

An Empire-Sized Win for Policyholders: New York Bad Faith Extends Beyond First-Party Coverage

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A New York federal court has broken new ground and laid a foundation for insureds to pursue damages flowing from bad faith claim handling practices. In a significant decision for policyholders, the Southern District of New York has clarified that bad faith claims (and the consequential damages that accompany them) are not limited to first-party insurance disputes. In *Renergy, Inc. v. Mt. Hawley Ins. Co.*, No. 25-CV-5073, 2026 WL 1192415 (S.D.N.Y. May 1, 2026), the court rejected an insurer's argument that New York law categorically bars bad faith claims stemming from third-party insurance.

The decision confirms that bad faith conduct may occur equally under property and liability policies and provides important guidance nearly two decades after *Bi-Economy* and *Panasia*, where the New York Court of Appeals held, in a first-party insurance dispute, that an insured may recover consequential damages for an insurer's breach of the duty of good faith and fair dealing when those damages were reasonably within the parties' contemplation at the time of contracting. The decision also underscores the availability of consequential damages for claims arising under either line of coverage.

Background

Renergy, Inc., the policyholder, sought coverage for costs arising from a pollution incident under a site-specific environmental liability policy.

After submitting the claim for approximately \$1.56 million, the insurer paid only a portion before engaging in problematic claims-handling practices, including reliance on a third-party consultant without any independent analysis, issuing duplicative document requests, and shifting its coverage positions after years of purported claim activity. The misconduct allegedly caused harm separate from amounts covered under the policy, including vendor liens, penalties, and lost business opportunities.

When the policyholder moved to amend its bad faith allegations, the insurer opposed, arguing that any amendment clarifying and adding facts to its bad faith claim would be futile because third-party bad faith claims are not legally cognizable under New York law, that the claim was duplicative of the breach of contract claim, and that consequential damages were inadequately pleaded.

The court accepted the policyholder's allegations as true and focused only on whether the proposed bad faith claim was plausible, not whether it would ultimately succeed. Finding the claim plausible on each of the three challenged grounds, the court rejected the insurer's futility arguments and granted *Renergy, Inc.* leave to amend.

Court's Analysis

Third-Party Bad Faith Claims Are Viable Under New York Law

First, and most significantly, the court held that New York law does not categorically limit bad faith claims to first-party insurance. The insurer argued that New York's recognition of bad faith claims handling and its consequential-damages remedy is confined to first-party policies. The court rejected that categorical proposition, explaining that while the leading Court of Appeals decisions (*Bi-Economy* and *Panasia*) arose in the first-party context, neither announced a rule excluding third-party liability coverage. The court specifically stated that "New York recognizes bad faith claims handling regardless of whether the claim involves first-party or third-party liability coverage."

A Bad Faith Claim Is Not Duplicative When It Targets Claims-Handling Conduct

Second, the court held that the policyholder's bad faith claim was not duplicative of its breach of contract claim. The insurer argued that both claims arose from the same alleged nonpayment of benefits and, therefore, the follow-on bad faith claim should be dismissed. The court disagreed, drawing a distinction between a breach of contract claim based on failure to pay amounts due under the contract and a bad faith claim based on improper claim handling. The court acknowledged that the allegations may overlap to some extent but emphasized that the complaint alleged conduct independent of the denial of coverage, including failure to conduct a fair investigation, reliance on inadequate analyses, repetitive document demands, and shifting coverage positions. It also noted that the damages sought for each claim were distinct.

The Policyholder Adequately Pleaded Consequential Damages

Third, the court held that the policyholder plausibly alleged entitlement to consequential damages resulting from the insurer's bad faith conduct. The insurer argued that the claimed damages, such as liens, penalties, and lost business opportunities, were not foreseeable or within the parties' contemplation at contracting. The court rejected that argument, reaffirming that, at the pleading stage, a policyholder need only plausibly allege that (1) the damages flowed from the breach, (2) the damages were reasonably foreseeable, and (3) the damages were within the reasonable contemplation of the parties at the time of contracting. The court specifically emphasized there is no heightened pleading standard for consequential damages and that the policy need not expressly provide for them.

Takeaways

Renergy provides meaningful support for third-party bad faith claims in New York by illustrating the reasons why such claims should not be confined only to first-party disputes. Consistent with the *Renergy* court's analysis, it is important for policyholders to keep the following in mind:

1. **Don't overlook bad faith in third-party claim disputes.** Bad faith claims handling is not confined to first-party coverage. Even under third-party liability policies, an insurer's mishandling of a claim can support a bad faith claim and consequential damages.
2. **Plead bad faith conduct distinct from nonpayment.** A bad faith claim that merely restates the insurer's failure to pay is likely to be dismissed as duplicative. Accordingly, the complaint must allege conduct independent of the insurer's failure to pay policy proceeds, such as unreasonable delay, failure to investigate, or other improper claims-handling behavior.

3. **Be specific about damages.** The *Renergy* court focused on the policyholder’s “specific alleged downstream damages” resulting from the insurer’s claims-handling conduct. Examples of sufficiently specific damages include vendor late fees, penalties, liens on the plaintiff’s property, and lost sale opportunities caused by outstanding liens, none of which would have fallen within the scope of disputed coverage. Allegations should rely on concrete facts rather than conclusory, bare-bones statements.
4. **Document everything.** Proper claim handling is critically important and a failure to follow industry custom and practice may carry real consequences. Gaps in the investigation, shifting coverage positions, or delays can support a bad faith claim and exposure beyond policy limits. A clear record of what the insurer knew, did, and when it did it can make all the difference.

While policyholders should keep these considerations in mind, experienced insurance coverage counsel can help identify insurer misconduct even when it may not be self-evident and help policyholders develop the factual record and position the case to maximize recovery.

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