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Devising the Trilateral Solution

This groundbreaking D&O liability insurance solution made the Southwest Airlines and AirTran Holdings merger possible.

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English majors might feel slighted by the compensation priorities of our culture. After all, it's the science-strong that get the headlines these days, right? Software entrepreneurs who launched themselves out of engineering studies and into the sun-kissed Silicon Valley are the ones that make the big money and give us poor slobs who value poetry an inferiority complex.

But when it comes to the coverage limits of an insurance policy, most could admit that everyone must take a back seat to the wordsmiths. It's the sentence crafters who rule here. Attorneys and other professionals who nailed their first-term Shakespeare paper as undergrads have a better chance of proving valuable in writing policy language than the best of the numbers crunchers or computer programmers.

That much, at the very least, is understood by Peter Taffae, the professional liability specialist who is the managing director of Los Angeles-based wholesale broker Executive Perils Inc.

Taffae, a former underwriter who helps to manage professional liability risk for Southwest Airlines, among other clients, and who has a genuine passion for his craft, found himself with a brain tickler in sorting out the directors' and officers' liability (D&O) insurance coverage implications in the Southwest Airlines and AirTran Holdings Inc. merger, which closed May 2. The merger agreement called for Southwest to cover the six-year tail of AirTran's D&O exposures.

First stop, check with the carrier on AirTran's program and see what they said, said Taffae.

"So we went to 'Carrier A' who was the current carrier on AirTran--and AirTran bought well over $100 million--and we asked them for a six-year runoff," Taffae said.

"The quote that came back was unacceptable for a couple of reasons," he said.

According to Taffae, the traditional way of handling the transfer of a D&O program is that the expiring or current carrier gets the run-off.

"In most, cases it still makes sense to buy the tail from the current carrier," Taffae said.

"But there are times when it is not the case, a lot of times people want to shop it to get the price. Remember, it is a six-year premium, so they are pretty big premiums," Taffae said. "So a lot of people want to shop it to drive the price down and minimize their cost. In this case, for reasons other than price, Southwest wanted to test the waters," he said.

And what happened was that Taffae and company hit it off with an entity that we will refer to as "Carrier B."

"We ended up clicking with Carrier B," Taffae said, adding that the insurer made a wonderful primary proposal.

"Economically, it was very competitive. Coveragewise it was excellent. We know the underwriters, and not only do we know them, they are on Southwest's program already," he said.

The Catch With Carrier B

But there was a catch. And here is where the English majors can puff out their chests and where Taffae thinks he well earns his commission. The merger agreement called for coverage terms for AirTran executives that were "at least as favorable" as those under the expiring carrier's policies. Try as they might, they couldn't get a policy from Carrier B that perfectly matched that of Carrier A.

So, Taffae and his team added an endorsement to Carrier B's policy

that said that, in any claims process, the most favorable provision of either policy would be used. The endorsement lists the specific policy numbers.

"We consciously used the policy number because we felt, if the market gets really hard, the forms could get more restrictive. Plus, we wanted the policy to be completely frozen. So then you could say, 'Yeah, but what if the market gets soft and the policy gets broader?' We didn't think we were authorized to take that chance because the merger agreement says no less favorable, so we had to lock it in," he said.

What we have in this instance is bilateral coverage, right?

We're not done yet. Southwest had its own existing D&O policy that was written by what we will call "Carrier C." Taffae thought it was a good policy. But he and others were worried about what would happen if a post-merger claim came in, alleging a pre-merger wrongful act. The thinking was that, because of Southwest's deep pockets, any claimant would name Southwest as a co-defendant.

"So we went to Carrier B and we negotiated with them, and ultimately we did the same thing with the carrier that we did for A with C," Taffae said.

That is, using specific policy numbers to freeze the language, the officers of the merged organization now had the best provision language of any one of three policies to protect them. Trilateral coverage was born.
Nifty, huh?

Classic Risk Manager's Dilemma

It's a good thing it happened because, according to Chris Thorn, Southwest's risk manager, he was in the classic risk managers' dilemma: i.e., arrange the coverage but don't get in the way of the deal.

From his perspective, nothing about this was easy. Pre-merger, Southwest and AirTran were fierce rivals, and there wasn't going to be a lot of cooperation if they needed to pull the policies apart and go over the policy language.

AirTran's general counsel kept asking Thorn, "Do you have the placement? Is it done, is it done, I need to review it."

"I was able to tell him, 'You know what? I did you a favor. The language you have that you have already reviewed, that is your coverage and then some,' " Thorn said.

The general counsel's reply? "Great, I don't have to read anything, perfect," was how Thorn recounted it.

"And the same with our general counsel. I said 'Hey, you liked our coverage. We are covered the same way with being reimbursed for the indemnification that we have provided. It is the same as the language that you are used to,' " Thorn said.

There just wasn't any time for this to work out any other way, according to Thorn.

"It takes time, and we didn't have time," he said.

GROUNDBREAKING

One D&O specialist called what Thorn and Taffae accomplished groundbreaking.

"This is the first time I have seen it in an M&A transaction," said Joe Monteleone, a New York-based partner with law firm Tressler LLC.

In any situation, whether it is an errors-and-omissions liability insurance policy and a D&O policy on the same program or the policies of merging programs, Monteleone said, it makes the best sense to use the specific policy numbers of the policies that one is either seeking coverage from or exclusions from.

"Any situation where you want to be sure that you are incorporating language from a policy or else in the situation where you want to make sure are not covering something in the policy ... simply refer to that policy by its number rather than trying to say, 'Oh, gee, let me make sure all of my terms match up well,' because the language is never identical," Monteleone said.