Interpleader: not a get-out-of-jail-free card

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The federal interpleader remedy was designed as a type of safe harbor. The purpose of these statutes (Federal Rule of Civil Procedure 22 and 28 U.S.C. Section 1335) is to permit a stakeholder to avoid the risk of liability for multiple claims for the same stake, where the stakeholder claims no interest in the stake and does not want to determine at its peril which of the claimants has the better claim. The remedy not only permits stakeholders to recover costs and attorney fees in filing an action (at the discretion of the court), it importantly permits stakeholders to exit the litigation between competing claimants at an early stage — thereby avoiding unnecessary litigation costs. In most cases, the stakeholder's liability is limited to the stake itself. In the first phase of the litigation, the stakeholder sues the competing claimants, deposits the stake with the court, and requests that it be discharged. In the second phase, the claimants battle it out over entitlement to the stake.

Insurance companies, however, still have an obligation to act in good faith. "Although an interpleading stakeholder need not sort out the merits of conflicting claims as a prerequisite to interpleader, good faith requires a real and reasonable fear of exposure to double liability or the vexation of conflicting claims. *See Union Cent. Life Ins. Co. v. Hamilton Steel Prods., Inc.*, 448 F.2d 501, 504 (7th Cir. 1971) ('[S]o long as there exists a real and reasonable fear of exposure to double liability or the vexation of conflicting claims ... , jurisdiction in interpleader is not dependent upon the merits of the claims of the parties interpleaded ... .')." *Michelman v. Lincoln Nat. Life Ins. Co.*, 685 F.3d 887, 894 (9th Cir. 2012) (citations omitted).

If an insurance company acts in bad faith, the use of interpleader will not shield it from the obligation to pay damages over and above the actual stake deposited with the court. For example, in *New York Life Ins. Co. v. Lee*, 232 F. 2d 811 (9th Cir. 1956), the court held that where an insurance company which had refused payment of the cash surrender value of a life policy was apparently liable for bad faith, an interpleader action would not affect its liability for attorney fees and interest. But as long as an insurance company has a good faith belief that it faces the possibility of multiple claims, filing an interpleader action will shield it from bad faith claims. *Minnesota Mut. Life Ins. Co. v. Ensley*, 174 F. 3d 977 (9th Cir. 1999).

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As to claims other than bad faith, it has been held that independent liability could exist where the stakeholder's conduct with respect to the interpleader action was "improvident, vexatious, or otherwise improper, even if not in bad faith." *Murphy v. Travelers Ins. Co.*, 534 F.2d 1155, 1164 (5th Cir. 1976). Until recently, however, there was little flesh on that particular bone.

At the district court level, interpleader defendants (claimants to the fund) who wish to assert claims against the stakeholder may find themselves in a strong uphill battle. Life insurance companies can be expected to argue that by filing an interpleader action, the company has effectively cut off further liability, and judges tend to be sympathetic with that point of view, often giving the benefit of any reasonable doubt to the insurance company.

In the absence of clear wrongdoing by the insurance company, any recovery by the claimants will be limited to the interpled amount. In *Prudential Insurance Company v. Hovis*, 553 F.3d 258 (3d Cir. 2009), the 3rd U.S. Circuit Court of Appeals held that the insurance company was not liable for failing to process a change of beneficiary form where it acted within its own guidelines and was blameless for the controversy that ensued (between the insurance broker/boyfriend of the deceased, who submitted the change form less than a month prior to her death and requested it be processed expeditiously, and a family member who was the original beneficiary of the life insurance policy).

The central question in *Hovis* was, how far does interpleader protection extend? "[T]he normal rule is that interpleader protection does not extend to counterclaims that are not claims to the interpleaded funds. *Cf. State Farm Fire & Cas. Co. v. Tashire*, 386 U.S. 523, 535, 87 S.Ct. 1199, 18 L.Ed.2d 270 (1967) (cautioning that 'interpleader was never intended ... to be an all-purpose "bill of peace"')."

The *Hovis* court stated, "Our decision in no way turns the interpleader device into an all-purpose get-out-of-jail-free card. What we hold here is that where a stakeholder is blameless with respect to the existence of the ownership controversy, the bringing of an interpleader action protects it from liability to the claimants both for further claims to the stake and for any claims directly relating to its failure to resolve that controversy. ... Our decision here is even potentially consistent with holding a stakeholder liable for its investigation of ownership of the stake, at least where defects in its investigation can plausibly be blamed for the existence of the underlying ownership controversy." But of course, in *Hovis* Prudential Insurance Company was ***not*** liable because the claimant in that case had not proved the company acted wrongfully, so its affirmation of potential stakeholder liability once again was dicta.

> The 9th Circuit ... [held] that the injured party could recover its costs and attorney fees ... *if* the insurance company stakeholder's negligence created the controversy in the first place.

In *Lee v. West Coast Life Insurance Company*, 688 F. 3d 1004 (9th Cir. 2012), however, the 9th Circuit turned dicta in ***Murphy*** and ***Hovis*** into an actual precedent, holding that the injured party could recover its costs and attorney fees for litigating with the other claimants within the interpleader proceeding itself under the "tort of another" rule, and the injured party could also recover its out of pocket damages sustained by being forced to compromise its claim in order to settle the case in the district court — *if* the insurance company stakeholder's negligence created the controversy in the first place. That is, the injured claimant could actually recover as damages the portion of the interpled stake it had given up in order to settle with the competing claimants. The Court of Appeals expressly rejected the holding of the district court that the claimants were not entitled to recover anything beyond the funds on deposit with the court.

Lee, then, stands for the proposition that the damages which flow from a stakeholder's negligence, and which would be recoverable in the absence of an interpleader, remain recoverable despite the filing of an interpleader action and are not cut off at the point such an action is filed.

In one respect, ***Lee*** was simply common sense in holding that insurance companies cannot escape liability for their own negligence by filing an interpleader action. In another respect, it is a landmark decision, holding that such liability could extend not only to litigation expenses incurred ***within the interpleader action itself, but also to an amount paid out of the interpleaded funds to competing claimants.*** It will be interesting to see how this ruling plays out. One thing that may change is that the demands of insurance companies to be released from interpleader litigation may be more vigorously contested by claimants in future litigation.

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