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TOPIC: Interpleader Does Not End Insurer's Liability in a Section 419A(f)(6) Plan

CITATIONS: *In Re Millenium Multiple Employer Welfare Benefit Plan, Debtor*, **-F3rd-,** Nos. 14–6006, 14–6007. (10th Cir. 11/13/2014); Federal Interpleader Act, 28 U.S.C. §§ 1335 and 2361; Federal Bankruptcy Act, 11 U.S.C. 542.

SUMMARY: As part of a Chapter 11 bankruptcy proceeding involving a Section 419A(f)(6) welfare benefit plan, a life insurer whose policies were part of the plan filed an interpleader action involving claims both for life insurance benefits, as well as for claims under state tort law. The bankruptcy court *allowed* the interpleader for claims involving benefits under the plan and benefits under the policies. However, the court *denied* interpleader relief for the state tort law claims.

On appeal, the U.S. District Court and later the U.S Court of Appeals for the Tenth Circuit, both acting *de novo*, reached the same decision. Both held that the interpleader statute requires an identifiable stake plus two or more adverse claims on the same property. These courts further held that the plaintiff's tort claims are general damages claims separate from claims relating to the policies or the premiums that paid for the policies. Thus, the interpleader relieved the insurer of liability on the policies, but not the general state law tort claims.

BACKGROUND: The welfare benefit plan sought bankruptcy court relief after numerous participants sued the plan. In an appeal from a final decision of a bankruptcy court, the U.S. Court of Appeals must independently review the bankruptcy court's decision, applying the same standard as the bankruptcy appellate panel or district court. In doing so, the Court of Appeals treats the bankruptcy appellate panel or district court as a subordinate appellate tribunal whose rulings are not entitled to any deference, although they may be persuasive.

In federal actions, such as bankruptcy, interpleader is a legal process which is governed by federal statutes. In general, a party to a lawsuit utilizes the interpleader statute to pay funds subject to the suit into a court, allowing the court to decide which party is entitled to them. Federal law delineates that a court's power under the interpleader statute is limited to determining which party is entitled to the "identified stake." In an action in interpleader, a court must first determine whether a single "identified stake" is present, and then must determine whether there are two or more *adverse* claims to that stake. It focusses on the substance of the legal claims asserted, and if all the elements are present, then the interpleader jurisdiction is considered proper. As a result, the court can then determine which party is entitled to the "stake."

FACTS: The plaintiffs alleged that agents of the life insurer fraudulently induced them to enter into participation agreements with the Millennium Plan. Specifically, the plaintiffs claimed the insurer's agents told them they could invest tax-deductible amounts in the Millennium Plan and later withdraw their investment tax-free, allegedly in compliance with IRC Section 419A(f)(6).

In 2005, the IRS audited the plaintiffs. As a result of the 2005 audit, the plaintiffs discovered the participation agreements did not comply with IRS regulations. The IRS served the plaintiffs with a Notice of Deficiency, seeking more than $760,000 in taxes and penalties based on their participation in the Millennium Plan.

The plaintiffs, along with others, then sought compensatory and punitive damages from the insurer, other life companies, the agents and finally the Millennium Plan. Faced with the participant law suits, the Millennium Plan filed a Chapter 11 petition with the bankruptcy court and removed the cases to federal court. All were ultimately settled, except for this one.

The plaintiffs had brought suit in Tennessee state court against the Millennium Plan, the life insurer, and others for fraud, negligent misrepresentation, civil conspiracy, violations of the Tennessee Insurance Code, violations of the Tennessee Consumer Protection Act, accounting malpractice, breach of fiduciary duty, unjust enrichment, and the establishment of constructive and resulting trusts.

As part of the bankruptcy proceedings, the Millennium Plan's bankruptcy trustee sued the life insurer, alleging the policies were property of the bankruptcy estate and that the insurer should be ordered to tender the cash value of the policies to the bankruptcy court.

In response, the life insurer sought interpleader relief before the bankruptcy court and the U.S. District Court for the Western District of Oklahoma. According to the insurer, it would be subject to duplicative liability if forced to surrender the cash value of the policies to the Millennium Plan's bankruptcy trustee, while simultaneously being sued elsewhere on the state tort law claims. The insurer therefore sought an order "requiring the [participants] . . . to interplead any and all claims or potential claims they have asserted or may assert against [the] Policies and against [insurer] relating to its obligations under [the] Policies." Additionally, the insurer sought "injunctive relief enjoining the [participants] from initiating or prosecuting any claims or proceedings against [insurer] in any other Court affecting or which may affect those obligations, in order to protect [insurer] from further exposure to potential dual liability and multiple, vexatious litigation."

Ultimately, the bankruptcy court entered an order granting the insurer's request to deposit into the court registry the amount of $6,822,331.44, which was the net cash surrender value of the policies owned by the Millennium Plan, including the policies insuring the plaintiffs. With respect to the plaintiffs' claims against the Millennium Plan, the bankruptcy trustee distributed the assets of the bankruptcy estate, including the $6,822,331.44 cash value of the policies, in accordance with the approved liquidation plan. The plaintiffs therefore received all of the cash value in the policies distribution in full satisfaction of their claims against the Millennium Plan.

The plaintiffs then moved to amend their complaint to dismiss with prejudice the claims against the Millennium Plan asserting all issues against Millennium had been resolved in the bankruptcy proceeding. In addition, the plaintiffs dismissed their claims for constructive trust and unjust enrichment against all the other defendants.

However, the plaintiffs continued to pursue tort claims against the life insurer for common law fraud, negligent misrepresentation, civil conspiracy, insurance fraud (under Tennessee state law), violations of the Tennessee Consumer Protection Act of 1977, and breach of fiduciary duties. In response, the life insurer petitioned the bankruptcy court for a permanent injunction pursuant to 28 U.S.C. § 2361, enjoining the plaintiffs from prosecuting any and all claims against the life insurer.

The insurer argued that it would be exposed to dual liability, unless all claims against it were dismissed. The insurer argued the plaintiffs' state law tort claims, if successful, would compel the insurer to disgorge the equivalent of all the premiums which had been paid into the policies. Thus, they would have to pay *twice* if the suits were successful. They further argued that the interpleader payment of the cash value eliminated any additional liability in the action under state law.

The bankruptcy court granted, in part, the insurer's petition for an injunction against further action. It found that interpleader jurisdiction was appropriate and granted the insurer's request for an injunction with respect to any claims of legal or equitable ownership over the policies and their values. However, even though the insurer had already paid the cash value into the bankruptcy court, it was denied an injunction on the issues of any claims for damages in tort flowing from the plaintiffs' reliance on the insurer's agents and the alleged misrepresentations regarding the Millennium Plan. It held those state law tort claims were beyond the scope of the court's interpleader jurisdiction. The bankruptcy court further dismissed the insurer's interpleader action since the plaintiffs had voluntarily dismissed with prejudice all claims of ownership over the policies.

The insurer appealed the bankruptcy court's decision to the U.S. District Court for the Western District of Oklahoma, arguing the bankruptcy court erred by limiting the scope of its injunction. The district court agreed with the bankruptcy court's analysis and result.

RESULT:

- The appeals court held that the interpleader remedy is not designed to consolidate all claims arising out of a single transaction or occurrence into one action. It cited the U.S. Supreme Court, noting that it has expressly rejected the notion that interpleader functions as "an all-purpose bill of peace."

- The court rejected the insurer's argument that it should be freed from any further proceeding. It held that the insurer failed to meet the requirements of the interpleader statute, since the plaintiffs' tort claims are not adverse to the Millennium Plan's claim to the policies.

- The court held that the remaining tort claims do not assert any ownership interest in the interpleaded policies or the premiums used to purchase those policies. It characterized the insurer's argument as "a thinly-veiled attempt to cap its potential liability at the amount of the premium payments it received from the Millennium Plan." It noted that the bankruptcy court recognized the remaining tort claims as independent fraudulent events which induced the plaintiff to enter into the Millennium Plan. As such these damages would not be limited by the value of or consideration paid for the policies.

RELEVANCE:

- This case stands for the proposition that an insurance company's liability in litigation related to Section 419A(f)(6) plans is not limited to policy values, or premiums paid. Here, even though the insurer paid the full cash value of the policies to the plaintiffs, it still may be liable for further damages. However, it is important to note that further damages are not a certainty. These damages will not necessarily be assessed, and if they are, will only occur if the plaintiffs are successful in subsequent legal proceedings.

- Although the present case involved only the insurer, the plaintiffs *also* sued the agent. If the plaintiffs are successful in the state law court, the agent's potential liability could include not only taxes and penalties, but *also* tort damages. These latter damages could be far in excess of the combined total of tax liabilities, policy cash values and premiums. Also note that this liability could far exceed the amount of any commissions the agent had earned.

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