ZELLE LLP

LONESTAR LOWDOWN

Dedicated to Texas First-Party Property Claims

The Zelle Lonestar Lowdown | Monday, August 31, 2026 | ISSUE 39

Welcome to The Zelle Lonestar Lowdown, our monthly newsletter bringing you relevant and up-to-date news concerning Texas first-party property insurance law.

In 2025, we focused on Collaboration. We had people reach out with article ideas, their own articles, and ideas for industry events. In 2026, we will continue that effort. We continue to invite our readers to let us know what they are worried about, legal topics that pique their interest, and new advances in the industry – all with a Texas twang.

As always, if you are interested in more information on any of the topics below, please reach out to the author directly. Zelle attorneys are always interested in talking about the issues arising in our industry. If there are any topics or issues you would like to see in the Lonestar Lowdown moving forward, please reach out to our editors: Shannon O'Malley, Todd Tippett, and Steve Badger.

INSIDE THIS ISSUE

Upcoming Events

You don't want to miss this!

September 10 – Steven Badger and Dennis Anderson will present at the Minnesota Insurance Alliance Appraisal Class and More! event in St Paul, MN.

September 15 – 16 – Jessica Port will present "The Ethics of Automation: Avoiding Bad Faith Claims in AI-Driven Claims Handling," for the 2026 PLRB Regional Innovation Summit in Dallas, TX.

September 16 – Zelle LLP is hosting a *What the Hail? London* Seminar at the Old Library @ Lloyd's, followed by a reception at Factory House co-sponsored by Engle Martin, Halliwell, and J.S. Held. Republic and At-Bay. Find more information here.

September 18 – Jennifer Gibbs will present "Implications of AI in the Insurance Industry, Risks, Regulations, and Future Trends" at the OCA Fall Conference in Midwest City, OK.

September 24 – Steven Badger will present "Insurance and Public Policy Issues Arising From the 9/11 Terrorist Attack" at the Kansas CPCU I-Day Festival in Overland Park, KS.

September 27-30 – Jane Warring will present at the FDCC 2026 Corporate Counsel Symposium in New Orleans, LA.

October 7 – Steven Badger will present at the P.L.A.N. Property Loss Appraiser & Umpire Certification appraiser training in Minneapolis, MN.

October 12 – Steven Badger will present at the Insurance Appraisal and Umpire Association (IAUA) Appraiser Conference in San Antonio, TX.

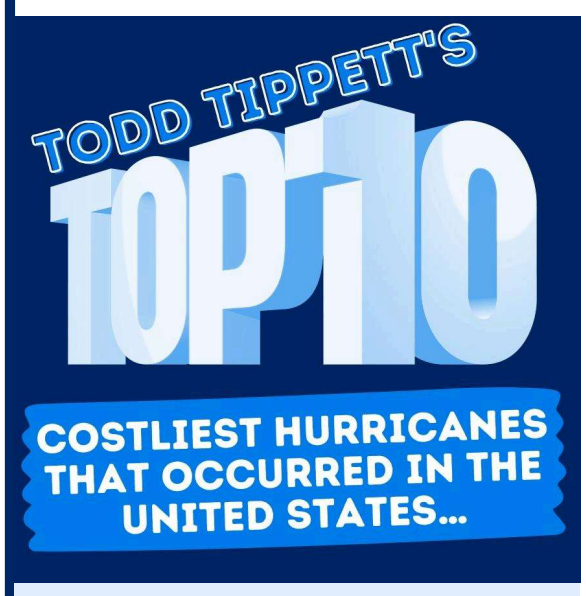
October 19 – Steven Badger will present "What the Hail? Top 10 Hail Claim Issues in 2026" at the Texas Association of Mutual Insurance Companies (TAMIC) 90th Convention in Round Rock, TX.

October 20-23 – Steven Badger will present "Hail Claims… What the Hail?" at the Virginia State Claims Association 2026 Conference in Williamsburg, VA.

October 26 – Steven Badger will present "Hail Claim Abuse – The Big Picture Fixes" at the Joint Claims Executives Association (JCEA) Fall Conference in Nashville, TN.

November 4-6 – Steven Badger, Jennifer Gibbs, and Bennett Moss will present at the PLRB Large Loss Conference in Nashville, TN.

November 25– Jason Reeves will co-present during the British Institute of International and Comparative Law (BIICL)'s online course on *Climate Change Litigation.* (4- 6 pm UK Time)



1. **Katrina (2005):** ~$198 billion (Louisiana, Mississippi, Florida)

2. **Harvey (2017):** ~$158 billion (Texas, Louisiana)

3. **Ian (2022):** ~$119 billion (Florida, Carolinas)

4. **Maria (2017):** ~$114 billion (Puerto Rico, U.S. Virgin Islands)

5. **Sandy (2012):** ~$87 billion (Mid-Atlantic and Northeast U.S.)

6. **Ida (2021):** ~$84 billion (Louisiana, Eastern U.S.)

7. **Helene (2024):** ~$79 billion (Florida, Southeast, Appalachia)

8. **Irma (2017):** ~$63 billion (Caribbean, Florida)

9. **Andrew (1992):** ~$59 billion (Florida, Louisiana)

10. **Ike (2008):** ~$43 billion (Texas, Louisiana)

Feel free to contact **Todd M. Tippett** at 214-749-4261 or ttippett@zellelaw.com if you would like to discuss these Tips in more detail.

News from the Trenches

by Steven Badger

I speak at a lot of events. Weekly. While the majority of the events are attended by people working for and with insurers, I am also fortunate to be asked to speak at events attended by contractors, public adjusters, and other policyholder advocates. I really enjoy these events, as it provides an opportunity for me to tell the insurance company side of the story.

The comments that I hear at these events are pretty consistent. Interestingly, 90% of the time the complaints involve State Farm, Allstate, Farmers, and USAA -- four companies I don't represent in claim litigation. I seldom hear complaints about the smaller Texas residential insurers that I represent. And I seldom hear complaints about my commercial insurer clients. Sometimes. But far less than the big four.

So why is that? I guess it could be because collectively these four insurers account for 40% of the residential insurance market, and there is not sufficient frequency with other insurers for policyholder advocates to see any patterns. Or perhaps these four very large insurers do behave differently than smaller residential and commercial insurers.

I honestly don't know the answer. But what I do know is that having reviewed 1000's of claim files involving my clients, I have never seen anything that comes even close to being an intentional denial or underpayment of a meritorious claim. Never. Are mistakes made sometimes? Sure. Do insurance companies sometimes create standards as to what constitutes damage that are different from what a contractor or public adjuster believes is damage? Of course. But I have never seen a claim file, or any other document from my clients, indicating a company mandate or directive to intentionally deny or underpay legitimate claims.

Which brings me to what's happening right now in Oklahoma with both State Farm and Allstate. It's a literal feeding frenzy of attacks on these two companies alleging that they created "initiatives" and "schemes" to deny meritorious claims.

I have closely reviewed the recently released State Farm documents. What I see in the documents is a company trying to create better standards as to what constitutes damage so they stop buying roofs that don't need to be replaced. That's it. And what is so wrong with that? Doesn't any for-profit company have the right to improve how they do business with the intent to save money? Of course they do. And insurance companies have that right as well. What you are not seeing are the statements in the documents about "improving quality" and "improving our accuracy". Instead, you are seeing just snippets that in isolation can be interpreted negatively.

We all know that the majority of shingle roofs alleged to be "damaged" by hail are actually just fine. Even with this "damage," the roofs would continue to perform their intended function for the remainder of their lives. But what contractor would be so dumb to reach that conclusion? They wouldn't make any money. So they allege everything is damaged. The insurer, knowing it is going to get sued if it denies the claim, often takes the path of least resistance (and expense), agreeing to replace the undamaged or minimally damaged roof.

Apparently, State Farm got tired of doing that and established clear standards as to what constitutes damage. Is that fraud? No. Is that a criminal enterprise? Not at all. Nowhere in the released documents did State Farm say "despite this roof being obviously damaged, we are denying the claim." That would be wrong. Instead, State Farm simply created improved standards clarifying the degree of damage necessary to warrant roof replacement. I don't see a problem with that. If that standard proves to be wrong, the issue can be addressed in appraisal or the courts. But it is not fraud or criminal activity.

It will be interesting to see how things play out in Oklahoma. In the meantime, I will continue to be a vocal supporter for all of my insurance company clients and their employees who I know work very hard every single day to achieve a fair and reasonable outcome in all of their claims. There is absolutely not a systemic fraudulent denial or underpayment problem in the hail claims world.

AI Update

Texas Business Court Judge Rules ChatGPT Conversations Can Qualify as Protected Work Product

by Jennifer Gibbs

A recent ruling from a Texas Business Court judge in *Tate Group Automotive LLC v. Legacy Automotive Capital LLC*, held that certain personal ChatGPT conversations qualify as protected work product under the Texas Rules of Civil Procedure, finding that the use of an AI tool such as ChatGPT does not automatically waive work product protection.

The Dispute

The case involves a 2025 dealership acquisition suit by Tate Group Automotive LLC. Third-party defendant Kris Tate used ChatGPT to assist with document review, analysis, and litigation strategy. Out of 53 ChatGPT conversations totaling approximately 1,800 pages produced in discovery, eight were withheld in their entirety on work-product grounds.

Defendants cited the 2026 federal case *United States v. Heppner*, in arguing that ChatGPT conversations are not work product because they were not prepared by or for counsel and/or did not reflect the strategy of counsel, and that any protections were waived by sharing information with a third-party technology vendor with no duty of confidentiality.

The Ruling

After *in camera* review, Judge Dorfman disagreed with the *Heppner* reasoning and said that he agreed with the federal cases cited by Tate — *Warner v. Gilbarco and Morgan v. V2X Inc.* — which noted that work product protections are waived by disclosure to an adversary or in a way that the materials would get in an adversary's hand.

Dorfman however, noted that Texas court rules have different standards for protecting attorney work product than the federal rules, adding that the state's rules "plainly appear on their face to extend that protection to Mr. Tate's chats." Dozens of other pages not meeting the standard, however, were ordered to be produced.

Key Takeaways

- **Work product protection can extend to AI-generated chats.** Where prompts and outputs reflect litigation strategy or mental impressions developed in anticipation of litigation, they may qualify for protection under applicable rules.
- **Using AI does not automatically waive privilege.** The court analogized AI tools to other litigation-support technologies and declined to treat disclosure to an AI platform the same as disclosure to an adversary.
- **Protective orders need updating.** Judge Dorfman recommended the parties amend their protective order to make "unquestionably clear" how confidential information may be shared with a third-party technology vendor, such as ChatGPT.
- **Confidentiality risks remain.** The court left open the question of whether uploading discovery materials into ChatGPT violated the existing protective order, suggesting that litigants must carefully evaluate data-control settings and platform terms before using AI to review case materials.

Looking Ahead

Judge Dorfman acknowledged the novelty of the issue, noting that all case authorities cited by each of the parties were published in 2026, with one court calling its own ruling "a question of first impression nationwide." As AI tools become increasingly more accessible and popular, practitioners should expect continued development of the law in this area and should take proactive steps to address AI use in their protective orders and should also be prepared to discuss the use of AI with clients, vendors, and experts in every matter that might ultimately result in litigation.

Texas Appellate Court Compels Trial Court Ruling on Insurance Appraisal Motion After Nearly a Year of Inaction

by Adrienne Nelson

In a per curiam memorandum opinion issued on July 14, 2026, the Fourteenth Court of Appeals in Houston conditionally granted a writ of mandamus directing a Harris County trial court to rule on two long-pending motions in an insurance dispute — a motion to compel appraisal and a motion for abatement — that had languished without action for close to a year. The decision in *In re Independent Mutual Fire Insurance Company*, No. 14-26-00503-CV, 2026 WL 2029725 (Tex. App.—Houston [14th Dist.] July 14, 2026, orig. proceeding), offers a pointed reminder to trial courts that unreasonable delays in ruling on properly submitted motions constitute an abuse of discretion subject to mandamus relief.

The case arose from a property insurance claim filed by policyholders Juan Pablo Cofre and Carolina Carbajal Solis (Juan and Carolina collectively, the “Insureds”) after a July 2024 storm damaged their insured property. In February 2025, the Insureds sued Independent Mutual Fire Insurance Company (“Independent Mutual”) for breach of contract, alleging that the insurance company underpaid or denied their claim. The Insureds also brought actions for bad faith and violations of Texas Insurance Code section 542.058.

On March 3, 2025, Independent Mutual filed its answer, which included a motion to compel appraisal and a motion for abatement. Following, on April 15, 2025, Independent Mutual filed a notice of submission, which set the motion to compel appraisal and motion for abatement by submission on May 19, 2025. Then the case sat waiting for a ruling.

On January 8, 2026, Independent Mutual filed a formal Request for the Court’s Rulings. However, the trial court took no action. On May 15, 2026, Independent Mutual filed a mandamus petition seeking a ruling on the Motion to Compel Appraisal and Motion to Abate.

On June 2, 2026, a status conference revealed the trial court’s apparent misunderstanding of appellate precedent: the court told counsel that the “only way” to obtain a ruling was to reset the motions on the “law-day docket” rather than the submission docket. *Indep. Mut.,* 2026 WL 2029725, *2. The appellate court flatly rejected that position, reaffirming its well-established rule that a party demanding a ruling may bring the matter to the court’s attention either by setting it for submission or for a hearing. *Id.*

The Fourteenth Court of Appeals applied the familiar two-part mandamus test, requiring the Independent Mutual, as relator, to show that the trial court abused its discretion and that there is no adequate remedy by appeal. *Id.* at *1. Regarding the first prong, the appellate court reiterated that when a motion is properly filed and pending, ruling on it is a ministerial act, and failure to do so within a reasonable time constitutes an abuse of discretion. *Id*. As to the second prong, the court noted that a relator generally lacks an adequate remedy by appeal from a trial court's refusal to rule on a pending motion. *Id.* at *3.

The appellate court acknowledged that there is no bright-line rule for what constitutes a "reasonable" time for a trial court to act, as the analysis depends on the circumstances of each case. Nevertheless, the court found that nearly a year without a ruling was clearly unreasonable. *Id.* at *2. The court drew support from its prior decision in *In re Hoffman*, No. 14-21-00697-CV, 2022 WL 288046, *1 (Tex. App.—Houston [14th Dist.] Feb. 1, 2022, orig. proceeding) (per curiam) (mem. op.), as well as the First Court of Appeals' holding in *In re The Univ. of Tex. MD Anderson Cancer Ctr.*, No. 01-19-00201-CV, 2019 WL 3418567, at *2 (Tex. App.—Houston [1st Dist.] July 30, 2019, orig. proceeding) (per curiam) (mem. op.), that a delay of more than twelve months on a plea to the jurisdiction constitutes an abuse of discretion. *Indep. Mut*., 2026 WL 2029725, *2.

This decision carries several practical implications for insurance litigators in Texas. First, it underscores the importance of creating a clear paper trail when seeking a ruling — filing notices of submission, requesting hearings, and following up with formal written requests for rulings are all steps that can support a later mandamus petition. Second, the opinion serves as a directive to any trial court that might insist on only one procedural path for obtaining a ruling, confirming that submission is an equally valid mechanism. Finally, the case reinforces that mandamus remains a viable tool when a trial court's inaction effectively stalls the litigation process, particularly in first-party insurance disputes where appraisal is a threshold contractual mechanism.

Fraud & Order: The SIU Files - Ripped from the Headlines: AI-Generated Images & Insurance Scams

by Marsheldondria C. Johnson

AI is being used to manipulate photos of damage and documents, and even to generate images of items and losses that never existed. Insurers are countering with AI-detection technology, but are policies keeping up with the changing times?

According to the 2026 Verisk State of Insurance Fraud study, 36% of consumers say they would consider digitally altering a claim image or document even if it broke insurer rules. 98% of insurance carriers agree that AI editing tools are fueling an increase in digital insurance fraud. Is your SIU team equipped for the challenge?

It starts with the contract. Most carriers still rely on standard concealment/fraud and misrepresentation clauses to address AI-fabricated claim evidence. Yes, those clauses do the job, since a fake photo is simply another form of material misrepresentation. But as this form of technology rapidly transforms our lives and the insurance industry, we must keep in mind that generic fraud language did not contemplate generative AI. As such, these provisions could fall short in the future when arguments over what misrepresentation covers arise when fraud consists of algorithmically generated pixels rather than a material misrepresentation typed into a form.

Something worth pondering: the addition of explicit disqualifying language naming AI-generated or AI-altered images and documentation in the claims-reporting and proof-of-loss provisions. This accomplishes two things:

1. Deterrence- A named prohibition puts claimants on notice before they submit anything, rather than after.
2. Litigation posture**-** If a coverage dispute follows, explicit language gives counsel a cleaner, less-arguable basis to deny or rescind than a general fraud clause stretched to fit a new fact pattern.

To illustrate how deleterious these schemes can be to the insurance industry, see the results of our internal AI experiments below.

Note these images were created within a matter of seconds.

Example of AI-generated estimate manipulation:

Original Estimate:

CONTINUED - General Conditions

QUANTITY	UNIT	TAX	O&P	RCV	AGE/LIFE	COND.	DEP %	DEPREC.	ACV
59. General Laborer - Flagger*									
8.00 HR	41.11	0.00	124.98	453.86	16/NA	Avg.	0%	(0.00)	453.86
60. General Laborer - Flagger*									
8.00 HR	41.11	0.00	124.98	453.86	16/NA	Avg.	0%	(0.00)	453.86
61. General Laborer - Roof Top Rigger*									
8.00 HR	41.11	0.00	124.98	453.86	16/NA	Avg.	0%	(0.00)	453.86
62. General Laborer - Ground Rigger*									
8.00 HR	41.11	0.00	124.98	453.86	16/NA	Avg.	0%	(0.00)	453.86
General Cleaning of Project Site									
63. General clean - up									
8.00 HR	44.89	0.00	136.46	495.58	16/NA	Avg.	0%	(0.00)	495.58
Dumpster For Roof Materials									
64. Sheathing - plywood - 3/4" CDX									
200.00 SF	2.26	0.00	171.76	623.76	16/150 yrs	Avg.	10.67%	(27.52)	596.24
65. Dumpster load - Approx. 30 yards, 5-7 tons of debris *									
1.00 EA	572.00	0.00	217.36	789.36	16/NA	Avg.	NA	(0.00)	789.36
Staging									
66. Initial set up, Staging and monitoring									
213.00 LF	0.25	0.00	20.24	73.49	16/NA	Avg.	0%	(0.00)	73.49
67. Progressive set up, Staging and monitoring									
213.00 LF	0.50	0.00	40.47	146.97	16/NA	Avg.	0%	(0.00)	146.97
68. Delivery charge (Bid Item) Truck Freight Roofing Materials*									
1.00 EA	50.00	0.00	19.00	69.00	16/NA	Avg.	0%	(0.00)	69.00
Totals: General Conditions		**0.00**	**2,657.71**	**9,651.60**				**27.52**	**9,624.08**
Total: Gutter & DS		**0.00**	**4,484.22**	**16,284.71**				**2,554.24**	**13,730.47**

EFIS

EFIS

QUANTITY	UNIT	TAX	O&P	RCV	AGE/LIFE	COND.	DEP %	DEPREC.	ACV
Detach & Reset Items								—	
69. Detach & Reset Ductwork - hot or cold air - Extra large size									
30.00 LF	27.88	0.00	317.83	1,154.23	0/30 yrs	Avg.	0%	(0.00)	1,154.23

Includes: On-site storage, foil tape and/or mastic, and labor.
Excludes: Any additional materials or hardware.
Note: Labor cost to disconnect and detach furnace ductwork from 24" x 8" to 20" x 16", store on site, and reinstall at a later time.
No life expectancy data

7/14/2025 Page: 11

AI-Manipulated Estimate:

CONTINUED - General Conditions

QUANTITY	UNIT	TAX	O&P	RCV	AGE/LIFE	COND.	DEP %	DEPREC.	ACV
59. General Laborer - Flagger*									
8.00 HR	43.50	0.00	132.32	479.94	16/NA	Avg.	0%	(0.00)	479.94
60. General Laborer - Flagger*									
8.00 HR	43.50	0.00	132.32	479.94	16/NA	Avg.	0%	(0.00)	479.94
61. General Laborer - Roof Top Rigger*									
8.00 HR	43.50	0.00	132.32	479.94	16/NA	Avg.	0%	(0.00)	479.94
62. General Laborer - Ground Rigger*									
8.00 HR	43.50	0.00	132.32	479.94	16/NA	Avg.	0%	(0.00)	479.94
General Cleaning of Project Site									
63. General clean - up									
8.00 HR	47.50	0.00	144.29	523.79	16/NA	Avg.	0%	(0.00)	523.79
Dumpster For Roof Materials									
64. Sheathing - plywood - 3/4" CDX									
200.00 SF	2.35	0.00	178.44	648.84	16/150 yrs	Avg.	10.67%	(29.19)	619.65
65. Dumpster load - Approx. 30 yards, 5-7 tons of debris *									
1.00 EA	625.00	0.00	237.50	861.21	16/NA	Avg.	NA	(0.00)	861.21
Staging									
66. Initial set up, Staging and monitoring									
213.00 LF	0.28	0.00	22.46	81.64	16/NA	Avg.	0%	(0.00)	81.64
67. Progressive set up, Staging and monitoring									
213.00 LF	0.55	0.00	44.93	163.28	16/NA	Avg.	0%	(0.00)	163.28
68. Delivery charge (Bid Item) Truck Freight Roofing Materials*									
1.00 EA	55.00	0.00	20.90	76.00	16/NA	Avg.	0%	(0.00)	76.00
Totals: General Conditions		**0.00**	**2,905.82**	**10,549.42**				**29.19**	**10,520.23**
Total: Gutter & DS		**0.00**	**4,913.28**	**17,812.17**				**2,698.43**	**15,113.74**

EFIS

EFIS

QUANTITY	UNIT	TAX	O&P	RCV	AGE/LIFE	COND.	DEP %	DEPREC.	ACV
Detach & Reset Items									
69. Detach & Reset Ductwork - hot or cold air - Extra large size									
30.00 LF	29.00	0.00	330.30	1,199.97	0/30 yrs	Avg.	0%	(0.00)	1,199.97

Includes: On-site storage, foil tape and/or mastic, and labor.
Excludes: Any additional materials or hardware.
Note: Labor cost to disconnect and detach furnace ductwork from 24" x 8" to 20" x 16", store on site, and reinstall at a later time.
No life expectancy data

7/14/2025 Page: 11

Example of an AI-generated damage exaggeration:

Original Photo

AI-Generated Photo

Top 3 Tools for Your SIU Team:

1. Metadata analysis- examining file creation data, editing history, and source signatures that AI-generated images often strip or fake.
2. AI-recognition software-detection tools trained to catch the artifacts (i.e., mismatched shadows, repeated pixel patterns, lighting inconsistencies) that give away synthetic images.
3. In-person inspection-when metadata or software flags a submission as suspect, an on-site adjuster visit remains the most reliable check available.

The Lowdown:

The rise of AI technology is quickly integrating into every facet of our lives, including our insurance claims. To ensure we are equipped to tackle the issues it can present, we must re-evaluate our lines of defense. Existing fraud clauses technically reach AI-fabricated claim evidence, but they weren't written with AI in mind, so the practical move for insurance carriers is to contemplate tightening policy language

to explicitly name AI-generated/altered submissions as disqualifying, while providing your SIU team with additional support with stronger proof-of-loss requirements and detection tools such as metadata analysis, AI-recognition software, and in-person inspections to keep pace.

Houston Federal Court Rules Appraisal Award Does Not Guarantee Full Payment in Wind/Hail Claims

by Claire Fialcowitz

The Houston Division of the Southern District of Texas recently delivered a pointed reminder to policyholders that they are not entitled to recover the replacement cost value of an executed appraisal award. In *Larry Hemingway & Kellie Hemingway v. American Economy Insurance Company, et. al.*, United States District Judge David Hittner granted summary judgment in favor of American Economy Insurance Company ("American") on the insureds' claims for breach of contract, breach of the duty of good faith and fair dealing, mental anguish, and violations of the Texas Insurance Code and Texas Deceptive Trade Practices Act. No. H-25-5626, 2026 WL 2280775, at *1 (S.D. Tex. Aug. 7, 2026).

After American initially determined that a wind/hail event did not cause damage to insured residential property, its insureds invoked appraisal of their claim. *See id.* On July 12, 2025, the parties received an executed appraisal award totaling $51,549.11 on a replacement cost value basis and $32,753.77 on an actual cash value basis. *See id.* On December 3, 2025, American advised the insureds of its intent to pay the award. *See id.* at *4. American issued an ACV payment to the insureds that same day in the amount of $32,184.57, less the applicable $7,000.00 deductible, and added $6,430.80 in statutory interest through American's December 3, 2025 payment. *See id.* The insureds then filed suit, alleging that American breached the policy by failing to pay the full amount of the replacement cost value of the appraisal award and by issuing payment nearly five months after receiving the executed appraisal award. *See id.* at *3–4.

As to the insureds' first allegation, the Court noted that the applicable policy provided that "'[i]f the cost to repair or replace is $2,500 or more, we will pay the difference between *actual cash value* and *replacement cost* only when the damaged or destroyed property is repaired or replaced.'" *Id.* at *3 (emphasis in original). As there was no evidence that the insureds completed repairs at the property as outlined in the appraisal award, the Court held that American properly withheld the recoverable depreciation and issued the appropriate amount to the insureds—the actual cash value of the award less the policy's applicable deductible. *See id.*

The insureds then asserted that the following policy provision required American to issue payment on the appraisal award within five business days of its receipt of the award: "'[i]f we [Defendant] notify you that we will pay your claim, or part of your claim, we must pay within 5 *business days* after we notify you.'" *Id.* at *4 (emphasis in original). The Court explained that this policy language only requires American to issue payment within five business days *of notifying* the insureds that it will issue payment on the claim—not that American has to issue payment within five business days of its receipt of any appraisal award. *See id.* As American notified the insureds of its intent to pay the actual cash value of the appraisal award plus statutory interest on December 3, 2025, the Court held that American's subsequent payment that same day was timely. Accordingly, the Court granted summary judgment in favor of American on the entirety of the insureds' breach of contract claim. *See id.*

Having found that all of the insureds' remaining causes of action stemmed from American's alleged breach of the policy and denial of policy benefits, the Court held that the insureds' extra-contractual claims failed as a matter of law. *See id.* at *4–5.

The Southern District of Texas' reinforcement that "recoverable depreciation" provisions are enforceable as written and of what constitutes "timely" payment provides a useful template for carriers to use when defending similar claims. For those policyholders and counsel out there that continue to send post-appraisal demands using the replacement cost value of an award and calculating statutory interest based on replacement cost value, give the *Hemingway* case another read.

BEYOND THE BLUEBONNETS

California Supreme Court Signals a Broadened Standard for Suing Excess Insurers

by Elizabeth (Betsy) Doyle

A fundamental principle of excess insurance is that an excess insurer's obligation to pay a covered loss does not arise until the underlying insurance has been exhausted. The California Supreme Court's decision in *Fox Paine & Co. v. Twin City Fire Insurance Co.*, S287404 (July 27, 2026) leaves that rule intact but reshapes the pleading analysis. Under *Fox Paine*, it may be more difficult for an untriggered excess insurer to obtain dismissal of declaratory relief and bad faith claims based solely on the absence of exhaustion if the complaint plausibly alleges: (1) a reasonable likelihood that exhaustion will occur and (2) pre-exhaustion conduct by the excess insurer that could support a bad faith claim. The *Fox Paine* decision takes a more nuanced approach than courts have previously applied.

Going forward, interested parties will want to keep tabs on two issues. The first is the Court's ruling that "additional considerations" may warrant application of a more lenient standard for declaratory relief, requiring only that a plaintiff plead a "reasonable likelihood" of attachment, rather than actual exhaustion. The second is the Court's emphasis on the covenant of good faith beginning at the inception of the insurance contract and not merely once the obligation to pay benefits arises. Although the Court declined to decide whether the Fox plaintiffs did, in fact, allege unreasonable pre-exhaustion conduct by the excess insurers amounting to bad faith, leaving that question for remand, the *Fox Paine* decision hints at a broadened pleading standard — that it is enough to allege that insurer misconduct may have impaired recovery of policy benefits before the duty to pay benefits arose — and a potential paradigm shift in coverage litigation in California.

Background

Private equity firm Fox Paine & Co. and related parties were insured under a professional liability insurance program consisting of a $10 million primary policy and four successive $10 million excess layers. A year-long dispute among Fox Paine's principals gave rise to extensive litigation. The primary insurer exhausted its $10 million policy limits by paying one group of insureds. The Fox plaintiffs subsequently sought coverage for their own litigation-related losses and filed suit against the excess insurers, asserting claims for declaratory relief under the excess policies and breach of the implied covenant of good faith and fair dealing.

The trial court held that the obligations of the higher-layer excess insurers could not arise until the underlying policies were exhausted and that the claims against the excess insurers were unripe while the plaintiffs' claims against the first-layer excess insurer remained unresolved. The First District Court of Appeal affirmed.

The Decision

Declaratory Judgment: "Reasonable Likelihood" of Exhaustion

The California Supreme Court reversed the lower courts' rulings in a unanimous decision. The Court ruled that "the absence of exhaustion is not fatal" to claims for declaratory relief under Civil Code Section 1060. It reasoned that "additional considerations" may warrant application of a more lenient standard requiring only a "reasonable likelihood" of attachment.

After weighing the hardships, as required to complete the "actual controversy" analysis, the Court concluded that requiring exhaustion of underlying limits before permitting an action for declaratory relief would impose an undue hardship by forcing insureds to engage in piecemeal litigation, "scaling the tower of excess insurance policy-by-policy." The Court found that this hardship outweighed the excess insurers' inconvenience of remaining in litigation that might ultimately prove unnecessary because any such burden could be managed by the trial court.

The Court remanded the issue back to the Court of Appeal to reevaluate the Fox plaintiffs' actual controversy allegations, including whether they must allege a covered loss reaching the excess attachment points, or whether "other considerations" justify application of the "reasonable likelihood" standard for pleading exhaustion, and whether the Fox plaintiffs' allegations in this case meet the applicable standard.

Breach of the Implied Covenant of Good Faith and Fair Dealing

Although the Fox plaintiffs did not dispute lack of actual exhaustion of the underlying policies, they alleged that the excess insurers engaged in bad faith conduct by favoring rival claimants and insureds, and concealing coverage decisions and settlements.

Instead of applying the typical "no coverage = no bad faith" equation, the Court took a more nuanced approach, based on general contract law and the "long-standing rule that neither party will do anything which will injure the right of the other to receive the benefits of the agreement." Reasoning that the covenant of good faith begins at the inception of the insurance contract, and not merely when the obligation to pay benefits arises, a plaintiff may adequately plead a cause of action for bad faith against an excess insurer by alleging facts showing that coverage under a policy *will* attach and that the excess insurer's misconduct has "impaired the insured's recovery of benefits owed to it under the policy."

Significantly, the Court remanded the issue to the Court of Appeal to determine whether, after applying the proper standard, the Fox plaintiffs' allegations were in fact sufficient to state a viable cause of action against the excess insurers for breach of the implied covenant of good faith and fair dealing before the obligation to pay benefits arose. The Court expressly declined to decide whether, "in unusual circumstances involving consequential harm to an insured," a bad faith claim may proceed even in the absence of coverage under the insurance policy, as argued by the Fox plaintiffs.

Takeaways

Fox Paine serves as a reminder that, while a high-layer excess insurer may be "up in the nosebleeds" on the coverage chart, it may still have pre-exhaustion claims handling exposure.

Stakeholders are wise to monitor the case to see how the Court of Appeal rules regarding the more lenient "reasonable likelihood" of attachment and the impact of an insurer's pre-exhaustion conduct on the predicate breach of contract needed to trigger liability for breach of implied covenant of good faith and fair dealing. Of course, we will also keep an interested eye on it as well.

For more information on any of the topics covered in this issue, or for any questions in general, feel free to reach out to any of our attorneys. Visit our website for contact information for all Zelle attorneys at zellelaw.com/attorneys.

Visit our Website

Reach out to Zelle LLP if your organization would benefit from a presentation, class, discussion, or seminar from one of our attorneys.

Thank you for reading this issue of The Zelle Lonestar Lowdown!

Visit our website to view all previous issues of The Zelle Lonestar Lowdown!

The Lonestar Lowdown All Issues

Contact Us!

Follow Zelle LLP on LinkedIn!

ZELLE LLP

Join The Zelle Lonestar Lowdown mailing list!

Sign me up!

The opinions expressed are those of the authors and do not necessarily reflect the views of the firm or its clients. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

If you would like to be taken off this distribution list without unsubscribing from all Zelle emails and updates, please click here.

Zelle LLP | 901 Main Street Suite 4000 | Dallas, TX 75202 US

Unsubscribe | Update Profile | Constant Contact Data Notice