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Settlement at Policy Limits and the Duty to Settle: Evidence from Texas

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Abstract

All liability insurance policies have coverage limits, and insurers usually control whether a case is settled or tried. If the insurer rejects a within-limits settlement offer, the insured bears the risk of an above-limits verdict. In response, virtually every state has imposed a "duty to settle" on insurers, which creates incentives for plaintiffs to make at-limits offers and for insurers to accept those offers when expected damages exceed limits. We study the association between the duty to settle, settlement at limits, claim duration, and defense costs using detailed data from Texas for 1988–2005 on closed, commercially insured personal injury claims. We focus principally on medical malpractice suits against physicians, but find consistent evidence for other types of cases. We find strong evidence that the duty to settle affects settlement dynamics. Essentially, all physician-defendant cases that settle at limits are preceded by an at-limits demand. Roughly 20 percent of physician-defendant cases settle at 90–100 percent of policy limits (broad at-limits) and 13 percent settle exactly at limits (exact at-limits). Broad- and exact-at-limits cases close about five months faster than similar "below-limits" cases—a roughly 20 percent shorter time from suit to settlement, controlling for payout and type of harm. Broad- and exact-at-limits cases also have substantially lower defense costs, controlling for case duration and complexity. More broadly, as the payout/limits ratio approaches 1 from below, duration declines (controlling for payout) and defense costs decline (controlling for payout and duration). Payouts above limits are uncommon; when they occur, insurers are the primary payers. Policy limits alone cannot explain these results; most likely they reflect a combination of policy limits and the duty to settle.

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