

## **Pennsylvania Supreme Court Determines that Preliquidation Payments Made to Policyholders Do Not Constitute Voidable Preferences Under the Pennsylvania Insurance Liquidation Statute**

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On February 23, the Supreme Court of Pennsylvania ruled on an important insurance coverage question—one that has been addressed infrequently by courts throughout the country: Can the liquidator of an insolvent insurance company recover preliquidation claim payments that the insurance company made to its policyholders on the ground that the payments are voidable preferences?

In *Ario v. Ingram Micro, Inc.*, \_\_\_ A.2d \_\_\_, 2009 WL 428450 (Pa. Feb. 23, 2009), a unanimous Supreme Court ruled that the liquidator of Reliance Insurance Company (Reliance) had no right to recover preliquidation claims payments made to Reliance’s policyholders in the ordinary course of business. As only the third state supreme court ruling on this issue, and the first ruling in favor of policyholders, *Ingram Micro* is a significant and welcome decision for both policyholders and Pennsylvania-domiciled insurers. It promotes certainty and predictability in the payment of claims under insurance policies, and serves to minimize concerns a policyholder may have, when dealing with a Pennsylvania-domiciled insurer, that claim payments received within a year of the insurer being placed into liquidation will be subject to a statutory clawback.

*Ingram Micro* involved payments that Reliance made to various corporate policyholders under first-party trade credit policies issued to them by Reliance for losses they suffered from their customers’ nonpayment for goods or services. The payments were made only after the policyholders reported the claims to Reliance and after they had submitted the required proofs of loss documenting the nature and extent of their losses. Within one year after the claims were paid, Reliance went into liquidation. The Reliance liquidator then sued the policyholders to recover the payments as preferential.

Under the Pennsylvania insurance liquidation statute, which is very similar to the laws of other states, a “preference” is the transfer by an insurer of money or property to or for the benefit of a creditor “for or on account of an antecedent debt” that is made within one year before the filing of a successful petition to place the insurer into liquidation.

The *Ingram Micro* court focused on the issue of whether the policy payments were made “on account of an antecedent debt,” emphasizing that if this requirement was not met there could be no preference. The liquidator argued that this requirement was met because the obligation to pay the claims—i.e.,

the “debt”—arose either when the policyholders first asserted claims against Reliance, or at the latest, when they submitted proofs of loss under the policies, thus making them “antecedent debts” when they were paid by Reliance months later. The policyholders, in turn, argued that the payments should be deemed to be ones made in the ordinary course because the term “antecedent debt” was not defined in the statute, and such an interpretation was consistent with longstanding judicial decisions under federal bankruptcy law. The policyholders also argued that to rule differently would lead to an unreasonable construction of the statute whereby all claims payments made by an insurer within a year of it being placed into liquidation would be preferences that must be repaid to the estate upon demand. The liquidator countered that, in contrast to federal bankruptcy law, the Pennsylvania statute does not provide for an “ordinary course of business” defense to a preference claim.

The *Ingram Micro* court sided with the policyholders. The Supreme Court first reasoned that the term “antecedent debt” was not defined in the statute or in the case law, and is not free from all ambiguity. It then examined the purpose of the statute, and considered the treatment of preferences under both federal bankruptcy law and other state laws. The Supreme Court was persuaded that finding an ordinary course of business exception to a preference claims best advanced the statutory goals of protecting the interests of policyholders and achieving the equitable apportionment of loss. The court also found it significant that federal bankruptcy law recognized an ordinary course of business defense to a preference claim. Finally, the court noted that a contrary interpretation of the statute might harm the insurance market in the Commonwealth. This could occur either because policyholders might decide to purchase insurance from insurers domiciled in other states, thereby placing Pennsylvania insurers at a competitive disadvantage, or because they might move their insurance from a Pennsylvania-based insurer that had begun to experience financial difficulties.

Significantly, the Pennsylvania Supreme Court found unpersuasive the decision of the Nebraska Supreme Court in *Wagner v. Gilbane Building Co.*, 276 Neb. 686, 757 N.W.2d 194 (Neb. 2008), where the court refused to read an implied ordinary course of business exception into the preference provision of Nebraska’s liquidation statute. The *Micro Ingram* court did cite with favor an unpublished decision in *Covington v. HKM Direct Market Communications, Inc.*, 2003 WL 22784378 (Ohio App. Nov. 25, 2003), where the Ohio intermediate appellate court ruled that preliquidation payments by an insolvent insurer to a trade vendor were not payments on account of an antecedent debt when made in the ordinary course of business.

In sum, *Ingram Micro* is good news for Pennsylvania insurers and policyholders. As a careful and well-reasoned decision, it is likely to be cited by other state courts presented with this issue, which may become a significant one if the current economic difficulties result in proceedings to rehabilitate or liquidate distressed insurance companies.

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