BREAKING NEWS:
New CA Supreme Court Coverage Case

Fox Paine & Company, LLC v. Twin City Fire Insurance Company
2026 WL 2148053

By Hon. Vedica Puri (Ret.)

Insurance coverage litigation is known to move at a glacial pace.

So, when the California Supreme Court issues a unanimous coverage opinion that presents a paradigm shift on when to sue an excess carrier for breach of contract and bad faith -- we all pay attention. (Ok, well, maybe not all, but certainly my fellow coverage nerds).

The story began with wildly successful investment bank partners, Saul Fox and Dexter Paine. They created Fox Paine Company LLC, based in the Bay Area, which managed funds worth over $1B. The beginning of the end came in 2007 when Paine created a third fund and launched his own company, with Fox as a minority participant. The partnership fell apart shortly thereafter. Fox sued Paine for breach of contract and breach of f*Id*uciary duty. Ensuing bitter litigation between the two partners and the company's insurance carriers will soon span two decades and many different states.

The former partners tendered a myriad of lawsuits against one another to their carriers under a $50M tower of Private Equity Professional Liability policies.

The policy chart covering FPC LLC is as follows:

Primary Policy	**Policy Amount**
Houston Cas. Co.	$10 million

Excess Policies	**Policy Amount**	**Attachment Point**
	First layer	
Twin City	$10 million	$10 million
	Second layer	
St. Paul	$10 million	$20 million
	Third layer	
Twin City	$10 million	$30 million
	Fourth layer	
Liberty Mutual	$10 million	$40 million

The San Francisco Litigation.

The San Francisco litigation (stayed for many years while the New York litigation proceeded) generated a very recent California Supreme Court decision which changes how and when insureds can plead in excess carriers. The Fox parties sued their primary and excess carriers for declaratory relief, breach of contract and bad faith alleging the carriers had made secret and massive payouts to the Paine parties related to the underlying litigation, while leaving the Fox parties high and dry. The Fox parties pled they had tendered defense costs to the carriers, the carriers failed to reimburse them and that the Fox parties had incurred losses (plus interest) "exceeding $43M, not subject to offset."

The carriers filed demurrers to all causes of action in San Francisco Superior Court alleging that the Fox parties had improperly sued the excess carriers without alleging exhaustion of the primary and first excess layers of insurance.

The trial court granted the demurrers in general, without leave to amend.

The Trial Court Ruling.

It is a basic tenet that excess insurance coverage is not triggered until exhaustion of an underlying policy. It is a rule, which California coverage practitioners have come to know and rely on for decades. "An excess insurer's coverage obligation begins once a certain level of loss or liability is reached; that level is generally referred to as the 'attachment point' of the excess policy. [Citations.]" (Croskey, et al., Cal. Practice Guide: Insurance Litigation (The Rutter Group 2023) ¶ 8:177.)" The trial court sustained demurrers without leave to amend on the declaratory relief and breach of contract claims holding that because Twin City only paid $6 million out of the $10M limit on its first excess policy, exhaustion has not yet occurred for any of the upper excess layers to be triggered.

The Court of Appeal ("COA") Decision Went to Great Lengths to Affirm the Trial Court.

The COA decision affirmed the trial court in all respects. First, the COA found that there was no actual controversy over whether excess layers had been reached, as required to obtain declaratory relief, because the Court would not assume as true plaintiff's allegation that it had incurred $43M in losses (which would have naturally pierced all the layers). Second, the COA held there was no breach of contract because the relevant excess policies had not yet attached upon the exhaustion of the underlying policies. And finally, the COA held the plaintiffs could not state a bad faith claim because there was coverage had no attached from the excess layers and coverage was a prerequisite to claiming bad faith.

The opinion went so far as to explain that the trial court could have also found that declaratory relief was not "necessary or proper." The general rule in California is that even if an "actual controversy" has been

shown (Code Civ. Proc., § 1060-1), a trial court has latitude not to entertain a claim for declaratory relief if it was not necessary or proper.

The CA Supreme Court Rejects a Strict Rule when Pleading Exhaustion

As to Decl. Relief Claim: The CA Supreme Court reversed the COA holding "that an insured may state a viable cause of action for declaratory relief regarding coverage and liability under an excess insurance policy even if all of the underlying insurance coverage has not yet been exhausted." *Id* @ *1. "While insureds in this position must adequately plead their covered losses, the relevant principles governing the availability of declaratory relief do not support a strict rule that would withhold this relief whenever exhaustion has not also been alleged." *Id*.

Instead, the Court adopted a new rule – at the pleading stage – related to exhaustion of policies: "for a declaratory judgment coverage action involving an excess policy to be ripe, **it must be practically or reasonably likely that the insured's potential liability will reach into the excess coverage**; absolute proof that the policies will be triggered is not required." *Id* @ *12 (emphasis added). Applying the new rule, the Court found the demurrer should not have been sustained as to the declaratory relief/breach of contract actions because (1) the dispute is sufficiently concrete (defense bills tendered and not paid) and (2) the insureds would suffer hardship if lack of exhaustion defeated their claims and required them to sue different carriers in different jurisdictions at different times possibly enabling inconsistent opinions.

The Court also offered the following guidance in how to apply the new rule, including that an insured can plead "the 'worst case or highest estimate of damages." *Id*. The Court cautioned trial courts, in performing the reasonable likelihood inquiry at the pleading stage "not give undue weight to what are at that juncture only *potential* defenses to coverage that may prove successful in future proceedings and ultimately prevent exhaustion." *Id*.

As to bad faith: the CA Supreme Court held that a bad faith claim against an excess carrier can survive demurrer even if the excess policies are not exhausted. After pointing out at that the COA's reliance on *Waller v. Truck Ins. Exchange* (1995) 11 Cal.4th 1, 36 (which generally stated that bad faith cannot occur unless policy benefits were due) was misplaced, the CA Supreme Court went on to state:

> When it is understood that a breach of the implied covenant of good faith and fair dealing can occur before coverage is due and prior to the breach of any obligation to pay benefits under a policy, and that in some instances it may be the insurer's bad faith itself that prevents an insured from fulfilling all of the conditions of coverage (see *Gruenberg v. Aetna Ins. Co.* (1973) 9 Cal.3d 566, 574–575, 108 Cal.Rptr.

> 480, 510 P.2d 1032 [recognizing a claim for bad faith in circumstances where the insured's failure to satisfy a condition of coverage was allegedly brought about by the insurers' bad-faith conduct]), it becomes clear that it would ask too much, too soon, from insureds to require them to plead the prior exhaustion of all underlying insurance before they may pursue a bad faith claim.
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> The proper focus at the pleading stage is not on whether coverage under a particular excess policy has already attached and payments under that policy are already due. Rather, at that phase of the proceedings an insured in plaintiffs' position needs only to allege facts that, taken as true, are sufficient to show that coverage under a defendant insurer's excess policy *will* attach — or that it would attach, if not for the excess insurer's bad-faith conduct — and that the insurer's misconduct has impaired the insured's recovery of benefits owed to it under the policy. *Id* @ *21.

While this case applies specifically and only to the pleading stage, it is a sea change in how an insured may plead its case against excess carriers.