Pennsylvania Supreme Court Recognizes an "Ordinary Course of Business" Exception to Preference Actions Brought by Liquidator of Reliance Insurance Company

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Duane Morris Wins Appeal for H. J. Heinz and Mitsui

On February 23, 2009, Pennsylvania became the second state to recognize an "ordinary course of business" exception to preference actions brought under a state insolvency statute where the defense is not expressly provided for in the statute. In *Joel S. Ario, Insurance Commissioner of the Commonwealth of Pennsylvania, in His Official Capacity as Liquidator of Reliance Insurance Company, Appellant v. H.J. Heinz Company, H.J. Heinz Company, L.P., H.J. Heinz Finance Company, and Portion Pac, Inc., et al., Appellees*, No. 21 MAP 2006 (Pa. Feb. 23, 2009), the Pennsylvania Supreme Court was faced with the issue of whether an insurer's pre-liquidation payment for a covered loss to an insured can be clawed back as a preference under the Pennsylvania Insurance Department Act of 1921 (the "Act"). The court concluded that a payment made by an insurer to an insured in the ordinary course of business does not constitute antecedent debt and, therefore, is not a preference under the applicable provisions of the Act.

Key to the court's reasoning was the impact a contrary decision would have on the Pennsylvania insurance market:

An insurance consumer's selection of an insurer might very well turn on whether a policyholder's receipt of monies paid for a loss by an insurer may be recovered as a voidable preference. . . .

The court concluded that insureds would simply not buy insurance from Pennsylvania-domiciled insurers should payments the insureds received for losses be subject to disgorgement.

In this case, the insurance commissioner argued that the underlying transfers by Reliance Insurance Company to policyholders were preferential because all of the statutory requirements had been met: the payments were made to the insureds less than one year before the rehabilitation, the payments were to creditors (the policyholders), and the payments were on account of antecedent debts (*i.e.*, the debts arose at the time the policyholders filed proofs of loss with Reliance months before Reliance paid the policyholders). The policyholders argued, inter alia, (i) that a payment made in the ordinary course of business is not a payment on account of an antecedent debt and (ii) the debt was not antecedent due to the fact that it did not arise until after the policyholders executed a form of "Certifications and Release," which was required under the policies before payment could be made on the underlying claims, and because the payments were made contemporaneously with the execution of the underlying Certifications and Release.[1]

In validating an ordinary course defense to preference claims, the court cited that analogous federal bankruptcy law recognizes an ordinary course exception to preference actions, and that at least one other jurisdiction has read an ordinary course of business exception into its insurance insolvency statute.

Rudolph J. Di Massa, Jr., and Sommer L. Ross, attorneys in Duane Morris' Philadelphia office, represented H.J. Heinz Company and Mitsui & Co. (USA), Inc. in this matter argued before the Pennsylvania Supreme Court on March 3, 2008. For a copy of the court's opinion, please click here.

For Further Information

If you have any questions about this Alert, please contact Rudolph J. Di Massa, Jr., anymember of the Business Reorganization and Financial Restructuring Practice Group or the attorney in the firm with whom you are regularly in contact.

Footnotes

1. The policyholders also argued that "policyholders" were not "creditors" under the preference provisions of the 1921 Act. The court did not address this issue because the payments were found in any event to have been made in the ordinary course of Reliance's business.