

# “What keeps you up at night?”

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## Pennsylvania Supreme Court recognizes an “ordinary course of business exception” to insurance law on voidable preferences

By James S. Gkonos and Andrea P. Brockway

Recently, in *Ario v. Ingram Micro, Inc.*, 965 A.2d 1194 (Pa. 2009), an opinion friendly to policyholders and Pennsylvania-domiciled insurers alike, Pennsylvania, via a unanimous Supreme Court decision, became the third state to carve out an “ordinary course of business exception” to its insurance voidable preference statute, 40 P.S. § 221.30. Also, for the first time, the Pennsylvania Supreme Court acknowledged that federal bankruptcy law was analogous to Pennsylvania’s insurance insolvency laws. The Court addressed the issue of whether payments made to policyholders for claims made under valid policies constituted voidable preferences under Pennsylvania’s Insurance Department Act of 1921 (“Insurance Act”).

Section 221.30 of the Insurance Act states, in pertinent part: “A preference is a transfer of any of the property of an insurer to or for the benefit of a creditor, for or on account of an antecedent debt, made or suffered by the insurer within one year before the filing of a successful petition [for rehabilitation].” By and large, state insolvency statutes, like federal bankruptcy statutes, contain provisions empowering the liquidator to recover voidable preferences. Although the statutory definition varies substantially across the states, voidable preferences are generally designed to achieve equitable apportionment of unavoidable losses incurred on the eve of insolvency. Further, the specter of a voidable preference action deters creditors from racing to dismember the debtor during his slide into bankruptcy. For many of the provisions of the Insurance Act relating to insolvency there is a paucity of case law and practitioners have struggled to interpret the scope and meaning of many of those provisions.

In 1999, Reliance issued credit insurance policies to various insureds, agreeing to indemnify the policyholders for losses arising from nonpayment for goods and services rendered. Each of the named policyholders suffered a loss and made a claim with Reliance by filing a claim. In the ordinary course, Reliance determined that the claims were covered by the terms and conditions of the policies at issue. In 2000 and early 2001, Reliance paid the claims. Subsequently, in May 2001, Reliance was placed into rehabilitation. Shortly thereafter, in October 2001, Reliance

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was placed into liquidation. The Commissioner, as liquidator, initiated actions against the named policyholders, arguing that the claim payments Reliance had made were “voidable preferences” subject to the claw-back provisions of the state’s Insurance Act.

The statutory requirement that the transfer be made “for or on account of an antecedent debt” was the focus of the *Ingram Micro* decision. If the antecedent debt element could not be satisfied, the transfer could not be found to be voidable. In determining whether payments made to policyholders constituted voidable preferences under Section 221.30, the Court noted that antecedent debt is not expressly defined in the Insurance Act. The Court then examined the intent of the legislature and analogous law to clarify the ambiguity. In so doing, the Court concluded that the underlying policies of the Act to protect policyholders, equitably apportion losses and to prevent races to courthouse by creditors would be best fulfilled by excluding from the definition of “antecedent debt” transfers made in the ordinary course of business. Equally as significant, the Court looked to exceptions developed to the bankruptcy law of preferences and found that “the use of bankruptcy law for guidance in interpreting ambiguous state insurance insolvency law is commonly accepted.”

In light of the current difficult market conditions, the *Ingram Micro* decision is undoubtedly heartening to both policyholders and Pennsylvania-domiciled insurers. The decision fosters certainty in the Commonwealth’s insurance market by assuring policyholders that claim payments in the ordinary course will be exempt from

claw-back under the voidable preference provisions thereby lessening the potential for wholesale “flights to quality” when a Pennsylvania insurer encounters financial difficulties. Equally as important, the decision opens the door in Pennsylvania to the use of the bankruptcy law to interpret Pennsylvania’s statutory insolvency laws, which may ultimately help in providing certainty to other provisions of the insolvency laws for which no statutory interpretive guidance exists.

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