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The Case of the Recalcitrant Client: The Dilemma of the Insurer When the Insured Fails to Cooperate

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In almost any field of liability insurance, the standard insurance policy contains a "cooperation clause" requiring the insured to cooperate with the insurer in settling claims and litigation under the policy. Breach of this cooperation clause by the insured is usually not a problem since the interests of the insurance company and the insured are parallel. In certain cases, however, the insured, for unknown and often irrational reasons, handicaps the company's efforts to prepare a defense to a claim by irresponsible behavior. All too often the result in such cases is that the plaintiff ends up with a default judgment or a verdict for an amount far in excess of the reasonable value of the case. Of course, the insurance company is left "holding the bag." Under the law as it currently exists in California, it is difficult to the point of near impossibility for the insurer to defend against enforcement of such a judgment. Even where there is a clear breach of the duty to cooperate, the insurer often finds that it has no remedy for this breach. This anomaly is due to the rule in California that a breach of the coopera-

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tion clause is not actionable unless there is a "substantial likelihood" of "substantial prejudice" to the insurer.¹ Moreover, in *Billington v. Interinsurance Exchange*,² the Supreme Court held that for the insured to show "substantial prejudice", it must show that the trier of fact would have "found in the insured's favor", had the insured complied with his duty to cooperate.³

While the precise definition of this phrase has never been tested in any reported decisions, if applied literally, it would indicate that the only way to establish "substantial prejudice" is to show that a defense verdict would have been rendered, but for the breach by the insured.

This article will suggest alternative methods of showing "substantial prejudice" consistent with *Billington* and taking into account recent significant changes in California law. In particular this article will suggest, first, that the restrictive holding in *Billington* should be modified to conform to the comparative fault principles enumerated in *Li v. Yellow Cab Co.*⁴ such that the insurer may satisfy the burden of proving "substantial prejudice" by showing that the apportionment of fault would have been different had the insured cooperated fully. The liability of the insurer would therefore be reduced by the proportion of fault properly attributable to the plaintiff.

Second, this article will suggest that the insurer should also be able to show prejudice by proving that the noncooperative conduct of the insured accounted for a significantly larger award of damages to the plaintiff than if the insured had cooperated, and accordingly, the liability of the insurer should be reduced by the amount of damages which the insurer proves is attributable to the noncooperation by the insured.

In so doing, this article will examine Insurance Code Section 11580, concerning the enforcement of judgments directly against the insurance company. The article will then trace the development of the case law leading up to the decision in *Billington* requiring the showing of substantial prejudice to prevail on the defense of breach of the cooperation clause by the insured. Finally, the article will discuss the application of the principles in *Li v. Yellow Cab Co.*⁵ to the problem of breach of the cooperation clause in the context of the suggestions made above.

1. See notes 45-73 and accompanying text *infra*.

2. 71 Cal. 2d 728, 456 P.2d 982, 79 Cal. Rptr. 326 (1969).

3. *Id.* at 737, 456 P.2d at 987, 79 Cal. Rptr. at 331.

4. 13 Cal. 3d 804, 532 P.2d 1226, 119 Cal. Rptr. 858 (1975).

5. *Id.*

ENFORCING JUDGMENTS DIRECTLY AGAINST THE INSURANCE
COMPANY: INSURANCE CODE SECTION 11580

Insurance Code Section 11580 provides that when a judgment is secured against the insured, an action for enforcement may be brought against the insurer based on the insurance policy and subject to its terms and limitations.⁶ This provision is implied by law into every insurance contract and, in effect, makes anyone negligently injured by the insured a creditor beneficiary under the policy.⁷ This provision differs, however, from a direct action statute in that it is based on an unsatisfied judgment.⁸ The injured party cannot sue the insurance company directly in the original action, nor may it be joined in the original action.⁹

Section 11580 specifically provides that such an action is subject to the terms and limitations of the policy.¹⁰ Nonetheless, the general rule that the insurer has all the defenses against the injured party that it would have against the insured has been considerably eroded.¹¹ For instance, although intentional misrepresentations in the application process will be a good defense against the insured, this may not relieve the insurance company from liability to the injured party.¹² In addition, the insured will be bound by a policy provision requiring actions to be brought within one year after accrual of the right, but the injured party is bound only by the general four-year statute contained in Code of Civil Procedure Section 337(1).¹³ Also, an insurer who defends

6. Insurance Code Section 11580 provides in part:

A policy insuring against losses set forth in subdivision (a) shall not be issued or delivered to any person in this state unless it contains the provisions set forth in subdivision (b). Such policy, whether or not actually containing such provisions, shall be construed as if such provisions were embodied therein.

• • • • •
(b) Such policy shall not be thus issued or delivered to any person in this state unless it contains all the following provisions:

• • • • •
(2) A provision that whenever judgment is secured against the insured or the executor or administrator of a deceased insured in an action based upon bodily injury, death, or property damage, then an action may be brought against the insurer on the policy and subject to its terms and limitations, by such judgment creditor to recover on the judgment.

7. *Zahn v. Canadian Indem. Co.*, 57 Cal. App. 3d 509, 512-13, 129 Cal. Rptr. 286, 287-88 (1976).

8. *Mel H. Binning, Inc. v. Safeco Ins. Co.*, 74 Cal. App. 3d 615, 619, 141 Cal. Rptr. 547, 548 (1977).

9. *Id.*

10. CAL. INS. CODE §11580(b)(2); see *Valladao v. Firemen's Fund Indem. Co.*, 13 Cal. 2d 322, 328, 89 P.2d 643, 646 (1939).

11. See *Clemmer v. Hartford Ins. Co.*, 22 Cal. 3d 865, 876, 587 P.2d 1098, 1103, 151 Cal. Rptr. 285, 290 (1978).

12. *Barrera v. State Farm Mut. Auto Ins. Co.*, 71 Cal. 2d 659, 677, 456 P.2d 674, 686-87, 79 Cal. Rptr. 106, 118-19 (1969).

13. *Olds v. General Accident Fire & Life Assurance Corp.*, 67 Cal. App. 2d 814, 820, 155 P.2d 676, 682 (1945).

against enforcement of a judgment on the basis of the insured's failure to cooperate must show "at the very least" the substantial likelihood that a jury would have found in the insured's favor, had the insured complied with his duty to cooperate, before relief will be granted.¹⁴

It is this third example upon which this article will focus. Theoretically, the insurer should be able to raise the affirmative defense of breach of the cooperation clause in a Section 11580 action where the insured's conduct is responsible for a default judgment or a verdict far in excess of the reasonable value.¹⁵ Case law, however, has emasculated this affirmative defense.¹⁶

Typically when a serious breach of the cooperation clause occurs, a default judgment against the insured in the underlying action results.¹⁷ This default judgment may result either by plaintiff's motion, as where plaintiff moves to have an answer struck under Code of Civil Procedure Section 2034 due to the insured's failure to attend deposition,¹⁸ or by defendant's motion, where defense counsel makes a motion to withdraw based on the insured's lack of cooperation and the insured fails to defend.¹⁹ Where the insurer withdraws, it avoids the possibility of an estoppel argument being raised against it later.²⁰ The insurer, however, may be sacrificing its opportunity to limit the damages prayed for in the complaint, if it is required to pay the default judgment in a subsequent Section 11580 action notwithstanding its withdrawal.²¹ Accordingly, the better route may be to stay in the suit as long as possible with the hope of reducing the total damages below the default level.

Once the underlying action is terminated, whether by default judgment or trial on the merits, the insurer who believes that the insured has breached the cooperation clause may either wait for the plaintiff to bring a Section 11580 action for enforcement,²² or may take the initiative and file a declaratory relief action.²³ Although the case law ap-

14. *Billington v. Interinsurance Exch.*, 71 Cal. 2d 728, 737, 456 P.2d 982, 987, 79 Cal. Rptr. 326, 331 (1969).

15. *Hall v. Travelers Ins. Companies*, 15 Cal. App. 3d 304, 308, 93 Cal. Rptr. 159, 161 (1971).

16. See note 41 and accompanying text *infra*.

17. See, e.g., *Campbell v. Allstate Ins. Co.*, 60 Cal. 2d 303, 304, 384 P.2d 155, 156, 32 Cal. Rptr. 827, 828 (1963); 15 Cal. App. 3d at 307, 93 Cal. Rptr. at 161.

18. CAL. CIV. PROC. CODE §2034(d); see 71 Cal. 2d at 734, 456 P.2d at 985, 79 Cal. Rptr. at 329.

19. See 15 Cal. App. 3d at 307, 93 Cal. Rptr. at 160.

20. *But see State Farm Fire & Cas. Co. v. Miller*, 5 Cal. App. 3d 837, 843, 85 Cal. Rptr. 288, 292 (1970). See generally CONTINUING EDUCATION OF THE BAR *California Automobile Insurance Law Guide* §1.23 (1973 & Supp. 1980).

21. See *Clemmer v. Hartford Ins. Co.*, 22 Cal. 3d 865, 884, 587 P.2d 1098, 1108, 151 Cal. Rptr. 285, 295 (1978).

22. See, e.g., 71 Cal. 2d at 744-45, 456 P.2d at 992, 79 Cal. Rptr. at 336; 15 Cal. App. 3d at 306, 93 Cal. Rptr. at 160.

23. See 5 Cal. App. 3d at 839, 85 Cal. Rptr. at 288. The insurer cannot seek declaratory relief concerning a breach of the cooperation clause prior to the rendition of a judgment against the

pears to say that the insurer has no obligation to pay a judgment until a Section 11580 action has been brought,²⁴ counsel should be alert to the possibility that an insurer who requires the plaintiff to go to court to enforce his judgment against the insured when the insurer does not have a reasonable chance of prevailing in the subsequent action may be found to have acted in "bad faith."²⁵

Nonetheless, where the insured has breached his duty to cooperate, it seems fair that the *insured* should bear the consequences of his actions, not the *insurer*. Thus, the question of whether the insured has actually breached this duty may be an important one.

THE INSURED'S DUTY TO COOPERATE

A standard part of any liability insurance policy, whether it be automobile, professional, or other, is a clause requiring the insured to cooperate with the company in settlement negotiations, attending trials and hearings, and assisting in securing evidence and witnesses.²⁶ This is one of the two main duties imposed on the insured in the standard liability insurance contract. The other, the duty to notify the company of any accidents or liability claims filed against the insured,²⁷ is related but outside the scope of this article. However, the same principles should apply to either.

No case establishes a standard to determine when the insured has breached his duty to cooperate. Rather, this is a factual question and is generally determined on a case by case basis.²⁸ In considering whether the insured has breached his duty to cooperate, counsel should look for a failure to disclose relevant information,²⁹ intentional misrepresentation to the company,³⁰ refusal to permit a defense,³¹ failure to attend

insured because it would be unable to show prejudice at that premature stage. *United Services Auto. Ass'n v. Martin*, 120 Cal. App. 3d 963, 966, 174 Cal. Rptr. 835, 836 (1981).

24. 71 Cal. 2d at 744-45, 456 P.2d at 992, 79 Cal. Rptr. at 336.

25. See generally Shernoff, *Insurance Company Bad Faith Law*, 17 TRIAL 23 (May 1981).

26. See generally 2 R. LONG, *THE LAW OF LIABILITY INSURANCE* §14.01 (1981); CONTINUING EDUCATION OF THE BAR *California Automobile Insurance Law Guide* §10.3 (1973).

27. See generally CONTINUING EDUCATION OF THE BAR *California Automobile Insurance Law Guide* §10.2 (1973).

28. *Porter v. Employers Liab. Ins. Corp.*, 40 Cal. App. 2d 502, 510-11, 104 P.2d 1087, 1092 (1940).

29. The insured may breach his duty to cooperate by failing to make fair and frank disclosure of information reasonably required by the insurer to enable it to determine if there is a defense or whether the insurer should settle. *Ford v. Providence Washington Ins. Co.*, 151 Cal. App. 2d 431, 440, 311 P.2d 930, 935 (1957). The insured must tell his insurer the complete truth concerning the facts involved in the complaint, and he must stick to this truthful version throughout the proceedings. *Id.* It was, however, held that there was no violation of this duty in *Ford v. Providence Washington Insurance Co.* even though the insured maintained throughout the action that he had not been the driver of the car and the jury impliedly found that he had been. *Id.* at 440-41, 311 P.2d at 935.

30. Actual misrepresentation to the insurer of important facts, as well as failing to disclose important information, may be the basis for a finding of a breach of the cooperation clause. Val-

deposition or trial,³² failure to participate in trial preparation,³³ or collusion with the plaintiff.³⁴

ladao v. Fireman's Fund Indem. Co., 13 Cal. 2d 322, 330, 89 P.2d 643, 647 (1939). Where the insured repeatedly and wilfully misrepresented to the insurer over a period of five months the actual conditions prevailing at the time of an accident, the insured was found to have breached the clause. *Id.* Moreover, where the insured verifies allegations contained in a pleading, the insurer has a right to rely on the truth of those pleadings in defending the action. *Wright v. Farmers Inter-Insurance Exch.*, 39 Cal. App. 2d 70, 72, 102 P.2d 352, 354 (1940). If the insured materially changes his version of the facts in subsequent testimony, this amounts to a breach of the cooperation clause. *Id.* at 73, 102 P.2d at 354. However, if a misstatement, even an intentional one, is corrected before it is relied upon, no breach of the cooperation clause is found. *Standard Accident Ins. Co. v. Winget*, 197 F.2d 97, 102 (9th Cir. 1952). Moreover, an insured should not be charged with lack of cooperation simply because of minor variances in various statements, or for unintentional or accidental mistakes in formal statements made by the insured, 40 Cal. App. 2d at 515, 104 P.2d at 1094. Thus, it has been held that if the insured signs a statement without reading it in which an adjuster has not accurately recorded what the insurer said, this does not amount to a breach. 39 Cal. App. 2d at 73, 102 P.2d at 353.

31. Refusal to permit a defense will also amount to a breach of the cooperation clause under certain conditions. *O'Morrow v. Borad*, 27 Cal. 2d 794, 800, 167 P.2d 483, 487 (1946). The insured is under no obligation to permit a sham defense to be set up in his name, nor can he be expected to verify any pleadings which he does not believe to be true, 13 Cal. 2d at 329, 89 P.2d at 646. He cannot, however, preclude the company from setting up any defense at all, nor can he arbitrarily or unreasonably decline to assist in making any fair and legitimate defense. *Bachman v. Independence Indem. Co.*, 112 Cal. App. 465, 478, 297 P. 110, 115 (1931). An insured who declines to allow any defense that does not admit his liability has breached his duty to cooperate with the insurance company, regardless of the insured's good faith belief in his liability. *Id.*

32. The failure to attend deposition or trial is the most obvious example of a breach of the cooperation clause by the insured. *See State Farm Fire & Cas. Co. v. Miller*, 5 Cal. App. 3d 837, 842-43, 85 Cal. Rptr. 288, 291 (1970). *But see Panhans v. Associated Indem. Corp.*, 8 Cal. App. 2d 532, 539, 47 P.2d 791, 793 (1935). Such a breach generally results in the entry of a default judgment against the defendant. *See CAL. CIV. PROC. CODE §2034(d)*. The insured breaches the cooperation clause by making it impossible for the insurer to ascertain his whereabouts or communicate with him. 5 Cal. App. 3d at 841-42, 85 Cal. Rptr. at 289-90. Thus, it has been held that the insured breached the cooperation clause even though the insurer never requested the insured to attend trial or to keep the insurer informed of his whereabouts. *Id.* The insurer must, however, exercise due diligence in an attempt to locate and provide for the attendance of the insured at trial or deposition. *Billington v. Interinsurance Exch.*, 71 Cal. 2d 728, 744, 456 P.2d 982, 992, 79 Cal. Rptr. 326, 336 (1969). In *State Farm Fire and Casualty Co. v. Moore*, the court held that the insurer had exercised due diligence where it employed a private investigator, checked credit sources, inquired of the FBI, checked the records of the Department of Motor Vehicles, and communicated with the parents of the insured. 5 Cal. App. 3d at 841-42, 85 Cal. Rptr. at 291.

33. Breach of the cooperation clause is not limited to the failure to appear at trial, but may occur before the trial by reason of the failure of the insured to participate in trial preparation. *Hall v. Travelers Ins. Co.*, 15 Cal. App. 3d 304, 308-09, 93 Cal. Rptr. 159, 161-62 (1971). Where the insured initially appeared at the office of the attorneys retained by his insurer and verified the answer, but later ignored requests sent by registered mail to be deposed, ignored personal contact by the insurer requesting his attendance at deposition, and ignored the requests of his counsel to talk with them in the preparation of the defense, the court found a breach of the cooperation clause and allowed attorneys for the insured to withdraw from the case. *Id.* at 309, 93 Cal. Rptr. at 162.

34. The cooperation clause may also be breached where the insured cooperates with the plaintiff in establishing his claim against the insurer. *See generally Insured Cooperation with Claimant in Establishing Valid Claim Against Insurer as Breach of Cooperation Clause*, Annot., 8 A.L.R. 3d 1345 (1966); CONTINUING EDUCATION OF THE BAR *California Automobile Insurance Law Guide* §9.8 (1973 & Supp. 1980). Collusion or fraud between the insured and the plaintiff relieves the insurer of liability. *Bachman v. Independent Indem. Co.*, 112 Cal. App. 465, 485, 297 P. 110, 118 (1931). In establishing this affirmative defense, however, the insurer must plead and prove all the elements of actual fraud. *See* 4 B. WITKIN, SUMMARY OF CALIFORNIA LAW *Torts* §447 (1974 & Supp. 1980). Thus, the burden of proof on this affirmative defense tends to be a rather formidable one. In order to prevail, the insurer cannot merely show that the insured acted

However, the duty to cooperate can involve legal as well as factual issues. A difficult question arises where the insured refuses to allow a particular cross-complaint to be made. Generally, a cross-complaint may not be made without authorization from the insured.³⁵ The insured, however, may be reluctant to bring in a third party tortfeasor where, for example, he has an important business relationship with that party, or for other similar reasons. In such a case, the insurance company may ultimately be required to pay a larger proportion of the damages because of the insured's refusal to allow the third party to be brought in on a cross-complaint. Although there are no California cases on this precise point, a line of New York cases holds that the insured has no obligation to the insurer to bring in outside parties, and therefore does not breach the cooperation clause by refusing to allow a particular cross-complaint.³⁶

Similarly, it appears to be an open question whether the insured breaches the cooperation clause by not consenting to a reasonable settlement.³⁷ The consent of the insured is not usually required for claims against liability policies where the insurance policy contains the standard provision enabling settlement by the insurer as it deems expedient.³⁸ However, a professional liability policy usually provides that no claim can be settled without the insured's written consent.³⁹ While

with an intent to aid the claimant. *See* 112 Cal. App. at 480-81, 297 P. at 116. Rather the insurer must show that the insured made false statements with the specific intent to defraud the company on a specious claim. *Zander v. Texaco, Inc.*, 259 Cal. App. 2d 793, 806, 66 Cal. Rptr. 561, 569 (1968). It has therefore been held that admissions of fault by the insured to the injured party accompanied by assurances that the insured's insurance will pay for the injuries and that the injured party will be "taken care of" does not amount to a violation of the cooperation clause, notwithstanding language in the policy that the insured will not voluntarily assume any liability. *Porter v. Employers' Liab. Assurance Corp.*, 40 Cal. App. 2d 502, 516, 104 P.2d 1087, 1094 (1940). It has also been held that there was no breach of the cooperation clause where the insured allowed a default judgment to be taken against him in return for a covenant not to execute where the insurer refused to defend, 259 Cal. App. 2d at 804, 66 Cal. Rptr. at 568-69.

In order to prevail on this defense, it must also be shown that the fraud was not "intrinsic"; that is, that the insurer did not have notice of the collusion prior to the judgment. *Id.* If the insurer did learn about the collusion before the judgment was rendered, it must exercise whatever remedy it can during the pendency of the underlying case or it will be estopped from collaterally attacking the judgment in a later action. *Id.* at 805, 66 Cal. Rptr. at 569-70.

35. *Huene v. Carnes*, 175 Cal. Rptr. 374, 376 (1981) (unpublished).

36. *United States Fire Ins. Co. v. Gould*, 43 A.D. 462, 467-69, (1974), 352 N.Y.S.2d 541, 543; *Ulanoff v. Croyden Shirt Co.*, 14 Misc. 13, 16, (1958), 174 N.Y.S.2d 357, 360; *American Surety Co. v. Diamond*, 154 N.Y.S.2d 918, 920-21 (1956). *See also* *Osbourne v. Hartford Accident & Indem. Co.*, 476 S.W.2d 256, 264 (Tenn. App. 1971), holding that the insurer had no right to require its insured to act to distribute liability among other insurers, and failure to do so was not a breach of the cooperation clause.

37. It should be noted that this issue is most applicable for claims made against a professional liability policy.

38. *See* CONTINUING EDUCATION OF THE BAR *California Automobile Insurance Law Guide* §10.13 (1973).

39. In the case of health care providers, the Business and Professions Code requires that the insurer must have the consent of the insured before entering into any settlement under the policy. Business and Professions Code Section 801 provides in part:

(b) Every insurer providing professional liability insurance to a physician and surgeon

there is no express provision for the insurer's recourse if the insured unreasonably withholds consent, it appears the insured is bound at the minimum by the covenant of good faith and fair dealing implied in every insurance contract.⁴⁰ It has previously been held that the duty to deal in good faith with the other party applies to the insured as well as the insurer.⁴¹ The standard is not applied as strictly against the insured,⁴² however, and no presumption of bad faith on the part of the insured would arise, for example, where the insured refused to settle an action, forcing the matter to trial, and the subsequent judgment was greater than the proposed settlement. The reasoning is that the insurer has no reasonable expectation on entering into the contract that the insured will accept an offer as a means of protecting the insurer from exposure since the insurer's pecuniary interest is not an object of the bargain.⁴³ Thus, to establish a breach of the cooperation clause by virtue of the insured's refusal to consent to a settlement, it appears the insurer must show actual bad faith on the part of the insured.⁴⁴

Finding a breach of the cooperation clause by the insured is only the first step in formulating a defense to an action to enforce a judgment under Insurance Code Section 11580. In addition to this, the insurer must also demonstrate that it has suffered "substantial prejudice" as a result of the breach by the insured.

licensed pursuant to Chapter 5 (commencing with Section 2000) of Division 2 or the Osteopathic Initiative Act shall send a complete report to the Board of Medical Quality Assurance or the Board of Osteopathic Examiners, as appropriate, as to any settlement or arbitration award over thirty thousand dollars (\$30,000) of a claim or action for damages for death or personal injury caused by such person's negligence, error or omission in practice, or rendering of unauthorized professional services. Such report shall be sent within 30 days after such written settlement agreement has been reduced to writing and signed by all parties thereto or within 30 days after service of such arbitration award on the parties.

(c) Notwithstanding any other provision of law, no insurer shall enter into such a settlement without the written consent of the insured, except that this prohibition shall not void any settlement entered into without such written consent. The requirement of written consent can only be waived by both the insured and the insurer. The provisions of this section shall only apply to a settlement on a policy of insurance executed or renewed on or after January 1, 1971.

In the case of other professionals, the custom of the industry is to require consent of the insured for settlement, and this is typically a provision of the insurance contract.

40. *Comunale v. Traders & General Ins. Co.*, 50 Cal. 2d 654, 658, 328 P.2d 198, 200 (1958).

41. *See Liberty Mut. Ins. Co. v. Altfillisch Construction Co.*, 70 Cal. App. 3d 789, 797, 139 Cal. Rptr. 91, 95 (1977).

42. *See Commercial Union Assurance Companies v. Safeway Stores, Inc.*, 26 Cal. 3d 912, 919, 610 P.2d 1038, 1045, 164 Cal. Rptr. 709, 714 (1980). This case did not actually involve consent to settlement by Safeway, but the logic is nonetheless persuasive. Safeway was insured by Travelers up to \$50,000, self-insured from \$50,000 to \$100,000, and insured for excess by Commercial Union for \$100,000 to \$20 million. Commercial Union sued Safeway contending that it had the opportunity to settle a \$125,000 judgment for \$60,000 and did not do so. Given the courts reasoning, however, there is no reason to believe a "consent" case would be decided differently.

43. *Id.*

44. *See generally* 2 R. LONG, LAW OF LIABILITY INSURANCE §14.17 (1981) [hereinafter cited as LONG].

SHOWING "SUBSTANTIAL PREJUDICE" IN CALIFORNIA

Witkin states that the most important defense which an insurance company may invoke when a judgment is rendered against an insured is the insured's violation of the cooperation clause.⁴⁵ Nonetheless, this defense has become so difficult to establish that it has atrophied to the point where it is virtually useless today. Our research discloses only two reported California decisions in the nearly 20 years since the formulation of the modern rule in *Campbell v. Allstate Insurance Co.*⁴⁶ where the insurer was successful in showing the necessary degree of prejudice,⁴⁷ and no California cases in the last ten years where the insurer has prevailed.

The California rule holds that a breach of the cooperation clause is not actionable unless there is a "substantial likelihood" of "substantial prejudice."⁴⁸ The majority view in the United States requires that a breach by the insured of the cooperation clause be substantial and material, but does not specifically require a showing of prejudice.⁴⁹ The California rule of "substantial prejudice," however, appears to represent the current trend in a number of jurisdictions.⁵⁰

Previously, California vacillated between requiring actual prejudice and allowing a presumption of prejudice. The rule first adopted in *Hynding v. Home Accident Insurance Co.*⁵¹ required actual prejudice stating that "violation of the condition by the assured cannot be a valid defense against the injured party unless in the particular case it appears that the insurance company was substantially prejudiced thereby."⁵² The California Supreme Court quickly began backing away from this view, however, in a number of cases by finding that prejudice could be presumed as a matter of law when there was no dispute that a substantial breach of a material condition had occurred.⁵³

45. 4 B. WITKIN, *SUMMARY OF CALIFORNIA LAW Torts* §763 (1974).

46. 60 Cal. 2d 303, 384 P.2d 155, 32 Cal. Rptr. 827 (1963).

47. The two cases are *Hall v. Travelers Ins. Co.*, 15 Cal. App. 3d 304, 93 Cal. Rptr. 159 (1971) and *Allstate Ins. Co. v. King*, 252 Cal. App. 2d 698, 60 Cal. Rptr. 892 (1967).

48. *Billington v. Interinsurance Exch.*, 71 Cal. 2d 728, 737, 456 P.2d at 982, 986-87, 79 Cal. Rptr. 330, 331 (1969).

49. See LONG, *supra* note 44, §14.03.

50. LONG, *supra* note 44, §14.04.

51. 214 Cal. 743, 7 P.2d 999 (1932).

52. *Id.* at 752, 7 P.2d at 1002.

53. See, e.g., *Valladao v. Fireman's Fund Indem. Co.*, 13 Cal. 2d 322, 330, 89 P.2d 643, 646 (1939); *Purefoy v. Pacific Auto. Indem. Exch.*, 5 Cal. 2d 81, 87, 53 P.2d 155, 158 (1935); *Wasson v. Atlantic Nat'l Ins. Co.*, 207 Cal. App. 2d 464, 467, 24 Cal. Rptr. 665, 667 (1962); *National Auto. & Cas. Ins. Co. v. Brown*, 197 Cal. App. 2d 605, 609-10, 17 Cal. Rptr. 347, 350 (1961); *Security Ins. Co. v. Snyder-Lynch Motors*, 183 Cal. App. 2d 574, 581, 7 Cal. Rptr. 28, 33 (1960); *Gibson v. Colonial Ins. Co.*, 92 Cal. App. 2d 33, 36, 206 P.2d 387, 388 (1949); *Wright v. Farmer's Auto. Inter-Insurance Exch.*, 39 Cal. App. 2d 70, 75, 102 P.2d 352, 355 (1940); *Margellini v. Pacific Auto.*

This "presumed prejudice" view, however, was eventually rejected by the high court in favor of a return to the stricter standard contained in the *Hynding* case.⁵⁴ In *Campbell v. Allstate Insurance Co.*,⁵⁵ the "substantial prejudice" portion of the rule was affirmed⁵⁶ and the Supreme Court unequivocally disapproved all previous cases that had stated that prejudice could be presumed or found as a matter of law.⁵⁷

In *Campbell*, the insured, who had been drinking, rear-ended the plaintiff. When served with summons and complaint, the insured failed to notify defendant and failed to answer the complaint. A default judgment was eventually entered in the amount of \$35,829.91, and plaintiff filed an action under Insurance Code Section 11580 against defendant insurer for the \$10,000.00 policy limits. The insurer asserted the defense of breach of the cooperation clause. The court had no difficulty in finding that the insured had breached the insurance contract by failing to cooperate.⁵⁸ However, the court held that this alone was not a sufficient defense to an action under Section 11580(b)(2).⁵⁹ The Supreme Court held that the insurer had the additional burden of proving that it was "substantially prejudiced" by the lack of cooperation.⁶⁰ The Supreme Court reversed the earlier trial court decision for the insurer and directed that judgment be entered for plaintiff on the basis that the evidence was clear that a jury would have found for the plaintiff even if the insured had cooperated.⁶¹

Subsequently, the modern rule was made even more restrictive in *Billington v. Interinsurance Exchange*,⁶² where the court held that the insurer must show the "substantial likelihood" of "substantial prejudice," rather than merely the reasonable probability.⁶³ Not only did the *Billington* court add the "substantial likelihood" standard, it also held that substantial prejudice could be shown only by establishing that a defense verdict would have been rendered, but for the breach.⁶⁴

In *Billington*, the insured had also been drinking and driving, but in

Ins. Co., 33 Cal. App. 2d 93, 98, 91 P.2d 136, 139 (1939); *Distributor's Packing Co. v. Pacific Indem. Co.*, 21 Cal. App. 2d 505, 508, 70 P.2d 253, 254 (1937).

54. *Campbell v. Allstate Ins. Co.*, 60 Cal. 2d 303, 305-06, 384 P.2d 155, 156-57, 32 Cal. Rptr. 827, 828-29 (1963).

55. 60 Cal. 2d 303, 384 P.2d 155, 32 Cal. Rptr. 827 (1963).

56. *Id.* at 305-06, 384 P.2d at 155-56, 32 Cal. Rptr. at 827-28.

57. *Id.* at 307, 384 P.2d at 157, 32 Cal. Rptr. at 829. The cases disapproved in *Campbell*, however, were disapproved only as far as they stated that prejudice could be presumed as a matter of law. *Id.* Thus these cases should still be good authority as to whether or not a breach of the cooperation clause has occurred.

58. *Id.* at 305, 384 P.2d at 156, 32 Cal. Rptr. at 828.

59. *Id.*

60. *Id.*

61. *Id.* at 306-07, 384 P.2d at 157, 32 Cal. Rptr. at 829.

62. 71 Cal. 2d 728, 456 P.2d 982, 79 Cal. Rptr. 326 (1969).

63. *Id.* at 737, 456 P.2d at 987, 79 Cal. Rptr. at 331.

64. *Id.*

this case plaintiff was a passenger. Here, the insured did forward a copy of the summons and complaint to the insurer, and the defenses of contributory negligence and assumption of the risk were affirmatively alleged in the answer filed to the complaint.

Before the personal injury suit was filed against the insured, he furnished the insurer with a statement in which he denied he was intoxicated on the night of the accident. However, the insured failed to appear at his deposition on at least seven occasions, in spite of the fact that "defendant, by registered and unregistered letter, telegrams, telephone calls, and at times, a combination of these methods, urged [insured] to attend."⁶⁵ Defendant's attorneys and an independent investigator employed by defendant talked to the insured on the telephone a number of times during this period explaining the necessity for his attendance at the deposition, and each time, the insured promised that he would be present at a future date. Eventually, plaintiff filed a motion to strike the insured's answer, and a default judgment was subsequently entered.

Plaintiff then brought a Section 11580(b)(2) action against defendant, and the trial court found that the insured had failed to cooperate and that his conduct had resulted in substantial prejudice.⁶⁶

Again, the Supreme Court had no difficulty in upholding the finding that the insured had breached the insurance contract by failing to cooperate.⁶⁷ However, the Supreme Court held that the trial court had applied an improper standard to determine whether the breach of the cooperation clause had resulted in substantial prejudice.⁶⁸ The trial court had found that the insurer had been prejudiced since it had been precluded from offering any evidence in support of the affirmative defenses of contributory negligence and assumption of the risk, and that the trier of fact *could have reasonably* accepted these defenses.⁶⁹ The Supreme Court held that it was insufficient that the trier of fact could have *reasonably* found for the defendant, rather the insurer must show the "*substantial likelihood*."⁷⁰ In formulating this stricter standard, the Supreme Court explained:

We hold, therefore, that an insurer, in order to establish it was prejudiced by the failure of the insured to cooperate in his defense, must establish at the very least that if the cooperation clause had not been breached, there was a substantial likelihood the trier of fact

65. *Id.* at 734, 456 P.2d at 985, 79 Cal. Rptr. at 329.

66. *Id.* at 736, 456 P.2d at 986, 79 Cal. Rptr. at 330.

67. *Id.* at 737, 456 P.2d at 986-87, 79 Cal. Rptr. at 330-31.

68. *Id.*

69. *Id.* at 736, 456 P.2d at 986, 79 Cal. Rptr. at 330.

70. *Id.* at 736-37, 456 P.2d at 986-87, 79 Cal. Rptr. at 330-31.

would have found in the insured's favor.⁷¹

Thus, the defense of breach of the cooperation clause is apparently available only in those cases where there is a substantial likelihood that there would have been a defense verdict, but for the breach by the insured.⁷² The insurer is denied a remedy in all other situations. No other state applies the "substantial prejudice" rule as restrictively as California.⁷³ Therefore, due to the *Billington* case, it is more difficult in California for the insurer to pursue a remedy for breach of the cooperation clause than in any other jurisdiction in the Union.

Billington was decided prior to the adoption of comparative fault in California. Since fault is now apportioned on a percentage basis, rather than an all-or-nothing basis, it stands to reason that the mandate of *Billington* should be modified to reflect the current practice.

APPLYING THE *LI* PRINCIPLES TO *BILLINGTON*

A. *Where Comparative Fault Is an Issue*

Under the decision in *Billington*, it is possible for the insurer to be without remedy even though there is no dispute that the insured breached the cooperation clause and that the damages would have been significantly less had there been no breach. Presumably, a verdict for plaintiff finding plaintiff 95% negligent is still not a verdict "in the insured's favor." Thus, if the insurer is forced to take a default in the main suit because of the insured's failure to cooperate, in defending against the enforcement of the default judgment under Insurance Code Section 11580, it must presumably show that the insured was zero percent negligent. This imposes a virtually impossible and manifestly unfair task on the insurer.

There have been no reported decisions since *Billington* clarifying what constitutes a "finding in the insured's favor" for the purposes of an action under Insurance Code Section 11580. At the time *Billington* was decided, however, any contributory negligence by the plaintiff

71. *Id.* at 737, 456 P.2d at 987, 79 Cal. Rptr. at 331.

72. See notes 63-71 and accompanying text *supra*.

73. Other states applying the substantial prejudice rule require prejudice to be established only by a preponderance of the evidence, not a substantial likelihood. *See, e.g.*, *Farley v. Farmers Ins. Exch.*, 91 Idaho 37, 39, 415 P.2d 680, 682 (1966); *M.F.A. Mut. Ins. Co. v. Cheek*, 66 Ill. 2d 492, 498-500, 363 N.E.2d 809, 813 (1977); *Jamison v. Farmers Mut. Auto Ins. Co.*, 181 Kan. 120, 125, 127, 309 P.2d 394, 399 (1957); *Home Indem. v. Walker*, 216 Md. 684, 687-88, 273 A.2d 429, 431 (1971); *Hendrix v. Jones*, 580 S.W.2d 740, 744 (Mo. 1979); *M.F.A. Mut. Ins. Co. v. Sailors*, 180 Neb. 201, 204-05, 141 N.W.2d 846, 849 (1966); *Foundation Reserve Ins. Co. v. Esquibel*, 94 N.M. 132, 134, 607 P.2d 1150, 1152 (1980); *Brakeman v. Potomac Ins. Co.*, 472 Pa. 66, —, 371 A.2d 193, 196 (1977); *Evans v. American Home Assurance Co.*, 252 S.C. 411, 420-22, 166 S.E.2d 811, 813 (1969); *Washington Ins. Guar. Assn v. Hill*, 19 Wash. App. 195, 196-98, 574 P.2d 405, 406 (1978); *McDonnell v. Hestnes*, 47 Wis. 2d 553, —, 177 N.W.2d 845, 849 (1970).

would have resulted in a defense verdict. Therefore, the danger of such an unfair application of the law was not then present. However, when the Supreme Court abrogated contributory negligence in favor of the comparative fault doctrine in *Li v. Yellow Cab*,⁷⁴ it stated that the all-or-nothing approach was inequitable because it failed to distribute responsibility in proportion to fault.⁷⁵ It declared the fundamental purpose of the new system to be to assign responsibility and liability for damage in direct proportion to the fault of the persons involved.⁷⁶

If the *Billington* case is applied literally, it preserves the inequities of the all-or-nothing approach which *Li* purported to eliminate. If the insurer is required to take a default, the plaintiff may get a windfall in a case where both the injured party and the insured were equally at fault. Rather than liability being assigned in proportion to fault as required by *Li*, the plaintiff will recover 100 percent of his damages despite his 50 percent negligence.

The most reasonable approach to harmonize the *Billington* rule with the *Li* principles is to allow the insurer to show "substantial prejudice" by showing the amount of negligence that would have been attributable to the plaintiff, had the insured cooperated. Where the case is actually litigated on its merits, this would allow the insurer to show that the apportionment of fault at trial would have been different, had the insured cooperated. Where a default is taken without the case being heard on its merits, this would allow the company to seek a determination of the respective fault of the insured and the plaintiff and offset the default judgment by the amount of the plaintiff's proportion of fault.

If this approach were adopted, the insurer would have a much more effective remedy for breach of the cooperation clause. While the insurer would still have to establish the "*substantial likelihood*," not the *reasonable probability*, of prejudice, it could at least establish substantial prejudice by simply showing that the comparative fault of the parties would have been different, but for the breach. It would then be economically feasible for the insurer to contest as little as a ten percent difference in the apportionment of fault due to the insured's noncooperation when the judgment in the underlying action was in excess of \$100,000. The plaintiff's judgment against the insured, of course, would not be affected in any way, since this would amount to a collateral attack on the judgment.⁷⁷ Only the liability of the insurance com-

74. 13 Cal. 3d 804, 532 P.2d 1226, 119 Cal. Rptr. 858 (1975).

75. *Id.* at 828-29, 532 P.2d at 1243, 119 Cal. Rptr. at 875.

76. *Id.* at 829, 532 P.2d at 1243, 119 Cal. Rptr. at 875.

77. See generally 5 B. WITKIN, CALIFORNIA PROCEDURE *Attack on Judgment in Trial Court*, §§4-15 (1971 & Supp. 1981).

pany would be adjudicated. As to the insured, the original judgment would be *res judicata*, and he would be personally liable to the plaintiff for the difference in the original judgment and the subsequent litigation under Insurance Code Section 11580.

While the *Li* principles are most applicable in comparative fault cases, the above rationale also finds application in cases where comparative fault is not raised as an affirmative defense, but where excessive damages are awarded.

B. Where Comparative Fault Is Not an Issue

In cases where comparative fault is not an issue, the meaning of a finding "in the insured's favor" is not susceptible to the ambiguities discussed above.⁷⁸ Nonetheless, where the insured breaches the cooperation clause and this conduct results in a higher damage award by the trier of fact than would otherwise be the case, equitable consideration would indicate that the insurer has been prejudiced and should have the same opportunity to shift liability for the difference to the guilty party. Thus, where the insurer can establish the substantial likelihood that the award of damages would have been less but for the breach by the insured of the cooperation clause, it should be allowed to reduce its liability by that amount.

This rule would be consistent with both the spirit of *Li* and practical observations contained in other leading cases. Previous opinions have recognized that the presence or absence of an insured at trial and his conduct, if present, may have a significant effect on the credibility of the defense case and the amount of damages awarded.⁷⁹ Since the liability of the insurance company does not generally extend to damages resulting from the insured's intentionally noncooperative conduct, it would be consistent with the spirit of *Li* to require the insured to bear responsibility for this portion of the damages, providing his conduct is serious enough to amount to a breach. The insured would be protected from overreaching by the insurer since the insurer would still have the burden of establishing that a breach had occurred and that there is a substantial likelihood that damages would have been less, had there been no breach. The insurer, on the other hand, is protected from paying damages which are outside both the scope of policy and the reasonable expectations of the parties.

78. See notes 74-77 and accompanying text *supra*.

79. See, e.g., *State Farm Fire & Cas. Co. v. Miller*, 5 Cal. App. 3d 837, 842, 85 Cal. Rptr. 288, 290 (1970); *Allstate Ins. Co. v. King*, 252 Cal. App. 2d 698, 710, 60 Cal. Rptr. 892, 897 (1967).

CONCLUSION

Considerable progress toward policing the insurance industry has been made recently. However, in the zeal to make sure that the individual is treated fairly, the reciprocal right of the insurance company to be treated fairly must not be disregarded. The law nominally recognizes the inherent unfairness of requiring the insurer to pay a verdict when it has not had a reasonable opportunity to defend against it because of the conduct of the insured. But in order to avail itself of this right, the insurer must show the "substantial likelihood" of "substantial prejudice." This "double substantial" standard has proved to be such a burden that it has all but eliminated the insurer's remedy.⁸⁰ In order to provide the insurer with some effective remedy for a breach by the insured of the cooperation clause, the insurer should be allowed to show prejudice in those cases where comparative fault is an issue by showing that the allocation of fault would have been different if not for the breach by the insured. In addition, whether or not comparative fault is an issue in a particular case, the insured should be allowed to show prejudice by showing that damages would have been less, but for the breach by the insured. If followed, this proposal would provide insurers with the remedy they deserve, but still be consistent with existing standards.

80. Concerning the substantial prejudice rule, Appelman observes that:

Such a rule is probably salutary where it is evident that the insured's infraction did not seriously impair the insurer's investigation or defense of the action. But if the rule is carried to the point of imposing an almost insurmountable burden of proving that the verdict was the result of the lack of cooperation, it would amount to a perversion of such contractual provision.

8 APPELMAN, *INSURANCE LAW & PRACTICE* §4773 (1981).

