# Lawyer Insights

## Eroding Insurance Policies: As Time Passes, Policyholders Lose Out

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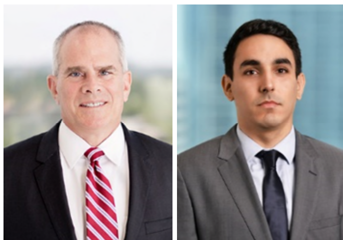

As is well known, on March 15, 2018, Miami-Dade County experienced one of the most horrific incidents in recent memory when a 175-foot-long section of the FIU-Sweetwater University pedestrian bridge collapsed onto Tamiami Trail. The collapse of the 950-ton structure resulted in six deaths, eight injuries, and more than 20 lawsuits. Unfortunately, as litigators for all sides continue to zealously advocate on behalf of their clients and time passes, the amount of insurance available to those who were affected by the horrifying incident will dwindle due to eroding insurance policies. As explained below, eroding insurance policies create a conflict between an insurance carrier and its insured as such policies tend to force an insurance company to make a decision between protecting its insured and offering the available limits as a settlement or taking the risk of defending its insured as available policy limits diminish. The decision made by the insurance carrier can result in severe consequences for all parties involved.

General liability insurance policies usually provide that the insurance carrier bear the duty to provide a defense to its policyholder against the alleged liability. In addition, general liability insurance policies impose the duty to indemnify the insured on the insurance carrier by paying for the damages that arise out of the insured's liability. Typically, the insurance carrier's obligation to defend terminates once the applicable limits of liability provided by the insurance policy are exhausted by satisfaction of a judgment or payment of damages. A majority of liability insurance policies treat defense expenses as separate and apart from the available policy limits. As a result, insurance carriers may be liable to continue their duty to defend and protect the insured from incurring substantial defense costs when the insured is unable to enter into reasonable settlement.

Enter eroding insurance policies.

Over time, insurance carriers have increasingly adopted provisions that provide for eroding limits within insurance policies. Eroding limit provisions, also known as wasting policy limits, defense-within-limits, cannibalizing or self-liquidating limits, reduce the insurance coverage limits available to an insured as certain costs and expenses are incurred during the defense of an insured. For example, eroding policy limits language usually provides that "any amount otherwise payable for damages under this coverage shall be reduced by amounts paid or incurred by the company in defense of any claim or suit against the insured." Effectively, every dollar spent in the defense of an action under an eroding insurance policy is a dollar less that will be available to settle or satisfy a judgment. These provisions are attractive to insurance carriers as it places a ceiling on the company's responsibility for legal fees and defense costs.

However, defending under an eroding insurance policy creates an undeniable conflict. On one hand, the insured has an interest in ensuring that the highest limits of liability are available for potential settlement

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opportunities or to satisfy a potential judgment. On the other hand, the insurance carrier may seek to aggressively defend the case which, in turn, decreases the amounts available to settle and/or satisfy a judgment. This creates a risk to the insured, as the insurance carrier may be unsuccessful in its defense efforts, ultimately leaving its insured with depleted insurance limits.

Accordingly, eroding insurance policies have the potential to create bad faith litigation premised on the insurance carrier's failure to adequately control the cost of defense or its failure to pursue settlement opportunity prior to exhausting the available policy limits.

Several states have enacted laws that regulate and restrict the issuance of eroding insurance policies in an effort to protect policyholders, e.g., NY Comp. Codes R. & Regs. tit. XI Section 71.3 [New York]; Minn. Stat. Ann. Section 60A.08 Subd. 13 [Minnesota]; Or. Rev. Stat. Ann. Secton 742.063 [Oregon]; and Colo. Rev. Stat. Section 10-4-419(3)(a) [Colorado]. However, the state of Florida has yet to enact a similar law. Moreover, Florida courts have not yet decided issues of bad faith in the context of eroding insurance policies, leaving individuals, like the ones involved in FIU litigations, wondering when the thin line into bad faith has been overstepped by an insurance carrier.

Cases from other jurisdictions may be instructive. For instance, in *Pueblo Country Club v. AXA Corp. Solutions Insurance,* 2007 WL 951790 (D. Colo. 28 March 2007), the insured was sued and tendered the defense to its insurance carrier. The insurance policy at issue was an eroding insurance policy with a $1 million limit. After proceeding to trial, a judgment was entered against the employer for more than $1.5 million, which the parties agreed to resolve via a settlement. However, by then, the insurance carrier had advanced more than $300,000 in defense costs and legal fees leaving the insured liable for the remaining amounts. The insured alleged that the insurance carrier had improperly refused to settle when its limits were being eroded by the insurance carrier's own conduct and control of the defense. The court denied the insurance carrier's bid for summary judgment on bad faith allegations holding that the carrier "was aware that attorney fees and costs were reducing the available policy limits and that [the insured] was exposed to a judgment in excess of the available limits, and nevertheless, acted unreasonably with regard to settlement of the case." Similarly, in *Agape Senior Primary Care v. Evanston Insurance*, 2016 WL 4804066 (D.S.C. Sep. 14, 2016), a court in South Carolina held that an insured adequately stated a claim alleging that its insurance carrier acted in bad faith for wasting available limits under an eroding insurance policy where an insurance carrier reassigned defense counsel, which resulted in unnecessary money being spent.

Despite the lack of Florida case law expressly addressing bad faith conduct in the context of eroding insurance policies, there is a vast amount of case law setting forth the principles underlying bad faith litigation, which can certainly be applied to circumstances involving eroding policy limits. Typically, an insurance carrier has a duty to protect its insured from a judgment exceeding the limits of the insurance policy by settling within those limits. See, e.g., *Berges v. Infinity Insurance,* 896 So. 2d 665, 668-69 (Fla. 2004). Thus, similar to *Pueblo Country Club* and *Agape Senior Primary Care*, an insurance carrier should be aware of its actions when defending its insured and the consequences associated with same. No matter how favorable an underlying case may appear, the insurance carrier should avoid leaving its insured exposed to an excess verdict at all costs. This requires that insurance carriers be aware of the available limits as they decrease over time under an eroding insurance policy.

Ultimately, insurance policies should serve the goal of adequately covering an insured for the potential risks that may arise. Eroding insurance policies appear to chip away at whether that coverage is adequate. The longer a claim goes on, and the more expensive a claim becomes, the less insurance an insured has to resolve the claim, deeming the insurance inadequate. Whether it is a minor incident or a major catastrophe

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like the FIU incident, one thing is certain: all parties should seek and take advantage of early settlement opportunities before there is a risk of policy limit depletion. Eroding insurance policies may diminish the available limits of coverage; however, they do not erode the insurance carrier's duty to act in good faith. Insureds should require their insurance carriers to act in good faith in all instances and, in particular, with respect to eroding policies so that the risk of reducing coverage is taken into account in negotiating settlements.

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