

Coverage Cutoffs in M&A Transactions: Five Things to Know About D&O Insurance “Tail” Coverage

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USA | November 20 2025

Because modern directors and officers (D&O) liability policies are written on a “claims made” basis, coverage is determined based on when the claim for wrongful acts is first made against an insured. If a company does not have a D&O policy in place, it risks being uninsured for claims made during a gap in claims-made coverage. D&O policies also contain “change in control” provisions limiting coverage for wrongful acts occurring after there is a change in ownership. So, what happens when a company is acquired, merges with another company, or sells its assets such that the selling entity no longer is a going company that maintains a D&O policy?

The approach taken in many transactions is securing “runoff” and “tail” coverages, which extend a policy’s coverage period beyond the date of the transaction and allows insureds to recover for claims alleging pre-transaction wrongdoing. However, from a practical standpoint, placing and pursuing coverage under tail policies can be fraught with peril. This article presents an overview of five common coverage issues to consider when runoff provisions are at play.

1. Negotiate Favorable Policy Provisions (and Then Follow Them).

D&O policies are not all created equal. Quite the opposite, as terms are heavily negotiable and customizable. This variety carries over to D&O policy runoff and tail coverage. For instance, many standard forms do not include guaranteed tail coverage with pre-negotiated term and pricing options. Leaving these critical coverage negotiations to chance can lead to real problems, especially when a company is insolvent or in bankruptcy where cash flow is paramount and large insurance premiums can exacerbate existing financial strain. Negotiating terms in advance can introduce certainty and predictability in the midst of complex transactions and ownership changes.

Policies may also impose varying degrees of requirements to select and effectuate tail coverage. For example, policies can require prompt notice of changes in management control, sometimes accompanied by additional underwriting requirements to secure coverage.

Understanding precisely when and how those provisions operate in practice can minimize conflict based on technicalities in the policy.

To help facilitate seamless insurance continuity in future transactions, policyholders should assess their D&O coverage placements and renewals with an eye towards future M&A activity and how runoff and tail provisions would be treated in those transactions.

2. Understand What Constitutes a Change in Control.

One basic but often overlooked question about tail coverage is when it even may be implicated. Companies and executives may have their own assumptions about when D&O policies will continue in force or require tail coverage, which may not match what the policy actually says. For example, some may assume that simply filing for bankruptcy automatically triggers a change in control. Or conversely, some may assume that a company's emergence from bankruptcy does not trigger runoff provisions in the absence of a more traditional acquisition or merger. Neither assumption may be true, and the policy will always control.

These kinds of misunderstandings can then lead to the failure to timely elect tail coverage, missed notice deadlines, and similar missteps that insurers can use to deny or limit coverage. Missing these nuances in policy language can leave policyholders exposed to D&O claims without a coverage safety net. Working closely with risk professionals, like brokers and outside coverage counsel, can help navigate these issues and avoid transactional-related gaps in coverage.

3. Be Wary of Straddle Claims.

A company can seemingly do everything right—place robust D&O coverage, monitor forthcoming changes in control, timely elect tail coverage, and submit a post-transaction claim for coverage alleging pre-transaction wrongdoing ostensibly covered by the tail policy. But then comes a surprise denial. Some of the biggest offenders that can seemingly negate tail coverage altogether are exclusions aimed at so-called “straddle” claims. Straddle claims allege misconduct both before and after the effective date of tail coverage.

Coverage grants in tail policies are tailored to respond only to claims alleging pre-closing wrongful acts. But some insurers go a step further in adding exclusions to policies that bar coverage for any claim based upon, arising out of, directly or indirectly resulting from, or in any way involving a wrongful act allegedly committed on or after the runoff date. These provisions eliminate coverage entirely—even for portions of the claim tied exclusively to pre-runoff wrongdoing—based on the presence of a *single* post-runoff wrongful act. That can lead to finger-pointing between insurers, especially where a surviving entity purchased a going-forward D&O policy that has a similarly broad exclusion barring coverage for any claim involving any pre-closing wrongful acts.

To avert contentious coverage battles, policyholders should closely scrutinize tail policies to eliminate or narrowly tailor these kinds of exclusions. Clarifying how policies address straddle claims can ensure that they do not fall through uncovered cracks because of conduct timing. Buyers and sellers should have an understanding of the pre-closing and post-closing insurance regimes that will be in place around a transaction in order to avoid any potential denials of straddle claims.

4. Reckoning with Reduced Limits and Coverages.

Policyholders purchasing tail coverage may also assume that all coverage terms remain intact. In addition to new exclusions, however, tail policies may also be accompanied by reduced limits. This can be especially important to monitor because the tail coverage in place as of the runoff date is finite and needs to respond to all claims throughout the entirety of the runoff period, which often lasts six years.

Tail endorsements for management liability policies may also include only certain coverages, most commonly D&O, and omit other coverages, like employment practices liability. Assessing the full suite of available tail and extended reporting periods can ensure there are no unexpected gaps in coverage for post-closing claims. For example, a selling company would likely want broad coverage, while a buyer who has agreed to pay for some, or all, of a tail policy may

argue that including atypical tail endorsements were not contemplated when an insurance cost-sharing arrangement was agreed to. Both sides of a transaction should endeavor to be as precise as possible when allocating costs and specifying expected tail policy terms to avoid disputes and ensure appropriate coverage throughout the transaction.

5. Consider Coverage for the Wind Down.

Tail coverage is especially important in bankruptcy as debtors seek to have plans confirmed and questions arise about protecting against historical or future liabilities. One overlooked aspect can be in liquidations requiring plan administrators or other individuals, like chief restructuring officers (CROs), to stay on after a plan is confirmed to wind down operations. Under most tail policies, D&O coverage terminates at the time of plan confirmation, even if exposure to claims challenging the orderly liquidation or winding down of the company does not cease. To address that, policyholders can secure “wind down” coverage to fill that gap and extend protection during wind-down phases to key administrators, CROs, and anyone else facing potential exposure for post-confirmation conduct.

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Runoff and tail coverage should protect companies and directors and officers against claims for legacy liabilities, but pitfalls abound. Remaining proactive to negotiate favorable terms and understanding and adhering to key policy provisions can help ensure continuity of coverage and avoid uninsured exposures and surprise denials after closing.

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