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Insurance Law

Ninth Circuit Holds That Interpleader Does Not Shield Insurer From Independent Tort Liability

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The Ninth Circuit recently joined its sister circuits to find that the federal interpleader remedy does not limit an insurer's independent tort liability for damages directly and proximately caused by its conduct. ***Lee v. West Coast Life Insurance Company***, Case No. 11-55026 (9th Cir. July 31, 2012).

In *Lee*, family members of a life insurance policyholder executed numerous change of ownership and beneficiary forms over the years. One of those forms, in 2005, was executed incorrectly at the direction of a West Coast agent, ultimately leaving two family members with the mistaken belief that they were beneficiaries under the policy. After the insured died, one family member submitted a claim, and other family members claimed entitlement to the proceeds. West Coast urged them to reach a mutual agreement, but they did not. Three claimants then sued West Coast for breach of contract and bad faith. West Coast filed a counterclaim in interpleader and deposited the policy proceeds with the court. Three other claimants filed counterclaims for negligence and declaratory relief against West Coast and crossclaims against the plaintiffs.

The family members ultimately reached a settlement to distribute the funds among themselves. But the counterclaimants continued to pursue their claims against West Coast for its alleged negligence in the 2005 beneficiary change, seeking as damages the value of the settlement proceeds allocated to the plaintiffs and their attorneys' fees incurred in litigating their claims. The district court granted partial summary judgment in West Coast's favor on the contract claims and the counterclaimants' claim for attorneys' fees, ruling that West Coast's liability for attorneys' fees incurred in litigating the ownership of the stake was "cut off" by the interpleader action, and that only the counterclaimants' negligence claim remained to be tried. West Coast subsequently filed a motion for a judgment as a matter of law on the negligence claim, which the district court granted. The district court reasoned that the counterclaimants had failed to allege cognizable damages flowing from West Coast's alleged negligent conduct.

The Ninth Circuit reversed. It found that while interpleader limits a stakeholder's potential liability where the only contested issue is the claimants' entitlement to the stake, where the stakeholder may be independently liable to one or more claimants, the interpleader action does not shield the stakeholder from tort liability or liability in excess of the stake. The court looked to *State Farm Fire & Cas. Co. v. Tashire*, 386 U.S. 523 (1967), in which the Supreme Court had found that interpleader could not be used to protect an insurer from being sued for claims relating to its obligations under a policy where the scope of the litigation in terms of claims and parties was more extensive than entitlement to the stake. The Ninth Circuit also cited its previous holding in *New York Life Ins. Co. v. Lee*, 232 F.2d 811 (9th Cir. 1956) that the purpose of the interpleader statute was to give the stakeholder protection, not "to wipe out the substantial claims of persons asserting rights against [insurance] companies." *Id*. at 814.

Turning to the district court's conclusion that attorneys' fees are not recoverable in interpleader actions absent a showing of bad faith, the Ninth Circuit found it to be error because the fees were sought as damages flowing from West Coast's alleged misconduct in an independent negligence claim, not for a bad faith claim or for the filing of the interpleader action. The court reasoned that the district court's holding "threatens to convert the interpleader action into a species of get-out-of-jail-free card, a device that would shield tortfeasors from liability for their negligent mistakes and limit their total financial exposure to the value of the stake."

In the end, the Ninth Circuit concluded that "the federal interpleader remedy does not shield a negligent stakeholder from tort liability for its creation of a conflict over entitlement to the interpleaded funds" and that, consequently, "a claimant may seek to recover all damages directly and proximately caused by the negligent stakeholder's conduct."

This decision reminds insurers that interpleader, though an important tool to avoid duplicate liability on contested claims, is not a "get-out-of-jail-free card" for independent torts. It also illustrates the importance of reminding insureds and agents to carefully review any ownership and beneficiary changes to make sure that they reflect the insureds' intentions.