
COMMENT

RETHINKING THE COOPERATION CLAUSE IN STANDARD
LIABILITY INSURANCE CONTRACTS

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[†] Editor-in-Chief, *University of Pennsylvania Law Review*, Volume 161; J.D. Candidate, 2013, University of Pennsylvania Law School; B.S., 2007, Northwestern University. I would like to thank Professor Tom Baker for introducing me to the intrigue and consequence of insurance law, and for providing invaluable feedback on this Comment; the editors of the *University of Pennsylvania Law Review*, especially Ben Cheng and Ben Softness, for their tireless work making this a better piece; my family for their unwavering support and encouragement, especially my mother, who predicted and nurtured my love of the law; and my wife, Alli, for everything. All remaining errors are my own.

INTRODUCTION

In 2006, a Texas appellate court reprinted the transcript of a telephone message left by Carol Alvarado for her husband's automobile liability insurance provider following a car accident that he had caused:

Hello. This is Carol Alvarado calling, and I'm calling in response to a letter of March 17, 2003, that I just received that's postmarked April 16, 2003. I'm speaking on behalf of my husband because I'm his guardian. He's had more problems since this accident of April 17th and the reason I'm calling is, as far as we're concerned, you can just go ahead and deny coverage for that accident; that would be fine with us if you just deny coverage with regard to the lawsuit. Just inform the parties that you're denying coverage, send us a copy of the letter, and I mean that's fine. We have—we having nothing that they can—there's nothing that they can do to us by suing us because, well, you know, we're pretty well judgment proof anyway, and my husband is injured. I, myself, have cancer, so we just don't have the resources, the energy to be involved in this at all. I don't have a phone. I can't call you back, so just go ahead and deny coverage with regard to that accident of that day, April 17, 2001. I'm speaking on behalf of my husband as his guardian and that's fine with us. Thanks.¹

In response to this message, Mr. Alvarado's automobile liability insurance provider indeed denied coverage. It declined to defend him in the lawsuit the victim brought following the accident. In that suit, the victim won a default judgment, and subsequently sued the insurer for the proceeds.² Claiming that Mr. Alvarado had breached the policy's cooperation clause, the insurer asserted that the policy had been nullified and argued that it could not be forced to indemnify Mr. Alvarado against the liability stemming from the accident.³ The *Trevino* court accepted this argument and denied the victims injured by Mr. Alvarado the right to collect their default judgment from the proceeds of his policy.⁴ Neither the victims nor the court should have had any reason to doubt the truth behind Ms. Alvarado's statement that she and her husband were judgment-proof; in fact, most people are.⁵ But neither should we underestimate the impact of her phone message. By refusing to cooperate with his insurer—indeed by refusing any involvement with the claims process—following an accident *he caused*, Mr.

¹ *Progressive Cnty. Mut. Ins. Co. v. Trevino*, 202 S.W.3d 811, 816-17 (Tex. Ct. App. 2006).

² *Id.* at 813.

³ *Id.*

⁴ *Id.* at 818.

⁵ See *infra* note 29 and accompanying text.

Alvarado substantially decreased the likelihood that the victims of his negligence⁶ would receive any compensation for their injuries.

At the heart of this problem is the policyholder's duty to cooperate in the investigation and disposition of his claims, and the general acceptance of that duty as a condition precedent to coverage under a liability insurance policy. Where, as in *Trevino*, a court accepts the argument that the policyholder breached this duty, the victim's chances at a full recovery plummet, because recovery for tort damages is almost impossible if limited to the personal assets of the tortfeasor.⁷ This Comment begins from the premise that, in a largely judgment-proof society, the cooperation clause in liability insurance policies creates perverse incentives for both policyholders and insurers. If breached, the cooperation clause enables the insurer to avoid indemnification duties, and the insurer benefits from the policyholder's noncooperation. Likewise, because all a judgment-proof policyholder stands to lose if found in breach is an unenforceable personal liability, he has no incentive to actively cooperate. When parties respond to these incentives, they impose the costs of accidents on their innocent victims.

Liability insurance literature has identified three central duties owed by the insurer to the policyholder that grow from the standard personal liability contract: the duty to defend covered claims against the policyholder,⁸ the duty to indemnify the insured against liability within policy limits stemming from covered claims,⁹ and the duty to settle those claims

⁶ The issue of Mr. Alvarado's negligence was litigated in his absence, and the court entered a default judgment in favor of the two victims. *Trevino*, 202 S.W.3d at 813.

⁷ See Tom Baker, *Liability Insurance As Tort Regulation: Six Ways That Liability Insurance Shapes Tort Law in Action*, 12 CONN. INS. L.J. 1, 4 (2005) (exploring liability insurance's "fundamental effect on . . . collectibility—the defendant's ability to pay and the facility with which the defendant can be made to pay"). Professor Baker argues that this effect on collectibility is so great, and that liability insurance is so overwhelmingly its only source, that a tortfeasor's applicable liability policy has become a "de facto element" of tort liability. *Id.* at 3; see also Jason M. Solomon, *Equal Accountability Through Tort Law*, 103 NW. U. L. REV. 1765, 1818 (2009) (noting that in the most common varieties of tort cases, "almost every person or entity sued is going to have a liability insurance provider that will take over the defense of the case and pay the cost of any settlement or judgment").

⁸ See 14 STEVEN PLITT, DANIEL MALDANADO & JOSHUA D. ROGERS, COUCH ON INSURANCE § 200:1 (3d ed. 2011) [hereinafter 14 COUCH] ("Most jurisdictions consider the duty to defend as arising from the contractual relationship produced by the insurance policy."); see also Tom Baker, *Liability Insurance Conflicts and Defense Lawyers: From Triangles to Tetrahedrons*, 4 CONN. INS. L.J. 101, 102 (1997) ("Most liability insurance policies assign the company the 'duty' . . . to defend the insured whenever the insured requests a defense against a defined set of claims.").

⁹ See 14 COUCH, *supra* note 8, § 200:3 ("In liability insurance policies generally, an insurer assumes . . . the duty to indemnify the insured, that is, to pay all covered claims and judgments against insured . . ."); see also Ellen S. Pryor, *The Stories We Tell: Intentional Harm and the Quest*

for a reasonable amount when feasible.¹⁰ The duty to cooperate stands opposite these as the central duty owed by the policyholder to the insurer. But while scholars have extensively examined, analyzed, and critiqued the insurer's duties of defense,¹¹ indemnification,¹² and settlement,¹³ the insured's duty to cooperate has not been adequately scrutinized. This Comment seeks to begin the scholarly discussion of the duty to cooperate by examining its impact on policyholder and insurer incentives, as well as on the resulting allocation of the costs of accidents. It goes on to propose several adjustments aimed at bringing the duty to cooperate back in line with its stated goals, as well as those of liability insurance in general.

Importantly, much of the harm this Comment seeks to eradicate arises when policyholders refuse to cooperate with their insurance companies when sued on a covered claim. While there are many breeds of non-cooperation,¹⁴ there is no indication—nor does this Comment suggest—that noncooperation is the prevalent policyholder reaction to being sued. Presumably, many policyholders comply with the requests of their insurers for reasons having little to do with their net worth: what the insurer requests may not present a burden, the policyholder may know the victim and affirmatively want to speed up the claims process, or the policyholder may simply believe that cooperating is the right thing to do. All of which prompts the question of whether this Comment ventures to fix that which, according to the old cautionary maxim, “ain’t broke.” But a system of liability insurance should not entrust its efficacy to the goodwill of its

for *Insurance Funding*, 75 TEX. L. REV. 1721, 1730 (1997) (describing the insurer's promise “to pay those sums that the insured becomes legally obligated to pay as damages. This is the duty to pay—often termed the duty to indemnify” (internal quotations and footnotes omitted)).

¹⁰ See 14 COUCH, *supra* note 8, § 203:12 (discussing the “[d]uty of reasonable settlement, generally”); see also Kyle D. Logue, *Solving the Judgment-Proof Problem*, 72 TEX. L. REV. 1375, 1379 (1994) (“Although the precise statement of this duty varies, most courts require that the insurer give ‘equal consideration’ to the interests of insureds when deciding whether to settle or litigate a claim.” (internal footnotes omitted)).

¹¹ See generally Betty R. Dohoney, *The Liability Insurer's Duty to Defend*, 33 BAYLOR L. REV. 451 (1981); Susan Randall, *Redefining the Insurer's Duty to Defend*, 3 CONN. INS. L.J. 221 (1997); Comment, *The Insurer's Duty to Defend Under a Liability Insurance Policy*, 114 U. PA. L. REV. 734 (1966).

¹² See, e.g., Pryor, *supra* note 9, at 1725-29 (discussing the parameters of the insurer's duty to indemnify for acts of intentional harm).

¹³ See generally Seth J. Chandler, *Reconsidering the Duty to Settle*, 42 DRAKE L. REV. 741 (1993); Kent D. Syverud, *The Duty to Settle*, 76 VA. L. REV. 1113 (1990); see also generally Charles Silver, *A Missed Misalignment of Interests: A Comment on Syverud*, *The Duty to Settle*, 77 VA. L. REV. 1585 (1991).

¹⁴ See *infra* Part II.

policyholders without an effective backstop of enforcement.¹⁵ If, as Professor Kenneth Abraham suggests, insurers can be “understood as the intermediary through which individuals motivated by concern for themselves become part of an enterprise that transforms selfish concern into altruism,”¹⁶ a structural defect in the policy that allows (indeed encourages) both the insurer and the policyholder to subvert that goal should not be forced to hang its remedial hopes upon an economically irrational goodwill. To be sure, voluntary policyholder cooperation serves liability insurance in many ways: it speeds up what is often a drawn out process,¹⁷ reduces costs to insurers who are not forced to track down the policyholder and coerce cooperation,¹⁸ and promotes the truth about the circumstances surrounding accidents.¹⁹ Relying on such voluntary cooperation, however, not merely to improve the delivery of insurance, but to hold the system together, is to beg divergent outcomes. This Comment proposes a duty to cooperate that instead relies on structural guarantees to serve the compensatory ends of the liability insurance system.

Part I examines the prevalent composition and interpretations of the cooperation clause and discusses in more detail the ways in which these interpretations create perverse incentives in practice. Part II details three categories of cases in which policyholders respond to such incentives. Part III identifies and evaluates two present judicial responses to this problem. Finally, Part IV offers a tentative solution to the problem, centered on altering the remedy for a breach of the cooperation clause to render it both a meaningful incentive for policyholder compliance and a meaningful guarantee of victim compensation.

¹⁵ See Kenneth S. Abraham, *Four Conceptions of Insurance*, 161 U. PA. L. REV. (forthcoming 2013) (manuscript at 38), available at http://ssrn.com/abstract_id=2016320 (describing a conception of insurance as a form of governance, in which “ongoing responsibilities and rights should run among the policyholders, and [in which] insurers should be obligated to enforce these rights and responsibilities”). Far from obligating insurers to enforce the duty to cooperate, the incentives created by the cooperation clause not only shift that burden to the policyholders but also enable insurers to benefit when policyholders ignore those rights and responsibilities.

¹⁶ *Id.* (manuscript at 50).

¹⁷ See *infra* note 44 and accompanying text.

¹⁸ For an example of a policyholder who decidedly failed to mitigate such investigatory expenses, see *Founders Ins. Co. v. Shaikh*, 937 N.E.2d 1186, 1190-91 (Ill. App. Ct. 2010). In attempting to track down a noncooperative policyholder, the insurer’s travails included sending private investigators to two addresses and a former place of employment and investigating whether the policyholder was incarcerated. *Id.*

¹⁹ See *infra* text accompanying notes 31-32.

I. THE COOPERATION CLAUSE BY DESIGN

The policyholder's duty to cooperate is reflected in the virtual omnipresence of a cooperation clause in consumer liability insurance policies.²⁰ Though a cooperation clause of some variety is found in almost every liability policy,²¹ this Comment focuses solely on such provisions and their effects in consumer automobile and consumer homeowner policies. The purpose of this limitation is three-fold. First, because such policies invariably deprive the policyholder of any bargaining power,²² and the standard language of such policies always includes a cooperation clause, the duty to cooperate is an unavoidable and uniform element of insurance in this context. Examining the duty to cooperate against this backdrop thus provides a consumer class with largely identical protections and obligations, free of the variations and personalizations that characterize more complex commercial policies.²³ This limitation also obviates the need for any analysis of the policyholder's level of sophistication. Second, because this Comment centers its criticism of the duty to cooperate on the deprivation of compensation for injured third-party tort victims through unilateral policyholder action, it demands a landscape in which that action can be isolated and analyzed as an individual, rational decision. In the context of more complex policies and corporate policyholders, the decision not to cooperate is likely to implicate a more complicated set of considerations beyond the present scope.²⁴ Third, personal liability insurance premiums comprise the vast

²⁰ See 14 COUCH, *supra* note 8, § 199:3 (“[I]nsurance policies, whether they are liability or indemnity policies, include what is commonly referred to as a ‘cooperation clause.’ In instances where a policy does not include such a clause, one has been implied in law.” (footnote omitted)).

²¹ See, e.g., ISO Props., Inc., Commercial Gen. Liab. Coverage Form § IV(2)(c) (2003) (on file with author) (“You and any other involved insured must: . . . Cooperate with us in the investigation or settlement of the claim or defense against the ‘suit’”); ISO Props., Inc., Exec. Liab. Coverage Form § VI(c) (2002) (on file with author) (“The ‘insured persons’ and the ‘company’ shall, as a condition precedent to their rights under this Policy, give to us all information, assistance and cooperation as we may reasonably require.”).

²² See *Am. Justice Ins. Reciprocal v. Hutchison*, 15 S.W.3d 811, 817 (Tenn. 2000) (classifying automobile liability policies as “contracts of adhesion”); Douglas R. Richmond, *Liability Insurers’ Right to Defend Their Insureds*, 35 CREIGHTON L. REV. 115, 122 (2001) (“At the outset, insurance policies are adhesion contracts, and it arguably is bad contract law to assume the existence of a term that favors the stronger party to such a contract. This is especially true in the insurance context because, in most instances, the insured has no opportunity to even negotiate for terms. With rare exceptions, insurance policies are take-it-or-leave-it documents.” (footnote omitted)).

²³ See TOM BAKER & SEAN J. GRIFFITH, *ENSURING CORPORATE MISCONDUCT* 51 (2010) (“The public company D&O market . . . has sophisticated parties on both the buyer’s and the seller’s side of the transaction, each with legal counsel at their disposal.”).

²⁴ Such considerations may include customer or community goodwill, fiduciary duties owed to shareholders, or public image.

majority of annual insurance expenditures in the United States.²⁵ Because this massive expenditure is spread through an equally large class of consumers, these relatively small liability policies are a ubiquitous element of the American legal system, and a primary way in which Americans resolve legal disputes.

In addition to being heavily standardized, the language of the cooperation clause is quite vague, providing insurance companies with a catch-all assistance provision,²⁶ the failure to comply with which results in nullification of the policy.²⁷ Courts have consistently ascribed two general purposes to the cooperation clause. First, it protects the insurance company's interests by conditioning coverage on active participation by the policyholder in all phases of the claims process. Second, it inhibits collusion between the policyholder and the victim by allowing the insurance company to avoid indemnification altogether should the policyholder attempt to "throw" the defense.²⁸ As currently articulated and enforced, however, the cooperation

²⁵ See KENNETH S. ABRAHAM, *THE LIABILITY CENTURY: INSURANCE AND TORT LAW FROM THE PROGRESSIVE ERA TO 9/11*, at 69 (2008) (noting that, at the time of publication, automobile liability insurance expenditures were twice those for worker's compensation insurance, more than five times those for medical malpractice insurance, and at least seven times those for products liability insurance).

²⁶ See, e.g., Travelers Prop. Ins. Cas. Co., Homeowners Policy § II(3)(c) (Policy no. [redacted]) (on file with author) (obligating the policyholder, "at our request, [to] help us (1) to make settlement; (2) to enforce any right of contribution or indemnity against any person or organization who may be liable to any insured; (3) with the conduct of suits and attend hearings and trials; (4) to secure and give evidence and to obtain the attendance of witnesses . . ."); Allstate Ins. Co., Deluxe Select Value Homeowners Policy § II(1)(c) (Sample Policy) (on file with author) ("At our request, an insured person will: 1) cooperate with us and assist us in any matter concerning a claim or suit; 2) help us enforce any right of recovery against any person or organization who may be liable to an insured person; 3) attend any hearing or trial.").

²⁷ See 14 COUCH, *supra* note 8, § 199:13. Various jurisdictions also require that the policyholder's breach be both material and substantial and that it result in prejudice to the insurer before the insurer can raise it as a defense to a request for indemnification. See *infra* Section III.A.

²⁸ See, e.g., Wildrick v. N. River Ins. Co., 75 F.3d 432, 436 (8th Cir. 1996) ("The purpose of a cooperation clause is to protect insurers and prevent collusion between insureds and injured parties." (quoting *Am. Guarantee & Liab. Ins. Co. v. Chandler Mfg. Co.*, 467 N.W.2d 226, 229 (Iowa 1991))); *United Servs. Auto. Ass'n v. Morris*, 741 P.2d 246, 250 (Ariz. 1987) ("[T]he purpose of a cooperation clause is to prevent insureds from compromising a claim for which the insurer unconditionally has assumed liability under the policy, thus obviating, at least to the extent of the policy limit bargained for, the insured's exposure to personal liability." (citing *Cay Divers, Inc. v. Raven ex rel. Lloyds of London*, 812 F.2d 866 (3d Cir. 1987))); *Iowa Mut. Ins. Co. v. Meckna*, 144 N.W.2d 73, 81 (Neb. 1966) ("The purpose of the cooperation clause is to prevent collusion between the injured and the insured and to facilitate the handling of claims by the insurer." (quoting *MFA Mut. Ins. Co. v. Sailors*, 141 N.W.2d 846, 849 (Neb. 1966))); *Am. Policyholder's Ins. Co. v. Baker*, 409 A.2d 1346, 1348 (N.H. 1979) ("The purpose of a cooperation clause is to protect the insurer in its defense of suits by obligating the insured not to intentionally and deliberately take any action which would substantially affect adversely the insurer's defense, settlement or other handling of the claim." (citing *Portsmouth Hosp. v. Indem. Ins. Co.*, 242 A.2d

clause fails to serve either of these purported purposes in a great number of cases, because most policyholders are judgment-proof against tort liability.²⁹ In theory, the cooperation clause derives its effectiveness from the threat of what happens when it is breached—namely requiring the policyholder to pay the judgment himself. But while the specter of personally financing a judgment should ideally serve as a sufficient deterrent to inimical or collusive behavior, to a judgment-proof defendant the deterrent

398, 401 (N.H. 1968)); *Am. Sur. Co. v. Diamond*, 136 N.E.2d 876, 879 (N.Y. 1956) (“The purpose of the cooperation clause is to constrain the assured to co-operate in good faith with the insurance company in the *defense* of claims.” (citing *Wenig v. Glens Falls Indem. Co.*, 61 N.E.2d 442, 444 (N.Y. 1945))); *Smith v. Nationwide Mut. Ins. Co.*, 830 A.2d 108, 113 (Vt. 2003) (“The primary purpose of a cooperation clause is to enable insurers to make a proper investigation while the information is fresh, enable them to decide upon their obligations, and protect them from fraudulent and false claims.”); *State v. Hydrite Chem. Co.*, 582 N.W.2d 411, 420 (Wis. Ct. App. 1998) (“The basic purpose of a cooperation clause is to protect the insurer’s interests and to prevent collusion between the insured and the injured party.” (quoting *Waste Mgmt., Inc. v. Int’l Surplus Lines Ins. Co.*, 579 N.E.2d 322, 327 (Ill. 1991))).

²⁹ See Stephen G. Gilles, *The Judgment-Proof Society*, 63 WASH. & LEE L. REV. 603, 609 (2006) (“[I]n the absence of liability insurance, most Americans are highly judgment-proof . . . this result is primarily attributable to legal rules that shelter assets and income from collection, rather than to simple inability to pay.”). As Professor Gilles suggests, judgment-proof status goes beyond mere inability to pay. Even a highly solvent defendant is unlikely to finance a judgment with personal assets. See Tom Baker, *Liability Insurance, Moral Luck, and Auto Accidents*, 9 THEORETICAL INQUIRIES L. 165, 173 (2007) [hereinafter Baker, *Moral Luck*] (“[A]utomobile accident lawyers report that individual defendants almost never have to pay any of their own money to settle a claim or satisfy a judgment. As a result, auto accident cases are, in practice, about collecting insurance.” (footnotes omitted)); Tom Baker, *The Blood-Money Myth*, LEGAL AFFAIRS, Sept.–Oct. 2002, at 43 (“Plaintiffs almost never collect real money from real people in ordinary tort cases . . . not only because it’s more difficult to collect money from people than from insurance companies, but also because plaintiffs and their lawyers have significant moral qualms about squeezing ‘blood money’ out of ordinary people for an ordinary wrong.”). In other words, not only are victims unlikely to collect from defendants without insurance, but defendants without insurance are unlikely to be sued in the first place. See Baker, *supra* note 7, at 5 (characterizing liability insurance as “a de facto element of tort liability”); Kent D. Syverud, *On the Demand for Liability Insurance*, 72 TEX. L. REV. 1629, 1634 (1994) (arguing that Americans “are most likely to find an attorney to handle [a] case and then to collect a judgment when [the] complaint alleges conduct covered by a liability insurance policy”). The pervasiveness of judgment-proof defendants would seem to suggest a significant lack of demand for liability insurance beyond mandatory schemes, but Professor Lynn LoPucki has suggested that

[e]ven a judgment-proof debtor may purchase liability insurance in the hopes of avoiding the necessity to file under Chapter 11 to deal with its obligations, to satisfy contracting parties who require them to carry insurance, to avoid the adverse publicity that may accompany financial irresponsibility, or merely to satisfy a felt moral obligation. Minimal levels of liability insurance coverage might well persist in a world where judgments could not be enforced.

Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 76 (1996).

capacity of such a threat is substantially weakened.³⁰ This is what is known as the “judgment-proof problem.” It calls into serious doubt whether the cooperation clause can effectively serve either of its purported goals.

At the heart of both stated goals—protecting insurer interests and preventing collusion—is a truth-serving function. The cooperation clause relies on the threat of personal liability to ensure full and active policyholder participation in the claims process—from investigation to settlement, and in rare cases, to trial.³¹ An involved and cooperative policyholder furthers the insurance company’s interests by ensuring that all relevant facts are disclosed in a timely fashion. Without the policyholder’s opposing account of the accident, the plaintiff has substantially greater leverage in his efforts to raise the settlement price.³² Similarly, the threat of personal liability theoretically ensures that when the policyholder *does* participate, he does so in a truthful and noncollusive manner. But this model demands a meaningful threat to scare out truthful disclosure and cooperation, something that is not possible in a largely judgment-proof society. This dynamic transforms the cooperation clause into an entirely different beast. With no meaningful economic incentive to cooperate, a rational policyholder will not go out of his way to aid his insurer. His insurer, in turn, will not indemnify him against his liability. In this way, the judgment-proof problem alters the cooperation clause in practice and dramatically inflates its importance. Nullification of the policy—once the insurer’s seldom used ace-in-the-hole—now becomes the rule rather than the exception, with the cooperation clause serving as a reliable escape hatch.

The policyholder’s incentives should not be the sole source of concern; the potential for *insurer* opportunism is also significant. An insurer that learns of a policyholder’s claim, and knows that the policyholder is likely to be judgment-proof, has little incentive to ensure cooperation. When the

³⁰ See LoPucki, *supra* note 29, at 82 (suggesting that, “[i]n a compulsory insurance system with judgment-proof insureds, th[e] incentive [to comply with the cooperation clause] . . . disappears, and insureds may be reluctant to cooperate”). But see Baker, *Moral Luck*, *supra* note 29, at 173-74 (noting that defendants in automobile accident cases often fail to realize that they are judgment-proof, a fact that their insurance companies routinely exploit).

³¹ See Baker, *Moral Luck*, *supra* note 29, at 174 (“[T]he bureaucratization of the automobile insurance claims adjustment process means that the vast majority of automobile liability claims are settled, typically without formal admission of fault . . . and many of those claims are settled without a lawsuit or other public record of the claim.”).

³² Of course, the policyholder’s account will not always serve to mitigate this leverage. First, that account could reveal the policyholder to be entirely at fault. Alternatively, if the claim arises in a no-fault state, then the policyholder’s account will theoretically have no impact on the result at all. For an account of the history of the “No-Fault Movement” and of how it has failed to take hold in more than a few states, see ABRAHAM, *supra* note 25, at 92-103.

policyholder, who has already paid his premiums, fails to cooperate, the insurer benefits by avoiding the payout, thereby creating the perverse incentive for the insurer to *discourage* cooperation, or at least to construe every minor lapse in participation as a breach of the duty to cooperate.

In one sense, this arrangement still serves both of the clause's goals, albeit in a very different manner. First, while policyholder cooperation cuts some investigative costs, avoiding indemnification altogether is perhaps the greater windfall. Second, while this transformed cooperation clause fails to serve as a meaningful disincentive to collusion, it still equips insurance companies with a tool to deny coverage should they detect it. But all this is far from the truth-seeking model of the cooperation clause implicitly endorsed by courts, and for which I have a strong preference.³³ Refusing to indemnify a judgment-proof policyholder leaves the accident victim with a virtually uncollectible judgment. Even if that victim is inclined to attempt to collect on the judgment, to do so requires the victim to expend his own resources to pursue the personal assets of someone who is quite possibly a member of his own community. From the victim's perspective, any realistic hope of recovery depends on the cooperation of two parties, neither of whom has any incentive to do so.

To this point, criticism of the cooperation clause has been framed by a purely theoretical examination of the existing incentive structure assuming a policyholder class that is largely judgment-proof. Part II of this Comment will move beyond the theoretical and examine the *effects* of these misaligned incentives as borne out by the case law.

II. THE COOPERATION CLAUSE IN PRACTICE: THREE CATEGORIES, ONE RESULT

Policyholders do respond to these perverse incentives. Though non-economic incentives to cooperate abound and are followed frequently,³⁴ many policyholders respond more powerfully to the economic ones and

³³ Only when the cooperation clause serves a robust, truth-serving function can the liability insurance system truly support and enable our notion of tort law. Although, throughout this Comment, I criticize the inability of the current system to adequately compensate accident victims, I posit that it is also important to compensate the *right* victims with proportionately *correct* amounts, by allowing legal doctrines like contributory negligence and assumption of risk to impact settlement values.

³⁴ Judgment-proof individuals have no economic incentive to purchase nonmandatory liability insurance at all. Still, some do, either because they overestimate their risk of personal liability, or because they respond to certain noneconomic incentives, such as moral obligation. See LoPucki, *supra* note 29, at 76. A great number of policyholders likely cooperate in the claims process for substantially similar reasons.

refuse to cooperate in the investigation of their claims. Because of the overwhelming tendency of cases involving personal liability insurance to settle,³⁵ case law adjudicating cooperation clause disputes is scant.³⁶ There are, however, three identifiable categories of cases involving defendants who breach the duty to cooperate and thus impose the costs of the accident on the innocent victim: the case of the prototypical noncooperative defendant, the Fifth Amendment case, and the policyholder settlement case.

A. *The Case of the Prototypical Noncooperative Policyholder*

The prototypical noncooperative policyholder injures someone in a way that gives rise to a potential liability covered by the terms of his policy but then fails to make or maintain adequate contact with his insurance company. The insurer then raises the policyholder's breach of the duty to cooperate as grounds for a refusal to defend the policyholder or indemnify him against any resulting liability. In some cases, the policyholder may inform his insurer of the claim against him but fail to maintain any further contact despite frequent calls from the insurer to do so.³⁷ In other cases, the policyholder may simply cause an accident and ignore the pending suit despite his knowledge of it and his potential coverage.³⁸ Such cases typically result in

³⁵ See *supra* note 31.

³⁶ A Westlaw search for state and federal cases since 1990 containing the term "liability insurance," either the term "duty to cooperate" or "cooperation clause," and either the term "automobile" or "homeowner," but excluding the term "CGL" (commercial general liability), produces a mere 239 results as of October 18, 2012. While there may be cases that, for one reason or another, fail to use the above terminology, that number is likely quite low. Additionally, a great number of these cases make only a passing reference to the cooperation clause without considering serious claims of its breach.

³⁷ See, e.g., *Arton v. Liberty Mut. Ins. Co.*, 302 A.2d 284, 286, 289 (Conn. 1972) (finding a breach when the insured effectively vanished, refused to contact the insurer, and provided the insurer with neither his contact information nor that of any witnesses); *Revolution Rent A Car v. Premier Ins. Co.*, 2005 Mass. App. Div. 155, 156 (Dist. Ct. 2005) (finding a breach when a policyholder failed to appear for three scheduled examinations under oath despite the fact that he attended a deposition two years later); *Gabor v. State Farm Mut. Auto. Ins. Co.*, 583 N.E.2d 1041, 1044 (Ohio Ct. App. 1990) (finding a breach of the duty to cooperate when "the insured[] refus[ed] to produce his income tax returns . . . which clearly prejudiced the insurer's investigation into possible motives for arson").

³⁸ See, e.g., *Am. Country Ins. Co. v. Bruhn ex rel. Estate of Kaufman*, 682 N.E.2d 366, 371-72 (Ill. App. Ct. 1997) (finding that a policyholder who failed to notify his insurer until three and a half years after the accident breached the cooperation clause, and that the insurer had no duty to indemnify him against the judgment against him). *But see* *Cowan v. Allstate Ins. Co.*, 594 S.E.2d 275, 276-77 (S.C. 2004). The *Cowan* court overturned a substantially similar decision and held that a South Carolina statute required the insurer to honor a judgment against an innocent automobile accident victim caused by a policyholder, despite his prejudicial lack of cooperation. *Id.* For a further discussion of this judicial solution to the undercompensation problem, and why it may not be the panacea it appears to be, see *infra* Section III.B.

one of two scenarios. In the first, the injured plaintiff receives a default judgment against the policyholder, which the plaintiff then attempts to enforce against the insurance company directly, essentially disputing the insurer's claims that the cooperation clause was breached.³⁹ Alternatively, the policyholder will surface long enough to settle the claim himself and assign his claims against the insurance company to the original plaintiff in exchange for the plaintiff's agreement not to execute the settlement against him personally.⁴⁰ Procedurally, the assigning of the claim occurs after the insurance company has refused to defend or indemnify, leaving the original plaintiff to stand in the shoes of the policyholder and litigate a breach of contract claim—alleging that the refusal to defend is in contravention of the policy—against the insurer.

Either scenario presents a significant obstacle to recovery for the victim. At the very least, the policyholder's actions have added an additional turn to the victim's road to recovery. And in a great many cases, this turn is an especially harrowing one that renders full recovery nearly impossible because of two exacerbating factors. First, in either scenario, the victim is left to litigate against the insurance company directly. Whether the victim pursues his claims against the policyholder's insurer on his own, or inherits the policyholder's claims, he is forced to use his own resources to bring an

³⁹ The current trend among the states is to permit such direct actions by the victim against the defendant's insurer. See 7A LEE R. RUSS ET AL., COUCH ON INSURANCE § 104:7 (3d ed. 2005) (observing the modern prevalence of statutes or policy provisions granting accident victims the right to sue injuring parties' liability insurers directly). *But see id.* § 104:2 ("As a general rule, and in the absence of a contractual provision or a statute or ordinance to the contrary, at common law the absence of privity of contract between the claimant and the insurer bars a direct action by the claimant . . .").

⁴⁰ Such agreements have become common, and have come to be known as *Miller-Shugart* agreements after the famous case of *Miller v. Shugart*, 316 N.W.2d 729 (Minn. 1982). In that case, the court upheld the right of a policyholder to enter into a settlement with the victim whereby the policyholder assigned all claims against the insurer to the injured party in exchange for a covenant to limit execution of the settlement amount to insurance proceeds only. *Id.* at 732. These agreements are also sometimes referred to as *Morris* agreements after the similar—and similarly famous—case of *United Services Automobile Ass'n v. Morris*, 741 P.2d 246 (Ariz. 1987) (in banc). Because these agreements almost always arise absent insurer consent, they are ripe ground for cooperation clause disputes. States are divided on the question of whether and under what conditions such settlements are enforceable. Compare *Corn Plus Coop. v. Cont'l Cas. Co.*, 516 F.3d 674, 680-81 (8th Cir. 2008) (holding that, under Minnesota law, a "Miller-Shugart agreement is enforceable against an insurer if it meets three conditions: the insured provided notice to its insurer of its intent to enter into such agreement; the settlement is not the product of fraud or collusion; and the settlement is reasonable and prudent"), with *Safeco Ins. Co. v. Superior Court*, 84 Cal. Rptr. 2d 43, 44-46 (Ct. App. 1999) (refusing to allow the victim's direct action suit to go forward against the policyholder's insurance company when the policyholder and the victim had entered into a *Miller-Shugart* style settlement).

action against a repeat player with near unlimited expertise and resources.⁴¹ At this point, the costs of litigation may outweigh the potential recovery, especially if he has first-party insurance to mitigate some of the losses,⁴² and the victim may abandon his claim. Of course, the insurance company could make a similar determination regarding the litigation and settle with the victim, but the insurer's solvency and the victim's disproportionate need for compensation combine to create overwhelming insurer leverage over settlement negotiations.⁴³ Additionally, insurance companies are rarely interested in the rapid settlement of claims, even when they have no intention of letting such a claim see the inside of a courtroom.⁴⁴

⁴¹ See Syverud, *supra* note 13, at 1160 ("Most automobile and property owners deal with one insurance company, and no more than one lawsuit. In contrast, insurance companies are bureaucratic repeat players who deal with many insureds and many lawsuits."); see also Milton Heumann & Jonathan M. Hyman, *Negotiation Methods and Litigation Settlement Methods in New Jersey: "You Can't Always Get What You Want,"* 12 OHIO ST. J. ON DISP. RESOL. 253, 285 (1997) (arguing that repeat players like insurance companies are more willing to "play 'hardball'" in settlement negotiations because the risk of any single loss at trial is outweighed by the benefits of settlements on favorable terms and the signaling effect such a strategy has on future would-be litigants).

⁴² It is important to note, however, that first-party insurance coverage, such as medical or short-term disability, often fails to cover the entirety of the loss. See Jeffrey O'Connell & John Linehan, *Neo No-Fault Early Offers: A Workable Compromise Between First and Third-Party Insurance*, 41 GONZ. L. REV. 103, 120 (2006) ("In the United States, coverage for various forms of accident loss remains tragically insufficient across the board [I]n many situations, an injured party must resort to the tort system to account for losses that remain uncompensated by first-party insurance."). The tort system, however, is often incapable of closing this gap. Because tort compensation is so frequently limited to insurance proceeds, low policy limits are the biggest threat to the effectiveness of the tort system. See Gary T. Schwartz, *Auto No-Fault and First-Party Insurance: Advantages and Problems*, 73 S. CAL. L. REV. 611, 628 (2000) (observing that the current system effectively limits liability to policy limits that are kept low by nonaggressive state mandatory minimums).

⁴³ See Robert W. Emerson, *Insurance Adjusters and Plaintiffs' Attorneys: From Claims Fraud Consensus to Settlement Reform*, 30 AM. BUS. L.J. 537, 553 (1993) (reporting the claims of plaintiffs' attorneys that insurance companies often "wrongly refus[e] to pay or delay[] . . . paying bills in order to gain negotiating leverage over claimants").

⁴⁴ As Professor Jay Feinman explains,

There are a very significant number of large cases, probably an increasing number in the last few years, in which liability is relatively clear and it is also clear that the victim's damages are substantial, yet the insurance company refuses to make an offer to settle the case, makes a disproportionately low offer that it refuses to raise, or makes an offer only very late in the process.

Jay M. Feinman, *Incentives for Litigation or Settlement in Large Tort Cases: Responding to Insurance Company Intransigence*, 13 ROGER WILLIAMS U. L. REV. 189, 193-94 (2008); see also *Campbell v. State Farm Mut. Auto Ins. Co.*, 65 P.3d 1134, 1148 (Utah 2001) (reporting evidence that "State Farm has systematically harassed and intimidated opposing claimants, witnesses, and attorneys . . . [and] instruct[ed] its attorneys and claim superintendents to employ 'mad dog defense tactics'—using the company's large resources to 'wear out' opposing attorneys by prolonging litigation, making meritless objections, claiming false privileges, destroying documents, and

The second exacerbating factor is the inherent information asymmetry whenever the victim is forced to litigate a cooperation clause dispute against the insurance company. Not only may the policyholder have indeed breached his duty to cooperate,⁴⁵ but the information required to litigate that claim is neither readily available to the victim nor cheap to unearth.⁴⁶ To say nothing of the fact that the victim had nothing to do with it. Indeed, it is the *insurer* that will have the records detailing the number of attempted contacts with the policyholder, by what method, and with what result. And it is the *policyholder* who will have the information regarding receipt of those communicative efforts, reasons for not responding, and efforts to reestablish contact. While liberal discovery rules enable the injured victim to procure this information, the initial distribution of that information presents another opportunity for the policyholder's apathy and the insurer's strategic delay to threaten timely recovery. Again, while the victim's likely goal in pursuing such an action against an insurer is to force an adequate settlement rather than to prevail in the dispute, the initial information asymmetry serves only to strengthen the insurer's existing leverage over those settlement negotiations.

The case of the prototypical noncooperative policyholder often results in the allocation of a substantial portion of the loss neither to the party best positioned to absorb and spread it (the insurer), nor to the party most responsible for causing it (the policyholder). For purposes of illustration, consider the case of *Martinez v. ACCC Insurance Co.*⁴⁷ There, two friends riding together in a car were injured when another driver ran a red light and the two cars collided.⁴⁸ Following the accident, the driver who ran the red light could not be reached by his insurance company or by the private

abusing the law and motion process"), *rev'd*, 548 U.S. 408 (2003); Tom Baker, *Blood Money, New Money, and the Moral Economy of Tort Law in Action*, 35 LAW & SOC'Y REV. 275, 288 (2001) (reporting industry accounts of "adjusters who delay paying claims of old people because those claims will be worth so much less once they die").

⁴⁵ The broad and vague language of the standard cooperation clause often makes it quite easy for an insurer to make out a *prima facie* case of noncooperation, which, of course, it has every incentive to do. If the policyholder has failed to appear at a scheduled hearing or a deposition, it is quite clear that he has breached his duty to cooperate. For this reason, litigation often focuses not on the issue of the policyholder's breach of the cooperation clause but on whether that breach was material and prejudicial. See *infra* Section III.A.

⁴⁶ A policyholder who has failed to cooperate with his insurer is unlikely to have a sudden change of heart and completely cooperate with the victim in making out the breach of contract claim against the insurance company, particularly because he has no skin in the game. The cost of uncovering this information through the discovery process increases the insurer's leverage in the settlement process.

⁴⁷ 343 S.W.3d 924 (Tex. Ct. App. 2011).

⁴⁸ *Id.* at 925.

investigator the insurance company hired, despite the repeated efforts of both.⁴⁹ The *Martinez* court found the driver's failure to cooperate in the investigation of his insurer's claim to be a breach of the cooperation clause and upheld the trial court's grant of summary judgment in favor of the insurer.⁵⁰ The injuries for which the victims were seeking compensation were not insignificant; when the underlying tort case proceeded to judgment due to the defendant's failure to appear, the court entered a default judgment of more than \$150,000.⁵¹ The procedural posture of this case reveals the victims' assessment of their chances of collecting from the policyholder herself: armed with a default judgment of \$150,000, the victims initiated an action against the defendant's insurer rather than pursuing a garnishment action directly against the defendant.⁵² The victims' willingness not only to pursue such an action but also to appeal the initial loss at trial underscores the fact that many victims cannot depend on first-party coverage to wholly cover their losses. In this case, the victims went uncompensated not because of any legal doctrine mitigating the policyholder's liability, but because of his simple failure (or election not) to respond to his insurer's phone calls.

B. *The Fifth Amendment Case*

Another category of cooperation clause dispute arises when the potential civil liability for which the policyholder is seeking indemnification is accompanied by potential criminal liability stemming from the same set of events. An example within the scope of this Comment might arise when a policyholder is both charged with vehicular manslaughter and sued for wrongful death.⁵³ Often, a policyholder faced with potential concurrent

⁴⁹ *Id.* at 927.

⁵⁰ *Id.* at 929-30.

⁵¹ *Id.* at 926.

⁵² *Id.* at 927; see also *Martinez v. ACCC Ins. Co.*, No. 08-03102-E, 2009 WL 8236036, at *1 (Tex. Cnty. Ct. Oct. 1, 2009) (final judgment in the initial garnishment action).

⁵³ See, e.g., *Miller ex rel. Estate of Hott v. Augusta Mut. Ins. Co.*, 335 F. Supp. 2d 727, 729 (W.D. Va. 2004) (granting summary judgment to an insurer seeking nullification of the policy on noncooperation grounds where the policyholder both invoked the Fifth Amendment in his criminal murder proceeding and sought indemnification under a homeowner's policy in the civil wrongful death action), *aff'd*, 157 F. App'x 632 (4th Cir. 2005); *Anderson v. S. Guar. Ins. Co.*, 508 S.E.2d 726, 732 (Ga. Ct. App. 1998) (holding that the homeowner-policyholder's duty to cooperate in a civil assault suit was not affected by her invocation of Fifth Amendment rights in the concurrent criminal proceedings); *Surabian v. Allstate Ins. Co.*, No. 73-2564, 1977 WL 186340, at *1, *4 (R.I. Super. Ct. Mar. 2, 1977) (holding that the policyholder breached the cooperation clause by invoking his Fifth Amendment right when faced with concurrent criminal and civil charges after stabbing a passenger in his car and causing her to fall from the car and injure herself).

criminal and civil liability will invoke his Fifth Amendment right against self-incrimination in order to avoid making a statement concerning the incident at issue. But while such an invocation does not alter the defendant's rights in a criminal investigation, the refusal to provide an account of the accident is in clear violation of the policy's cooperation clause.⁵⁴ Insurance companies use this breach to avoid indemnifying the policyholder against any resulting liability, exposing the policyholder to personal liability and leaving the victim to seek compensation from the policyholder's personal assets or not at all.

At the policyholder level, this structure seems unremarkable. It introduces a trade-off into the policyholder's decisionmaking calculus: he can either exercise his Fifth Amendment right in an effort to mitigate his criminal liability, or he can comply with the terms of the policy and mitigate his civil liability through indemnification. Imposing this dilemma upon a *solvent* policyholder may seem perfectly acceptable: he must choose between risking civil or criminal liability. But a *judgment-proof* policyholder transfers the ramifications of this dilemma to the accident victim.⁵⁵ A judgment-proof policyholder does not even have an economic incentive to waive his Fifth Amendment rights. Such a policyholder is thus likely to opt for Fifth Amendment protection, removing the insurer from the civil litigation entirely and limiting the victim's potential sources of compensation to the policyholder's personal assets.

The Fifth Amendment case often leaves the victim in the same position he finds himself in the case of the prototypical noncooperative policyholder⁵⁶—litigating against the insurer directly⁵⁷—except that in the Fifth Amendment case, the victim's chances at recovery may be even further diminished. In these cases, the victim has little ground on which to rest a breach action against the insurer. The very nature of these cases entails an *acknowledgment* by the policyholder that he is violating the terms of the policy due to countervailing criminal considerations. The victim is thus likely forced to

⁵⁴ See, e.g., *Miller*, 335 F. Supp. 2d at 733 (finding a breach of the duty to cooperate when the insured refused to make a statement to his insurer during investigation for a wrongful death action despite the fact that such refusal was made pursuant to the insured's Fifth Amendment right); *Anderson*, 508 S.E.2d at 731 (holding that the policyholder "cannot wield her Fifth Amendment privilege as a shield and a sword by demanding coverage and a defense under the insurance contract, while at the same time refusing to answer questions material to determining [the insurer]'s duties under the contract").

⁵⁵ But see *infra* text following note 58.

⁵⁶ See *supra* Section II.A.

⁵⁷ See *supra* notes 38-39 and accompanying text.

argue either that the breach was not material or that the resulting prejudice to the insurer was not substantial.⁵⁸

Additionally, the judgment-proof problem applies significant pressure to the notion that policyholders are justifiably forced to make a trade-off in the Fifth Amendment case. Theoretically, if the liability insurance system forces upon the policyholder a choice between the criminally protective custody of the Fifth Amendment and its civil counterpart of indemnification, a structure that permits the policyholder to escape indemnification while simultaneously invoking the Fifth Amendment could be perceived as giving a windfall to the policyholder. A judgment-proof policyholder enjoys precisely this double protection. While the Fifth Amendment's protection is uniform, a judgment-proof policyholder does not need insurer indemnification to enjoy protection against personal civil liability; he has both protections immediately upon invocation of the Fifth Amendment. For the judgment-proof policyholder, the aforementioned choice becomes easy, and funnels compensation away from the victims of accidents.

C. *The Policyholder Settlement Case*

The final category of cooperation clause dispute arises when the policyholder settles the case with the victim without the consent of the insurance company. In most of these cases, the insurer will use this lack of consent as the basis of a breach action and refuse to indemnify.⁵⁹ This basic fact pattern has many complex variations, including instances in which the insurer agrees to defend the policyholder but does so under a reservation of rights.⁶⁰ This Comment, however, focuses on the subset of these cases in

⁵⁸ See *infra* Section III.A.

⁵⁹ See, e.g., *Am. Family Mut. Ins. Co. v. Zavala*, 302 F. Supp. 2d 1108, 1122 (D. Ariz. 2003) (holding that when an insurer has agreed to assume liability for a claim, a subsequent *Morris* agreement between the policyholder and the plaintiff violates the cooperation clause); *Waddell v. Titan Ins. Co.*, 88 P.3d 1141, 1144 (Ariz. Ct. App. 2004) (observing that a policyholder's settlement without consent when the insurer has not expressed an intent to contest coverage is a violation of the duty to cooperate).

⁶⁰ "Reservation of rights" refers to an insurer's decision to "reserve" its right to contest its obligation to cover the policyholder's claim while nonetheless providing the policyholder's defense. Courts are split as to whether the policyholder has a right to settle the case himself without the insurer's consent where the insurer has made a reservation of rights. Compare *Patrons Oxford Ins. Co. v. Harris*, 905 A.2d 819, 828 (Me. 2006) ("[W]here the insured is being defended under a reservation of rights, the insured . . . may negotiate with the claimant and enter into a settlement that protects his interests."), with *Safeco Ins. Co. v. Super. Ct.*, 84 Cal. Rptr. 2d 43, 44, 45 (Ct. App. 1999) (holding, despite a reservation of rights, that "[w]hen the insurer provides a defense to its insured, the insured has no right to interfere with the insurer's control of the defense, and a stipulated judgment between the insured and the injured claimant, without the consent of the insurer, is ineffective to impose liability upon the insurer"). The disposition of

which there has been no insurer reservation of rights and in which courts have generally found that unilateral policyholder settlement violates the policy.

Illustrative is the case of *Smith v. Progressive Casualty Insurance Co.*⁶¹ There, the policyholder was contacted by the victim's attorney before he had the chance to speak with his insurer.⁶² The two sides then entered into a consent judgment whereby the policyholder assumed a \$10,000 liability in exchange for an agreement by the victim to limit execution of the judgment to insurance proceeds.⁶³ The policyholder's insurer attempted to set aside the consent judgment and conduct its own defense, but this effort was quashed by the court.⁶⁴ However, when the victim initiated a collection action against the insurer seeking indemnification of the consent judgment, the appeals court found that the policyholder had breached the cooperation clause and that the insurer owed no duty to either party.⁶⁵ That victims are frequently willing to enter into such *Morris* agreements, placing their last hope of recovery with the tortfeasor's insurance company, reflects the prevailing attitude toward collecting tort judgments from personal assets.

More so than the preceding two, this category presents a problem that is largely informational.⁶⁶ If the victim knew *ex ante* that a settlement or consent judgment made without the insurer's consent would not be enforceable in a subsequent action, he would never make such an agreement.⁶⁷ When such an agreement is made, blame rests with the victim's attorney; some jurisdictions are less likely than others to allow a policyholder settlement without consent to nullify the policy, but it is assuredly the attorney's responsibility to be aware of the enforceability of such a settlement within the victim's jurisdiction. Perhaps this category of case demands a different

these cases also often depends on additional factors, such as whether the insurer refused to settle in bad faith and the amount of the proposed settlement *vis-à-vis* policy limits.

⁶¹ 61 S.W.3d 280 (Mo. Ct. App. 2001).

⁶² *Id.* at 282.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.* at 284.

⁶⁶ Although the main challenge in this category is informational, some perverse incentives remain. An insurer who knows that a policholder's unilateral decision to settle will relieve it of any duty to indemnify has no incentive to prevent that outcome. By the same token, the savvy policyholder who settles on the condition that the victim's collection be limited to insurance proceeds, *e.g.*, *supra* text accompanying note 63, does not care (as an economic matter, anyway) whether that sum is collectible.

⁶⁷ What is odd about *Smith* is that the court felt the policyholder knew, or at least should have known, that the insurer would not be bound by the settlement. The court found that "the insured was put on notice that by entering into the consent judgment with [the victim], without notice to [the insurer], he placed his insurance coverage in jeopardy." *Smith*, 61 S.W.3d at 284.

solution than the other two—one geared toward facilitating more robust notice of settlement consequences and earlier involvement of insurers. For while this category, like the preceding two, reveals an acknowledgement by both the policyholder and the victim that the former is likely judgment-proof, this final category differs in that it involves an effort by the policyholder to preserve insurance proceeds nonetheless.⁶⁸ In this way, these cases will arise only when parties *fail* to respond to the perverse economic incentives discussed above. If the policyholder were not judgment-proof, no rational victim would agree to limit execution on a judgment to one potentially dry source;⁶⁹ if the policyholder *were* judgment-proof, no rational *policyholder* would take the time to negotiate and settle at all.

D. *The Impact of the Heavy Settlement Environment on Cooperation Clause Cases*

Examples in which these three types of cases are actually litigated in a courtroom are scant, because the vast majority of personal liability insurance cases are settled.⁷⁰ This observation holds true at every stage of the insurance litigation process. Even when the relationship between insurer and policyholder has broken down, if the victim pursues a direct action against the insurer, those parties are also almost certain to settle. Once the plaintiff is forced to attempt to collect from the defendant's insurer, the cooperation clause surely plays a role in shaping settlement negotiations. The specter of a policyholder breach drives down the likelihood that the victim would prevail were the issue to proceed to trial. As a result, settlement values decrease. Additionally, the somewhat peculiar relationship between the victim and the insurance company⁷¹ imports three additional obstacles to the plaintiff's attempt to achieve a fair settlement price.⁷²

⁶⁸ On this final point: the temporal structure of the claim matters, as does the event that leads the insurer to raise the cooperation defense. If the policyholder fails to respond to his insurer, thereby prompting the insurer to disavow coverage, and then later surfaces to enter into a settlement or consent judgment with the victim, that case is properly characterized as belonging to one of the first two categories. The parameters and the ensuing observations of this third category hold true only when the policyholder's settlement is *the event* that prompts the cooperation defense and when the insured is not otherwise giving the insurer the run-around. Only under these circumstances can the problem truly be deemed informational.

⁶⁹ This holds true unless the victim can secure a settlement premium in exchange for the uncertainty of collection from the insurer.

⁷⁰ See Baker, *Moral Luck*, *supra* note 29, at 174.

⁷¹ See generally Baker, *supra* note 8, at 113.

⁷² The first two obstacles resemble the aforementioned factors exacerbating the victim's difficulties in making out a breach claim against the insurer. See *supra* text accompanying notes 41-46.

First, the victim's settlement efforts are once again undermined by a massive information asymmetry. If a settlement negotiation is driven by the likelihood of success on the merits, then the party with the better information about that likelihood has the upper hand.⁷³ This party is undeniably the insurer. To be sure, given the relative infrequency with which these types of cases see actual judicial resolution, information is scarce to begin with. Yet it is quite certain that, whatever the facts, the insurer will have seen substantially similar cases. While nothing prevents plaintiffs' attorneys from becoming experts at dealing with liability insurance companies, the latter always enjoys a broad institutional knowledge base.

Second, the insurance company almost always has both institutional competence and resources that far outmatch anything the victim's attorney could provide. Between the expertise to more accurately assess the victim's claim, and its built-in legal advantages—including in-house counsel and simple financial clout—insurers have the institutional tools to drive down the eventual settlement price.⁷⁴

Third, the negotiating parties' unequal levels of need for the funds at issue has a substantially negative impact on the victim's efforts to achieve a favorable settlement. Almost by definition, the victim has a greater need to receive compensation than the insurer does to retain the funds. And while this disparity is likely present whenever an insurance company and an individual negotiate a settlement, it is especially acute when the negotiation is between the victim and the insurer against the backdrop of a potential cooperation clause breach. In those cases, the negotiation is likely to take place long after the accident occurred and the initial need for compensation arose. For an illustration of this point, consider again the case of Mr. Alvarado, whose wife left the message encouraging the insurance company to deny coverage *a full two years after the accident occurred*.⁷⁵

Additionally, the victim's very pursuit of tort compensation suggests a financial gap between his first-party insurance coverage and the damages

Their impact on the settlement process, however, is both more acute and more uniform, and universally impacts any victim who faces their injurer's insurer directly.

⁷³ See Ben Depoorter, *Law in the Shadow of Bargaining: The Feedback Effect of Civil Settlements*, 95 CORNELL L. REV. 957, 964 (2010) (noting the impact on settlement amounts of disparate levels of information).

⁷⁴ See Francis J. Mootz III, *Holding Liability Insurers Accountable for Bad Faith Litigation Tactics with the Tort of Abuse of Process*, 9 CONN. INS. L.J. 467, 519 n.136 (2003) (“[L]iability insurance carriers are particularly expert in sophisticated claims assessment and litigation and are constant repeat players in this realm.”). *But see* Baker, *supra* note 7, at 10 (noting that “[m]any liability insurance company executives would assert that their repeat player advantage is more than outweighed by the bias of judges and juries” and that this expectation drives settlement prices).

⁷⁵ See *supra* notes 1-6 and accompanying text.

stemming from the injury. The importance of this potential gap must not be understated. While many sources of first-party compensation—such as medical, disability, uninsured motorist, and life insurance—frequently cover typical injuries, not all Americans carry adequate amounts of such insurance. While the average automobile tort victim may have sufficient insurance to cover minor damages to a car, the same cannot be said when that damage is instead a broken leg, and even less so when the damage is a deceased spouse. As previously discussed, insurers' responses to these pronounced levels of need is often to impose massive delays in the settlement process.⁷⁶ Delays in the settlement process work against a victim who cannot afford to wait for a better deal. Armed with the ability to wait as long as legally practicable before actually settling the claim, the solvent insurer can simultaneously deplete the victim's resources, ratchet up the urgency of the victim's need, and hence drive down the settlement value—all while incurring virtually no additional cost.

III. THE COOPERATION CLAUSE IN COURT: MISGUIDED RESPONSES

To their credit, courts have not ignored the problems caused by the continuing use of the cooperation clause in an increasingly judgment-proof environment. Professor Lynn LoPucki has observed that the “problem has been severe enough in the current system to prompt courts and legislatures in most states to adopt ‘reach and apply’ rules to prevent post-loss actions of insureds from voiding coverage or preventing recovery from insurers.”⁷⁷ Though Professor LoPucki provides several examples of such solutions,⁷⁸ one that is particularly noteworthy is that from the case of *Storm v. Nationwide Mutual Insurance Co.*⁷⁹ In that case, the Virginia Supreme Court held that an injured party is a beneficiary under an automobile liability insurance policy from the moment the injury occurs, provided the vehicle was being

⁷⁶ See *supra* notes 43-44 and accompanying text.

⁷⁷ LoPucki, *supra* note 29, at 82-83.

⁷⁸ See, e.g., *Mandeville v. Shelby Mut. Plate Glass & Cas. Co.*, 5 Conn. Supp. 306, 309 (C.P. 1937) (“The statute, to effectuate its manifest purpose to safeguard the rights of the injured person, prohibits any cancellation or annulment of the policy by any agreement between the insurance company and the assured after the injury.” (quoting *Guerin v. Indem. Ins. Co.*, 42 A. 268, 270 (Conn. 1928))). Some courts have construed mandatory insurance statutes even more liberally, as barring cancellation of the policy based not just on an agreement between the insurer and the policyholder, but also, in limited situations, on unilateral post-loss policyholder breaches. See *infra* notes 92-98 and accompanying text.

⁷⁹ 97 S.E.2d 759 (Va. 1957).

operated with the consent of the policyholder.⁸⁰ But such a response merely facilitates direct actions against insurers by victims. While providing victims with a cause of action potentially increases their chances of receiving compensation for their injuries, it fails to account for the fact that insurers can still defend against such causes of action by claiming that the policyholder breached the duty to cooperate. In any event, causes of action are widely available to victims either through similar judicial interpretation, legislative mandate, or as the result of particularly prevalent settle-and-assign practices.⁸¹ This Comment starts with the assumption that victims can readily bring actions against insurers demanding indemnification of policyholder liabilities. The focus, instead, is on the significant obstacles to that action's success. Thus, judicial action such as that driving *Storm*, while certainly a necessary precursor, cannot properly be classified as a response to the problem this Comment addresses.

The judicial actions that follow can more properly be termed "responses," but while they correctly identify the problem of victim undercompensation, they are largely inadequate because they focus too heavily on raising the bar for what is considered a breach of the cooperation clause rather than addressing the underlying problems of misaligned incentives. This Part identifies and evaluates two classes of judicial response—the erection of obstacles to the insurer's use of the cooperation clause as a defense, and the eradication of the cooperation clause in mandatory insurance schemes.

A. *Obstacles to the Use of the Cooperation Clause*

Recognizing the basic contours of the problem of victim undercompensation, courts in many jurisdictions have placed substantial hurdles in the path of insurers seeking to use a policyholder's violation of the cooperation clause as a defense to indemnification. These obstacles take various forms and often stem from common law notions of breach of contract. Almost uniformly, courts have imposed on insurance companies the requirement that the policyholder's failure to cooperate be prejudicial to the insurer before it can serve as the basis for a refusal to indemnify.⁸² The

⁸⁰ *Id.* at 762.

⁸¹ See *supra* note 40 and accompanying text.

⁸² See 14 COUCH, *supra* note 8, § 199:76 ("In order to be relieved of its obligations under an insurance contract, many jurisdictions take the view that an insurer must show not only that the insured breached the contract, but also that it was prejudiced as a result." (footnotes omitted)); see also, e.g., *Holt v. Utica Mut. Ins. Co.*, 759 P.2d 623, 630 (Ariz. 1988) (in banc) ("Even if an insured breaches a cooperation clause, the insurer may not use that fact as a defense unless the breach has caused substantial prejudice."); *State Farm Fire & Cas. Co. v. S.S.*, 858 S.W.2d 374, 386 (Tex. 1993) ("An insurer has no obligation to indemnify an insured who fails to cooperate and

policyholder's failure to appear or to provide documents per the insurer's request is generally not per se sufficient to establish prejudice;⁸³ rather, the insurer is required to demonstrate that the policyholder's failure to cooperate prevented the insurer from pursuing a beneficial strategy that would have been open to it but for the policyholder's breach.⁸⁴ Many jurisdictions have sought to make this standard even more exacting, by stressing contract law requirements of materiality and substantiality.⁸⁵ These requirements leave the door open for courts to consider whether a policyholder's actions, in the aggregate, may constitute substantial compliance with the policy despite minor lapses in cooperation.⁸⁶ Courts have also mandated that insurers actively attempt to secure policyholder cooperation.⁸⁷ In practice, these

prejudices the insurer's rights and obligations under the policy." (emphasis added)). *But see* *Miller v. Augusta Mut. Ins. Co.*, 157 F. App'x. 632, 638 (4th Cir. 2005) ("A material breach of the duty to cooperate relieves the insurer of its liability under the policy, even if the insurer is not prejudiced by the lack of cooperation." (applying Virginia law)); *Am. Country Ins. Co. v. Bruhn*, 682 N.E.2d 366, 372 (Ill. Ct. App. 1997) ("The defendants claim that the [the insurer] must establish prejudice to deny coverage based on a lack of cooperation. However, in this case, such an assertion is absurd. The only way the [insurer] can prove prejudice caused by the lack of cooperation is to know what [the policyholder]'s statement would have revealed. Since [he] refused to give . . . a statement, the [insurer] cannot know how it was prejudiced.").

⁸³ *See* *Oloff-Michael v. Mut. Benefit Ins. Co.*, 262 F. Supp. 2d 602, 604 (D. Md. 2003) ("[P]rejudice cannot be surmised or presumed from the mere fact of delay." (citation omitted)).

⁸⁴ *See, e.g., Tran v. State Farm Fire & Cas. Co.*, 961 P.2d 358, 365 (Wash. 1998) (en banc) ("Interference with the insurer's ability to evaluate and investigate a claim may cause actual prejudice." (citation omitted)).

⁸⁵ *See, e.g., Fellows v. Mauser*, 302 F. Supp. 929, 934 (D. Vt. 1969) ("[B]efore there can be a breach of the duty to cooperate, the failure on the part of the insured must be material or substantial." (citing *Curran v. Conn. Indem. Co.*, 20 A.2d 87, 89 (Conn. 1941)); *Patel v. Allstate Ins. Co.*, 570 N.E.2d 357, 361 (Ill. App. Ct. 1991) (finding an issue for trial of whether the insured "substantially complied with the terms of the policy"); *Gabor v. State Farm Mut. Auto. Ins. Co.*, 583 N.E.2d 1041, 1043 (Ohio Ct. App. 1990) ("To constitute a defense to liability, an insured's lack of cooperation must result in material and substantial prejudice to the insurance company." (citing *State Farm Mut. Auto Ins. Co. v. Holcomb*, 458 N.E.2d 441, 445 (Ohio Ct. App. 1983))).

⁸⁶ *See* *Harris v. Prudential Prop. & Cas. Ins. Co.*, 632 A.2d 1380, 1382 (Del. 1993) (noting that to establish a breach of the cooperation clause, the insurer must prove "substantial breach of the provision"); *Buckeye Union Ins. Co. v. Chuchanis*, No. CA-6274, 1984 WL 7244, at *1 (Ohio Ct. App. Jan. 30, 1984) (finding the policyholder's self-initiated admission of fault in an affidavit "a substantial breach of the duty to cooperate").

⁸⁷ *See, e.g., Cincinnati Ins. Co. v. Irvin*, 19 F. Supp. 2d 906, 910 (S.D. Ind. 1998) ("[F]or an insurance company to be relieved of liability based on an insured's breach of its cooperation clause, the insurance company must prove . . . that the company used good faith efforts and diligence to obtain the insured's cooperation . . ."); *Allstate Ins. Co. v. Loester*, 675 N.Y.S.2d 832, 834 (Sup. Ct. 1998) ("The insurer must demonstrate that, (1) it acted diligently in seeking to bring about the insured's co-operation, (2) the efforts employed by the carrier were reasonably calculated to obtain the insured's cooperation, and (3) the attitude of the insured, after his cooperation was sought, was one of willful and avowed obstruction." (internal quotation marks omitted)); *Smith v. Nationwide Mut. Ins. Co.*, 830 A.2d 108, 116 (Vt. 2003) ("To successfully invoke a defense of noncooperation, diligent effort to secure the cooperation of a recalcitrant

vaguely worded, fact-specific, subjective standards provide courts not with a rigorous rubric by which to assess policyholder behavior, but rather with open-ended tools with which to combat perceived insurer opportunism.⁸⁸

This approach is fundamentally misguided, because rather than seeking to correct the misaligned incentives at the root of the problem, it seeks simply to limit the class of individuals to whom the problem applies. While raising the threshold for a noncooperative breach mitigates the ill effects in that instance, it does not eradicate them, as some noncooperation will undoubtedly meet the various judicial requirements described above. In other words, such a solution is of little consolation to victims whose policyholders *did* materially and prejudicially breach. And it is all the more troublesome that whether a victim's compensation is preserved turns not on need, contributory culpability, or severity of injury, but on the wholly independent and arbitrary measure of policyholder cooperation.⁸⁹ Though apparently designed to effectuate the compensatory goals of liability insurance, such an arbitrary method of determining which victims should be compensated is actually a perversion of those goals. The following observation of an Illinois court is illustrative:

Because automobile policies serve to protect members of the public who are injured by the insured's negligence, "an insurer will not be relieved of its contractual responsibilities unless it proves it was substantially prejudiced by the insured's actions or conduct in regard to its investigation or presentation or defense of the case."⁹⁰

insured is required, and, as found by one court, it includes more than simply sending letters to the insured, or telephoning them and requesting their appearance at trial . . .").

⁸⁸ See *Loester*, 675 N.Y.S.2d at 834 (finding that the policyholder's having "ignored correspondence" was "palpably insufficient" to meet the "heavy" burden on insurers attempting to avoid indemnification because of the cooperation clause); Hazel Beh & Jeffrey W. Stempel, *Misclassifying the Insurance Policy: The Unforced Errors of Unilateral Contract Characterization*, 32 CARDOZO L. REV. 85, 126 (2010) ("[T]he cooperation requirements have often not been stringently enforced by courts and anything resembling substantial compliance is usually enough . . .").

⁸⁹ In fact, the *greater* the policyholder's culpability—in refusing to assist in the insurer's defense—the less likely victim compensation becomes. Also discouraging is that it is often difficult to find a principle reconciling the disparate results in which cooperation clause breaches are and are not found to be prejudicial. Compare *Progressive Cnty. Mut. Ins. Co. v. Trevino*, 202 S.W.3d 811, 817 (Tex. Ct. App. 2006) (finding a policyholder's cooperation clause breach prejudicial when he filed a pro se answer and encouraged the insurer to refuse indemnification), with *Irvin*, 19 F. Supp. 2d at 916 (finding a policyholder's "disappear[ance] without explanation" insufficient to establish per se prejudice).

⁹⁰ *United Auto Ins. Co. v. Buckley*, 962 N.E.2d 548, 557 (Ill. App. Ct. 2011) (quoting *Founders Ins. Co. v. Shaikh*, 937 N.E.2d 1186, 1193 (Ill. App. Ct. 2010)).

This statement underscores the inherent absurdity in recognizing that, although liability insurance is designed to address victim need in response to policyholder negligence, neither factor influences the division of the limited compensation pool.

In applying the test this way, courts seem content to leave the cooperation clause intact, and then to arbitrarily concentrate its adverse consequences on an undeserving, albeit limited, class of accident victims. Such a response ignores the fact that, as presently constituted, the cooperation clause simply cannot work in a largely judgment-proof society. When the environment in which a duty exists undergoes a fundamental change such that the obligation can no longer function as originally intended, the tenor of that obligation should undergo similar alteration.⁹¹

B. *Proscription of the Cooperation Clause as a Defense in Mandatory Liability Insurance Schemes*

A second class of response has been to prohibit insurance companies from raising the policyholder's lack of cooperation as a defense to indemnification in mandatory insurance schemes.⁹² This approach pays lip service to what is widely acknowledged to be the legislative intent behind mandating the purchase of liability insurance: to provide adequate compensation for the victims of accidents.⁹³ Adopting this rule, the Michigan Supreme Court observed that:

⁹¹ Cf. Note, *Taking Reichs Seriously: German Unification and the Law of State Succession*, 104 HARV. L. REV. 588, 595-96 (1990) (observing that “[u]nder the law of treaties, the principle of *rebus sic stantibus* . . . implies that treaties have identifiable purposes and that if changes in the international system frustrate those purposes, states should be allowed to terminate their obligations” (footnote omitted)).

⁹² See *Coburn v. Fox*, 389 N.W.2d 424, 428 (Mich. 1986) (noting that “failure of the insured to cooperate with the insurer is not a valid defense” in a mandatory insurance scheme); see also *Prudential Prop. & Cas. Ins. Co. v. Johnson*, No. 92C-02-91, 1992 WL 301725, at *1 (Del. Super. Ct. Oct. 21, 1992) (holding that the Delaware statute mandating automobile liability insurance “bars Prudential’s attempt to have the policy declared void for the failure of a covered driver to cooperate”); *Rodgers-Ward v. Am. Standard Ins. Co.*, 182 S.W.3d 589, 593 (Mo. Ct. App. 2005) (holding that “the ‘cooperation clause’ in [the] motor vehicle liability policy is unenforceable . . . to the extent it purports to deny [the victim] the minimum liability coverage required by” state law); *Tibbs v. Johnson*, 632 P.2d 904, 906 (Wash. Ct. App. 1981) (noting that Washington’s insurance policy provisions “cannot be undermined by contract”).

⁹³ See, e.g., *Walker v. State Farm Mut. Auto. Ins. Co.*, 661 F. Supp. 930, 932 (D. Del. 1987) (noting that the “requirement of mandatory insurance is intended to protect persons injured by a driver”), *aff’d*, 845 F.2d 1019 (3d Cir. 1988); *Weeks v. Wimple*, 669 F. Supp. 499, 501 (D.D.C. 1987) (calling “the expressed purpose of the [compulsory automobile liability insurance] act to provide protection for all victims”); Christopher J. Robinette, *Why Civil Recourse Theory Is Incomplete*, 78 TENN. L. REV. 431, 468 n.326 (2011) (“Compulsory automobile insurance was a legislative attempt to further the compensation of automobile accident victims.”).

Allowing [the insurer] to successfully assert a defense of noncooperation . . . after plaintiffs had secured a default judgment would deny plaintiffs the protection intended by the no-fault act. A defendant whom plaintiffs had successfully sued under the no-fault act would suddenly become an uninsured motorist when plaintiffs attempted to collect their judgment.⁹⁴

To its credit, the *Coburn* court recognized the inherent problem in allowing policyholder action to subvert the interests of members of the “class intended to be protected” by the legislatively imposed liability insurance scheme in the first place.⁹⁵ State statutes of this nature—often termed “financial responsibility” statutes—impose obligations that are largely uniform,⁹⁶ and courts have widely interpreted them as creating “absolute” or “frozen” liability coverage,⁹⁷ meaning that even a violation of the policy cannot defeat it.⁹⁸ Of course, while this response achieves the admirable result of ensuring compensation for accident victims despite a policyholder’s failure to cooperate, such compensation is generally limited to the statutory minimum required amount.⁹⁹ As a result, the cooperation clause continues

⁹⁴ *Coburn*, 389 N.W.2d at 429. That Michigan’s mandatory insurance derives from a no-fault act is irrelevant for present purposes. All states, most of which are not no-fault jurisdictions, mandate liability coverage, see *infra* note 96, and the observations of the *Coburn* court hinged on the standard rather than the unique aspects of Michigan’s scheme.

⁹⁵ *Coburn*, 389 N.W.2d at 429.

⁹⁶ See 16 RICHARD A. LORD, WILLISTON ON CONTRACTS § 49:33 (4th ed. 2011) [hereinafter 16 WILLISTON] (“[C]ompulsory insurance and ‘financial responsibility’ legislation has been adopted in all states, making automobile liability insurance mandatory The basic thrust of these acts is to encourage motorists to procure and maintain automobile liability insurance so that victims of motor vehicle accidents will have a reliable source from which to seek compensation for their injuries.”).

⁹⁷ *Tibbs*, 632 P.2d at 907.

⁹⁸ See 16 WILLISTON, *supra* note 96, § 49:33 (“Motor vehicle financial responsibility laws are remedial statutes and are therefore liberally construed with the goal of effectuating their purposes. Since the purpose of these statutes is to protect innocent individuals who are injured by financially irresponsible drivers, a number of courts interpret their acts to provide the greatest possible protection to persons within their ambit. Moreover, it has been said that financial responsibility statutes are declaratory of a public policy that supersedes any more general public policy applicable to ordinary insurance law or contracts.” (footnotes omitted)). For an example of a court construing statutory language in this fashion, see *Tibbs*, 632 P.2d at 907.

⁹⁹ In *United Services Automobile Ass’n v. Markosky*, the argument was proffered “that liability coverage in excess of the statutory minimum limits is, in effect, mandatory from the perspective of the insurer” and that the public policy considerations that prevented an insurer from denying coverage to a noncooperative policyholder up to the statutory limits demanded the same result for coverage in excess of those limits. 530 S.E.2d 660, 663-64 (S.C. Ct. App. 2000). The court flatly rejected this argument, however, observing that to extend absolute liability beyond statutory minimums would be to “construe the plain language of the statute to extend the public policy beyond that which was plainly intended.” *Id.* at 664.

to provide insurers with a valid tool to escape indemnification for policyholder liability beyond the statutory minimum.¹⁰⁰ Surely, there is an argument that because coverage beyond the statutory minimum is uncommon,¹⁰¹ a solution that threatens above-minimum coverage in some accidents while guaranteeing at least minimum coverage to all victims is a good compromise. I offer a twofold counter. First, it fails to go far enough; fairness demands that all bargained-for liability coverage be preserved in the face of policyholder noncooperation. Second, coverage above the minimum, however rare, should be encouraged and protected rather than jettisoned as a rarity not worth the structural support.

That said, a system that preserves minimum coverage achieves much that is desirable. It recognizes that both the judgment-proof policyholder's disincentive to cooperate and the insurance company's incentive toward opportunistic policy nullification can combine to harm innocent victims of accidents, and it partially rectifies that problem by guaranteeing that at least a portion of those accident victims receive at least a portion of applicable insurance proceeds. But beyond the readily apparent shortcoming—that this solution ignores the class of victims who are deprived of compensation from applicable, but not mandatory, liability insurance¹⁰²—this solution has two major pitfalls.

First, the statutory minimum coverage is painfully inadequate.¹⁰³ This problem may appear to be purely legislative. Perhaps, because a judgment-proof defendant cannot be expected to purchase insurance beyond the minimally required amount, capping victim compensation at this level is the best we can do. If victim compensation depends on a higher level of minimum coverage, the argument goes, that is a task for the legislature. Two

¹⁰⁰ See, e.g., *Harris v. Prudential Prop. & Cas. Ins. Co.*, 632 A.2d 1380, 1382 (Del. 1993) (forcing the insurer to provide the victim only the statutory minimum of \$15,000 when the noncooperative policyholder had a \$100,000 liability limit and the victim had won a judgment of \$54,000).

¹⁰¹ Stephen Brobeck & J. Robert Hunter, *Lower-Income Households and the Auto Insurance Marketplace: Challenges and Opportunities*, CONSUMER FED'N AM. (Jan. 30, 2012), <http://www.consumerfed.org/news/450> (noting the infrequency with which low-to-moderate income families purchase auto liability insurance beyond the minimum amount required).

¹⁰² Despite its status as a nonmandatory liability insurance, homeowner's liability insurance, due to its prevalence as an attachment to the insurance policies required by most mortgage companies and its relatively low cost, often represents a victim's only chance at recovering tort damages for everyday harms.

¹⁰³ See Brobeck & Hunter, *supra* note 101 (surveying minimum coverage amounts by state and noting that they are often "not sufficient to fully compensate other motorists involved in serious crashes who are not deemed at fault"); see also Ron Lieber, *Consider Worst Case with Zipcar*, N.Y. TIMES, Apr. 23, 2011, at B1 (criticizing "the pathetically low bare (automobile liability) minimums that each state requires").

observations weaken this argument. First, minimum coverage is calibrated not to what victims need but to what policyholders can reasonably afford. If insurance were cheaper, policyholders—and, consequently, victims—would get more coverage for their money. By mandating coverage without addressing the fundamentally misaligned incentive, this class of solution risks both making insurance more expensive and compounding the inadequacy of minimum coverage. While a judgment-proof policyholder might choose to cooperate despite having no economic incentive to do so (for instance, if he feels a moral obligation to the victim¹⁰⁴) that policyholder has even less of an incentive to cooperate if he knows that his insurance proceeds will go to the victim whether he cooperates or not.¹⁰⁵ Widespread lack of policyholder cooperation may lead to increased costs for insurance companies, higher premiums, and less coverage for the minimum amount paid. Moreover, people do insure beyond the minimum amount. To the extent a victim's need likewise exceeds minimums, we should seek a solution that preserves the entirety of the policyholder's coverage.

The second major pitfall of the “frozen liability” class of solutions is that it fails to protect insurer interests, one of the purported goals of the cooperation clause. Instead, this solution pushes the claims process in practice further and further from the truth-serving ideal embodied in the cooperation clause's language.¹⁰⁶ As discussed above, with such a solution in place, judgment-proof policyholders have even less of an incentive to cooperate than they do without one. As such, this solution seems less concerned with unveiling the truth about accidents and assigning liability *correctly* than it does with providing at least some financial redress to victims. Such a step blurs the line between mandatory liability insurance schemes and limited victim compensation funds.

Clearly that is not all bad. If one of the primary goals of liability insurance in the first place is to ensure that funds are available to compensate victims of accidents, then perhaps the system's increasing resemblance to an automatic no-fault fund is encouraging. But a response that systematically subordinates the interests of insurance companies in favor of the public

¹⁰⁴ See *supra* note 34.

¹⁰⁵ In fact, there is a chance that the policyholder's cooperation might *decrease* the victim's chances at receiving the compensation. Thus a policyholder who feels morally obligated to ensure his insurance proceeds flow to the victim, who knows that his cooperation might reveal facts that would threaten the policy's applicability, and who knows that noncooperation is not a defense, may very well opt to ignore his insurer completely. To be sure, this approximates a sort of unilateral collusion, but is unlikely to threaten victim compensation under a “frozen liability” scheme.

¹⁰⁶ See *supra* text accompanying notes 31-32.

good is myopic. Such efforts will invariably be met with a robust and organized opposition that will delay and mitigate the effectiveness of any solution. Insurer interests are best served when policyholders truthfully and actively participate in the claims process, thereby allowing the insurer to effectively negotiate fair settlement prices and curb expenditures. Insurance companies, as members of the private sector, compete to offer a better product than their competitors, and to do so more efficiently. We should seek a solution that recognizes and embraces this fact and attempts to remedy cooperation clause problems within that framework.

IV. THE COOPERATION CLAUSE REIMAGINED

Combined, the above responses paint a picture of judicial and legislative reactions to the cooperation clause problem that both recognize the misaligned incentive structure and begin to craft solutions that favor accident victims. But while those solutions attack the *reach* of the cooperation clause, the solution proposed by this Comment instead targets the *remedy* for a violation in an effort to realign incentives and restore the clause's intended efficacy. Two goals are centrally important to this proposed solution. First, it must place all or substantially all of the cost of a cooperation clause violation on the breaching policyholder himself rather than on the accident victim. Second, it must redesign that cost such that it functions as a meaningful incentive for judgment-proof policyholders to actively cooperate. A tentative path—with both a contractual and a legislative component—toward these goals follows.

A. *A Contractual Response*

The contractual component of the response centers upon the remedy for a cooperation clause violation. Rather than negating the whole policy and nullifying the insurer's duty to indemnify the policyholder's liability, a breach of the cooperation clause should result in the activation of a cost-shifting mechanism, whereby the insurer can recover the defense costs, but not the actual amount indemnified, from the noncooperative policyholder. Under this structure, the insurer would be responsible for indemnifying up to policy limits whenever the policyholder were found liable (or the insurer decided to settle). Following this indemnification, though, an insurer would be free to initiate an action for defense costs against the noncooperative policyholder.

In addition to protecting victims, this arrangement serves two important purposes. First, it serves a collectibility function by getting around the

judgment-proof problem. The costs of an insurer's defense of a policyholder are much more likely to be collectible from the policyholder—even a poor one—than is the entire judgment amount, because for the experienced insurers these are not expensive lawsuits.¹⁰⁷ Far from the headline-grabbing legal fees of complex corporate litigation, the defense costs in these types of cases are likely kept quite low by the frequency with which cases settle and the streamlined claims process in place at most insurance companies.¹⁰⁸ Second, this mechanism serves a positioning function. Rather than pitting the victim of the accident against either the insurer or the breaching policyholder, this mechanism places the onus for collection on the insurance company, a repeat player with both the expertise and the resources to efficiently and effectively pursue such actions. Ideally, the obligation to pay defense costs could function as a fine that insurers could levy upon non-cooperative policyholders backed by the coercive power of an eminently collectible legal judgment as an alternative.

This latter positioning point is of particular importance. As it stands now, the majority of cooperation clause litigation takes place between the accident victim and the insurer, while the party presumably most responsible for both the accident and the denial of compensation simply settles, assigns, and disappears. This component of the solution would free the victim of this bureaucratic burden and remove ancillary financial disincentives to the victim's pursuit of rightful compensation. To be sure, classification of this revised remedy as strictly within the terms of the liability contract does not tell the whole story; it would be disingenuous to attempt this reconsideration of duties from a purely interpretive standpoint.¹⁰⁹ Full realization of this goal is likely to necessitate some form of legislative or administrative action, such as an insurance commission regulation prohibiting insurance companies from denying indemnification based wholly on post-accident policyholder activity. Such a rule would ideally preserve the right of

¹⁰⁷ Professor Stephen Gilles has observed that “almost everyone could pay a \$1000 claim in full—if not in a lump sum, then in periodic installments. Claims of that magnitude, however, are normally too small to be worth litigating under the standard contingent-fee arrangement, which typically gives the plaintiff's attorney one-third of the judgment or settlement.” Gilles, *supra* note 29, at 608.

¹⁰⁸ Additionally, the settlement negotiation process will ideally be less complex. If the insurer knows that its duty to indemnify is tied solely to policyholder liability rather than being impacted by post-loss policyholder behavior, there is presumably less traction for complex settlement negotiations.

¹⁰⁹ It would not be rigorously honest to attempt to classify a policyholder who has failed to cooperate as having substantially complied with the terms of the policy, as compliance with the cooperation clause in its present form has rightfully been considered a condition precedent. *See, e.g., Progressive Cnty. Mut. Ins. Co. v. Trevino*, 202 S.W.3d 811, 816 (Tex. Ct. App. 2006).

insurers to refuse indemnification based both on collusive schemes between the policyholder and the victim—as that could not properly be termed *wholly* policyholder behavior—and on *pre*-accident policyholder behavior such as application fraud.¹¹⁰

B. *A Legislative Response*

The second component of my solution is legislative in nature, and has as its goal the creation of a more powerful incentive for policyholders to cooperate. If policyholders indeed respond to such incentives, and if the judgment-proof problem can be overcome, then the class of disputes implicating cooperation clause violations will shrink considerably. In my view, state legislatures should impose criminal sanctions on noncooperative policyholders. Penalties could entail fines, or in the case of automobile insurance, the suspension of the policyholder's driver's license. This response is both perfectly reasonable and potentially very effective.

It is reasonable in two regards. First, the idea of sanctions as an enforcement mechanism for insurance obligations is not a new one. Every state punishes its citizens who drive cars without purchasing the minimum liability coverage.¹¹¹ Use of a state's criminal justice apparatus to assure socially optimal behavior is neither a new concept nor one that is overly harsh in this context, especially when one considers both the noncooperative policyholder's culpability and his relatively low compliance costs. Second, state punishment of the failure to purchase mandatory insurance stems from the legislative conviction that victim compensation is a social good worthy of the criminal justice system's protection. As demonstrated, a policyholder's noncooperation often has the same effects *vis-à-vis* victim compensation as would a failure to purchase insurance in the first place. The protection afforded by existing criminal statutes and that of the present proposal both

¹¹⁰ In contrast to his lack of cooperation, a policyholder's fraudulent representation on an insurance application much more dramatically alters the lens through which we consider the policy and whether the insurer should be able to avoid its obligations. If the policyholder has not been truthful in his disclosure, the policyholder has been unjustly enriched through the receipt of more insurance at a cheaper price than would presumably have been available to him had he been completely forthcoming. If the insurer fully indemnifies in this situation, it will have financed the policyholder's fraud. Exploration of the notion that insurers should be forced to fully indemnify and then permitted to recover from the policyholder the difference between the premiums they did pay and the premiums they would have paid had they been truthful is a topic for another day.

¹¹¹ See Jeffrey E. Thomas, *An Interdisciplinary Critique of the Reasonable Expectations Doctrine*, 5 CONN. INS. L.J. 295, 308 n.67 (1998) ("Automobile insurance is required as a condition to driving in most states" (citing ROBERT H. JERRY, II, UNDERSTANDING INSURANCE LAW § 132(a)(2) (2d. ed. 1996))); see also *id.* ("[M]ost lenders will require homeowners insurance as a condition of financing the purchase of a home.").

seek to prevent identical ills. Admittedly, it takes a leap to extend this protection beyond the mandatory insurance realm, but the centrality of liability insurance to a state's tort law system should empower state legislatures to take a bigger hand in regulating policyholder behavior.

Support for this component's effectiveness is likewise twofold. First, a criminal sanction will function as a much more powerful incentive to cooperation than nullification of the policy. A small fine poses few collectibility concerns, and suspension of a license is an unavoidable and uniformly applicable consequence. It also draws coercive power from both the stigma and the collateral consequences of a criminal penalty. Second, it once again removes victim-level barriers to compensation by ensuring that neither the negative consequences nor the enforcement obligations of the cooperation clause lie with the victim.

This solution also more vigorously protects the insurer's interests. While, as previously mentioned, nullification of a policy is clearly in the insurer's interest, and this solution limits insurers' ability to avoid their obligations, this burden is purely financial; insurers will adjust premiums to compensate for any significant adverse financial impact. The real benefit to insurers derives from the truth-serving function that increased cooperation will promote. Insurance companies compete with one another to design and implement the most cost-efficient claims management processes. To succeed and maximize profits, an insurance company needs to outperform its competitors in this regard. The more information regarding an accident that is available to an insurer, the more that insurer's relative competitive advantage will be tied to things within its control, such as the design of its claims process, the competency of its adjusters, and the effectiveness of its settlement negotiations. A minor financial disadvantage resulting from having to indemnify a greater number of losses is easily mitigated by modest premium hikes. But the informational disadvantage brought about by the cooperation clause's current failure to incentivize the truth moves the industry toward an undesirable corporate playing field on which innovative design and corporate competency play too small a role in creating a competitive advantage.

C. *A Tailored Fifth Amendment Response*

Ideally, the above two solutions will work in concert both to encourage greater levels of cooperation and to preserve compensation for victims. There is, however, one class of noncooperative policyholder for whom criminal punishment would be problematic—those policyholders invoking their Fifth Amendment rights in a parallel criminal case. Arguably, it would

be impermissible to hold a policyholder criminally liable for the collateral consequences of his invocation of a constitutional right.¹¹² Thus the Fifth Amendment problem demands an alternative solution to replace the imposition of criminal sanctions.¹¹³ I propose two: a judicial/interpretive solution, and in the alternative, a legislative one.

The first begins with a question: If noncooperation is subject to a rule of reasonableness, what is so unreasonable about refusing to cooperate when to do so may hasten criminal liability?¹¹⁴ While such a litigation strategy surely faces an upstream swim against the flow of precedent,¹¹⁵ momentary reflection will reveal that this is an eminently sensible query. Hence, the proposal is that courts consider policyholders who fail to cooperate due to their invocation of the Fifth Amendment to have nevertheless substantially complied with their policies. This proposal is consistent with the existing, obvious limits to a court's finding of noncooperation. One cannot imagine a court declaring a policyholder in breach if he was kidnapped and thus unable to respond to his insurer's phone calls. Similarly—though a slightly less extreme case—a court would refuse to find a breach if cooperation were possible only under circumstances that would place the policyholder in grave danger. This exercise is likely to be purely theoretical given the farfetched nature of the factual suppositions, but if our intuition is to excuse noncooperation in those cases, why not also when cooperation is possible only under circumstances that would create a substantial likelihood of

¹¹² Courts are in agreement that nullification of the insurance policy is a permissible consequence of a defendant's invocation of Fifth Amendment rights. *See Miller v. Augusta Mut. Ins. Co.*, 157 F. App'x 632, 638 n.6 (4th Cir. 2005) (permitting "the blanket invocation of his Fifth Amendment rights [to] sufficiently establish[] the policyholder's failure to cooperate"). That would perhaps not be true if the consequences were criminal in nature. *See United States v. Jackson*, 390 U.S. 570, 582 (1968) (holding that legislative objectives "cannot be pursued by means that needlessly chill the exercise of basic constitutional rights"). The basic difference here is that policy nullification is a consequence imposed by a private party pursuant to a consensual bilateral contract, while a criminal sanction is unilaterally imposed by the State. Though it is not entirely clear whether courts would consider such an imposition "needless," given the goal of encouraging cooperation, it is clear that the criminalization of a refusal to provide potentially self-incriminating testimony faces an uphill battle to constitutionality in any context.

¹¹³ This should not come as a surprise. A policyholder who invokes his Fifth Amendment right does so because he is backed into the Hobson's choice of criminal or civil liability. That is a markedly different situation from the prototypical noncooperative policyholder who chooses inaction over action because the former is both easier and lacking a downside. Identical consequences for the accident victim unite these two noncooperative policyholders, but because the underlying incentives to which they respond differ widely, a one-size-fits-all solution is inappropriate.

¹¹⁴ For this central question and the rhetorical answer it begs, credit is owed to Professor Tom Baker.

¹¹⁵ *See supra* Section II.B.

criminal liability, or even incarceration? One possible criticism is that there is a moral component to the Fifth Amendment case—that allowing invocation to leave intact the possibility of indemnification rewards criminals. While this answer may carry intuitive merit, it falls apart when we consider that for judgment-proof defendants, the real beneficiary of indemnification is the victim. There is no windfall to a judgment-proof criminal defendant in avoiding civil liability.

The second potential replacement for criminal sanctions to remedy the Fifth Amendment problem is a legislative grant of immunity for all testimony in civil insurance proceedings. The Supreme Court has held “immunity from use and derivative use” of testimony a valid substitute for the privilege against compelled self-incrimination.¹¹⁶ Thus, if a state legislature declared that any statement made in a civil insurance proceeding, or under oath to an insurer, could not be used to prosecute or develop leads against the policyholder in a parallel criminal proceeding, then the compulsion of policyholder testimony would be constitutional. There appear to be few disadvantages to the grant of such immunity. Without it, policyholders will refuse to cooperate and potentially deprive accident victims of compensation while prosecutors must proceed without a statement from the policyholder-defendant; *with* the immunity, policyholders cooperate and preserve compensation for their victims, while prosecutors must still proceed without a statement from the policyholder-defendant. In practice, such immunity can be difficult to police, as it may be hard to prove that the prosecution did in fact draw a lead from immunized testimony, but characteristics unique to the insurance context allay such concerns. First, it will be quite easy to shield this testimony from prosecutors, especially if it comes during a closed-door deposition. Furthermore, because insurance companies notoriously delay action on claims,¹¹⁷ there is a reasonable probability that the immunized testimony will *follow* the resolution of the criminal case.

D. *Observations on the Impact on Premiums*

As mentioned above, because this solution limits the instances in which an insurer can refuse to indemnify a policyholder's liability, it poses the risk that premiums will increase as insurers attempt to cover these increased

¹¹⁶ *Kastigar v. United States*, 406 U.S. 441, 453 (1972); *see also id.* at 462 (holding that because use and derivative use immunity “leaves the witness and the prosecutorial authorities in substantially the same position as if the witness had claimed the Fifth Amendment privilege[.]” compelled testimony under such an immunity is constitutional).

¹¹⁷ *See supra* notes 43-44.

expenditures.¹¹⁸ Beginning with the assertion that it is impossible to gauge *ex ante* the effect a change such as this one will have on premiums, I nonetheless offer three observations designed to mitigate concerns over premium increases. First, the truth-serving function of this solution may serve to decrease settlement amounts for legitimate reasons. Cooperative policyholders with actual incentives to engage in the claims process may provide their insurers with leverage in the settlement negotiation process. While doctrines like assumption of risk and contributory negligence are unlikely to be litigated with any real frequency given the heavy settlement environment, facts implicating such factors may decrease settlement amounts and curb insurer expenses.¹¹⁹ Second, even if premiums did increase as a result of this scheme, it is unlikely that such an increase would be significant. It is important to note that this solution implicates only the liability component of automobile and homeowner's policies, for which the corresponding proportion of the premiums is often very low.¹²⁰ Finally, this solution merely represents an effort to shift that portion of the cost of accidents currently borne by the victims themselves onto the party best positioned both to internalize and to spread those costs—the insurance company.¹²¹ As all policyholders are potential victims of judgment-proof tortfeasors,¹²² a modest premium hike that brings with it a greater likelihood of recovery—if such an injury were to occur—is a mutually beneficial exchange.

¹¹⁸ See Suzanne Yelen, Note, *Withdrawal Restrictions in the Automobile Insurance Market*, 102 YALE L.J. 1431, 1445 (1993) (observing that the mere anticipation of increased costs as a result of new regulation or legislation often leads to increases in premiums).

¹¹⁹ Because tort victims generally collect far below their actual need, what I term *decreases in settlement for legitimate reasons* are still likely to leave victims undercompensated vis-à-vis what they would get if they went to trial. Without drastic increases in state mandatory minimums, however, the tort system will never be able to fully compensate victims for their losses. In the absence of complete compensation, we should at least strive for a system that compensates victims proportionately according to the relative merits of their cases.

¹²⁰ See GEICO, Family Auto Policy (Policy no. [redacted]) (on file with author) (setting the six month premium for \$300,000 per victim of bodily injury liability—well beyond the statutory minimum coverage—at a mere \$91.30 every six months, or less than 25% of the total premium).

¹²¹ Liability insurance itself is designed to serve this very goal. See Richard B. Stewart, *Crisis in Tort Law? The Institutional Perspective*, 54 U. CHI. L. REV. 184, 187 (1987) (advocating strict enterprise liability in torts “because the enterprise is in the best position to spread the risk of injury through liability insurance”). By allowing insurers to foist concentrated costs back onto accident victims, the cooperation clause subverts the institution of liability insurance. Because the modern tort system depends so greatly upon liability insurance to ensure its ability to continue to serve its compensatory purpose, see *supra* note 29, the cooperation clause likewise threatens the tort system itself.

¹²² See ABRAHAM, *supra* note 25, at 102 (“[H]aving an auto accident has become an unfortunate yet unsurprising occurrence in the lives of ordinary people . . .”).

CONCLUSION

The solution outlined above ameliorates the potential harm caused by all three categories of noncooperation. First, the prototypical noncooperative policyholder is prevented from unilaterally depriving his victim of compensation through his refusal to respond to insurer requests. Though potential criminal sanctions—the threat of driver’s license suspension and a more collectible fine—will combine to deter blatant noncooperation, the victim is not the one who bears the costs in the event that such deterrence fails. In bearing that cost, the insurer indemnifies the policyholder against a loss contemplated and bargained for in the policy and retains the ability to recoup defense costs—something it would be unable to do in the event of full cooperation. Second, a policyholder invoking his Fifth Amendment right to silence no longer foists the costs of the accident onto his victim. According to my view, liability insurance claims parallel to a criminal charge are treated as sufficiently distinct from one another, and the former are able to proceed by design. Whether this happens by immunity or through a new judicial interpretation of the cooperation clause, the accident victim is no longer forced to subsidize the constitutional rights of the individual who caused the accident. Finally, when a policyholder settles without the insurer’s consent, the victim of the accident will not be penalized for the policyholder’s informational deficiency. Though the problem of policyholder settlement without consent demands better education of policyholders to inform them that such settlements violate the terms of the policy, when such efforts fail, this solution preserves compensation for the victim.

The prevalence of liability insurance today has enabled great strides toward solving the problem of victim undercompensation. Without the provision of effective and well-regulated liability insurance, plaintiffs would be almost completely deprived of any opportunity to collect on hard-fought and deserved judgments, and the tort system would devolve into little more than an arena in which to assign blame. But while liability insurance in many ways rectifies the collection problems posed by a largely judgment-proof society, it is nonetheless not immune from letting that same judgment-proofness subvert much of the good that has been done.

The cooperation clause poses this very risk. Designed to encourage truthful cooperation by policyholders by threatening personal liability, neither the threat nor the goal enjoy any efficacy in a world that is largely judgment-proof. When policyholders react to the economic incentives created by the combination of their freedom from personal liability and the cooperative obligations imposed upon them, they threaten victim compensation. That this is not a rampant problem owes largely to most policyholders’

refusal to follow (or understand) these perverse economic incentives. Rather than relying on policyholders' good will and sense of moral obligation, we should instead redesign the cooperation clause so that it can serve its worthy purpose without the risk of rational policyholder subversion.