

## Insurer Entitled To Recover Defense Payments From Another Insurer Following Policy Rescission, Says Third Circuit

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The Third Circuit ruled that an insurer was entitled to reimbursement of defense costs it incurred prior to the rescission of its policy from an insurer that provided coverage to the same policyholder. *Berkley Assurance Co. v. Colony Ins. Co.*, 2021 WL 1625521 (3d Cir. Apr. 27, 2021).

The dispute arose from a building demolition that killed and injured several individuals. The building owner was insured under a policy issued by Colony, and was also listed as an additional insured under a policy issued by Berkley Assurance to the demolition company. Colony's policy contained an "other insurance" provision that made it secondary to any other insurance that provided coverage. When the injured victims and decedents' estates filed suit against the building owner, Berkley agreed to defend under a reservation of rights. While the underlying litigation was pending, Berkley sought a declaration that its policy was void ab initio based on misrepresentations in the application. A state court granted Berkley's motion, finding that rescission was warranted. Thereafter, Berkley sued Colony for equitable subrogation and unjust enrichment, seeking payment of the defense costs it incurred before the Berkley policy was rescinded. A Pennsylvania federal district court granted Berkley's summary judgment motion and the Third Circuit affirmed.

Colony argued that Berkley was precluded from seeking equitable subrogation because Berkley had a legal duty to defend, or alternatively, because Berkley voluntarily paid the defense costs. The court rejected both assertions. The court explained that once Berkley's policy was void ab initio, the insurer was relieved of all rights and responsibilities, both prospectively and retroactively. As such, Berkley had no duty to defend the suit. In so ruling, the court distinguished Pennsylvania precedent which holds that an insurer is not entitled to reimbursement of defense costs incurred during the period in which a declaratory judgment action regarding the duty to defend is pending. In those cases, the Pennsylvania Supreme Court explained that allowing reimbursement "would amount to a retroactive erosion of the broad duty to defend." However, the same policy concerns are not raised where a policy is declared void from inception.

The Third Circuit also rejected Colony's contention that Berkley was barred from seeking equitable contribution because it acted as a "volunteer" in paying defense costs. The court explained that Berkley "was acting out of a concern that it would be subject to a bad faith suit" if it did not pay defense costs. Finally, the court rejected Colony's argument that the equitable subrogation claim failed because Colony never breached its duty to defend. The court stated that the "proper inquiry is whether someone else discharged an obligation for which Colony is primary liable" and that once the void ab initio order was issued, "Colony retroactively became the primary insurer from the date of loss."

