

SURETY TODAY PRESENTATION

Given by

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This is the eighth edition of the Surety Today. I am joined today by Marc A. Campsen, as associate in our surety/law group. Our topic today is “Interpleaders.”

I. NATURE AND PURPOSE OF INTERPLEADER ACTIONS

Marc: Good afternoon, everyone. The nature and the purpose of an interpleader action are to potentially protect a stakeholder from having to defend against multiple lawsuits and from the risks of multiple liability or inconsistent obligations against the stake. So, really, what does this mean? An interpleader action is a procedural device used to resolve conflicting claims over money or property. This is the stake at issue. Now relative to the surety, the stake is usually always going to be the penal sum of the bond. Essentially, an interpleader action permits an entity holding money or property known as the “stakeholder” to deposit the stake into the court and let the court decide who is entitled to it and how much that entity should get. Dividing the stake among the claimants like this is often referred to as “pie splitting” for obvious reasons. Now in this regard, in addition to protecting the stakeholder, an interpleader action can protect multiple claimants to the stake when the claims on the stake exceed the total amount of the stake, because the court will distribute the limited stake equitably among claimants to ensure the fund is not depleted so that all claimants are at least partially compensated. I think we can all agree that this happens at least from time to time with claims on a particular bond. So, in sum for the nature and purpose of the interpleader action, the goal is to resolve a many-sided dispute economically and expeditiously in a single proceeding, primarily to protect the rights of the stakeholder. In our case it would be the surety, but also to protect the claimant.

A. Federal Interpleader

Interpleader actions are available in federal court and in most state courts. In federal court, there are two ways to initiate an interpleader action, either by federal rule of civil procedure or by federal statute. A “Rule Interpleader” is permitted under the rule of civil procedure 22, but Rule Interpleader does not give rise to jurisdiction in federal court without another independent basis, such as a federal question or diversity of citizenship among the parties. The other main thing to know about Rule Interpleader is that it doesn’t require a deposit of the stake into the court. So, if you pursue a Rule Interpleader in the surety context, you don’t have to write the check for the entire amount of the penal sum right in the beginning of the litigation, you can actually hold onto it.

“Statutory Interpleader” is based on the federal Interpleader Act. Unlike rule interpleader, it expressly provides jurisdiction in federal court as well as providing certain remedies that flow directly to the stakeholder that are not afforded in rule interpleader. We will

discuss that in the next section. One of the main differences between rule interpleader and statutory interpleader is that statutory interpleader does require deposit of the stake, you have to write the check and deposit it with the court, basically along with the Complaint and you know, you may never get that money back, basically. That's sort of the purpose of the interpleader because you feel there are valid claims to it.

So, both rule and statutory interpleaders embody the same supporting policies protecting the stakeholder, and generally perform the same function. They can often be considered redundant. But because they have two different types of jurisdictional requirements, one or the other may not be available so that's something that needs to be evaluated before filing in federal court. In any event, one of the primary benefits of instituting in federal court under either rule or statutory interpleader is that the procedure and mechanisms are often going to be the same across the country in any jurisdiction that you're in. You don't have to worry about individual jurisdictional quirks or nuances that arise in state court.

B. State Interpleader

Like I said, in most state courts, interpleader is available. We're in Maryland, so for example, Maryland Rule of Civil Procedure 2-221 expressly permits interpleader, but in my experience in interpleader actions in state courts in Maryland, for whatever reason, they simply are not as well versed in interpleader actions as federal courts, and they aren't quite as efficient and don't run as smoothly. I would say the primary reason that a stakeholder would want to file in state court is that they have to, not that they want to, because they don't meet the jurisdictional requirements of federal court.

C. Strict or True Interpleader/In the Nature of Interpleader

Now, there are two types of interpleaders, not rule and statutory like we were talking about, but two conceptual types of interpleaders. One is strict or true interpleader, and the other is in the nature of interpleader. If the action is a strict or true interpleader, the stakeholder asserts no claim to the stake. In other words, the stakeholder is disinterested in that money or property that it is depositing with the court. In the surety context, that could arise in circumstances where the surety recognizes the validity of all claims on the bond that exceed the penal sum, they don't claim any rights to retain any of the penal sum, and they just want to deposit it into the court and let the court sort out who gets what. By contrast, if the action is in the nature of interpleader, then the stakeholder claims an interest in the stake, so it's the opposite, by way of example, the surety would claim an interest in the penal sum, and this would arise in cases where, although there are multiple claimants, some of those claims the surety doesn't feel are valid, or they feel they have proper defenses to, and think they can retain at least a portion of the penal sum or the stake that's deposited in the court.

So, to put this all in perspective, when a surety receives multiple claims on a bond that exceed the penal sum, and is unsure of who has valid claims or to what extent each claimant is owed, an interpleader action can provide a good option to protect the surety from multiple

lawsuits, potential inconsistent liabilities and as we will address a little later, some liabilities where the penal sum is depleted before it's paid out to all of the claimants.

II. ATTRIBUTES OF INTERPLEADER ACTIONS

Mike: So let's focus on the mechanics of the interpleader actions. Really, I'm not going to get in too deeply over any kind of procedures or that kind of stuff, because that's really for your outside counsel. I want to give an overview of some of the interpleader actions by focusing on some of the specific attributes of interpleader actions so that you can have familiarity with the major benefits of an interpleader action and decide in the future if these benefits fit your particular facts in a given matter so that you can know what your options are and know that interpleader is an option. I also am just going to focus on federal interpleader, because it has broader application and more uniformity in comparison to the various interpleader statutes and rules in the various states as Marc was talking about, since there is a lot of lack of uniformity throughout the country on that.

A. Minimum Diversity

So the first attribute of federal statutory interpleader is concept of minimum diversity. Ordinarily, in order to obtain federal subject matter jurisdiction, you would need to have a federal question jurisdiction basis or diversity. So, federal question would be something like the Miller Act. Diversity requires that the plaintiffs all be from a different state, citizens of a different state from all of the defendants, and the amount in controversy has to exceed, I believe it's \$75,000. I don't know if they changed that recently, I should have checked. So, for example, if one of three plaintiffs is from Maryland and one of ten defendants is also from Maryland, you don't need diversity requirements. You need to have complete diversity in order to meet diversity jurisdiction, in general. Now under the federal interpleader statute, the amount of the stake needs only to be \$500, so right there the diversity amount has been lowered from \$75,000 to \$500, and to meet diversity in an interpleader action, all there has to be is two of the claimants have to be citizens of different states, so if the plaintiff is a citizen of Maryland and one of ten defendants is from Maryland, that's fine because the citizenship of the plaintiff is irrelevant in interpleader actions. As long as two of the claimants are from different jurisdictions, different citizenships, then you meet the minimum diversity requirement for federal interpleader. Federal rule interpleader, as Marc pointed out, is a little bit different. It does require meeting the traditional diversity requirements.

B. Nationwide Jurisdiction

A second attribute of federal statutory interpleader is that you can achieve nationwide jurisdiction. Ordinarily, in order to sue someone in a jurisdiction, you need to have a statute that allows you to do that like the long arm statute or the person has to consent to the jurisdiction or they have to have constitutionally required minimum contacts with the jurisdiction in order to obtain personal jurisdiction over that individual in a given forum. But in a federal interpleader statute, the court is given nationwide jurisdiction over all claimants to the stake wherever they reside. 28 U.S.C.A. § 2361 states that a district court may issue its process for all claimants,

where they reside or may be found. Thus, in statutory interpleaders, the minimum contacts of the claimant with the jurisdiction are irrelevant and this gives the surety maximum flexibility in instituting the action and allows the interpleader to bring all claimants and potential claimants before the same tribunal, thereby furthering the nature and purpose of the interpleader action, as Marc was talking about.

C. Binding Unknown Claimants

A third attribute of federal statutory interpleader is the ability to unknown claimants. Marc and I had a case in the DC federal court where the principal was being uncooperative and ultimately went out of business, so we had no idea how many potential claimants there were. There were numerous claimants, there were going to be claims in excess of the penal sum of the bond, so we convinced the court to allow us to provide notice by publication to any potential unknown claimants on this bond to try to get everyone into this action so that on the backend when we got our discharge, we wouldn't get anyone coming out of the woodwork saying they didn't get notice. We were permitted to proceed on the basis of providing constructive notice to potential claimants to give us some protection there. You can get that typically in interpleader actions.

D. Injunction/Discharge

Finally, one of the additional features or primary features or benefits of an interpleader action is the injunctive relief and also the discharge that you can get. 28 U.S.C. §2361 permits the federal court, where the interpleader action has been filed, to issue an injunction. The statute provides that in any civil action of interpleader or in the nature of interpleader, the district court may enter its order restraining any claimant from instituting or prosecuting any proceeding in any state or United States court affecting the property, instrument or obligation involved in the interpleader action. So, obviously, this is a nationwide injunctive power. It applies to all courts, federal and state, it is broad and extensive, and gives the court the ability to stop ongoing cases or prevent cases from being filed against the surety or the bond once you've instituted interpleader action. The injunctive relief can be obtained right away, initially in the case without any notice or opportunity of the opposing party to be heard or to come before the courts. If you get that injunctive relief, it's kind of like the automatic stay in bankruptcy. You can also get a discharge. Once you have deposited the penal sum of the bond, you can petition the court to be discharged and you can obtain a discharge absolving you from any further liability on that bond. So, obviously that is one of the primary benefits of the interpleader action for the stake holder.

III. RECOVERY OF ATTORNEY'S FEES

Marc: I'm going to be talking about attorneys' fees and costs recovery now. In federal court, you can definitely get attorneys' fees and costs and in the state court, again depending on your jurisdiction, it may be possible - in Maryland for example you certainly can.

A. Federal Court

First in federal court, generally costs and fees are only going to be available to the disinterested stakeholder. That would be in the true or strict interpleader action we talked about earlier where you just deposit the funds that you know you are not getting back, you have no interest in the funds, as opposed to the nature of interpleader where you want to retain some of the funds and it really turns, maybe into true litigation. Initially under federal law, there is no express provision in either rule or statutory interpleader for fees and costs, but regarding costs, Federal Rule of Civil Procedure 54 governing judgments permits courts to award costs to prevailing parties. This does not include attorneys' fees, but courts nonetheless recognize that this rule applies to statutory and rule interpleader actions as far as recovery of costs of court filings and other costs you may incur.

Regarding fees, again there is no express statutory or rule authorization for fee recovery in an interpleader action. But, courts are permitted within their discretion to award fees under essentially traditional rules of equity, so it's always going to be a discretionary based award that means you may get it or you may not get it; it depends upon the facts of each case. Fees are typically only awarded to disinterested stakeholders as I said, that have deposited the stake into the court, conceded liability to the full value of the stake, and requested discharge from the litigation, as Mike was talking about earlier. Generally, those arise in your statutory interpleader, where you are disinterested and seek a discharge after filing, and not so much in the rule interpleader where you may not even have deposited the stake into the court.

Now importantly, requesting fees does not constitute an interest in the stake, which could turn a disinterested stakeholder into an interested stakeholder. Courts have held that even if you want your attorneys' fees to be paid from the stake, that does not make you an interested party. Now the philosophy behind the awarding of fees is that the disinterested stakeholder has been forced to expend time and money to resolve the dispute that it had no hand in creating. I think in the surety context this arises generally because the surety is just providing the bond; it's not out there actively performing the principal's obligations, at least at the outset, and so it's clear that the principal's failures are what are creating disputes and the need for interpleader actions in the first instance, and that's why a surety would seek fees in an interpleader action.

The amount of the fees and costs recoverable are generally limited to those incurred in initiating the interpleader action and are also limited generally by reasonableness. So, when you're seeking fees, you're limited to only the cost of drafting and filing a complaint and related motions to the complaint, such as motions for depositing fees, affidavits and other forms like that, and for the court costs that you have incurred in filing. A stakeholder is not really going to be able to recover for the money and time spent in attempting to resolve the dispute prior to litigation, and that includes pre-litigation investigations. Finally, the smaller the stake, the general rule of thumb is the smaller the recovery of attorneys' fees, and that's something to keep in mind when you're putting together the filings.

B. State Court

Now in state court, like I said, fees are awarded in most states. In Maryland, for example, the Maryland interpleader rule expressly provides for awards of costs and fees, which is actually

different than the federal interpleader, so you have to be aware of what jurisdiction you are in. If you're in state court, have your counsel check on that. Now in both federal and state court, these must be pled in the complaint and like I said, they are within the discretion of the trial court and for this reason, while obtaining fees is possible, it's not always a slam dunk so to speak.

Briefly, for some examples, in Maryland state court, I had an interpleader action for a surety on an auto dealer bond and the penal sum there was only \$25,000 and the court denied us all of our costs and fees, and its grounds were preventing depletion of funds that would be distributed to individuals who had been harmed by the principal/auto dealer's actions. I think this is a pretty unique situation where all of the claimants happened to be consumers and the court was really looking out for them based on its findings under consumer protection concerns. Now in federal courts, certainly case law is replete with examples of disinterested stakeholders, including sureties being awarded their attorneys' fees, so while it is discretionary, it's not uncommon, and by way of example and to draw a distinction with state court, I filed numerous interpleader actions around Maryland up and down the east coast for insurance carriers, not sureties specifically, but insurance carriers. In those cases, we have been awarded fees every time even though the defendants in those cases are also individuals.

In the surety context, Mike referenced the case we had in DC a minute ago, and that case was in the District of Columbia federal court, and there the parties ultimately reached an agreement as to how the estate would be distributed among the claimants, and part of that agreement was recovery of attorney's fees for the surety, and this is interesting because there the surety was able to recover some of its costs and fees and it avoided the risk of getting a low fee award or no fee award, and the claimants were unable to avoid having an unusually or larger than a desired fee award, reducing their stake in the claim, so that's always an option too, once the interpleader is filed, you can seek to get fees through an agreement, not necessary through the court.

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