Avoiding the Flames

Navigating the Dangers of Multiple Claimant-Burning Limit Policy Scenarios

By Jay Barry Harris and Hema P. Mehta

Because defense-within-limits provisions erode indemnification funds for judgments or settlements, it is important to understand their effect.

Insurers have twin duties—providing defense *and* indemnity to their insureds. Insurance policies contain limit of liability clauses that set forth the amount of money that the insurers will pay for indemnity during a certain policy period. In most commercial general liability (CGL) policies, there is no similar cap on defense costs. Without a limit, in theory, defense costs are unlimited.

In the past several years, many insurers have begun including defense-within-limits provisions, including in commercial general liability policies. These policies are sometimes referred to as "eroding," "wasting," "burning," or "exhausting" policies. In these policies, the limits of the applicable coverage are diminished by defense costs and expenses; for each dollar that is spent defending an action, there is one less dollar available for indemnity. Consequently, an insurance policy's stated limit does not always equate to the amount that will be available to settle a claim or to satisfy a judgment. These provisions permit insurers to transfer to insureds the unlimited and unpredictable risk involved in defense costs.

Because these provisions encompass defense costs as well as indemnification for any judgment or settlement, it is important to understand the effect of these provisions. The effect becomes pronounced when there are multiple claims within the same policy period or contested cases for which high defense costs could surpass the limit of liability. When there are multiple claims, insufficient policy limits, and the potential for excess exposure, defense-within-limits provisions play a key role in assessing risk exposure and trial strategy.

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In addition, an insurer's obligation to provide a defense as well as indemnity may terminate upon the exhaustion of the applicable limits, whether through the payment of defense costs or claims to third parties. Under these circumstances, an insured is exposed to both litigation costs and any resulting settlement or judgment.

Defense counsel must be cognizant of the consequences of eroding limits and factor that into an overall defense strategy. Communicating with an insurer and an insured are paramount. Inefficiency and unnecessarily costly defense strategies can lead to additional expenses that deplete the monies available for potential settlement or to satisfy a judgment.

The Validity of Defense-Within-Limits Provisions

Because of the potential effect of these clauses on defense and indemnity, insureds have challenged their validity. In determining the validity of these clauses, courts have focused upon the language of a clause to determine if an insured had sufficient notice of what the defense-within-limits provision sought to include within the policy's limit of liability, especially when the insurer could withdraw its defense of the insured upon exhaustion of the limit. Various examples of provisions that have been upheld are:

- Loss means damages, settlements, judgments, and defense expenses. *California Dairies, Inc. v. RSUI Indemnity Co.*, 2010 U.S. Dist. Lexis 64049 (E.D. Cal., June 25, 2010); *Continental Ins. Co. v. Bangerter*, 37 Cal. App. 4th 69 (Cal. App. 1995).
- Defense expenses include the attorney's fees, legal costs, and expenses spent to defend the underlying suit. *Weber v. Indemnity Insurance Co. of North America*, 345 F. Supp. 2d 1139 (D. Haw. 2004).
- Policy provided that insurer "shall not be obliged… to defend any suit after the applicable limit… has been exhausted by… settlements." *Chicago Ins. Co. v. Hills Ins. Co.*, 2009 U.S. Dist. Lexis 91068, at *5 (N.D. Ind. September 30, 2009).

In *Abstract & Title Guaranty Co., Inc. v. Chicago Ins. Co.*, 489 F.3d 808, 811 (7th Cir. 2007) (Indiana law), the policy provided that there was no duty to defend after the applicable limit had been "exhausted by the payments of judgments, settlements, Damages or Claim Expenses, as applicable." The court held that deposit of funds equal to limit of coverage constituted a payment of claim expenses relieving the insurer of obligation to defend. In *Carolina Casualty Ins. Co. v. Estate of Studer*, 555 F. Supp. 2d 972 (S.D. Ind. 2008), the policy provided that "duty to defend or settle ends when the Liability Coverage Limit of Insurance has been exhausted by payment of judgments or settlement." The court held that because Carolina Casualty unconditionally deposited the maximum amount required by the policy with the court and acknowledged that its liability would fully consume that amount, it had no further contractual duty to assume the costs of defense, including attorney's fees. In *Carolina Casualty Ins. Co. v. Estate of Zinsmaster*, 2007 U.S. Dist. Lexis 81291, at *7 (N.D. Ind. October 30, 2007), under the policy, the duty to defend ended "when the Liability Coverage Limit of Insurance has been exhausted by payment of judgments or settlements." The insurer filed an interpleader action and deposited with the court the maximum amount due under the policy. The court held that Carolina Casualty was absolved of its duty to defend.

In *Country Mutual Ins. Co. v. Anderson*, 628 N.E.2d 499, 80 (Ill. App. 1993) (Illinois law), the court held that when policy limits are exhausted by the payment of a judgment or a settlement, the insurer does not have any further obligation to defend the insured, even if there are actions pending at the time of exhaustion or commenced thereafter.

In addition, in *Maguire v. Ohio Cas. Ins. Co.*, 412 Pa. Super. 59 (1992), the court noted that when the language of a policy is clear that an insurer's duty to defend ends upon exhaustion of policy limits, the insurer has no obligation to defend actions brought against its insured after the insurer has paid its policy limits. Lastly, in *American States Ins. Co. v. Arnold*, 930 S.W.2d 196, 198 (Tex. App. 1996), the court held that under the unambiguous policy language, the duty to defend terminated when the policy limits were exhausted.

However, in *Illinois Union Insurance Co. v. North County Ob-Gyn Medical Group*, S.D. California, 2010 U.S. Dist. Lexis 50095, at *6 (S.D. Cal. May 18, 2010), the policy defined "loss" as "damages, judgments, settlements… awarded by a court, and Costs, Charges, and Expenses incurred by any of the Insureds." The court held that this was insufficient because the insured could not have known that its policy limits would be eroded by defense costs. In *Kocse v. Liberty Mut. Ins. Co.*, 387 A.2d 1259 (N.J. Super. 1978), the court stated that when the policy was not explicit, the insurer could not withdraw from a defense after paying policy limits. The duty to defend continued even after payment of the policy limits. In *American Service Ins. Co. v. China Ocean Shipping Co.*, 932 N.E.2d 8, 12 (Ill. Ct. App. 2010), the policy provided that the insurer "will not defend any suit after it has paid the applicable limit of its liability for the accident which is the basis of the lawsuit." The court held that the insurer did not discharge its duty to defend by filing of interpleader action and deposit of policy limits with the court.

Principally, the courts are concerned with whether the defense-within-limits provision provides an insured with sufficient notice of what the provision seeks to include within the policy's limits of liability. Given the fundamental rule that ambiguous provisions will be construed in favor of the insured, it is essential that the defense-within-limits provision be clear and concise.

Good-Faith Obligations: What Are They?

Insurers are undoubtedly faced with conflicting choices when multiple claimants erode an insured's insurance limits. An insurer may settle fewer than all claims against its insured within a given policy period even though the settlements may deplete or exhaust the entire policy limits. However, the method for resolving these multiple claims becomes an issue.

Courts have adopted various approaches when dealing with multiple claimant-eroding limits insurance scenarios, and an insurer's obligation will vary depending upon the jurisdiction. The following are the most frequent approaches to address this prickly issue:

- Resolve claims on a pro rata basis: available limits are pro-rated based on the severity of the injuries sustained by the claimants.
- Resolve claims on a first-come-first-serve basis: claims are paid in the order that they are adjudicated or settled.

- Resolve as many of the claims as possible irrespective of the severity of the injury.
- Resolve the high-exposure and severe injury cases first, then settle the remaining cases.

The Pro Rata Rule

When there are multiple claims and the policy limits are insufficient to compensate each claimant fully, some courts have applied the pro rata rule. This rule distributes the policy proceeds on a pro rata basis, in accordance with the amount of damage suffered by each claimant. Each claimant's portion of the pro rata recovery is limited by the maximum per person policy limit. *Wondrowitz v. Swenson*, 392 N.W.2d 449 (Wis. Ct. App. 1986); *Allstate v. Ostenson*, 713 P.2d 733, 735 (Wash. 1986); *Christlieb v. Luten*, 633 S.W.2d 139, 140 (Mo. Ct. App. 1982); *State Farm Mut. Auto. Ins. Co. v. Hamilton*, 326 F. Supp. 931 (D.S.C. 1971); *Burchfield v. Bevans*, 242 F.2d 239 (10th Cir. 1957) (Oklahoma law); *Underwriters for Lloyds of London v. Jones*, 261 S.W.2d 686 (Ky.1953); *Century Indemnity Co. v. Kofsky*, 161 A. 101 (Conn. 1932).

With this approach, an insurer may be at a disadvantage because it may have to wait to settle claims until after it receives confirmation that all claims have been submitted or until the statute of limitations has run. Under this approach, defense expenses may increase, reasonable settlement opportunities may pass, claims may be left unresolved, and an insured may be subject to greater excess exposure.

Consequently, interpleader may be the best option to prevent the complete erosion of the policy limits by defense costs. Interpleader is a mechanism by which a party who possesses property or funds can bring together multiple claimants into a single judicial proceeding to have the court decide which claimants are entitled to the funds. Federal Rule of Civil Procedure 22(1) and 28 U.S.C. §§1335 (1976) provide for interpleader. In addition, most states have a rule of civil procedure regarding interpleader.

However, filing an interpleader does not equate to immunizing an insurer against allegations of bad faith. An insured may still argue that interpleader benefits an insurer rather than the insured. Interpleader "merely passes the buck from the insurer to the court and provides little protection for the insured." *Texas Farmers Ins. Co. v. Soriano*, 844 S.W.2d 808, 843(Tex. App. 1992) (dissenting opinion) (citation omitted). In fact, interpleader does not provide a mechanism for limiting an insured's excess exposure and therefore does not extinguish the insured's exposure.

Although bad faith may be alleged, there have been no cases in which bad-faith liability has been found by interpleading policy limits. In fact, a few cases have found that merely interpleading funds does not constitute bad faith. *See Monumental Life Ins. Co. v. Lyons-Neder*, 140 F. Supp. 2d 1265, 1270 (M.D. Ala. 2001) (holding that a bad-faith claim for refusal to pay could not be maintained); *Schwartz v. State Farm Fire & Casualty Co.*, 88 Cal. App. 4th 1329 (Cal. App. 2d Dist. 2001); *Lehto v. Allstate Ins. Co.*, 31 Cal. App. 4th 60 (Cal. App. 2d Dist. 1994) (holding that an insurer's interpleader of policy limits did not constitute bad faith); *Bowers v. State Farm Mut. Auto. Ins. Co.*, 460 So. 2d 1288, 1290 (Ala. 1984) (holding that "absent some evidence to the contrary, the mere filing of an action of interpleader does not amount to evidence of bad faith dealing on its part").

First to Settle Rule

There are two approaches to handling multiple claims that threaten to erode an insured's insurance limits: the first to judgment approach and the first to settlement. The first to judgment approach provides for distribution of policy proceeds based on priority of judgments. *See Sampson v. Cape Indus., Ltd.*, 540 N.E.2d 1143 (Ill. App. Ct. 1989); *Goad v. Fisher*, 257 A. 2d 433 (Md. 1969); and *David v. Bauman*, 196 N.Y.S.2d 746 (N.Y. Sup. Ct. 1960). However, this approach is disfavored by most jurisdictions because it flies in the face of the public policy of encouraging settlements.

The first to settle approach, the favored method, recognizes that insurers can settle any number of multiple claims, even though the settlements would deplete or exhaust the policy limits. *See, e.g., Elliot Co. v. Liberty Mut. Ins. Co.*, 434 F. Supp. 2d 483, 499 (N.D. Ohio 2006) (interpreting Connecticut, Delaware, New York, Ohio, and Pennsylvania law); *Gen. Sec. Nat'l Ins. Co. v. Marsh*, 303 F.Supp.2d 1321, 1325–26 (M.D. Fla. 2004); *Farinas v. Fla. Farm Bureau Gen. Ins. Co.*, 850 So. 2d 555, 561 (Fla. Dist. Ct. App. 4th Dist. 2003); *Texas Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312, 315 (Tex. 1994); *Allstate Ins. Co. v. Evans*, 409 S. E. 2d 273, 274 (Ga. App. 1991); *Cont'l Cas. Ins. Co. v. Peckham*, 895 F.2d 830, 835 (1st Cir. 1990) (Massachusetts law); *Voccio v. Reliance Ins. Co.*, 703 F.2d 1, 2–4 (1st Cir. 1983) (Rhode Island law); *Holtzclaw v. Falco, Inc.*, 355 So. 2d 1279, 1286–87 (La. 1978); *Negron v. Eveready Ins. Co.*, 53 A. D. 2d 815 (N.Y. App. Div. 1976), *appeal dism'd*, 359 N. E. 2d 429 (N.Y. 1976); *Hartford Cas. Ins. Co. v. Dodd*, 416 F. Supp. 1216 (D. Md. 1976); *State Farm Mut. Auto. Ins. Co. v. Murphy*, 348 N.E.2d 491, 493–94 (Ill. App. 2d Dist. 1976); *Harmon v. State Farm Mutual Auto. Ins. Co.*, 232 So. 2d 206, 207–08 (Fla. App. 1970); *Liguori v. Allstate Ins. Co.*, 184 A.2d 12, 16-17 (N.J. Super. 1962); *Alford v. Textile Ins. Co.*, 248 N.C. 224, 103 S.E. 2d 8, 13 (N.C. 1958); and *Bennett v. Conrady*, 180 Kan. 485, 305 P. 2d 823, 827–28 (Kan. 1957).

Defense counsel must be cognizant of the consequences of eroding limits and factor that into an overall defense strategy.

The theory is that if insurers were required to know of and to evaluate all potential claims against their insureds before settling any one claim, insurers would be discouraged from accepting reasonable settlement offers at an early stage of the litigation, which could potentially interfere with the public policy of encouraging settlements. On the other hand, for severely injured claimants, the first to settle approach may seem unfair. Claims involving claimants with severe injuries generally take longer to resolve because more time is needed to evaluate the injuries and to determine the ultimate prognosis and loss. Accordingly, settlements involving minor injuries can deplete a disproportionate amount of the available limits before any reasonable settlement negotiations can commence on a serious injury claim or claims.

The first to settle rule does not require an insurer to settle with the first claimant who presents an offer to settle within the policy limits. However, many courts have held that an insurer must act in good faith, reasonably, and without negligence when entering into settlements that deplete or exhaust the policy limits. Specifically, an insurer has a duty to act in good faith with respect to the disbursement of the proceeds. The facts and the circumstances of each case determine whether an insurer acted in good faith. Factors that a court will examine include "the probability of the insured's liability, the extent of the damages incurred by the claimant, the amount of the policy limits, the adequacy of the insurer's investigation and the openness of communications between the insurer and the insured…." *Smith v. Audubon Insurance Co.*, 679 So. 2d 372, 377 (La. 1996). *See also Maguire v. Ohio Casualty Ins. Co.*, 602 A.2d 893 (Pa. Super. 1992); *Viking Ins. Co. v. Hill*, 787 P.2d 1385, 1390 (Wash. App. 1990). An insurer cannot require an insured to bear the burden of a full investigation from the beginning or abandon its defense of a claim in the middle of a suit under circumstances that are prejudicial to the insured. *See Lumberman's Mut. Cas. Co. v. McCarthy*, 8 A.2d 750, 752 (N.H. 1939). Essentially, the settlements must be fair and reasonable under the relevant circumstances, and insurers must attempt to settle as many claims as possible within the applicable policy limits.

Given the fundamental rule that ambiguous provisions will be construed in favor of the insured, it is essential that the defense-within-limits provision be clear and concise.

Settle More Claims or Settle High-Exposure Claims

In some jurisdictions, an insurer may have to choose between exhausting the policy limits by (1) settling more claims by resolving smaller value claims first, or (2) settling one or more major claims with higher value and potential exposure. Under these circumstances, an insurer is well-advised to investigate all claims fully and determine how best to enter into settlements and limit an insured's exposure to an excess judgment, especially when a wiser settlement approach could reduce or limit an insured's excess exposure. *See DeWalt v. Ohio Cas. Ins. Co.*, 513 F.Supp.2d 287 (E.D. Pa. 2007) (finding that under Pennsylvania law, declining to offer policy limits to one claimant before evaluating claims from other claimants did not constitute bad faith); *General Security National Ins. Co. v. Marsh*, 303 F. Supp. 2d 1321 (M.D. Fla. 2004) (holding that an insurer's settlement in the multiple claimants context where the insurer paid the policy limits to settle a wrongful death claim, which presented a greater risk of excess judgment, leaving a personal injury claim representing less exposure unpaid, was reasonable and in keeping with its good-faith duty); *Levier v. Koppenheffer*, 879 P.2d 40 (Kan. App. 1994) (holding that an insurer acted in bad faith by settling a smaller claim for the policy limits, leaving the insured exposed to a damage claim that exceeded $2 million, where the larger claim could have been settled within the policy limits).

Regardless of the approach, at least one court has concluded that the following should be used as a guide in the multiple claimants-limited insurance contexts: (1) an insurer must investigate all claims fully; (2) an insurer should keep an insured fully informed of all meaningful developments in the case, including defense expenditures, the amount of coverage remaining, potential exposure, and status of settlement negotiations; (3) the available policy limits should not be exhausted without attempting to settle as many claims as possible; and (4) an insurer should work to eliminate or to minimize potential excess judgments against an insured through fair and reasonable settlements. *See Farinas v. Florida Farm Bureau General Ins. Co., 850 So.2d 555* (Fla. App. 2003) (insurer should attempt to settle as many claims as possible within the available policy limits, but avoid indiscriminately settling claims where the insured's excess liability might be minimized through settlement). *see also Safeco Ins. Co. v. Ritz*, 2006 U.S. Dist. Lexis 1604 (E.D. Ky. January 12, 2006); *General Security National Ins. Co. v. Marsh*, 303 F. Supp. 2d 1321 (M.D. Fla. 2004).

In addition, defense counsel should notify an insured and an insurer of the preliminary liability analysis and budget of potential costs as soon as possible. If defense counsel concludes that potential defense costs will severely diminish or exhaust the policy limits, the insured and the insurer must be notified immediately.

Further, if defense attorneys may normally be inclined to act aggressively early on in a case, especially during discovery, they must be aware that every dollar spent on a defense ultimately restricts negotiating power and will decrease the amount available to satisfy a settlement or a judgment. An insured may also put greater pressure on a defense attorney to negotiate an early settlement. This attitude may be different from the norm, where an insured urges a vigorous defense. On the other hand, even when the eroding limits are at stake, an insured may want to vigorously defend based on liability or a fear of appearing weak, which would potentially result in opening the door to other frivolous claims. Regardless, a defense attorney must keep an insured and an insurer informed of the suggested litigation strategy and its potential effect on both the defense of a case and on the available indemnity limits.

Notifying an Insured Is Paramount

An insurer's communication with an insured is always important. However, in situations involving multiple claims and a defense-within-limits provision, communication by an insurer to an insured becomes essential. Because defense-within-limits provisions defense-related costs erode or reduce available coverage, an insured is potentially prejudiced every time his or her appointed counsel acts, since every dollar spent by an insurer on a defense reduces the available coverage. In these cases, an insurer must advise an insured, in writing, that (1) there are conflicting interests; (2) there is a potential that the claims may exceed the policy limits; (3) it will make every attempt to minimize exposure as quickly as possible; (4) it will keep the insured apprised of defense expenditures and the amount of remaining coverage and fully abreast of all settlement demands and offers and meaningful developments in the negotiations; and (5) the insured has an opportunity and right to retain personal counsel and has the opportunity to voice objections to the insurer's evaluations or strategy. This approach will also afford an insured an opportunity to be involved in settlement negotiations and to contribute toward settlement to protect against excess exposure.

Insureds have alleged negligence, breach of contract, and bad faith when an insurer failed to notify the insured of settlement demands in excess of the policy limits, thereby exposing the insured to a potential excess judgment. *See Levier v. Koppenheffer*, 879 P.2d 40, 45 (Kan. App. 1994).

Excess Coverage: Key Issues and Concerns

For excess insurance purposes, a key issue is whether a primary policy with a defense-within-limits clause exhausts a primary policy upon payment of defense costs. If there is an umbrella or form following excess policy, the payment of defense costs may exhaust the primary policy and accelerate the excess insurer's potential obligations. *Coleman Co. v. California Union Ins. Co.*, 960 F.2d 1529, 1530–37 (10th Cir. 1992) (Kansas law). On the other hand, if there is a true excess policy, the payment of defense costs may not exhaust the primary policy. In *Harnischfeger Corp. v. Harbor Ins. Co.*, 927 F.2d 974, 974-77 (7th Cir. 1991) (Wisconsin law), the court noted that indemnity would exhaust the primary policy, not defense expenses. Specifically, the court stated, "the insurance business underlying limits are understood to mean sums paid to claimants, and not the insured's out-of-pocket expenses."

An even more perplexing issue could arise when one claim is covered by the primary and excess policy but the other is only covered by the primary policy. At first glance, an excess insurer may take the position that resolving the claim that is not covered has no effect on its duty to indemnify. However, at least one court, the Fifth Circuit, has held that settling an uncovered claim affects the excess carrier's obligation to indemnify.

In *Indemnity Insurance Company of North America, et al. v. W&T Offshore, Inc.*, 756 F.3d 347 (5th Cir. 2014), W&T Offshore (W&T), an energy exploration and development company, sustained significant damage to its operations as a result of Hurricane Ike. Anticipating that W&T would seek recovery for its removal of debris (ROD) expenses under its umbrella/excess insurance policies (umbrella policies), the four umbrella insurers underwriters (underwriters) sought a declaratory judgment that they were not liable for W&T's ROD damages. In their motion for summary judgment, the underwriters argued that the umbrella policies only took effect if W&T's underlying/ primary insurance was exhausted by claims that would be covered by the umbrella policies. Because W&T's underlying insurance was admittedly exhausted by claims not covered by the umbrella policies, the insurers argued that they had no liability. In its cross-motion for summary judgment, W&T argued that the umbrella policies took effect once all the underlying insurance was exhausted, regardless of how that exhaustion occurred.

The Fifth Circuit granted W&T's motion for summary judgment. The court found that nothing in the text of the coverage provision or the definition of the "retained limit" specified how the limit of the underlying policies must be reached or what would happen if the retained limit was exhausted by non-covered claims. Specifically, the insuring agreement provided as follows:

> **INSURING AGREEMENTS**
> **I. COVERAGE**
> We will pay on behalf of the Insured those sums in excess of the Retained limit that the Insured becomes legally obligated to pay by reason of liability imposed by law or assumed by the Insured under an Insured Contract because of Bodily Injury, Property Damage, Personal Injury or Advertising Injury that takes place during the Policy Period and is caused by an Occurrence happening anywhere in the world. The amount we will pay for damages is limited as described in INSURING AGREEMENT III, LIMITS OF INSURANCE.

Further, "Section III—Limits of Insurance" outlines "the most [that the umbrella policies] will pay" under various scenarios. The limits of insurance did not indicate the breadth of coverage or requirements for exhausting the retained limit. Moreover, it did not state that the retained limit referred exclusively to sums covered by the umbrella policies. The court noted that the plain text of the coverage provision stated that the umbrella policies would cover any damages in excess of the retained limit that were covered by the contract.

Defense counsel should notify an insured and an insurer of the preliminary liability analysis and budget of potential costs as soon as possible.

The court concluded that the umbrella policies provided coverage in four ways. First, if the retained limit was met, the umbrella policies would pay sums for covered damages in excess to that limit. Second, if the underlying policies were reduced by claims covered under the policy, the umbrella policies would pay sums, not in excess of the retained limit, but in excess of the reduced limits of the underlying policies. Third, if the underlying policies became exhausted by covered claims, the umbrella policies would act as the underlying insurers and had the obligation to defend against covered claims. And finally, if the umbrella policies provided the only coverage, they again must act as the underlying insurers and must defend against covered claims.

Consequently, if an excess policy does not delineate how the primary policy must be exhausted, under the insuring agreement, limits of insurance, or elsewhere, the excess policy would apply when the primary policy became exhausted, regardless of how the primary policy became exhausted.

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Practice Tips

While properly handling claims involving multiple claimants and a defense-within-limits clause varies depending on the jurisdiction, there are some general practical considerations.

Good-faith obligations owed by an insurer with a defense-within-limits clause require an insurer to do the following:

- Advise an insured of any conflicting interests.
- Advise that there is a potential that the claims may exceed the policy limits.
- Make every attempt to minimize exposure as quickly as possible and avoid unnecessary and unreasonable defense costs.
- Keep an insured informed of defense costs as they accumulate and the amount of remaining coverage and fully abreast of all settlement demands and offers and meaningful developments in the negotiations.
- Afford an insured an opportunity to be involved in settlement negotiations and to contribute toward settlement to protect against excess exposure.
- Advise an insured that the insured has the opportunity and right to retain personal counsel and has the opportunity to voice objections with the insurer's evaluations or strategy.
- Make every attempt to settle as early as possible.

To avoid a potential bad-faith action, an insurer should do the following:

- Identify all claimants and potential claimants.
- Fully investigate all claims and determine how best to enter into settlements and limit an insured's exposure to an excess judgment, especially when a wiser settlement approach could reduce or limit the insured excess exposure.
- Demonstrate, in writing, a full and complete investigation and evaluation of all claims. This will demonstrate that any settlements reached were fair and well-reasoned and will show an insurer made good-faith efforts to settle and to minimize uninsured exposure to its insured.
- Attempt to settle as many claims as possible within the available policy limits—settlements must be fair and reasonable under the relevant circumstances and the insurer must work to eliminate or minimize potential excess judgments against the insured through fair and reasonable settlements.

Defense counsel must

- Be cognizant of the consequences of eroding limits, specifically that every dollar spent on a defense ultimately restricts negotiating power and will decrease the amount available to satisfy a settlement or judgment, and factor this into an overall defense strategy.
- Communicate with an insurer and an insured.
- As soon as possible, provide an evaluation, recommendation, and budget regarding the settlement potential of all claims, including all pending demands and lawsuits. If defense counsel concludes that potential defense costs will severely diminish or exhaust the policy limits, an insured and an insurer must be notified immediately.
- Avoid inefficiency and unnecessarily costly defense strategies that could lead to additional expenses that deplete the monies available for potential settlement or to satisfy a judgment.
- If efforts at a global settlement are unsuccessful, consider filing an interpleader action to prevent the complete erosion of the policy limits by defense costs. FTD