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THE DUTY TO DEFEND—*Brown v. Lumbermens Mutual Casualty Company*

INTRODUCTION

There are thousands of words defined in *Webster's Ninth New Collegiate Dictionary*. Few of these words have a more clear or definite definition than the word "exhaust."¹ Yet, the North Carolina Supreme Court found ambiguity in the word "exhaust" and used this ambiguity to expand the duty to defend under an insurance policy. In doing so, the court trampled upon established rules of insurance law² and continued North Carolina's deviation from the principle that insurance policies should be strictly construed.³

This Note has five purposes. First, this Note reviews the facts of *Brown v. Lumbermens Mut. Casualty Co.*⁴ Second, this Note examines the judicial logic of the *Brown* decision. Third, this Note addresses public policy concerns left unanswered by the courts. Fourth, this Note examines *Brown's* impact on N.C. Gen. Stat. § 20-279.21(b)(4). Finally, this Note concludes that while *Brown* should be applauded for extending the duty to defend, the court unnecessarily stretched basic principles of contract law to justify its decision.

THE CASE

Brown was involved in an automobile accident with Hinson in 1983.⁵ Hinson sued Brown in 1984 for injuries sustained in the accident.⁶ Lumbermens Mutual Casualty Company [hereinafter LMCC], Brown's automobile insurance carrier, employed outside

1. WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 434 (9th ed. 1987)(defining "exhaust" to mean to consume entirely; to use up).

2. Policies of liability insurance, like all other written contracts, are to be construed and enforced according to their terms. If plain and unambiguous, the meaning thus expressed must be ascribed to. *Lane v. Aetna Casualty & Sur. Co.*, 48 N.C. App. 634, 637, 269 S.E.2d 711, 714 (1980), *review denied*, 302 N.C. 219, 276 S.E.2d 916 (1981).

3. *See Great Am. Ins. Co. v. C.G. Tate Constr. Co.*, 303 N.C. 387, 390, 279 S.E.2d 769, 771 (1981)(discussing North Carolina's deviation from strict construction principles).

4. 326 N.C. 387, 390 S.E.2d 150 (1990).

5. *Id.* at 389, 390 S.E.2d at 151.

6. *Id.*

counsel to defend Brown.⁷ Counsel for Brown informed LMCC that Brown would probably be found liable and predicted a jury verdict of between \$50,000 and \$75,000.⁸ LMCC filed an offer of judgment to pay \$25,000, the policy limits under Brown's insurance policy.⁹ Hinson rejected LMCC's offer and demanded \$43,000 to settle the claim.¹⁰ LMCC then offered the policy limits to Hinson in partial satisfaction of her claim.¹¹ Brown objected and refused to contribute to settling the claim.¹² LMCC subsequently paid the policy limits to Hinson, and Hinson released LMCC from future claims.¹³ Counsel retained by LMCC was allowed to withdraw from representing Brown.¹⁴ LMCC subsequently discharged its counsel.¹⁵ Brown did not employ new counsel.¹⁶ Hinson obtained a \$45,000 verdict against an unrepresented Brown on May 1, 1985.¹⁷

Brown filed a separate action against LMCC alleging that LMCC breached its insurance contract by failing to defend Brown.¹⁸ The trial court granted LMCC's motion for summary judgment, ruling that the duty to defend terminated upon payment of the policy limits.¹⁹ The court of appeals reversed and remanded, concluding that the duty to defend provision in LMCC's policy was ambiguous.²⁰ The court of appeals determined that

7. *Id.*

8. *Id.* at 389, 390 S.E.2d at 151.

9. *Id.*

10. *Id.*

11. *Id.* at 390, 390 S.E.2d at 151-52.

12. *Id.* at 390, 390 S.E.2d at 151.

13. *Id.* LMCC paid Hinson pursuant to N.C. GEN. STAT. § 1-540.3 (1983 & Supp. 1988) and an Advance Payment Agreement. *Id.*

14. *Id.* at 390, 390 S.E.2d at 152.

15. *Id.*

16. *Id.* at 391, 390 S.E.2d at 151. Brown also alleged that General Motors negligently failed to investigate the design, construction and assembly of the brake system on Brown's 1979 Cadillac. Apparently, this allegation forms part of the basis of Brown's claim against General Motors. *Id.* at 391, 390 S.E.2d at 152.

17. *Id.* at 390, 390 S.E.2d at 152. "The trial court entered judgment on the verdict but credited the judgment with the \$25,000 LMCC paid Hinson," leaving Brown personally liable for \$20,000. Brown obtained counsel and appealed. The court of appeals found no error. See *Hinson v. Brown*, 80 N.C. App. 661, 343 S.E.2d 284, review denied, 318 N.C. 282, 348 S.E.2d 138 (1986).

18. *Brown v. Lumbermens Mut. Casualty Co.*, 326 N.C. 387, 391, 390 S.E.2d 150, 152 (1990).

19. *Id.*

20. *Id.*

LMCC had not specified the manner in which the coverage limits would have to be exhausted before its duty to defend was discharged.²¹ The supreme court affirmed.²² The supreme court held that a unilateral tender²³ of the policy limits without effecting a settlement of the claims against the insured does not relieve an insurance carrier of its duty to defend.²⁴

BACKGROUND

A. *The McCarthy Decision*

Lumbermens Mut. Casualty Co. v. McCarthy,²⁵ the leading case limiting an insurance company's duty to defend after payment of its policy limits, was decided over fifty years ago. The court in *McCarthy* set forth two diverse propositions regarding the duty to defend after payment of the policy limits.²⁶

McCarthy held that an insurance company had no duty to defend after paying its policy limits.²⁷ *McCarthy* also, in dicta, formulated the standard for another principle which is now accepted in some jurisdictions.²⁸ The insurer cannot avoid its obligation to defend against an insured's contingent liability by making an early payment of the policy limits without effectuating a settlement or

21. *Id.*

22. *Id.*

23. A unilateral tender occurs when the insurance company pays the limits of liability under the insurance policy without consent of the insured. See *Brown v. Lumbermens Mut. Casualty Co.*, 326 N.C. 387, 391, 390 S.E.2d 150, 152 (1990).

24. *Id.* at 397, 390 S.E.2d at 155-56.

25. 90 N.H. 320, 8 A.2d 750 (1939). *McCarthy* resulted from an automobile collision involving Mr. McCarthy and his son. Individual suits were filed against both Mr. McCarthy and his son. The actions were tried together and resulted in verdicts against both. The insurance company paid the policy limits to satisfy the judgment against the son. The insurance company subsequently notified Mr. McCarthy that by paying the limits of the policy, it had discharged its obligation under the policy. The insurance company advised Mr. McCarthy to obtain other counsel as its duty to defend terminated upon payment of the policy limits. LMCC filed a petition to determine (1) whether it was under any obligation to further defend and (2) whether it was obligated to pay the judgment. *McCarthy*, 90 N.H. at ____, 8 A.2d at 751. See also Zulkey & Pollard, *The Duty to Defend After Exhaustion of Policy Limits*, FOR THE DEFENSE, June 1985, at 21, 23-24 [hereinafter Zulkey & Pollard].

26. Zulkey and Pollard, *supra* note 25, at 23 (citing *McCarthy*, 90 N.H. at 323, 8 A.2d at 752).

27. *McCarthy*, 90 N.H. at ____, 8 A.2d at 752.

28. Zulkey & Pollard, *supra* note 25, at 23.

without obtaining the insured's permission.²⁹

The dichotomous language in *McCarthy* sparked the current split of judicial opinion regarding the duty to defend after payment of policy limits. Nationally, there are two diverse views.³⁰ "One view is that the insurer is excused from paying the insured's defense costs once the total amount of the coverage has been paid."³¹ The opposite view is that payment of the policy limits does not terminate the insurer's duty to defend.³²

B. 1966 Comprehensive General Liability Policy Language Change

Prior to 1966, the standard comprehensive general liability policy [hereinafter CGL] did not contain a provision requiring an insurance company to defend its insured after the policy limits

29. *Brown v. Lumbermens Mut. Cas. Co.*, 326 N.C. 387, 395, 390 S.E.2d 150, 155 (1990) (citing *Anderson v. United States Fidelity & Guar. Co.*, 177 Ga. App. 520, 521, 339 S.E.2d 660, 661 (1986)). See also *Anchor Casualty Co. v. McCaleb*, 178 F.2d 322 (5th Cir. 1949) (applying Texas law); *Simmons v. Jeffords*, 260 F. Supp. 641 (E.D. Pa. 1966); *Liberty Mut. Ins. Co. v. Mead Corp.*, 219 Ga. 6, 131 S.E.2d 534 (1963); *Sutton Mut. Ins. Co. v. Rolph*, 109 N.H. 142, 244 A.2d 186 (1968).

30. *Zulkey & Pollard*, *supra* note 25, at 21.

31. *Id.* at 22 (citing *Denham v. LaSalle-Madison Hotel Co.*, 168 F.2d 576 (7th Cir.), *cert. denied*, 355 U.S. 871 (1948); *General Casualty Co. v. Whipple*, 328 F.2d 353 (7th Cir. 1964); *Allstate Ins. Co. v. Montgomery Trucking Co.*, 328 F. Supp. 415 (N.D. Ga. 1971); *Aetna Casualty & Sur. Co. v. Certain Underwriters at Lloyds of London*, 56 Cal. App. 3d 791, 129 Cal. Rptr. 47 (1976); *National Union Ins. Co. v. Phoenix Assurance Co.*, 301 A.2d 222 (D.C. App. 1973); *Hartford Accident & Indem. Co. v. South Carolina Ins. Co.*, 252 S.C. 428, 166 S.E.2d 762 (1969); *Liberty Mut. Ins. Co. v. Mead Corp.*, 219 Ga. 6, 131 S.E.2d 534 (1963); *Oda v. Highway Ins. Co.*, 44 Ill. App. 2d 235, 194 N.E.2d 489 (1963); *Traveler's Indem. Co. v. New England Box Co.*, 102 N.H. 380, 157 A.2d 765 (1960); *Lumbermens Mut. Casualty Co. v. McCarthy*, 90 N.H. 320, 8 A.2d 750 (1939)).

32. *Zulkey & Pollard*, *supra* note 25, at 21 (citing *Anchor Casualty Co. v. McCaleb*, 178 F.2d 322 (5th Cir. 1949); *ACandS, Inc. v. Aetna Casualty & Sur. Co.*, 576 F. Supp. 936 (E.D. Pa. 1983); *Commercial Union Ins. Co. v. Pittsburgh Corning Corp.*, 553 F. Supp. 425 (E.D. Pa. 1981); *Simmons v. Jeffords*, 260 F. Supp. 641 (E.D. Pa. 1966); *National Casualty Co. v. Insurance Co.*, 320 F. Supp. 617 (N.D. Ohio 1964); *Travelers Indem. Co. v. East*, 240 So. 2d 277 (Miss. 1970); *St. Paul Fire & Marine Ins. Co. v. Thompson*, 150 Mont. 182, 433 P.2d 795 (1967); *Prince v. Universal Underwriters Ins. Co.*, 143 N.W.2d 708 (N.D. 1966); *American Employers Ins. Co. v. Goble Aircraft Specialties, Inc.*, 205 Misc. 1066, 131 N.Y.S.2d 393 (N.Y. Sup. Ct. 1954), *appeal withdrawn*, 1 A.D.2d 1008, 154 N.Y.S.2d 835 (1956).

were exhausted.³³ The insurance industry changed the wording of the standard CGL policy in 1966.³⁴ Following this change, the standard CGL policies have included a provision to the effect that an insurer does not have to defend a suit after the limits of liability have been exhausted by payment of judgments or settlements.³⁵

C. *Recently Interpreted Cases Extending the Duty to Defend*

More recently, standard CGL policies have contained the language used by LMCC in *Brown*. The language states:

We will pay for bodily injury or property damage for which any covered person becomes legally responsible because of an automobile accident. We will settle or defend, as we consider appropriate, any claim or suit asking for these damages. In addition to our limit of liability, we will pay all defense costs we incur. Our duty to settle or defend ends when our limit of liability for this coverage has been exhausted.³⁶

There have been few cases interpreting this specific language.³⁷ But, cases have held that an insurer cannot make a unilateral tender of its policy limits without effecting a settlement or obtaining a judgment.

*Stanley v. Cobb*³⁸ involved a personal injury action arising from an automobile accident.³⁹ The insured had \$15,000 liability limits in the insurance policy issued by American International Group [hereinafter the primary carrier].⁴⁰ The injured plaintiff's automobile policy included underinsured motorist coverage under-

33. *Brown v. Lumbermens Mut. Casualty Co.*, 326 N.C. 387, 395, 390 S.E.2d 150, 154 (1990). See also Zulkey & Pollard, *supra* note 25, at 22.

34. *Brown*, 326 N.C. at 395, 390 S.E.2d at 154. See also Van Vugt, *Termination of the Insurer's Duty to Defend by Exhaustion of Policy Limits*, 44 INS. COUNSEL J. 254, 257 (1977)[hereinafter Van Vugt].

35. *Brown*, 326 N.C. at 395, 390 S.E.2d at 154 (citing Van Vugt, *supra* note 34, at 257 n.5). The post-1966 policy language did not appear in the majority of the cases cited *supra* notes 31-32. Van Vugt, *supra* note 34, at 257 n.5.

36. *Brown*, 326 N.C. at 389, 390 S.E.2d at 153.

37. *Id.* at 395, 390 S.E.2d at 154 (citing *Stanley v. Cobb*, 624 F. Supp. 536 (E.D. Tenn. 1986); *Samplly v. Integrity Ins. Co.*, 476 So. 2d 79 (Ala. 1985); *Anderson v. United States Fidelity & Guar. Co.*, 177 Ga. App. 520, 339 S.E.2d 660 (1986); *Pareti v. Sentry Indem. Co.*, 536 So. 2d 417 (La. 1988)).

38. 624 F. Supp. 536 (E.D. Tenn. 1986).

39. *Id.*

40. *Id.* at 537.

written by Nationwide Insurance Company.⁴¹

Counsel for the insured moved for permission to withdraw from further defense of the case upon payment by the primary carrier of the \$15,000 liability limits.⁴² The underinsured motorist carrier opposed the primary carrier's motion to withdraw.⁴³ The district court denied the primary carrier's motion to withdraw.⁴⁴ The court stated that the limit of liability could not be exhausted in a manner other than that specified by the policy.⁴⁵ "There were no provisions in the primary carrier's policy which gave the insurer the right to avoid the obligation of defense by paying into court any definite sum of money."⁴⁶ The court held that absent a clause specifically granting such a right, the insurance contract had to be interpreted by its plain meaning.⁴⁷

In *Samply v. Integrity Ins. Co.*,⁴⁸ Samply, the negligent insured, collided with a car driven by Hatter.⁴⁹ Samply's insurance policy with the Integrity Insurance Company [hereinafter Integrity] contained a \$10,000 limit of liability.⁵⁰ Integrity filed a declaratory judgment action naming Samply and the Hatters as defendants.⁵¹ Integrity sought to have the limits of its liability established at \$10,000 and to be discharged from the suit upon payment of the policy limits into the court.⁵² The trial court ruled in favor of Integrity and discharged it from any further defense of Samply.⁵³ The Supreme Court of Alabama reversed and remanded.⁵⁴ The *Samply* court held "that the better rule of law is that an insurer . . . cannot avoid its duty to defend against an insured's contingent liability by tendering the amount of its policy limits into court without effectuating a settlement or obtaining the consent of

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.* at 536.

45. *Id.* at 537.

46. *Id.* at 538.

47. *Id.*

48. 476 So. 2d 79 (Ala. 1985).

49. *Id.* at 80.

50. *Id.* The Samplys' policy provided coverage limited to \$10,000 per injured person and \$20,000 per accident. *Id.*

51. *Id.* The declaratory judgment action also named the Hatters' daughter. *Id.*

52. *Id.*

53. *Id.* at 81.

54. *Id.* at 84.

the insured.”⁵⁵

In *Anderson v. U.S. Fidelity and Guar. Co.*,⁵⁶ the appellant Anderson defended several suits filed by parties allegedly injured in a multiple-vehicle collision in which Anderson was involved.⁵⁷ U.S. Fidelity and Guaranty Company [hereinafter U.S. Fidelity] paid the balance of the policy coverage to the court and was discharged from defending Anderson.⁵⁸ Reversing the trial court’s decision, the Georgia Court of Appeals stated, “we do not agree . . . that the term exhaust encompasses the paying into court of the policy limits, but interpret that term to mean the payment either of a settlement or of a judgment wholly depleting the policy amount.”⁵⁹

The rulings in *Stanley*, *Samply* and *Anderson* interpreted contract language identical to the policy language involved in *Brown*.⁶⁰ The decisions clearly demonstrate the national movement of extending the duty to defend after the policy limits have been tendered.

ANALYSIS

A. *The Brown Holding*

Brown held that an insurer’s duty to defend continues until the coverage limits of the insured’s policy have been exhausted in the settlement of a claim or until a judgment against the insured is reached.⁶¹ According to *Brown*, an insurance company’s unilateral tender of the policy limits without effecting a settlement will not relieve an insurance company of its duty to defend the claim against the insured.⁶²

55. *Id.* at 83-84.

56. 177 Ga. App. 520, 339 S.E.2d 660 (1986).

57. *Id.* at ____, 339 S.E.2d at 660. Three of the claims were settled by Anderson. Other claims were filed in different courts. *Id.*

58. *Id.*

59. *Id.* at ____, 339 S.E.2d at 661.

60. See *Stanley v. Cobb*, 624 F. Supp. 536, 537 (E.D. Tenn. 1986); *Samply v. Integrity Ins. Co.*, 476 So. 2d 79, 80 (Ala. 1985); *Anderson v. United States Fidelity & Guar. Co.*, 177 Ga. App. 520, ____, 339 S.E.2d 660, 660 (1986).

61. *Brown v. Lumbermens Mut. Casualty Co.*, 326 N.C. 387, 394, 390 S.E.2d 150, 154 (1990).

62. *Id.* at 397, 390 S.E.2d at 155-56.

B. *Brown's Rationale*

Brown was a case of first impression for the appellate courts of North Carolina.⁶³ The court started its analysis by citing various cases referencing general insurance law principles.⁶⁴ The most important principles being that “[a]ny ambiguity in the policy language must be resolved against the insurance company and in favor of the insured.”⁶⁵

The court affirmed the principle that there is not a statutory duty to defend under a standard insurance policy⁶⁶ and that an insurer’s duty to defend “is broader than its obligation to pay damages under a particular policy.”⁶⁷ The supreme court recognized the principle that LMCC could presumably contractually limit its duty to defend because the duties to defend and indemnify arise by contract.⁶⁸

C. *Ambiguity in the Policy*

The court then discussed ambiguity in the policy language.⁶⁹ The court determined that the pertinent policy language was ambiguous and must be construed in favor of the insured.⁷⁰ According to the court, LMCC failed to define the word “exhaust” in the policy definitions or in the insuring agreement.⁷¹ The court determined that an insurer could exhaust its coverage limits in a number of ways and gave examples of how insurance policy limits could be exhausted.⁷² Also, the court stated that “other methods of ex-

63. *Brown v. Lumbermens Mut. Casualty Co.*, 90 N.C. App. 464, 475-77, 369 S.E.2d 367, 372-75 (1988), *aff'd*, 326 N.C. 387, 390 S.E.2d 150 (1990).

64. *Brown*, 326 N.C. at 391-93, 390 S.E.2d at 152-53.

65. *Id.* at 392, 390 S.E.2d at 153 (quoting *Woods v. Insurance Co.*, 295 N.C. 500, 505, 246 S.E.2d 773, 777 (1978)).

66. *Id.* at 391, 390 S.E.2d at 152; *see also* N.C. GEN. STAT. § 20-279.21 (1983 & Supp. 1988)(stating requirements of a motor vehicle liability policy).

67. *Brown*, 326 N.C. at 392, 390 S.E.2d at 153 (quoting *Waste Management of Carolinas, Inc. v. Peerless Ins. Co.*, 315 N.C. 688, 691, 340 S.E.2d 374, 377, *reh'g denied*, 316 N.C. 386, 346 S.E.2d 134 (1986)(stating also that “the extent of the duty to defend requires resolution of scope of the policy provisions”)).

68. *Brown v. Lumbermens Mut. Casualty Co.*, 90 N.C. App. 464, 475, 369 S.E.2d 367, 373 (1988), *aff'd*, 326 N.C. 387, 390 S.E.2d 150 (1990).

69. *Brown*, 326 N.C. at 393-94, 390 S.E.2d at 153-54.

70. *Id.* at 393, 390 S.E.2d at 153.

71. *Id.* at 393-94, 390 S.E.2d at 153-54.

72. *Id.* at 394, 390 S.E.2d at 154 (stating that the insurance company could pay the policy limits (1) “into the court and interplead conflicting claimants in a declaratory judgment action;” (2) “to one of several claimants in return for a com-

hausting coverage limits were possible."⁷³

The court focused on the manner in which coverage must be exhausted before the duty to defend terminates.⁷⁴ The court relied on cases from other jurisdictions which have interpreted insurance language identical to the policy language in *Brown*.⁷⁵

1. *Pareti v. Sentry Indem. Co.*

The court relied heavily on *Pareti v. Sentry Indem. Co.*⁷⁶ in justifying its holding. The Paretis brought suit against an automobile insurer, Pennsylvania General Insurance Company [hereinafter Penn. General], Penn. General's insured, the Schnellers, and their own underinsured motorist carrier, Sentry Indemnity Company [hereinafter Sentry].⁷⁷ "Sentry filed a cross-claim against the Schnellers, seeking indemnity for all amounts that Sentry might be required to pay [the Paretis] under their underinsured motorist policy. . . ."⁷⁸ Shortly thereafter, the Paretis executed a compromise and release agreement with the Schnellers and Penn. General.⁷⁹ The agreement released the Schnellers and Penn. General from all further liability in exchange for the Schnellers' \$50,000 limits of liability.⁸⁰ The Paretis reserved their rights against their own underinsured motorist carrier, Sentry, in the compromise agreement.⁸¹ Sentry made no payments to the Paretis under their underinsured motorist coverage at the time of the settlement with the Schnellers and Penn. General.⁸² The settlement exhausted the

plete settlement of that claim against its insured;" (3) "in full or partial satisfaction of a judgment against its insured;" (4) "as an advance sum to its insured in lieu of investigating whatever defenses might be available;" or (5) "to the injured party, in return for a release of only the insurer and not the insured"). *Id.*

73. *Id.*

74. *Id.* The ambiguity was not in the meaning of the word "exhaust," but was in the manner by which the coverage must be exhausted before the duty to defend terminated. *Id.*

75. The *Brown* majority used *Stanley*, *Samply*, and *Anderson* to support its decision. For a discussion of these cases, see *supra* notes 38, 48, 56 and accompanying text.

76. 536 So. 2d 417 (La. 1988).

77. *Pareti v. Sentry Indem. Co.*, 536 So. 2d 417, 419 (La. 1988).

78. *Id.*

79. *Id.*

80. \$50,000 was the limit of Pennsylvania's "per person" liability for the accident. *Id.*

81. *Id.*

82. *Id.*

Schneller's insurance policy liability limits.⁸³ Sentry filed a third-party action against the Schnellers seeking indemnification or contribution.⁸⁴ The Schnellers' automobile insurer, Penn. General, declined to defend them because the limits of liability had been exhausted in the settlement of Pareti's claims.⁸⁵ The Schnellers filed a cross-claim against Penn. General seeking reimbursement of attorney's fees incurred as a result of Penn. General's refusal to defend.⁸⁶

The *Pareti* court held that under the facts presented, the insurer had no duty to defend the other claims.⁸⁷ Interestingly, the policy language in *Pareti* was identical to that involved in *Brown*, yet the Supreme Court of Louisiana found it to be unambiguous.⁸⁸ However, the *Pareti* court stated in a footnote⁸⁹ that the same policy language could be found ambiguous if the case involved a situation where an insurer attempted to tender its policy limits without obtaining a settlement or judgment.⁹⁰ "When an insurer merely tenders its limits without obtaining a settlement of any claim for its insured, a strong argument can be made that it has neither exhausted its policy limits nor fulfilled its fiduciary duty to discharge its policy obligations to the insured in good faith."⁹¹

It is interesting to note that the *Pareti* decision, upon which the *Brown* majority relied so heavily, contained a statement of an elementary principle of insurance law that the *Brown* majority failed to mention.⁹² "[C]ourts have no authority to alter the terms of policies under the guise of contractual interpretation when the policy provisions are couched in unambiguous language."⁹³ Thus, it was crucial for the *Brown* majority to find ambiguity in the fact that LMCC did not include the various methods by which the pol-

83. *Id.*

84. *Id.* at 417.

85. *Id.* at 417, 419.

86. *Id.* at 420.

87. *Id.* at 424.

88. *Id.*

89. *Id.* at 421 n.3.

90. *Id.*

91. *Id.* at 422-23. See also *Samplly v. Integrity Ins. Co.*, 476 So. 2d 79 (Ala. 1985). Unilateral tenders by the insurer have generally been viewed as insufficient to terminate the duty to defend. *Id.* at 421 n.3.

92. *Id.* at 420-21.

93. *Id.* at 420. (citing *Monteleone v. American Employer's Ins. Co.*, 239 La. 773, 120 So. 2d 70 (1960); *Edwards v. Life & Casualty Ins. Co.*, 210 La. 1024, 29 So. 2d 50 (1946)).

icy limits could be exhausted. When one reads *Pareti*, understanding that the Louisiana Supreme Court stated that the pertinent policy language was unambiguous in certain situations,⁹⁴ the *Brown* majority's staunch reliance on *Pareti* is severely weakened.

D. Dissent

Justice Whichard's dissenting opinion correctly identified that "neither the word 'exhausted' nor the manner of 'exhausting' the policy limits [was] ambiguous. . . ." ⁹⁵ "The only reasonable interpretation [of the term 'exhaust'] is that by paying its full policy limits to the party injured by its insured, defendant [insurance company] 'exhausted' its limits of liability and ended its duty to settle or defend."⁹⁶

Justice Whichard correctly stated that the majority perceived a double meaning in the policy language in *Brown*.⁹⁷ The majority's interpretation "in effect reinserts policy language into the contract that was standard in post-1966 insurance contracts" but which was omitted from the *Brown* policy.⁹⁸

Justice Whichard rightfully accused the majority of reading more into the contract than was present.⁹⁹ Justice Whichard correctly pointed out that "the contract neither states nor implies a provision limiting 'exhaustion' of policy liability limits to settlement or judgment, or even to a tender for settlement."¹⁰⁰ The language specifying the means of exhaustion was patently absent.¹⁰¹

The Supreme Court of North Carolina acknowledged the fact that "an insurer's duty to defend . . . is determined by the language in the insurance contract."¹⁰² By affirming the North Caro-

94. *Id.* at 420-21.

95. *Brown v. Lumbermens Mut. Casualty Co.*, 326 N.C. 387, 398, 390 S.E.2d 150, 156 (1990)(Whichard, J., dissenting).

96. *Id.* at 398, 390 S.E.2d at 156.

97. *Id.* The double meaning is that (1) "the duty to defend or settle ends only after judgment or settlement" or (2) "it ends when the policy limits are exhausted in any other manner." *Id.*

98. *Id.* The post-1966 language provides that "[t]he company shall not be obligated to pay any claim or judgment or to defend any suit or prosecute or maintain any appeal after the applicable limits of the Company's liability has been exhausted by payment or any judgments or settlements." *Id.*

99. *Id.* at 399, 390 S.E.2d at 157.

100. *Id.* (citing *Gross v. Lloyds of London Ins. Co.*, 121 Wis. 2d 78, 83, 358 N.W.2d 266, 269 (1984)).

101. *Id.* at 399, 390 S.E.2d at 157.

102. *Id.* at 392, 390 S.E.2d at 153 (citing *Liberty Mut. Ins. Co. v. Mead Corp.*,

lina Court of Appeals decision,¹⁰³ the court also acknowledged the general insurance principle that the duties to defend and indemnify in an insurance policy arise by contract.¹⁰⁴ Therefore, LMCC could contractually limit its duty to defend.¹⁰⁵

LMCC clearly drafted its policy language so that its duty to defend ended upon payment of its policy limits. To override this basic contractual right, the appellate courts of North Carolina found a clearly defined seven letter word to be ambiguous.¹⁰⁶ In doing so, the supreme court trampled upon yet another general insurance principle of policy construction, one which the supreme court also recognized in its opinion.¹⁰⁷ "In construing an insurance policy, nontechnical words, not defined in the policy, are to be given the same meaning they usually receive in ordinary speech, unless the context requires otherwise."¹⁰⁸ The word "exhaust" is clearly a nontechnical word which LMCC did not define in its policy. Nevertheless, the court found ambiguity.¹⁰⁹

The North Carolina Supreme Court did not have to find ambiguity in the word "exhaust" in order to rule that the duty to defend extends beyond exhaustion of the insured's policy limits. Two cases cited by the *Brown* majority addressed identical contract language as involved in *Brown*. These cases reached their decisions either by not addressing ambiguity or holding the pertinent contract language was unambiguous.¹¹⁰ The court's lengthy discussion

219 Ga. 6, 8, 131 S.E.2d 534, 535 (1963)).

103. *Id.* at 397, 390 S.E.2d at 156.

104. *Brown v. Lumbermens Mut. Casualty Co.*, 90 N.C. App. 464, 475, 369 S.E.2d 367, 373 (1988), *aff'd*, 326 N.C. 387, 390 S.E.2d 150 (1990).

105. *Id.*

106. See *infra* note 1 and accompanying text; see also AMERICAN HERITAGE DICTIONARY 475 (2d ed. 1982)(explaining that exhaust is a broad term meaning to use up, consume or deplete).

107. See *Brown v. Lumbermens Mut. Casualty Co.*, 326 N.C. 387, 392, 390 S.E.2d 150, 153 (1990).

108. *Id.* (quoting *Grant v. Insurance Co.*, 295 N.C. 39, 42, 243 S.E.2d 894, 897 (1978); see also *Davis v. Maryland Casualty Co.*, 76 N.C. App. 102, 104, 331 S.E.2d 744, 746 (1985).

109. *Brown*, 326 N.C. at 393, 390 S.E.2d at 153.

110. The *Anderson* court reached its results after concluding that the provision was not ambiguous, but that it clearly requires exhaustion of limits in the payment of a settlement or judgment before the duty to defend terminates. *Anderson v. United States Fidelity & Guar. Co.*, 177 Ga. App. 520, 521, 339 S.E.2d 660, 661 (1986). *Samplly* failed to mention ambiguity, but nevertheless construed the provision in favor of the insured. *Samplly v. Integrity Ins. Co.*, 476 So. 2d 79, 83 (Ala. 1985).

of ambiguity in the word exhaust was unnecessary. The North Carolina Supreme Court could have easily reached its decision by completely avoiding the ambiguity issue and citing *Anderson* and *Samply* as authority.¹¹¹

E. Public Policy Concerns

The *Brown* decision avoided three public policy concerns that could adversely affect the citizens of North Carolina. These public policy concerns are (1) discouragement of advance payments pursuant to N.C. GEN. STAT. § 1-540.3; (2) potential escalation of insurance costs; and (3) the indirect effect of encouraging drivers to purchase minimum limits of liability.

1. Discouragement of Advance Payments

The *Brown* dissent stressed public policy concerns arising from extending the duty to defend in light of N.C. GEN. STAT. § 1-540.3(a).¹¹² The statute provides for advance payments by an insurance company to an injured person without constituting an admission of liability nor acting as a bar, release, accord and satisfaction, or discharge of obligation.¹¹³ One of the policy reasons behind enactment of N.C. Gen. Stat. § 1-5403(a) was to encourage advance partial payments by insurance companies prior to settlement of a claim.¹¹⁴ The statute allows seriously injured persons requiring long-term medical care to accept partial payments from an insurer before determination of liability.¹¹⁵ These payments constitute neither admissions of liability nor full satisfaction of an injured party's claim on the part of the insurer.¹¹⁶

The *Brown* decision will discourage "advance payments since the carrier will be responsible for the defense costs even if an advance payment is made."¹¹⁷ This liability for defense costs will en-

111. See *Anderson*, 177 Ga. App. at 521, 339 S.E.2d at 661; *Samply*, 476 So. 2d at 83.

112. *Brown v. Lumbermens Mut. Casualty Co.*, 326 N.C. 387, 402-03, 390 S.E.2d 150, 158-59 (1990)(Whichard, J., dissenting).

113. N.C. GEN. STAT. § 1-540.3(a) (1983 & Supp. 1988).

114. *Brown*, 326 N.C. at 402, 390 S.E.2d at 159 (citing *Thornburg v. Lancaster*, 303 N.C. 89, 94, 277 S.E.2d 423, 427 (1981), *overruled on other grounds*, *Daniels v. Montgomery Mut. Ins. Co.*, 320 N.C. 669, 360 S.E.2d 772 (1987)).

115. *Brown*, 326 N.C. at 402, 390 S.E.2d at 159.

116. *Id.*

117. Petition for Discretionary Review at 6, *Brown v. Lumbermens Mut. Casualty Co.*, 326 N.C. 387, 390 S.E.2d 150 (1990)(No. 337P88A).

courage the carrier not to make payments prior to trial in the hope that the jury will return a verdict in an amount less than the carrier's liability limits."¹¹⁸ The carrier will be justified in taking this risk since *Brown* has eliminated one of the principle benefits of an advance payment, avoiding defense costs.¹¹⁹

2. *Potential Escalation of Insurance Costs*

The *Brown* court did not address a second public policy concern which was clearly raised in LMCC's petition for discretionary review.¹²⁰ Extending an insurance company's duty to defend after the policy limits have been exhausted will dramatically escalate the costs of insurance.¹²¹ Insurance carriers have set insurance premiums "based on understanding that the carrier's duty to defend is satisfied upon the payment of its policy limits."¹²² The decision will cause insurance premiums to escalate "since insurers will now be required . . . [to defend] for multi-million dollar injury even though liability is clear and the carrier's maximum exposure is \$25,000."¹²³

3. *Encouraging Financial Irresponsibility*

A third public policy concern not addressed by the court is that the *Brown* decision indirectly subsidizes financial irresponsibility. *Brown* will encourage many drivers to shirk their potential liability responsibilities by purchasing the minimum limits of liability provided by statute.¹²⁴ The court's decision drastically broadens the duties of an insurance company's duty to defend. As such, the decision broadens the coverage. The public understands that a significant benefit of liability insurance is not only to pay for damages as a result of negligent acts; but, more importantly that the costs of legal defense are generally paid in addition to the limits of liability.¹²⁵

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.*

124. See N.C. GEN. STAT. § 20-279.21(b)(4) (1983 & Supp. 1988)(providing the minimum policy limits required for automobile insurance).

125. A standard feature in all automobile insurance policies is that in addition to the specified limits of liability, the insurer will pay for defense costs. See United Services Automobile Association (USAA) Auto Policy form

Three of the four cases cited by the *Brown* majority in support of its decision involved insureds who elected to purchase minimum or inadequate limits of liability.¹²⁶ In these cases, the duty to defend would not have been litigated had the insured accepted the potential liability exposure and acted in a financially responsible manner by obtaining liability coverage in excess of the minimum limits.

The *Brown* decision does nothing to encourage individuals to purchase more than the minimum limits of liability. Rather, the court's opinion increases the benefits of the insurance contract by requiring an insurance company to provide a defense even after it has paid the applicable policy limits. Therefore, *Brown* provides additional justification for individuals to purchase inadequate limits of liability protection.

F. Effect of Brown on the Underinsured Motorist Statute

The *Brown* court also failed to address the impact, if any, its holding may have on the provisions of the underinsured motorist statute, N.C. Gen. Stat. § 20-279.21(b)(4).¹²⁷ Although the underinsured motorist statute was not an issue in *Brown*,¹²⁸ the United States District Court for the Eastern District of North Carolina did address the issue in 1988.¹²⁹ In *Gunn v. Whichard*,¹³⁰ the court

5000NC(04)(Rev. 8-90) at 3.

126. See *Stanley v. Cobb*, 624 F. Supp. 536, 537 (E.D. Tenn. 1986); *Samplly v. Integrity Ins. Co.*, 476 So. 2d 79, 80 (Ala. 1985); *Pareti v. Sentry Indem. Co.*, 536 So. 2d 417, 419 (La. 1988).

127. See N.C. GEN. STAT. § 20-279.21(b)(4) (1983 & Supp. 1988) (stating that any insurer providing primary liability insurance on an underinsured highway vehicle, upon payment of all of its applicable limits of liability, may be released from further liability or obligation to participate in the defense of such proceedings).

128. See *Brown v. Lumbermens Mut. Casualty Co.*, 326 N.C. 387, 390 S.E.2d 150 (1990).

129. See *Gunn v. Whichard*, 707 F. Supp. 196 (E.D.N.C. 1988) (*Gunn* involved an automobile accident in 1987. Plaintiff *Gunn* alleged that defendant *Whichard* negligently operated his automobile causing *Gunn* personal injuries. Plaintiff further alleged the liability of Bobby *Whichard* under the family purpose doctrine. Defendant's liability carrier, New Hampshire Insurance Company, "tendered its limits in partial satisfaction of plaintiff's claim and in full satisfaction of all claims against New Hampshire." *Id.* at 197. New Hampshire Insurance Company applied to the court for an order discharging it from further liability or obligation to defend pursuant to N.C. GEN. STAT. § 20-279.21(b)(4). Plaintiff's underinsured carrier objected to New Hampshire Insurance Company's motion to withdraw.).

stated that "the underinsured motorist statute allows the primary liability carrier to pay its limits and obtain a release of its obligation under the policy to defend and indemnify."¹³¹ Arguably, *Gunn* provides the necessary guidance for an interpretation of the statute. But this case is merely a federal court's interpretation of how the North Carolina courts would address the issue. *Brown* will inevitably arise in litigation regarding a primary carrier's attempt to be relieved of its duty to continue to provide a defense.¹³² Only time will tell what effect *Brown* will have on N.C. Gen. Stat. § 20-279.21(b)(4).

CONCLUSION

Brown v. Lumbermens Mut. Cas. Co. is but another in a growing number of North Carolina cases which have continued to expand the benefits of insurance policies. *Brown* moves North Carolina farther away from the strict construction of the common law principles of the freedom to contract.¹³³ The supreme court's decision in *Brown* will prevent an insurance company from unilaterally tendering policy limits to avoid the expenses of future litigation. As one court has stated, "A most significant protection afforded by the policy—that of defense—is rendered a near nullity if the duty to defend terminated upon unilateral tender of the policy limits."¹³⁴ The Supreme Court of North Carolina's ruling in *Brown* all but guarantees that such a situation will not occur to the citizens of North Carolina.

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130. 707 F. Supp. 196 (E.D.N.C. 1988).

131. *Id.* at 200.

132. At least one North Carolina superior court judge has ruled that *Brown* overrides N.C. GEN. STAT. § 20-279.21(b)(4). Judge J. Milton Read, Jr., Superior Court Judge of North Carolina, District 14, ruled that the language of Progressive Insurance Company's policy placed no restrictions on the payment of defense costs and did not provide for a withdrawal of the defense obligation by a primary carrier upon tendering its policy limits. Judge Read ruled that the primary carrier must defend its insured regardless of any language in the statute. See *Hocutt v. Winborne*, No. 89-CVS-01232 (Aug. 21, 1990).

133. *Great Am. Ins. Co. v. C.G. Tate Constr. Co.*, 303 N.C. 387, 390-99, 279 S.E.2d 769, 771-75 (1981).

134. *Brown v. Lumbermens Mut. Casualty Co.*, 326 N.C. 387, 396-97, 390 S.E.2d 150, 155 (quoting *Simmons v. Jeffords*, 260 F. Supp. 641, 642 (E.D. Pa. 1966)).