's. GE then submitted its proposal to the Air Force including material contained in AT's proposal to it. Subsequently, AT fulfilled its second team membership requirement by assisting GE in orally presenting its proposal to the Air Force. The Air Force then selected GE as prime contractor, provided a suitable contract could be negotiated. GE was not selected on the basis of its proposal, which*was not completely acceptable technically, but rather on a statement of its expected performance. During negotiations with the Air Force, AT informed GE that it "expected a sole source procurement from GE on the EM sensor."³ GE, however, after successfully negotiating the prime contract, solicited competitive bids for the EM sensor from a number of companies including AT, and ultimately decided to build part of the EM subsystem itself. AT brought this bill in equity to restrain GE from using sensor information

⁴⁴ Compare the technique used effectively in *Nollenberger v. United Air Lines Inc.*, 216 F. Supp. 734 (S.D. Cal. 1963), where eleven special interrogatories allowed the court to compute the award as the sum of five items (of several steps each), under the provisions of Rule 49(b), F.R. Civ. P. The variables of income taxes on earnings and on yield from the award and inflation were included explicitly.

¹ 1964 Mass. Adv. Sh. 949, 199 N.E.2d 538 (1964).

² Nuclear explosions generate various types of radiated effects, including optical, acoustical, seismic and electromagnetic; measurement of the different effects is accomplished by means of sensing devices called "sensors," optical radiation being measured by optical sensors, and electromagnetic radiation by electromagnetic (EM) sensors. The contract finally awarded by the Air Force to GE stipulated the use of EM sensors and required that they be capable of determining the direction and measuring the yield, or magnitude, of nuclear detonations.

³ *Air Technology Corp. v. General Elec. Co.*, supra note 1, at 954, 199 N.E.2d, at 543.