

Litigation

Deep Dive

Blue Bell Case Highlights Risks of Skimping on Insurance Coverage

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An ongoing first-of-its-kind Delaware trial testing corporate oversight claims underlines the limits of insurance policies meant to shield the personal assets of directors and officers sued for mishandling company operations.

Insurance typically funds the cash settlements that have ended similar shareholder derivative actions in Delaware's Chancery Court before trial. But Blue Bell Creameries hasn't settled. Court records indicate Blue Bell's senior leaders, facing claims tied to a fatal 2015 listeria outbreak, made an unusual move to seek defense coverage under insurance policies that apply to bodily injury or property damage.

Commercial general liability policies aren't designed to cover management liability disputes, attorneys and brokers say. That's where separate directors' and officers' insurance comes in, and almost all public companies buy it because they face increased regulatory scrutiny and the potential for securities claims.

Two Travelers Cos. units sued Blue Bell in Texas federal court over its attempt to tap into its CGL policies, several years into the shareholder litigation in Delaware seeking to hold the ice cream maker's directors and officers accountable for failing to adequately monitor production and warning signs before the listeria outbreak. A federal appeals court later found those policies excluded payments for legal defense costs because they didn't cover intentional misconduct.

An alleged violation of the duty of oversight usually fits squarely within the definition of “wrongful acts” that directors’ and officers’ policies generally cover, said Geoffrey Fehling of Hunton Andrews Kurth LLP. However, privately held companies sometimes opt out of D&O insurance or seek cheaper policies with more exclusions or lower coverage limits.

The company didn’t respond to emails seeking comment.

At minimum, a D&O policy is likely to cover a big company’s legal costs even if its policy language barred coverage for a potential settlement or judgment. That still leaves its senior leadership on the hook if they’re found liable for oversight failures.

The shareholder behind the Delaware lawsuit estimates Blue Bell suffered damages of at least \$257 million from the production shutdown and nationwide product recalls during the outbreak, plus millions in legal fees from multiple criminal and civil court actions. The privately held company questioned those calculations.

Insurance Dispute

Blue Bell said its general liability insurer should’ve covered its defense in Delaware because its “directors and officers were sued for business decisions they made while acting according to their duties as directors and officers,” according to its 2022 appeal in the dispute with the insurer.

The Fifth Circuit, siding with the insurer, found the shareholder in the Delaware case sought “damages to compensate for Blue Bell’s economic loss caused by its directors’ and officers’ breach of fiduciary duties,” which aren’t covered under a policy for “bodily injury.”

General liability policies mainly cover claims for bodily injury or property damage, and Blue Bell argued the listeria poisoning fell under the “injury” category, said Raul Gastesi of Gastesi Lopez Mestre & Cobiella PLLC.

“They made a pretty good argument” in the insurance case, but the federal courts “didn’t buy it because they’re not being sued for the personal injury” in the Delaware lawsuit, he said. “They’re being sued for the economic loss of their judgment, so the policy doesn’t cover that type of action.”

The Travelers units told a district court that Blue Bell knew the difference between the types of policies because it cited cases where derivative actions fell under D&O policies.

“Courts do not ‘routinely’ or even occasionally find coverage under CGL policies for shareholder derivative suits,” the units said in a brief.

Board Duties

Not all boards make the necessary preparations for potential litigation.

Sitting on a board is perceived as prestigious, and potentially an easy paycheck for attending infrequent meetings, but there's much more to consider when signing the insurance policies, said Jason Bishara of Florida-based NSI Insurance Group.

"If you don't have these things properly structured and you're not meeting your fiduciary responsibility, you could be left in a situation where you have no coverage," he said.

That can happen when a company is insolvent or bankrupt, or when it has reached its coverage limits, he said. That's where D&O and other management liability policies can back up general liability policies.

These nuances in coverage tend to get missed when companies lack proper corporate governance mechanisms, such as independent committees, Bishara said. "If the board does their job and if they set up these proper committees and then they follow these committees, it's very hard to prove bad faith."

D&O policies tend to favor boards and executives, and insurers view funding defense costs or contributing to a settlement as "almost always preferable to betting on the outcome of a trial," Gastesi said. "That dynamic is what makes D&O recovery more reliable than recovery under many other commercial lines."

Oversight Concerns

The claims Blue Bell faces in Delaware have long been considered the toughest to advance because they require showing intentional dereliction of duty or conscious disregard for known obligations.

The company's senior leaders testified they met more frequently than most boards, and that important food safety information was widely available to employees and directors. The judge overseeing the Delaware trial repeatedly questioned the dearth of details in board meeting minutes about sanitation concerns. Additional arguments are scheduled July 28.

The case, along with a slate of recent oversight claims, disrupted the belief that such lawsuits are prone to failure. Large cash settlements in other cases have been a "wake-up call," though "from what is understood in the market, none of those have settled outside of policy limits," said Peter Tomczak, a Baker McKenzie partner.

A perception that Delaware's courts began favoring shareholders' oversight claims created a lot of "noise" that companies face increasing litigation risks. In response, companies appear to be stacking more D&O insurance coverage, which is considered reliably "fit for purpose as opposed to other types of insurance," Tomczak said.

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