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Civil Procedure -- Use and Constitutionality of the Federal Interpleader Act

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NOTES AND COMMENTS

Civil Procedure—Use and Constitutionality of the Federal Interpleader Act

After the passage of the Federal Interpleader Act,[1] uncertainty developed as to the extent to which the Act should be available to insurance companies defending assureds against two or more injured parties.[2] The question also arose whether its authorization of federal jurisdiction on the basis of minimal diversity is constitutionally permissible. In *State Farm Fire & Cas. Co. v. Tashire*[3] the United States Supreme Court addressed itself to both problems in defining the proper use of the Act and holding it constitutional.

Tashire arose out of a collision between a truck and a bus in Northern California in which many passengers were injured. Four passengers from California brought suit in a California state court against the bus line and bus driver, both citizens of California, and the truck driver, a citizen of Oregon. It was anticipated that other passengers from California and elsewhere would also sue. Before other suits were brought or judgment was reached in any pending suit, State Farm, representing only the truck driver on a liability insurance policy for 20,000 dollars,[4] interpleaded in the

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[1] The first Federal Interpleader Act was passed in 1917 and successive amendments expanded its usefulness. For legislative history see 3 J. MOORE, FEDERAL PRACTICE § 22.06 (2d ed. 1967). Relevant portions of the Act read as follows:

> The district courts shall have original jurisdiction of any civil action of interpleader . . . filed by any person, firm, or corporation . . . having in his custody or possession money or property of the value of $500 or more, or having issued a . . . policy of insurance . . . of value or amount of $500 or more . . . if
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> (1) Two or more adverse claimants, of diverse citizenship . . . are claiming or may claim to be entitled to such money or property, or to any one or more benefits arising by virtue of any . . . policy . . . ; and if
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> (2) the plaintiff has . . . paid . . . the amount due under such obligation into the registry of the court, there to abide the judgment of the court . . . .

28 U.S.C. § 1335 (1965).

[2] *See, e.g.*, 2 W. BARRON & A. HOLTZOFF, FEDERAL PRACTICE AND PROCEDURE § 551 (1961, Supp. 1967).

[3] 386 U.S. 523 (1967).

[4] The policy was a standard automobile liability insurance contract in

United States District Court for the District of Oregon. State Farm asked that all persons who were suing or might sue the assured, i.e., persons with potential claims to the proceeds of assured's insurance policy, be enjoined from any action in any other court against both the *assured* and insurer, and that such actions be confined to that district court. When the injunction was granted, it appeared that State Farm, which could not be made a party to any state court suit until a judgment against the assured might be had, would be able to force all persons suing the assured into a federal district court of its own choosing both for trial on liability and for apportionment of the insurance policy proceeds.[5]

The Ninth Circuit Court of Appeals construed the statutory language, "claimants . . . [who] are claiming or may claim," to mean only persons with judgments against the assured who would then be entitled under the insurance contract to sue the insurer and held that interpleader did not lie against potential claimants to the insurance fund.[6] On appeal to the Supreme Court, it was held that the words "may claim" do permit the insurer to interplead potential claimants to the insurance proceeds.[7] But it was further held that the scope of interpleader should be limited to proration of the

which State Farm promised to defend the assured in any action against him arising out of an automobile accident. State Farm was required under the contract to pay only if the assured were found liable for the accident or upon settlement. Under California law and the contract an injured party could not maintain a direct action against the insurance company until a final judgment against the assured was reached. 386 U.S. at 539.

[5] Interpleader is a procedural device, arising out of equity, in which a stakeholder asks the court to determine the rights of parties with conflicting claims that equal or exceed the amount of a fund in the stakeholder's possession. The classic example of an interpleader is one who has found a treasure trove to which he has no right and whom is being sued or threatened by several parties claiming the money. The interpleader pays the money into court and asks the court to bring in the parties and adjudicate their rights. Haynes v. Felder, 239 F.2d 868 (5th Cir. 1957). The Federal Interpleader Act was passed primarily to make this device available in the situation where there are claimants in several states and no state process would be sufficient to bring all the parties into a single forum. *See generally* Chafee, *Interpleader in the United States Courts*, 41 YALE L.J. 1134 (1932); Chafee, *The Federal Interpleader Act of 1936*, 45 YALE L.J. 1161-67 (1936); Chafee, *Federal Interpleader Since the Act of 1936*, 49 YALE L.J. 377, 414-17 (1940).

[6] Tashire v. State Farm Fire & Cas. Co., 363 F.2d 7 (9th Cir. 1966). The theory of the Ninth Circuit was that since the injured parties had no direct action against the insurance company until after judgment, they could not be "claimants" against the insurance company.

[7] 386 U.S. at 533.

insurance proceeds.[8] Under this construction, the Act amounts to a device for impounding insurance funds for eventual proration among parties successful in securing judgments on liability in whatever courts they chose to bring their actions.

In addition, the Supreme Court raised, on its own motion,[9] the question of the use of minimal diversity[10] in the Act and held that it is consistent with the grant of federal jurisdiction in article III of the Constitution "to controversies . . . between citizens of different states . . . "[11] This question was left in the wake of *Strawbridge v. Curtiss*,[12] the famous case that laid down the rule of complete diversity. In *Strawbridge* a plaintiff from Massachusetts was not permitted to join a defendant from Massachusetts with a defendant from Vermont. In holding that jurisdiction would not lie unless every party to the suit could sue in diversity every party aligned against him, the Court seemed to construe only the general diversity statute. Nevertheless, the similarity of the statutory language "or the suit is between the citizen of a state where the suit is brought, and a citizen of another state . . . "[13] to the word-

[8] *Id.* at 537.

[9] Even if an issue of the court's jurisdiction is not argued, the Supreme Court may still raise it. This procedure was followed in Treinies v. Sunshine Mining Co., 308 U.S. 66 (1939) where the Court considered the constitutionality of the Interpleader Act of 1936 and held that if claimants were from different states and the interpleader was from the same state as one of the claimants, there was still complete diversity because the interpleader was not a real party in interest.

[10] The Act grants jurisdiction where there is minimal diversity between claimants regardless of the citizenship of the interpleader. Where all the claimants to a fund are from state A and the stakeholder is in state B, the Act is not available for lack of diversity among the claimants, but the stakeholder in state B can interplead through FED. R. CIV. P. 22 because there is complete diversity between the claimants and the stakeholder. If claimants are citizens of states A and B and the stakeholder is a citizen of state C, there is complete diversity *and* there are claimants of diverse citizenship, but only under the Act can the stakeholder get service of process on all claimants. Under rule interpleader, service of process is limited to the state where the action is brought. FED. R. CIV. P. 4(f). 28 U.S.C. § 2361 (1965) gives, on the other hand, nationwide service of process when the Act is used. Where claimants are citizens of states A and B and the stakeholder is a citizen of State A, there is incomplete or minimal diversity, and only the Act is available. This unusual use of minimal diversity to support federal jurisdiction is dramatically illustrated in Haynes v. Felder 239 F.2d 868 (5th Cir. 1957), where a stakeholder from Texas was allowed to interplead one claimant from Texas along with a rival group of persons with a joint claim, of whom three were from Texas and one was from Tennessee.

[11] U.S. CONST. art III, § 2.

[12] 7 U.S. (3 Cranch) 267 (1806).

[13] Judiciary Act of Sept. 24, 1789, 1 Stat. 78.

ing of Article III gave rise to the question whether the Constitution likewise requires complete diversity.[14] Later cases limited the force of *Strawbridge*,[15] and critics argued that the rule of complete diversity should be applied solely to the general diversity statute.[16] In so holding in *Tashire* the Supreme Court settles the issue and leaves Congress free to expand or contract the use of diversity as long as there is at least minimal diversity.

The construction of the Federal Interpleader Act in *Tashire* presents an ironic situation. The holding allowing expansion of interpleader to potential as well as judgment claimants for proration is at least a technical victory for insurers. But it is actually of much greater benefit to claimants because there is no other device available at present by which claimants can procure proration of insurance funds.[17] The holding limiting the use of interpleader solely to proration denies insurers, however, a great advantage sought from the statute, i.e., to use the statute as a joinder device to bring trials on liability into a single court.[18] It will remain to be

[14] In Shields v. Barrow, 58 U.S. (17 How.) 130, 145 (1855) the Supreme Court indicated that complete diversity might be required by the Constitution.

[15] *E.g.*, Wichita R.R. & Light Co. v. Public Util. Comm'n, 260 U.S. 48 (1922); Supreme Tribe of Ben-Hur v. Cauble, 255 U.S. 356 (1921); Louisville, C. & C. R.R. v. Letson, 43 U.S. (2 How.) 497, 554-56 (1844).

[16] 3 J. MOORE, FEDERAL PRACTICE § 22.09 [1] (2d ed. 1967); Chafee, *Federal Interpleader Since the Act of 1936*, 49 YALE L.J. 377, 393-98 (1940).

[17] The "first-in-time, first-in-right" rule, followed in most states that have decided the question, gives an insurance fund to the first of several claimants to get judgment against the assured. Thus one of several injured parties may not petition the court to have the insurance fund impounded for distribution or require the insurers to settle with all claimants. Alford v. Textile Ins. Co., 248 N.C. 224, 103 S.E.2d 8 (1958); Annot., 70 A.L.R.2d 416 (1960). In Comment, *Pro-Rating Automobile Liability Insurance to Multiple Claimants*, 32 U. CHI. L. REV. 337 (1965) four significant reasons from the opinions for denying proration to plaintiffs are listed:

1. The injured party has no standing to sue an insurer.
2. Proration would result in undue delay for the parties.
3. The insurer should not be burdened with duty to judge the settlement value of all possible claims.
4. If an insurer is not free to settle as it will, it might result in higher judgments for which the insurer might later be liable to the assured for failure to settle in good faith.

For suggested solutions to the problems in this complex area see Keeton, *Preferential Settlement of Liability-Insurance Claims*, 70 HARV. L. REV. 27 (1956).

[18] In *Tashire* the District Court not only required that trials on liability against State Farm be tried in Oregon, but later broadened the injunction to require that all suits against the bus line and bus driver, citizens of California, *also* be tried in Oregon. For a dramatic report on the reaction this kind of tactical move can have on plaintiffs, see Travelers Indem. Co. v. Greyhound Lines Inc., 260 F. Supp. 530 (W.D. La. 1966).

seen whether the advantages to insurers of the right to interplead potential claimants will be sufficient to motivate insurers so to use the Act and thereby make the device of proration available to all claimants.

It has always been held that once two or more injured parties obtained judgments against an assured in excess of policy limits, the insurer could interplead them to prorate the fund.[19] This procedure has several advantages to the insurer. It relieves him of the need to go into several courts to defend against several judgment creditors racing for execution. It also eliminates the possibility of liability in excess of the policy limits because the insurer is absolved of responsibility for distribution of the fund.[20] Finally, other claimants to the fund are cut off.[21] Although the first-in-time rule would usually protect the insurer after the fund is exhausted, it has been suggested by at least one court that if an insurer exhausted funds in a state that applies the first-in-time rule, it might still be held liable for failure to apportion funds equitably between the injured parties in a state that does not recognize that rule.[22]

Although two early cases, decided before the words "may claim" were written into the Interpleader Act in 1948, limited the use of interpleader to injunctions against parties that had obtained judgments on liability in other courts,[23] later decisions permitted the insurer to interplead all claimants whether or not any judgment had been reached.[24] In upholding this construction of the 1948 Act, the Supreme Court in *Tashire* noted that it would, by negating the first-

[19] *E.g.*, Pan American Fire & Cas. Co. v. Revere, 188 F. Supp. 474, 482 (E.D. La. 1960) *See also,* Klaber v. Maryland Cas. Co., 69 F.2d 934 (8th Cir. 1934) (implying this possibility under 1926 Act).

[20] Pan American Fire & Cas. Co. v. Revere, 188 F. Supp. 474 (E.D. La. 1960).

[21] Burchfield v. Bevans, 242 F.2d 239 (10th Cir. 1957).

[22] Underwriters at Lloyd's v. Nichols, 363 F.2d 357 (8th Cir. 1966).

[23] Klaber v. Maryland Cas. Co., 69 F.2d 934 (8th Cir 1934); American Indem. Co. v. Hale, 71 F. Supp. 529 (W.D. Mo. 1947).

[24] Underwriters at Lloyd's v. Nichols, 363 F.2d 357 (8th Cir. 1966); Pacific Indem. Co. v. Marceaux, 263 F. Supp. 892 (W.D. La. 1966); Travelers Indem. Co. v. Greyhound Lines, Inc., 260 F. Supp. 530 (W.D. La. 1966); Commercial Union Ins. Co. v. Adams, 231 F. Supp. 860 (S.D. Ind. 1964); Pan American Fire & Cas. Co. v. Revere, 188 F. Supp. 474 (E.D. La. 1960). *But cf.* Burchfield v. Bevans, 242 F.2d 239 (10th Cir. 1957) (applying state law); National Cas. Co. v. Insurance Co. of North America, 230 F. Supp. 617 (N.D. Ohio 1964) (rule interpleader). For state cases allowing interpleader see Century Indem. Co. v. Kofsky, 115 Conn. 193, 161 A. 101 (1932); Underwriters for Lloyds v. Jones, 261 S.W.2d 686 (Ky. 1953); Fidelity & Cas. Co. v. LePage, 105 N.H. 327, 200 A.2d 12 (1964).

in-time rule, eliminate the motivation for a race to judgment on the issues of liability and therefore allow an insurer a more orderly defense.[25] Implicit in the decision, however, is the idea that since proration allows an equitable division of funds that is otherwise unavailable, it is hoped that public-spirited insurers will often use it.[26]

Nevertheless, the second holding in *Tashire,* limiting the use of the Act to proration alone, may discourage insurers from using the Act. Probably the real motive behind the increased use of the Act by insurers has been a desire to sweep into a single court all litigation arising out of an accident, including the issues of liability.[27] That this use of interpleader as a bill of peace could also be advantageous for claimants is illustrated by the recent case of *Commercial Union Ins. Co. v. Adams*[28] in which an insurer interpleaded seventy persons of diverse citizenship who were injured in a gas explosion. In granting an injunction against all trials on liability in any state or other federal court, the district court said it was "essential that the claims be determined by the same trial of facts . . . in order to minimize the disparity that would otherwise result" in the later proration of claims.[29]

Under the facts in *Tashire,* however, it was obviously unfair to the claimants to force them into a district court in another state for trials on liability, and one may suspect that this was a tactical move largely designed to pressure claimants into unfavorable settlements.[30] The opinion also points out that the claimants in *Tashire* had joined several defendants and it would be especially anomalous to allow a party with a relatively minor stake in a case to choose the forum for all litigants.[31] Federal courts are, in addition, properly reluctant to deprive claimants of their choice of courts or to re-

[25] 386 U.S. at 533.
[26] *Id.*
[27] See recent cases cited *supra* note 22.
[28] 231 F. Supp. 860 (S.D. Ind. 1964).
[29] *Id.* at 867.
[30] 386 U.S. at 534. This could be cured, however, by change of venue under 28 U.S.C. 1404(a) (1964).
[31] In *Tashire* the suits against the bus line and bus driver were more important than those against the truck driver. Assuming that the truck driver was insolvent, the most that claimant could hope to collect would be 20,000 dollars on the policy. Suits against the other defendants involved large sums as they were financially responsible. See also Travelers Indem. Co. v. Greyhound Lines, Inc., 260 F. Supp. 530 (W.D. La. 1966) where relief similar to that in *Tashire* was given for similar reasons.

move litigation from state courts unless a statute clearly so requires.[32]

The Supreme Court was undoubtedly correct in its construction of the Act. Even though the use of interpleader to effect proration among all claimants will result in delay before any successful claimant can get execution against an insurer, and even though a claimant will have to go into a second court to collect, the benefits of an equitable distribution will inure to all claimants and outweigh the procedural disadvantages. This is the only effective device at present to achieve proration, and it might be desirable for Congress to extend the provisions of the Act to allow an insurer to bring in the underlying litigation in appropriate cases,[33] since this would in turn encourage insurers to interplead all claimants. But the better solution might be other legislation, based on minimal diversity,[34] to allow a claimant to demand proration, leaving injured parties free to bring their actions on liability in whatever courts they choose.

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Constitutional Law—De Facto Segregation—The Courts and Urban Education

In the controversial decision of *Hobsen v. Hansen*,[1] the United States District Court for the District of Columbia[2] found evidence of discrimination in the policies, practices and administration of the School Board and in the continued existence of *de facto* segregation[3] in the school system. The court concluded that the Negro

[32] *E.g.*, National Cas. Co. v. Insurance Co. of North America, 230 F. Supp. 617 (N.D. Ohio 1964). Professor Chaffee argued that interpleader should not extend to trials on liability. Chaffee, *Federal Interpleader Since the Act of 1936*, 49 YALE L.J. 377, 420 (1940).

[33] For example, when most of the claimants are from a single state and the interpleading insurer is the principal fund holder as in Commercial Union Ins. Co. v. Adams, *supra* note 28.

[34] In the words of the Supreme Court, "Art. III poses no obstacle to the legislative extension of federal jurisdiction, founded on diversity, so long as any two adverse parties are not co-citizens." 386 U.S. at 531.

[1] 269 F. Supp. 401 (D.D.C. 1967)

[2] Judge J. Skelly Wright, a member of the United States Court of Appeal for the District of Columbia, was sitting as District Judge in this suit pursuant to 28 U.S.C. § 291 (c) (1964).

[3] *De facto* segregation is a term used interchangeably with racial imbalance denoting a fortuitous separation of races. A predominantly northern and western phenomenon, it occurs when rigid neighborhood pupil assignments are imposed on racially homogeneous neighborhood populations. See