

**Small v Arch Capital Group, Ltd.**

2010 NY Slip Op 30535(U)

March 10, 2010

Supreme Court, New York County

Docket Number: 600869/07

Judge: Richard B. Lowe

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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HON. RICHARD B. LOWE, III

PART 56

*Justice*

*Scanned to New York E-File*

*Lewis Small*

INDEX NO. 600 869/07

- v -

MOTION DATE 11/4/09

*Arch Capital*

MOTION SEQ. NO. 010

MOTION CAL. NO. \_\_\_\_\_

The following papers, numbered 1 to \_\_\_\_\_ were read on this motion to/for \_\_\_\_\_

PAPERS NUMBERED

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits \_\_\_\_\_

Replying Affidavits \_\_\_\_\_

Cross-Motion:  Yes  No

Upon the foregoing papers, it is ordered that this motion

**MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION**

**FILED**

MAR 15 2010  
NEW YORK  
COUNTY CLERK'S OFFICE

*HON. RICHARD B. LOWE, III*

Dated: 3/10/10

J.S.C.

Check one:  FINAL DISPOSITION  NON-FINAL DISPOSITION

Check if appropriate:  DO NOT POST

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK: IAS PART 56

-----X  
LEWIS SMALL, Individually and as Trustee of the  
RICHARD SMALL VOTING TRUST and the  
AMERICAN INDEPENDENT COMPANY VOTING  
TRUST; RICHARD SMALL; DAVID WILSTEIN;  
LEONARD WILSTEIN; DENISE WILSTEIN; GARY  
WILSTEIN; RONALD WILSTEIN; and FREDERICK  
GITTEMAN,

Index No. 600869/07

Plaintiffs,

-against-

ARCH CAPITAL GROUP, LTD;  
AMERICAN INDEPENDENT COMPANIES, INC.,  
as successor by merger to AMERICAN INDEPENDENT  
INSURANCE HOLDING COMPANY; TDH CAPITAL  
PARTNERS; and TDH III, L.P.,

Defendants.  
-----X

**Hon. Richard B. Lowe, III:**

Plaintiff Lewis Small ("Small") sues in his individual capacity as a former shareholder of the corporate defendants, and as trustee for two voting trusts. The individual plaintiffs, David, Leonard, Denise, Gary and Ronald Wilstein have claims that parallel Small's. Defendant American Independent Companies (AmCo) is sued as the successor by merger to American Independent Insurance Holding Company (AmCo Holding). Arch Capital Group Ltd. (Arch) is a former creditor and reinsurer of AmCo Holding, and is currently its parent company. The other defendants, TDH Capital Partners, and TDH III, L.P. (together, TDH) are former AmCo Holding creditors.

In a previous decision, this court dismissed the first three counts of plaintiffs'

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complaint based on a failure to state causes of action for fraud and breach of fiduciary duty. In motion sequence #010, 011, and 012, defendants move for summary judgment dismissing plaintiffs' fourth cause of action, for breach of contract. In motion sequence #013, plaintiffs also move for summary judgment. Motion sequences #010, 011, 012, and 013 are consolidated for disposition.

### **Background**

The facts alleged in the complaint were analyzed in a decision and order of this court entered on May 28, 2008 ("May 28 decision"), and will be summarized here.

Plaintiffs allege that they sold their shares in AmCo Holding for \$1.25 million in cash, and a contingent interest in the recovery from certain legal proceedings in which AmCo Holding and Small were named as parties. The terms of this sale of stock to Arch are set forth in a Reorganization Agreement dated December 31, 2000 (the Agreement), which closed on February 28, 2001. According to plaintiffs, TDH, Smalls AmCo Holding and Gitterman all received a right to share in any proceeds from such lawsuits pursuant to the Agreement.

Plaintiffs allege that a joint venture with the defendants in this action was created in order to prosecute the parties' mutual interest in the outcome of three legal proceedings and a claim that was filed under AmCo Holding's Directors and Officers liability insurance policy (the D&O Claim).

In addition, the individual plaintiff Small claims that, as an attorney and the former chairman of AmCo Holding, the Agreement granted him the right to continue to manage

the lawsuits and the D&O Claim being prosecuted for the benefit of the joint venture. (Plaintiffs concede that two of these lawsuits had been submitted to binding arbitration prior to execution of the Agreement.) Small claims that his right to manage the lawsuits was subject only to the right of AmCo Holding and TDF to “information and to consultation, and to their prior written approval of strategic decisions, including settlement and the selection or removal of lead counsel.” In addition, claim plaintiffs, AmCo Holding agreed to continue to fund the costs and expenses of the lawsuits up to a maximum of \$500,000, after the closing of the Agreement in February 2001. Plaintiffs claim that AmCo Holding’s agreement to fund the prosecution of the lawsuits and the D&O Claim after the closing of the Agreement constitutes an implicit agreement to use good faith.

The breach alleged in the fourth cause of action rests on two theories: one, that defendants failed to permit the individual plaintiff, Small, to manage and control then pending litigation by AmCo against Arch (the Lederman lawsuit); and, two, that defendants failed to fully fund the litigation expenses of the Lederman lawsuit, as the parties had agreed. Small now adds to these contractual claims the argument that defendants had a motive to breach the contract, based on their desire not to alienate other members of the insurance industry, including prospective reinsurance customers. According to plaintiff, the Arch defendants labored under a serious undisclosed conflict of interest.

In the May decision, this Court not only dismissed all of the claims that were based

on defendants' alleged fraud and breach of fiduciary duty, but also found that claims for breach of fiduciary duty and for breach of the implied covenant of good faith and fair dealing had to be dismissed where the claims, and the damages sought to be recovered, were concurrent with the damages claimed for the alleged breach of contract. Following the dismissal of those claims, the only claims remaining in the case are those based on an alleged breach of paragraph 9.10 of the parties' written agreement.

The full text of paragraph 9.10 states the following:

Administration of Lawsuits. After the Closing, Lewis Small will continue to assist and manage the Lawsuits on behalf of the Company and TDH to the extent his health permits, subject to the following: (i) Small will provide the Company and TDH with all information relating to each Lawsuit, including the status thereof, and will consult with the Company and TDH regarding the Lawsuits at any time requested by the Company or TDH; (ii) the prior written approval of the Company and TDH will be required for any strategic decisions relating to the Lawsuits, including without limitation settlement of all or any portion of any Lawsuit and selection or removal of legal counsel or other professional advisors (provided that the Company and TDH will not agree to a settlement that does not provide for the release of Small as a defendant in the Lawsuits); (iii) Small agrees not to take any position that would, directly or indirectly, negatively affect in any material respect the reputation of the Company, its shareholders, TDH or its partners; and (iv) the Company will continue to fund reasonable fees and reasonable expenses of the Lawsuits (based on appropriate supporting written invoices) up to a maximum of \$500,000.

## Discussion

A movant's burden on a motion for summary judgment is to establish that there are no material issues of fact (*Zuckerman v City of New York*, 49 NY2d 557 [1980]). Once a movant has met this burden, the party opposing the motion must come forward with proof of the existence of a triable issue (*Indig v Finkelstein*, 23 NY2d 728 [1968]).

A claim for breach of contract requires proof of the contract, performance of the contract by one party, a breach by the other party, and damages. (See *WorldCom, Inc. v Sandoval*, 182 Misc 2d 1021 [Sup Ct, NY County 1999]).

In support of the first branch of plaintiffs' motion for summary judgment, plaintiffs claim that the Agreement contained defendants' promise to let Small manage the Lederman lawsuit on behalf of all of the stakeholders. According to Small, this included the right to hire and fire counsel, and to select witnesses. Small points to the following phrase in Section 9.10 of the Agreement as proof that he had the right to manage the lawsuits: "After the Closing, Small will continue to assist and manage the Lawsuits ...". Small claims that the defendants' interpretation of "manage," as revealed in deposition testimony, was inconsistent with the parties' intent at the time the Agreement was drafted.

"Whether a contract is ambiguous is a matter of law for the court" to determine. (*Hirsch v Food Resources, Inc.*, 24 AD3d 293, 295 [1<sup>st</sup> Dept 2005]). The language of the contract with respect to the meaning of "manage" is clear on its face: Small was to continue to assist and manage the lawsuits on behalf of the company, subject to three very

specific contractual conditions, namely: (1) Small was to consult with, and provide information to the company, or TDH at any time requested; (2) prior written approval of the company was required for any strategic decisions, including the selection or removal of legal counsel; and (3) Small would not take any position that would negatively affect the company, or its shareholders, either directly, or indirectly. Volumes of exhibits have been offered by Small to support his claim that defendants breached the Agreement when they refused to follow Small's advice regarding the hiring and firing of counsel on the Lederman action. However, here there is no ambiguity in the contract with respect to the authority delegated to Small, and the court will not delve into the various meanings of the word "manage" posited by Small, in the absence of an ambiguity.

Accepting as true all of the evidence Small has offered on these issues, for purposes of determining this motion, the court finds that Small has failed to establish a prima facie case of entitlement to summary judgment on this branch of his motion by failing to establish a contractual obligation on the part of the defendants to permit Small the degree of control over the management of the Lederman lawsuit which he now claims to have been entitled to exercise.

Small also claims that the defendants breached that portion of the Agreement which obligated them to fund the Lederman litigation, following the closing of the Agreement, up to \$500,000. Small relies on an excerpt from Section 9.10 of the Agreement: "After the Closing ... [AIICO] will continue to fund reasonable fees and expenses of the Lawsuits ... up to a maximum of \$500,000." Small again offers to

interpret language which is clear on its face. According to Small, only expenses incurred after the closing of the Agreement should be included in satisfying defendants' \$500,000 funding obligation, and only expenses actually incurred and paid constitute legitimate expenses under the Agreement. Litigation expenses incurred prior to the closing, including expenses incurred in connection with the state arbitration proceedings, were not intended to be included in calculating whether or not defendants have met their funding obligation, claims Small. Legal fees which were billed but not paid were also not intended to be part of this funding obligation. While Small contests the meaning of the term, "funded," there is no ambiguity in the Agreement, and no restriction on the method the company was entitled to use to determine which were reasonable fees or expenses. Small claims that because Section 9.10 starts off with the phrase, "After the closing," therefore, only litigation expenses which arose from that day forward could be included in determining when the defendants' \$500,000 funding obligation had been fulfilled. But the plain language of the Agreement states that the defendants' funding obligation "will continue," without any distinction between expenses which were funded before the Agreement had been entered into, and those which were incurred after the closing of the Agreement. The specific exceptions to the fund, which Small now seeks to delineate, were never carved out in the Agreement when it was drafted, and will not be inserted as new or additional terms, after the fact, by the court. "[L]ongstanding contract interpretation principles prohibit [the court] from adding a missing term to an unambiguous [contract]." (*Vermont Teddy Bear Co. v 538 Madison Realty Co.*, 1 NY3d

470, 472 [2004]). Small's argument that only fees or expenses incurred after the closing of the Agreement are to be considered in determining when the defendants have met their \$500,000 funding obligation belies the plain meaning of the Agreement, and begs for a construction other than the natural meaning of the language contained in the Agreement: defendants' obligation to fund the Lederman litigation continued, from before the Agreement was entered into, and subsequent to its execution, up to the amount of \$500,000.

Plaintiffs have also failed to establish a prima facie case with respect to the claim that the defendants improperly distributed the proceeds from the state lawsuits. Plaintiffs object to the deduction of certain of the legal fees incurred in connection with prosecuting the Lederman litigation, and to the defendants' demand for a release and waiver before the proceeds will be distributed. The individual plaintiff Small, having executed a release, has no standing to object to the distribution of proceeds. The remaining plaintiffs have failed to establish that the requirement that they sign a waiver and release violates any express or implied terms of the parties' Agreement.

Plaintiffs concede that motive is not an element of a claim for breach of contract. The plaintiffs' evidence of motive and the belated and unsupported claim of a conflict of interest on the part of the defendants appear to have been offered to bolster the breach of contract claim. These allegations fail to establish a separate ground for an award of damages to plaintiffs, apart from the breach of contract claim, and are dismissed.

Plaintiffs also complain that the defendants' inclusion of post-closing expenses in

the calculation of the \$500,000 funding commitment violated the defendants' duty of good faith and fair dealing. No reasonable person would have agreed that the defendants' commitment to fund the lawsuits included post-closing expenses, argue the plaintiffs.

The implied covenant of good faith and fair dealing is implicit in all contracts (*Dalton v Educational Testing Service*, 87 NY2d 384 [1995]). “[The duty], however, is not without limits, and no obligation can be implied that ‘would be inconsistent with other terms of the contractual relationship’” *id.* at 389, quoting *Murphy v American Home Prods. Corp.*, 58 NY2d 293, 304[1983] [a student claiming an error in grading is entitled to relief that comports with a testing company’s contractual promise]).

Having previously held that the Agreement between the parties in this case is not ambiguous, the court will apply the principles used to analyze agreements in sophisticated commercial real estate transactions, which are “‘negotiated between sophisticated, counseled business people negotiating at arm’s length’” (*Vermont Teddy Bear Co.*, 1 NY3d at 475 [citation omitted]).

[C]ourts should be extremely reluctant to interpret an agreement as impliedly stating something which the parties have neglected to specifically include....Hence, courts may not by construction add or excise terms, nor distort the meaning of those used and thereby make a new contract for the parties under the guise of interpreting the writing.

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In the absence of any ambiguity, we look solely to the language used by the parties to discern the contract’s meaning

(*id.* at 475 (internal quotation marks and citations omitted)).

In the absence of any ambiguity, the court will not read into the parties' agreement a limitation on the expenses to be included in defendants' funding obligation which limitation was not expressly included by the parties when the Agreement was drafted (*id.*).

In support of their motions for summary judgment, defendants assert that plaintiffs have failed to establish a prima facie case of entitlement to judgment on the fourth cause of action, for breach of contract and breach of the implied covenants of good faith and fair dealing. Even if all the proof adduced by plaintiffs in discovery were found to be true by the trier of fact, plaintiffs would still be unable to prove a prima facie case of breach of contract or breach of the implied covenants of good faith and fair dealing.

With plaintiffs' failure to establish their prima facie case in this proceedings defendants are entitled to judgment dismissing the complaint, in its entirety, with prejudice, as a matter of law.

### **Conclusion**

Accordingly, it is

ORDERED that plaintiffs' motion for summary judgment is denied; and it is further

ORDERED that defendants' motions for summary judgment are granted, and the complaint is dismissed, and the Clerk is directed to enter judgment in favor of said

defendants, with costs and disbursements as taxed by the Clerk.

Dated: March 10, 2010

ENTER:



J.S.C.

**W. RICHARD B. LOWE, III**

**FILED**

**MAR 15 2010**

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