When Does Your Insurance Company Have to Defend You in Court?

Commercial general liability insurance pays for lawsuit settlements or court judgments that an organization would otherwise have to pay for certain types of harm others suffer. These include bodily injuries, property damage, advertising injuries, and personal injuries such as violations of privacy. Another benefit of this insurance, however, can be just as valuable or even more so: coverage for the cost of legal defense.

The standard CGL insurance policy gives the insurance company "the right and duty to defend the insured" against any suit seeking damages. Conversely, the company has no duty to defend the insured against a suit seeking damages for an incident the policy does not cover. The company's duty to defend ends when it has paid out the policy's maximum limit of insurance for settlements or judgments. Most policies provide coverage for defense costs in addition to the amounts available for payment of damages.

Because the company does not have to defend a claim it believes the policy does not cover, disputes about whether a duty exists can arise between the company and the insured organization. Courts in most states have given the policy a broad interpretation and favored the insured. For example, New York's highest court has said that "an insurer will be called upon to provide a defense whenever the allegations of the complaint `suggest ... a reasonable possibility of coverage.'" However, courts have put limits on the duty. A Texas court in 1997 ruled that a court may not "read facts into the pleadings, look outside the pleadings, or imagine factual scenarios that might trigger coverage." Also, an insurance company's defense of a claim does not necessarily mean that the policy covers the claim. Another Texas decision in the same year held that the company's duty to pay for the damages is governed by the facts of the case, not just the possibility of coverage.

Suppose the insured is a construction firm. An employee, frustrated by a particular task, throws a wrench, striking and injuring another contractor's employee on the job site. The injured employee sues the contractor and the worker. The CGL policy does not cover injuries expected or intended by the insured. If a court decides the employee expected the wrench to injure someone else, the policy will not cover the settlement. However, it is possible that the employee expected or intended no such thing. Because the possibility of coverage exists, the insurance company will have to defend the firm and the employee against the lawsuit.

Now assume the insured is a restaurant. A group has dinner after spending the afternoon tailgating at a football game. One person, already intoxicated from the tailgating, has six beers with dinner and leaves the restaurant very intoxicated. He makes a wrong turn, walks into busy traffic, and suffers serious injuries when a car strikes him. He sues the restaurant for his injuries. The CGL policy does not cover injuries for which the insured is liable by reason of contributing to a person's intoxication if the insured is in the business of selling alcoholic beverages. Because there appears to be no possibility that the restaurant's policy will cover this claim, the insurance company has no duty to provide defense.

The cost of defending a lawsuit can often exceed the cost of the settlement. All businesses should discuss their liability coverage with their insurance agents to ensure that they have the protection they need if they get sued. The agent can identify coverage gaps and recommend solutions. They may involve additional premiums; better that a business pays more for insurance than endure bankruptcy due to uncovered legal costs.