INSURER’S DUTY TO SETTLE

I. Insurer’s Obligations with Respect to a Settlement Offer

a. What standard applies to insurer’s evaluation of potential settlements?


2. “Negligence” Standard: Insurer’s conduct must be at least equal to what a reasonable person would do in the management of his own affairs. G. A. Stowers Furniture Co. v. Am. Indem. Co., 15 S.W.2d 544, 547 (Tex. Comm’n App. 1929); Yorkshire Ins. Co. v. Seger, 279 S.W.3d 755, 768 (Tex. App. 2007) (“[t]o prove an insurer's negligent failure to settle a claim, i.e., a Stowers claim, the insured must establish that (1) the claim is within the scope of coverage, (2) a demand was made that was within policy limits, and (3) the demand was such that an ordinary prudent insurer would have accepted it, considering the likelihood and degree of the insured's potential exposure to an excess judgment.”); Robinson v. State Farm Fire & Casualty Co., 583 So. 2d 1063, 1067 (Fla. Dist. Ct. App. 5th Dist. 1991) (insurer must settle, if possible, “where a reasonably prudent person, faced with the prospect of paying the total recovery, would do so.”).

3. “Disregard the Policy Limits” Standard (a.k.a “No policy limit” standard): Court considers whether a prudent insurer without policy limits would have accepted the offer. Note: This is the dominant standard. Appleman on Insurance § 23.02[2][d]; see also Transport Ins. Co. v. Post Expesx Co., 138 F.3d 1189, 1192 (7th Cir. 1998) (“Most states, of which Illinois is one, require insurers to devise a litigation strategy (and make settlement offers within the policy limits) as if the insurer bore the full exposure.”).

b. What factors should be considered by insurer in evaluating the reasonableness of a settlement offer?

1. Weight of the evidence against the insured on liability and damages (i.e., whether the injured claimant is likely to succeed or fail in his action against the insured). Wade v. Emcasco Ins. Co., 483 F.3d 657, 667 (10th Cir. 2007) (in deciding whether the insurer's refusal to settle constituted a
breach of its duty to exercise good faith, court should consider the strength of
the injured claimant's case on the issues of liability and damages,
among other factors); McKinley v. Guar. Nat'l Ins. Co., 159 P.3d 884, 888
(Idaho 2007) (same); Travelers Indem. Co. v. Royal Oak Enters., 429 F.
Supp. 2d 1265, 1271 (M.D. Fla. 2004) (finding that insurer could not have
acted negligently or in bad faith by refusing to settle a claim against which
the insured had a valid defense).

2. Whether there is a substantial likelihood that if the case proceeds to trial,
the jury verdict would be higher than the limits of coverage under the
policy. Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co., 236 S.W.3d 765,
776 (Tex. 2007); Highlands Ins. Co. v. Continental Cas. Co., 64 F.3d 514
(9th Cir. 1995); Scottsdale Ins. Co. v. Indian Harbor Ins. Co., 2014 U.S.

3. Comparison of risks involved to insured and insurer (i.e., impact on
relative financial wellbeing of insurer and insured should settlement not be

II. If the Insurer Refuses to Settle on the Basis of No Coverage, Is the Insurer Exposed
to Extra-Contractual Liability?

a. Duty to settle applies only to covered claims. If insurer refuses to accept
settlement offer and it is subsequently determined that there is no coverage,
insurer has no liability. Rocor Int'l v. Nat'l Union Fire Ins. Co., 77 S.W.3d 253,
261 (Tex. 2002) (“to trigger an insurer's statutory duty to reasonably attempt
settlement of a third-party claim against its insured, the policy must cover the
claim”); Cont'l Cas. Co. v. City of Jacksonville, 550 F. Supp. 2d 1312, 1336
(M.D. Fla. 2007) (“a 'bad faith' action for failing to settle a claim does not accrue
until there is a determination of whether the insurer is required to indemnify the
insured.”).

b. Where an insurer rejects settlement offer, but it is subsequently determined
that there is coverage, there is a split in authority:

1. Majority Rule: Insurer’s reasonable but mistaken doubts about coverage
do not excuse failure to settle where the settlement offer is reasonable.
LEXIS 59911, *11-12 (S.D. Tex. June 2, 2011); Eskridge v. Educator &
Executive Insurers, Inc., 677 S.W.2d 887, 890 (Ky. 1984).

i. Rationale for Majority Rule: an insurer that fails to settle does so at
28775 *7 (N.D. Cal. Mar. 5, 2012) (an insurer that fails to settle
based on coverage questions assumes the risk of exposure to a
claim for breach of the duty of good faith and fair dealing in the event coverage is established).

ii. Insurer retains the ability to enter into agreement with the insured reserving its right to assert a defense of non-coverage even if it accepts a settlement offer, such that insurer can seek reimbursement of the settlement payment from the insured. 3-23 Appleman on Insurance § 23.02 [6][c][ii][B].

2. Minority Rule: Insurer’s reasonable but mistaken doubts about coverage may excuse failure to settle even where settlement offer is reasonable. Stevenson v. State Farm Fire & Casualty Co., 257 Ill. App. 3d 179, 186 (Ill. App. Ct. 1st Dist. 1993) (insurer’s refusal to settle within the policy limits did not render it liable to the insured or his assignee because coverage was fairly debatable); Mowry v. Badger State Mut. Casualty Co., 129 Wis. 2d 496, 517 (Wis. 1986) (bad faith in refusing to settle should be found only if there is no fairly debatable coverage question); Fla. Stat. § 624.155 (1)(b); State Farm Mut. Auto. Ins. Co. v. Laforet, 658 So. 2d 55, 63 (Fla. 1995) (in evaluating a claim for insurer’s bad faith refusal to settle, court may consider the substance of the coverage dispute or the weight of legal authority on coverage issues).

III. Settlement Demand Within Policy Limits and Reasonable; Coverage Defenses: Insurer’s Options

a. Policy provides for reimbursement of uncovered defense costs and indemnity payments.

b. Policy does not provide for reimbursement of uncovered defense costs and indemnity payments.


2. Insurer’s options:

i. Notify insured of settlement opportunity and ask it to agree in writing to reimburse insurer if coverage is found not to exist;

ii. If insured refuses (98% likely):

(a) In DJ that hopefully is pending, file motion for an order authorizing insurer to accept settlement offer subject to
reimbursement by insured if coverage is found not to exist; or

(b) Tell the insured to either pay settlement itself or assume defense.

IV. Covered vs. Uncovered Damages: How Should The Insurer Evaluate A Settlement Offer When Only Part Of The Damages Are Covered?

a. Although the majority of jurisdictions hold that coverage issues do not affect the reasonableness of a settlement offer, coverage issues do affect whether the insurer is obligated to accept such an offer. This means that, in determining whether to accept a settlement demand, the insurer need not consider non-covered damages. *PPG Industries, Inc. v. Transamerica Ins. Co.*, 20 Cal. 4th 310 (Cal. 1999) (insurer properly disregarded insured’s exposure to punitive damages in evaluating a settlement demand, because such damages were not covered under the policy).

b. But insurers should be careful to make settlement offers based on a realistic evaluation of the covered exposure, no matter how the offer is packaged or described. Where the covered damages alone realistically could exceed policy limits, an insurer would be well-advised to settle the case, even if the settlement includes non-covered damages. 3-16 Appleman on Insurance § 16.06 [4][b].