

Ending Duty to Defend


By Thomas R. Newman

When dealing with multiple claims and insufficient limits to cover an insured's total potential exposure, the insurer must be extremely cautious in settling less than all of the claims.

Exhausting Policy Limits When Settling Less than All Lawsuits



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A liability insurer's duty to defend its insured against covered lawsuits seeking damages is purely contractual. There is no common law duty to defend. *All-Star Ins. Corp. v. Steel Bar, Inc.*, 324 F. Supp. 160, 163 (N.D. Ind. 1971).

Accordingly, courts will look to the language of the policy at issue to determine whether an insurer has a defense obligation and, if so, the extent of that obligation.

Since 1986 the present Insurance Services Office (ISO) standard form Commercial General Liability policy (CGL) expressly states that

[o]ur right and duty to defend ends when we have used up the applicable limit of insurance in the payment of judgments or settlements under Coverages A [bodily injury and property damage] or B [personal injury and advertising liability] or medical expenses under Coverage C [Form CG 00 01 12 07].

The ISO 1966 and 1973 CGL policies achieved the same result by using somewhat different wording "the company shall not be obligated to pay any claim or judgment or to defend any suit after the applicable limit of the company's liability has been exhausted by the payment of judgments or settlements." Form GL 00 02 01 73.

The previous ISO wording made the underwriting intent clear and unambiguous: an insurer does not have a duty to defend after paying judgments or settlements that exhaust the policy limits. *See, e.g., American States Ins. Co. v. Arnold*, 930 S.W.2d 196, 201 (Tex. App. 1996). But several important issues remained for the courts to weigh in on.

Is an insurer's duty to defend terminated by settlements that, while exhausting the applicable policy limits, do not settle all outstanding lawsuits, or claims within a lawsuit, against the insured? May an insurer terminate its duty to defend by paying its policy limits to get one insured out of an action, to the detriment of another insured who remains in the action?

Must an insurer wait until all potential claimants have filed all potential claims against one or more insureds before settling with a particular claimant?

Would a non-settling claimant have a cause for complaint because a settlement

would deplete or exhaust coverage otherwise available for his or her injuries?

What constitutes an insurer's good faith when it settles some but not all of the lawsuits or claims against the insured?

"First in Time, First in Right"

When multiple claimants bring lawsuits against one or more insured defendants seeking damages for bodily injuries or death arising from a single occurrence and, based on a reasonable evaluation, the policy limits are plainly insufficient to cover the insured's total potential exposure, courts generally apply the rule "first in time, first in right." *Voccio v. Reliance Ins. Cos.*, 703 F.2d 1, 3 (1st Cir. 1983). This principle "applies regardless of whether the priority is by way of judgment or by way of settlement." *World Trade Ctr. Props. LLC v. Certain Underwriters at Lloyd's of London*, 650 F.3d 145, 151 (2d Cir. 2011); *Allstate Ins. Co. v. Russell*, 13 A.D.3d 617, 788 N.Y.S.2d 401, 402 (N.Y. App. Div. 2004); *Castoreno v. Western Indemnity Co.*, 213 Kan. 103, 110, 515 P.2d 789, 794 (Kan. 1973).

A liability insurer "has discretion to settle whenever and with whomever it chooses, provided it does not act in bad faith." *World Trade Ctr. Props. LLC v. Certain Underwriters at Lloyd's of London*, 650 F.3d 145, 151 (2d Cir. 2011); *Allstate Ins. Co. v. Russell*, 13 A.D.3d 617 (N.Y. App. Div. 2004). Unless someone alleges bad faith with respect to settlement negotiations, an insurer can agree to a settlement that will release some but not all of the insureds. *Anglo-American Ins. Co. v. Molin*, 670 A.2d 194, 198 (Pa. Commw. Ct. 1995). The insurer "has no duty to pay out claims ratably and/or consolidate them." *Allstate Ins. Co. v. Russell*, 13 A.D.3d 617 (N.Y. App. Div. 2004). It can settle less than all claims even if a settlement exhausts policy limits so that the insured and other claimants are left without coverage under the policy. *Liquori v. Allstate Ins. Co.*, 76 N.J. Super. 204, 208, 184 A.2d 12, 17 (N.J. Super. Ct.

1962). When an insurer “has paid the full monetary limits set forth in the policy, its duties under the contract of insurance cease.” *Boris v. Flaherty*, 242 A.D.2d 9, 12, 672 N.Y.S.2d 177, 180 (N.Y. App. Div. 1998).

When a covered occurrence gives rise to multiple claims, the insurer does not need to wait until all of the claimants have filed all potential claims against its insureds

cannot obtain a global settlement and settles less than all of the claims, it would face a bad faith lawsuit only if it did not undertake the settlement in good faith.

The strong public policy encouraging speedy settlements supports the “first in time, first in right” rule. *Harmon v. State Farm Mut. Auto. Ins. Co.*, 232 So. 2d 206, 208 (Fla. Dist. Ct. App. 1970); *Richard v. Southern Farm Bureau Cas. Ins. Co.*, 212 So. 2d 471, 479 (La. Ct. App. 1968), *aff’d*, 223 So. 2d 858 (La. 1969). If insurers were required to know of and evaluate all potential claims against their insureds before settling any individual claim, then insurers could only settle if they were willing to assume the risk that the remaining coverage would not be sufficient to cover a future claim arising from the same occurrence. Such a rule would discourage insurers from accepting reasonable settlement offers at an early litigation stage. As the Texas Supreme Court wrote,

when faced with a settlement demand arising out of multiple claims and inadequate proceeds, an insurer may enter into a reasonable settlement with one of the several claimants even though such settlement exhausts or diminishes the proceeds available to satisfy other claims. Such an approach, we believe, promotes settlement of lawsuits and encourages claimants to make their claims promptly. *Texas Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312 (Tex. 1994).

As a general rule, non-settling third-party claimants do not have grounds for complaining that a settlement depleted or exhausted policy proceeds that otherwise would have been available to them and left them without recourse against the insurer. An insurer’s duty “is to its insured. It owes no correlative contractual duty to third-party claimants.” *Peckham v. Continental Cas. Ins. Co.*, 895 F.2d 830, 835 (1st Cir. 1990). As the Supreme Court of Kansas explained:

The insurer certainly could not be enjoined by plaintiffs from settling with other persons injured in the same accident and thereby exhausting the fund to the exclusion of plaintiffs.... If we were to follow plaintiffs’ theory it could lead us to a result where one injured person could enjoin the compromise and settlement by an insurer of the claim of

another injured person in the same accident. This would be in direct conflict with what has just been stated. The better rule is that where, as here, an insurer settles two of five claims arising out of an automobile accident, such settlement is not contrary to public policy as against the remaining three claimants who reduced their claims to judgment. *Bennett v. Conrady*, 180 Kan. 485, 491–92, 305 P.2d 823, 828 (Kan. 1957).

Similarly, a liability insurer may settle claims against one insured under a particular policy even if the settlement exhausts the policy proceeds to the detriment of another named insured or an additional insured. An insurer is “free to settle suits against one of its insureds without being hindered by potential liability to co-insured parties who have not yet been sued.” *Travelers Indem. Co. v. Citgo Petroleum Corp.*, 166 F.3d 761, 764–65 (5th Cir. 1999) (interpreting Texas law).

The New York Supreme Court, Appellate Division took a contrary position, followed by a minority of courts, without passing on the merits, upholding as legally sufficient a complaint alleging that the defendant insurer

attempted to force and coerce the plaintiff to accept an offer of settlement in the amount of \$6,250... combined with an allegation of a threat that if the offer should be rejected by the plaintiff, the defendant would conduct individual settlement negotiations with other claimants and “thereby reduce the amount of money which would have otherwise been available for the payment of any judgment, which the said plaintiff herein might recover against the [insureds].” *Obad v. Allstate Ins. Co.*, 27 A.D.2d 795, 279 N.Y.S.2d 128 (N.Y. App. Div. 1967).

A Texas Court of Appeals was presented with a case in which a primary insurer, having settled up to its policy limits and obtained a release on behalf of its named insured, refused to defend an additional insured in a separate action arising from the same accident. The additional insured’s excess insurer assumed the defense and then sued the primary insurer to recover its costs. The Texas Court of Appeals found that the primary insurer had not breached a duty in obtaining the settlement for its named insured, and its duties to the

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before settling with a particular claimant. *Hartford Casualty Ins. Co. v. Dodd*, 416 F. Supp. 1216, 1219 (D. Md. 1976); *State Farm Mutual Auto Ins. Co. v. Hamilton*, 326 F. Supp. 931, 934 (D. S.C. 1971). As one court explained, “[w]hether multiple claims are to be treated one at a time or collected and evaluated together, is a choice solely within the discretion of the insurer.” *Liquori v. Allstate Ins. Co.*, 184 A.2d 12, 17 (N.J. Super. Ct. 1962).

As long as an insurer does not act in bad faith, it does not need to notify non-settling third-parties of a proposed settlement. *Arrow Exterminators, Inc. v. Zurich American Ins. Co.*, 136 F. Supp. 2d 1340, 1355 (N.D. Ga. 2001). When “a presumptively valid and adequate award has been made to one of several claimants, the fact that the remaining claimants, or any one of them, have not been taken into the confidence of the settling parties falls far short of establishing an adequate ground for equitable relief.” *Liquori v. Allstate Ins. Co.*, 184 A.2d 12, 17 (N.J. Super. Ct. 1962). If an insurer

additional insured terminated when that settlement exhausted the policy limits. *American States Ins. Co. of Texas v. Arnold*, 930 S.W.2d at 202–203.

Good Faith

An insurer has a duty to act in good faith when dispersing the proceeds of a liability insurance policy, and the insurer's "termination of its duty to defend, like all transactions between insurer and insured, requires the insurer to have acted in good faith." *NIA Learning Center, Inc. v. Empire Fire & Marine Ins. Cos.*, 2009 U.S. Dist. Lexis 92991, at *19 (E.D. Pa. 2009). When an insured has surrendered all control over the handling of a claim to the insurer, the insurer assumes "a duty to exercise such control and make such decisions in good faith and with due regard for the interests of the insured." *Boston Old Colony Ins. Co. v. Gutierrez*, 386 So. 2d 783, 785 (Fla. 1980). The duty of good faith requires one of two things of an insurer. An insurer must give "the interest of the insured" consideration "equal to that consideration given its own interest," *Voccio v. Reliance Ins. Cos.*, 703 F.2d 1, 3 (1st Cir. 1983); *Liberty Mut. Ins. Co. v. Davis*, 412 F.2d 475, 483 [5th Cir. 1969]. Or the insurer must "treat the claim as if it were alone liable for the entire amount." *Bell v. Commercial Ins. Co. of Newark*, 280 F.2d 514, 515 (3d Cir. 1960); *Brown v. United States Fid. & Guar. Co.*, 314 F.2d 675, 678 (2d Cir. 1963). When the policy limits are less than an insured's potential exposure, "the insurer cannot put its own interests first, but must negotiate as it would if its liability limits were unbounded." *Peckham v. Continental Cas. Ins. Co.*, 895 F.2d 830, 834–35 (1st Cir. 1990).

In *Peckham*, the court summarized the insurer's obligation in a multiclaim, limited coverage situation as follows:

The insurer has both the right and the duty to exercise its professional judgment in settling, or refusing to settle, such claims—but it must do so mindful of the insured's best interests and in good faith. The insurer's goal should be to try to effect settlement of all or some of the multiple claims so as to relieve its insured of so much of his potential liability as is reasonably possible, considering the paucity of the policy limits.... So long as it acts in good faith, the insurer

is not held to standards of omniscience or perfection; it has leeway to use, and should consistently employ, its honest business judgment.... The carrier, in fine, "will not be held to prophesy."

Peckham, 895 F.2d at 835.

An insurer may not "dump its limits" by settling a claim for more than it is reasonably worth simply to avoid or terminate its duty to defend. *In re East 51st St. Crane Collapse Litigation*, 2010 N.Y. Misc. Lexis 6310, at *10 (Sup. Ct. N.Y. Co. 2010), *aff'd*, 84 A.D.3d 512, 923 N.Y.S.2d 64 (N.Y. App. Div. 2011); *Maguire v. Ohio Cas. Co.*, 412 Pa. Super. 59, 65–66, 602 A.2d 893, 896 (Pa. Super. 1992), *appeal denied*, 532 Pa. 656, 615 A.2d 1312 (Pa. 1992). As one court wrote,

The exercise of good faith prevents an insurer from entering into a dubious release in order to quickly exhaust the limit of its liability to the insured. "An insurer which hastily enters a questionable settlement simply to avoid further defense obligations under the policy clearly is not acting in good faith and may be held liable for damages caused to its insured."

Maguire v. Ohio Cas. Co., 412 Pa. Super. at 65, 602 A.2d at 896. *See also*, *Shuster v. South Broward Hosp. Dist. Physicians' Prof'l Liab. Ins. Trust*, 591 So. 2d 174, 177 (Fla. 1992) ("Clearly, the intent of the parties would not have been to allow the insurer to escape its primary duty to defend and indemnify the insured merely by paying out the full sum of the policy limits in bad faith.").

Illustrative Cases

In *Farinas v. Florida Farm Bureau Gen. Ins. Co.*, 850 So. 2d 555, 561 (Fla. Dist. Ct. App. 2003), Farm Bureau's insured, Copertino, lost control of his car, crossed a median, and hit an oncoming car, causing the deaths of five teenagers and severe injuries to seven others, including a 14-year-old girl who was rendered a quadriplegic. The policy limits were \$100,000 per claim and \$300,000 per accident.

Within two weeks of the accident, Farm Bureau settled for the policy limits with the driver of the other car and in two of the death actions. It then filed a declaratory judgment action against the insured to determine whether it had any further

duty to defend after having paid the policy limits. The remaining claimants intervened and ultimately filed third-party bad-faith actions alleging that Farm Bureau entered into settlements without due regard for the interests of the insured.

While the trial court granted a summary judgment to Farm Bureau concerning all the appellants, the Florida District

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"dump its limits" by settling a claim for more than it is reasonably worth simply to avoid or terminate its duty to defend.

Court of Appeal reversed the decision and remanded the case for a jury trial to decide whether the insurer had met its good-faith duty and had undertaken a reasonable claims settlement strategy. The court stated:

Farm Bureau's good faith duty to the insured requires it to fully investigate all claims arising from a multiple claim accident, keep the insured informed of the claim resolution process, and minimize the magnitude of possible excess judgments against the insured by reasoned claim settlement. This does not mean that Farm Bureau has no discretion in how it elects to settle claims, and may even choose to settle certain claims to the exclusion of others, provided this decision is reasonable and in keeping with its good faith duty.

Id.

The Florida District Court of Appeal held that a jury needed to decide whether Farm Bureau had met its good-faith duty and undertook a reasonable claims settlement strategy.

[T]here are many factual issues for the jury to resolve, including whether Farm Bureau's quick settlement with three of the possible claimants was reasonable, whether Farm Bureau's rejection

of global and other settlement options contemplated the best interests of the insured, whether Farm Bureau adequately investigated the facts of all of the claims, and whether Farm Bureau properly rejected advice of legal counsel and suggested settlement strategies proposed by Farm Bureau employees.

Id.

Even if the insurer knows that it will exhaust its policy limits, it must still conduct a thorough investigation, retaining whatever experts may be necessary.

This is a very questionable decision. The insurer paid its \$300,000 per accident limit to settle three claims against its insured in a case that in the end could have had a verdict potentially far in excess of that limit and the insurer could not have settled a quadriplegic case for the policy's \$100,000 per claim limit.

In *re East 51st St. Crane Collapse Litigation* involved multiple, consolidated wrongful death, personal injury, and property damage claims arising from a construction crane collapse. 2010 N.Y. Misc. Lexis 6310, at *10 (Sup. Ct. N.Y. Co. 2010), *aff'd*, 84 A.D.3d 512, 923 N.Y.S.2d 64 (N.Y. App. Div. 2011). Lincoln, primary insurer of the project's construction manager, Joy, sought to intervene in the action to settle the claim of Rite Aid, a store in the vicinity of the accident that was damaged when the crane collapsed, for \$1,000,000, or to deposit \$1,000,000 with the court. That sum represented the full amount of coverage provided by Lincoln to Joy and to the owner of the property as well as to the developer of the property and the general contractor as additional named insureds. Lincoln also moved for a declaration that upon paying its full policy limits, either in settling Rite Aid's claims or by depositing the limits with the court, Lincoln's obliga-

tion to pay the defense costs of its insured and additional named insureds was completed according to the terms of the applicable insurance policy.

The insured defendants opposed Lincoln's motion, arguing that the proposed settlement with Rite Aid was not in good faith but only undertaken to relieve Lincoln of its obligation to defend the actions against the insureds and additional insureds and that, in any case, neither the settlement, nor a deposit with the court, relieved Lincoln of its continuing obligation to defend.

The court found nothing in the terms of the contract permitting Lincoln to deposit the full amount of its coverage with the court without the consent of the named insured. Rather, the insurance policy clearly predicated extinguishment of Lincoln's obligation to defend on payment by Lincoln of the full amount of the policy coverage solely in satisfaction of a judgment or a settlement. Because the court did not find a New York case directly on point, the court considered cases in other jurisdictions where the courts had allowed insurers to do what Lincoln sought to do, while emphasizing that for the insurer to be relieved of its duty to defend, based on full payment of the insurance proceeds in settlement, the insurer must have acted in "good faith" and "not attempted to 'artificially exhaust' its obligations by tendering its policy during the litigation." *Id.* at *7.

The court found Lincoln's policy language terminating its duty to defend was unambiguous and that

[t]here is no provision that such payment must cover all judgments or settlements in a multi-party litigation, nor can the policy language be construed in that manner. Absent an allegation of bad faith, or a claim that a settlement is unreasonable, an insurer who pays the entire proceeds of its policy in settlement of a claim in multi-party litigation, can be released from the continuing obligation to defend where the policy's language clearly and unambiguously provides for such result.

Id. at *8-*9

The court rejected Lincoln's proposed settlement with Rite-Aid, finding that where a substantial portion of discovery involving questions of liability has yet

to be completed, such a large settlement that would deplete the entire primary insurance at this stage of the litigation without the settlement of even one of the personal injury plaintiffs, is not in the best interests of the insureds, nor the litigation as a whole.

Id. at *11.

Lincoln then proposed another settlement: it would pay its \$1,000,000 policy limit to the estate of a deceased construction worker, who was unmarried and had no children, solely based on the estate's claim for pre-impact terror. The estate had not presented evidence at that point to demonstrate whether and, if so, for how long, the construction worker had suffered pre-impact terror. After the court rejected that proposed settlement as far in excess of amounts awarded in similar cases, Lincoln proposed yet another settlement: the settlement would divide Lincoln's policy limit between Rite Aid (\$450,000), and a severely injured construction worker, Perez (\$550,000), who underwent three separate surgeries to repair multiple fractures and had incurred \$160,000 in medical expenses and a \$189,000 Worker's Compensation lien. This time the court found the settlement was fair and reasonable and made by Lincoln in good faith. It granted Lincoln's application to intervene and declared that on paying the full amount of the settlement, Lincoln was released from its obligation to provide any further defense to the defendants. *Id.* at *15. In a subsequent appeal in the same case, the Appellate Division noted that, "The motion court found no indication that the settlement had been entered into as a means to inappropriately exhaust the policy." Slip op. 7-8 (Feb. 5, 2013).

In *Liberty Mut. Ins. Co. v. Davis*, 412 F.2d 475 (5th Cir. 1969), Liberty's insured driver, Bess, a penniless, itinerant fruit picker, struck the rear end of a car occupied by Mr. and Mrs. Rawls. Bess' car then careened head-on into a car occupied by plaintiffs, Mr. and Mrs. Davis and their three children. The double collision resulted in serious injury to the five Davises and the two Rawlses. It was soon evident to all concerned that the injuries to two Davises alone would exceed Liberty's \$20,000 per accident policy limit, and the Rawls' claim also would exceed \$20,000. The Davises' attorney offered to compromise for \$20,000.

Although Liberty recognized that it would have to pay the policy limit, it refused the offer to compromise for fear that it would be liable to the Rawls if it depleted the entire amount of the insurance proceeds by settling with the Davises. House counsel for Liberty offered

the practical suggestion that all potential claimants involved in the 10 P.M. episode, or their attorneys, be notified that the value of claims will doubtless exceed limits, and that these people be invited to participate jointly in efforts to reach agreement as to disposition of available funds. If agreement cannot be reached after expenditure of reasonable effort, then I can see no present reason why individual claims could not thereafter be disposed of individually on the basis of fair value, first come, first served.

Id. at 478.

Liberty ignored this advice and filed an interpleader action. Meanwhile, state court proceedings resulted in an affirmed default judgment in favor of Mr. and Mrs. Davis for \$48,500 against Bess, which Liberty could have settled for the policy limits, but it did not because of its concern about the Rawlses' claims. Eventually, Liberty paid a garnishment judgment of \$27,526.85, its policy limits, plus interest and expenses. The Davises then obtained an assignment from Bess, who was in prison, of any claim that Bess might have against Liberty for damage to Bess resulting from the company's refusal to settle the Davises' claim. In consideration of this assignment, the Davises released their claim to the unpaid portion of Bess' judgment debt.

When the assignees sued based on a refusal-to-settle claim, Liberty removed the case to the U.S. District Court for the Middle District of Florida. After reviewing all of the evidence, the district court denied the insurer's motion for a directed verdict on the issue of bad faith in the refusal to settle. The jury returned a verdict in favor of the Davises for \$27,593, plus interest, and the court added \$10,000 for attorneys' fees.

The United States Court of Appeals for the Fifth Circuit affirmed the judgment, finding that while, undoubtedly, Liberty's concerns about having to pay more than its policy limits were relevant to the ultimate jury question of bad faith, they did

not, as a matter of law, justify the trial court's directing a verdict for the insurer. It was for the jury to decide whether Liberty's refusal to settle was primarily in its own interests and with too little regard for its insured's interests.

When several claimants are involved, and liability is evident, rejection of a single offer to compromise within policy limits does not necessarily conflict with the interest of the insured. He hopes to see the insurance fund used to compromise as much of his potential liability as possible. Of course, if the fund is needlessly exhausted on one claim, when it might cancel out others as well, the insured suffers from the company's readiness to settle. To put the point another way, even if liability be conceded, plaintiffs will usually settle for less than they would ultimately recover after trial, if only to save time and attorney's fees. Each settlement dollar will thus cancel out more than a dollar's worth of potential liability. Insured defendants will want their policy funds to blot out as large a share of the potential claim against them as possible. It follows that, insofar as the insureds' interest governs, the fund should not be exhausted without an attempt to settle as many claims as possible. But where the insurance proceeds are so slight compared with the totality of claims as to preclude any chance of comprehensive settlement, the insurer's insistence upon such a settlement profits the insured nothing. He would do better to have the leverage of his insurance money applied to at least some of the claims, to the end of reducing his ultimate judgment debt.

Id. at 480-481.

The Fifth Circuit concluded that efforts to achieve a prorated, comprehensive settlement may excuse an insurer's reluctance to settle with less than all of the claimants, but need not do so. The question is for the jury to decide. As this Court put it in *Springer v. Citizens Casualty Company*, 5 Cir. 1957, 246 F.2d 123, 128-129, it is "a question for jury decision whether the insurer had not acted too much for its own protection and with too little regard for the rights of the insured in refusing to settle within the policy limits". [sic] Here, bearing in mind

the existence of multiple claims and the insured's exposure to heavy damages, did the insurer act in good faith in managing the proceeds in a manner reasonably calculated to protect the insured by minimizing his total liability? In many cases, efforts to achieve an overall agreement, even though entailing a refusal to settle immediately with one or more



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parties, will accord with the insurer's duty. In other cases, use of the whole fund to cancel out a single claim will best serve to minimize the defendant's liability. Considerable leeway, of course, must be made for the insurer's honest business judgment, short of mismanagement tantamount to bad faith.

Id. at 481.

Practical Considerations

As shown above, when a liability insurer with a duty to defend deals with multiple claims arising from a single covered occurrence, and a reasonable assessment of the injuries suffered by one or more of the claimants indicates that the total value of the claims will exceed the aggregate policy limits, the insurer must treat the claims as if its policy was unlimited. In practice, this means the following.

First, an insurer must not skimp on the defense that it provides to its insureds. Even if the insurer knows that it will exhaust its policy limits, it must still conduct a thorough investigation, retaining whatever experts may be necessary.

Second, an insurer must provide an insured with experienced defense counsel, qualified to handle the particular type of case, and it must pay the prevailing rate in the community for the counsel's serv-

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ices. It may not minimize its defense costs by seeking out an inexperienced, newly minted lawyer eager for clients who is willing to work for considerably less.

Third, an insurer should not make any settlement offer whatsoever until it has sufficient facts about liability and damages, obtained through discovery or otherwise, to enable it to understand, evaluate, and quantify fairly an insured's exposure and the likelihood of an adverse trial result.

Fourth, if possible, an insurer should defer making any settlement decisions until after all potential claimants have made all potential claims or until after the claimants have filed lawsuits against the insureds. This may not always be possible if an insurer receives a policy limits settlement demand that will not settle everything globally but that the insurer must respond to or else risk a potential bad-faith lawsuit in the event of an excess judgment.

In such a case, an insurer's dilemma is that it

has a duty to settle claims where it receives reasonable offers to do so, although settling may exhaust the policy limit and expose the non-settling insureds to personal liability; yet, by not settling, the insurer may subject itself to greater liability beyond the policy limit—an "excess verdict"—if it loses and is found to have unreasonably refused settlement.

NIA Learning Center, Inc. v. Empire Fire & Marine Ins. Cos., 2009 U.S. Dist. Lexis 92991, at *22 (E.D. Pa. 2009). This is where the "first in time, first in right" rule protects an insurer if, in good faith, it has seriously considered and accepted a reasonable settlement offer.

Fifth, when claims against an insured have a total value that amounts to more than the limits of the policy, and the insured may be personally liable to others, the insurer must inform the insured in writing of its conflicting interests, advise the insured of its rights, and keep it fully abreast of all settlement demands and offers and meaningful developments in the negotiations. *Peckham v. Continental Cas. Ins. Co.*, 895 F.2d at 834. Keeping an insured fully informed of all settlement demands and offers is especially important in cases involving multiple claimants and an insufficient limit "for payment to one claimant, exhausting or unreasonably depleting the available fund, may leave the insured unprotected—or nearly so—in respect to other claimants." *Id.* at 835.

Sixth, an insurer always should consult an insured and the insured's counsel about the priority of claims for settlement purposes. Which claims present the greatest excess exposure? To which claims do an insured and the insured's counsel believe that the available policy limits should be allocated? While an insurer is not bound by an insured's wishes, if it does not follow them, it should have a well-documented, sound reason for its decision.

Seventh, if an insurer achieves less than a global settlement that exhausts the policy limits, the insurer must take steps to transfer control of the defense to the insured. ISO has a standard form endorsement to the CGL coverage part, "New York Changes—Transfer of Duties When a Limit of Insurance Is Used Up," CG 26 21 10 91, that sets out what is expected of each of the parties to facilitate the transfer of the defense to the insured. The steps that an insurer should take, as outlined in this endorsement, are good practices that should be followed throughout the country, not merely in New York. They include:

An insurer must notify the first named insured in writing as soon as practicable that the applicable policy limit has actually been used up to pay a settlement and that

its duty to defend lawsuits seeking damages subject to that limit has ended.

The insurer then should initiate and cooperate in the transfer of control to any appropriate insured of all claims and lawsuits seeking damages that are subject to that limit and that were reported to the insurer before that limit was used up.

The insured must cooperate in the transfer of control of those claims and lawsuits.

The insurer must take such steps as it deems appropriate to avoid a default and continue the defense of lawsuits until an orderly transfer is completed, provided that the insured is cooperating with it in completing the transfer to new defense counsel.

The first named insured and any other insured involved in a lawsuit seeking damages subject to the exhausted limit must arrange for the defense of the lawsuit within a time period agreed to between the insured and the insurer. Without such an agreement, arrangements for the continued defense of the lawsuit should be made as soon as practicable.

In Summary

Although courts have found the policy wording by which an insurer's duty to defend is terminated on exhausting its limits by paying covered claims to be clear and unambiguous, when dealing with multiple claims and insufficient limits to cover an insured's total potential exposure, the insurer must be extremely cautious in settling less than all of the claims. When a defendant's policy limits are insufficient, a plaintiff's attorney always looks out for a potential bad-faith claim in an attempt to take the cap off the policy limits and increase the amount available to compensate the injured plaintiff. The "first in time, first in right" rule will protect an insurer if, in good faith, it has consulted with the insured on the priority for settling claims and has carefully considered and then accepted a reasonable settlement offer. But until such a settlement is reached and its policy limits exhausted, the insurer must not skimp on its investigation or the defense that it provides to the insured even when it knows from the outset that it is only a matter of time before its policy limits are exhausted and that those limits are insufficient to settle all of the claims against its insured.



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