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

- X

JEROME FELDMAN, HUGH CHAIRNOFF, ROBERT E. KLINE, AND JOHN A. FELICETTI, individually and on behalf of all others similarly situated,

Plaintiffs,

v.

NATIONAL WESTMINSTER BANK, N.A. t/a FLEET BANK OF NEW YORK, N.A.,

Defendant.

Index No. 605549/99
Part Cal. No. 15984

- X

ROBERTA HAYES, PATRICK R. BROCKER, SELINA H. EHRLEIN as Executrix of the Estate of ARMAND S. EHRLEIN, DAVID E. FISK, JAMES M. GALLAGHER, MICHAEL F. KACZYNSKY, JOHN. E SHANAHAN, and BRETT SMITH,

Plaintiffs,

-against-

NATIONAL WESTMINSTER BANK, N.A. t/a FLEET BANK OF NEW YORK, N.A.,

Defendant.

Index No. 403545/00
Part Cal. No. 16236

- X

GAMMERMAN, J.:

This is a breach of contract action by former executives of National Westminster Bancorp, Inc. ("Bancorp"), who allege that Bancorp failed to properly calculate the awards issued pursuant to an incentive bonus plan. A joint bench trial of the consolidated actions was conducted between April 5 and 10, 2001. For the following reasons, I direct that judgment be entered in each action favor of defendants.

In July, 1990, Bancorp adopted a Phantom Stock Appreciation Plan (the "Stock Plan"), effective as of January 1, 1990. As set

forth in section I of the Stock Plan, the program was created "to provide key employees with financial incentives for improving the long-term performance of [Bancorp] and its subsidiaries, and increasing the value of these financial institutions to the parent, National Westminster Bank PLC." Under the Stock Plan, participants were granted awards in "Unit" denominations. Pursuant to section 2.14:

> "Unit" means a bookkeeping unit established solely for purposes of administering the Plan and presenting a cash amount equal in value to one-thirty-thousandth (1/30,000th) of a share of Stock of Bancorp . . . Units do not represent Stock or fractional shares of Stock.

Section 2.13 provided that "'Stock' means common stock of Bancorp (no par value), of which there are 1,000 shares issued and outstanding." Pursuant to section 4.1, "[e]ach Phantom Stock Award represent[ed] the right to receive payment from Bancorp . . . of an amount of cash equal to any appreciation in the Fair Market Value of on Unit between the date of grant and the date of exercise of the Phantom Stock Award."

Section V governed the valuation of Bancorp's stock for the purpose of making awards under the Stock Plan. Section 5.1 required that a "Valuation" be made of Bancorp's stock at least once a year by a "Designated Investment Bank or other financial advisor." However, that section also provided that "[n]otwithstanding the foregoing in the event of a Change of Control of Bancorp, the valuation shall reflect the purchase price for Bancorp." Section 5.2 stated that "[e]ach Valuation

performed as provided above [pursuant to section 5.1] shall be final and binding upon all Participants at all times during which such Valuation shall be in effect."

Section 6.1, "Adjustments to Phantom Stock Awards, provided as follows:

> In the event that the number or value of the outstanding share of Stock are increased or decreased by reason of a recapitalization, reclassification, merger, or combination of share, or dividend or other distribution, the number of Phantom Stock Awards, and/or the Fair Market Value of a share of Stock or of a Unit at the date of grant of a Phantom Stock Award, shall be appropriately adjusted . . . so that the proportionate interest represented by the Phantom Stock Awards of each Participant will, to the extent practicable, be maintained as before the occurrence of such event.

The Stock Plan was administered by the Compensation Committee of Bancorp's Board of Directors (the "Committee"). The Committee consisted of Richard Kogan, the Chief Executive Officer of Shering-Plough Corp.; Elizabeth Bailey, a professor at the Wharton School; Edwin Nixon, an IBM executive and an outside director of Bancorp's parent, National Westminster Bank PLC ("Natwest PLC"); Alfred Teo, a New Jersey business leader; and John Tugwell, Bancorp's Chief Executive Officer.

Section 8.1 of the Stock Plan provided that "[t]he Committee shall interpret the provisions of the Plan and its decisions shall be final and binding on all Participants." More specifically, section 8.2 states that

> The Committee shall, subject to the provisions of the Plan, determine to whom

> Phantom Stock Awards will be granted, the time or times at which Phantom Stock Awards will be granted, and the number of Phantom Stock Awards to be granted . . . prescribe rules and regulations under the Plan; and construe the Plan and make all other determinations and take all other actions deemed necessary or advisable for the proper administration of the Plan.

Section 8.3 vested responsibility for the "routine operation of the Plan" in the Executive Vice President for Human Resources of Bancorp, whose responsibilities under the Stock Plan included "obtaining the necessary Valuations under the direction of the Committee, coordinating the efforts of other employees involved in the administration of the Plan, and communicating information about the Plan to Participants."

Section 8.4 set forth a limitation on the liability of Bancorp. It provided:

> Neither Bancorp, any Affiliate, any member of the Board of Directors or the Committee, any Designated Investment Bank, nor any agent of Bancorp, any Affiliate, or the Committee shall be liable for any action or determination made in good faith with respect to the Plan, any Valuation, or any Phantom Stock Award granted hereunder.

Section 8.5 provided that the Stock Plan was to be governed by Delaware Law. Finally, section 9.1 governed amendments to the Stock Plan. It stated:

> The Board of Directors or the Committee may amend the Plan at any time; provided, however, that the Committee may not, without the approval or ratification of the Board of Directors, amend the Plan so as to materially increase the cost of the Plan to Bancorp or any Affiliate, and provided further that no amendment to the Plan shall materially

> adversely affect the rights of any Participant with respect to any previously granted Phantom Stock Award without the consent of such Participant. Notwithstanding the foregoing, any amendment to the Plan that is (i) technical or clarifiying in nature, or relates solely to matters of Plan administration, and (ii) would have no material effect upon the cost of Plan, may be adopted by the Executive Vice President, Human Resources.

Morgan Stanley was ultimately selected as the Designated Investment Bank to perform the annual valuations required by section 5.1. In valuing the units under the Stock Plan, Morgan Stanley took into account capital infusions from Natwest PLC to Bancorp totaling approximately $1.2 billion between 1991 and 1994. Morgan Stanley offset those infusions by employing the concept of "notional shares," i.e., by deeming that additional Bancorp shares had been issued to Natwest PLC in exchange for the capital contributions. By 1994, payments under the Stock Plan to participants were based upon a per-unit value of approximately $37, employing a figure of 3,057 notional shares. All communications to Stock Plan participants up to that time were based on the figures derived from Morgan Stanley's methodology.

In Fall of 1995, Natwest Plc was engaged in merger negotiations with various other banks. In the course of due diligence, one of the potential buyers, First Union, evaluated the Bancorp Stock Plan and determined that the per-unit payout would be approximately $120, not $37, in view of the fact that definition of "Stock" in section 2.13 was based on 1,000 shares outstanding. However, Bancorp thereafter continued to make

payouts consistent with the methodology previously employed over the life of the Stock Plan. Thus, in September 1995, the Committee approved a series of executive employment contracts, which awarded additional units based upon the use of 3,057 notional shares.

Nevertheless, with merger negotiations underway, Bancorp was still concerned with the discrepancy between the Stock Plan definition of "Stock" and the number of shares historically used to calculate payments. Bancorp's counsel drafted an amendment to section 2.13, changing the definition of "Stock" to mean "common stock of Bancorp (no par value), the notional number of shares [i.e. 3,057] of which is determined from time to time by the Designated Investment Bank (i.e., Morgan Stanley)." This proposed amendment, together with other proposed changes to the Stock Plan, was presented to the Committee at its March 28, 1996 meeting. The Committee unanimously recommended that the amendment be adopted by the Bancorp's Board of Directors. However, while the minutes of the Board's meeting reflect that it "approved, ratified and confirmed" the actions of the Committee, they do not refer to the proposed amendment to the definition of "Stock". Nor is the amendment to section 2.13 among the various resolutions reproduced in the text of the Board's minutes.

In May 1996, Fleet Bank, N.A. was merged with and into NatWest Bank N.A. ("NBNA"), with the surviving entity assuming the name Fleet Bank of New York, N.A. ("Fleet"). Prior to the effective date of the merger, Bancorp assigned to NBNA the

sponsorship of the Stock Plan, together with the associated obligations. On May 17, 1996, Fleet paid out approximately $30 million to the Stock Plan participants. The payments were based upon a valuation of Bancorp which reflected the merger purchase price, with the Stock Plan unit prices derived on the basis of 3,057 notional shares. These actions followed, alleging that failure to calcuate the awards on the 1,000 share figure set forth in section 2.13 constituted a breach of the Plan.

The threshold, and, as it develops, dispositive issue is the interpretation and effect of the exculpatory language of section 8.4 of Plan. As noted, that section immunizes Bancorp from liability for "any action or determination made in good faith with respect to the Plan,"and specifically extends that immunity to "any Valuation, or any Phantom Stock Award granted hereunder" (emphasis added). Defendants argue that a literal interpretation of the section would excuse even an outright breach of the Plan, where the breach arose out of a good faith, but mistaken, reading of the Plan's provisions. Plaintiffs counter that good faith can never excuse an actual breach of an unambiguous (or even an ambiguous) contractual term. Assuming that a good faith defense does exist, the parties also debate whether Bancorp did act in good faith in employing the additional notional shares in making the post-merger payments under the Plan.

As a matter of common law, "good faith is not a defense to a breach-of-contract claim", Flanders & Medeiros, Inc. v Bogosian, 65 F.3d 198 (1st Cir 1995); see, Halifax Fund, L.P. v Response

USA, Inc., 1997 WL 33173241 (Del Ch 1997). However, under Delaware law the parties are free, through the terms of the contract itself, to limit or eliminate liability for breach of the contract, see, Donegal Mut. Ins. Co. v Tri-Plex Sec. Alarm Sys., 622 A.2d 1086 (Del Super Ct 1992) (enforcing exculpatory clause which limited liability on contract and negligence claims to $250). Although such disclaimers are strictly construed, "they should not be construed contrary to the plain and ordinary meaning of the words and probable intent", Lafate v New Castle County, 1999 WL 1241074 (Del Super Ct 1999). Contracts must be read in a way that gives effect to all of their provisions, see, Continental Ins. Co. v Burr, 706 A.2d 499, (Sup Ct Del 1988), and provisions which limit liability are not an exception to this rule, see, Donegal, supra.

I conclude, first, that the plain language of section 8.4 does excuse a good faith breach of the Plan's terms. It specifically immunizes Bancorp from liability determinations taken with respect to a contract -- the Plan itself -- and even more specifically, with respect to any determinations taken with respect to two contractually-created obligations -- the Valuations and the Phantom Stock Awards. For plaintiffs' interpretation of the clause to have meaning, the immunity afforded by section 8.4 would have to apply to some kind of liability other than contractual liability. However, the only liability created by the Plan is contractual liability, and any violation with respect to establishing a Valuation or an award of

units would necessarily involve a breach of the relevant terms of the contract.

Plaintiffs nonetheless argue that an exculpatory clause, at most, can only excuse the breach of contractual terms that are ambiguous. Although there is some Delaware authority to that effect interpreting the statutory immunity, under the Revised Uniform Liability Act, of a partner who acts in good faith reliance on the provisions of a partnership agreement, see, Continental Ins. Co. v Rutledge & Co., Inc., 750 A.2d 1210 (Del Ch 2000); Gotham Partners L.P. v Hallwood Realty Partners, L.P., 2000 WL 1476663 (Del Ch 2000)("Gotham I"); Gotham Partners L.P. v Hallwood Realty Partners, L.P., 2001 WL 846054 (Del Ch 2001)("Gotham II"), nothing in those cases diminishes the power of the parties to excuse, through an unambiguous contractual exculpatory clause, a good faith breach of any contractual provision. Indeed, to the extent those cases are relevant to the effect of the separate contractual exculpatory provisions of the relevant contracts, they confirm the parties' right to "contract around" duties otherwise imposed by law, Rutledge, supra; see Gotham I, supra; Gotham II, supra. Furthermore, even assuming that a contractual exculpatory clause can trump only those other provisions of the contract that are ambiguous, i.e., those "subject to only one plausible interpretation", Rutledge, supra, it cannot be said that an interpretation of the Plan as authorizing the use of notional shares was implausible. Apart from the fact the Plan was so interpreted throughout its life, I

do not find that section 2.13's definition of Stock unambiguously mandates the use of a 1,000 share figure in connection with a Valuation. It merely notes, as an historical matter, that 1,000 shares were outstanding, without reference to the use of that number in a Valuation. Section 2.14 additionally provides that "Units do not represent Stock or fractional shares of Stock," further attenuating the relationship between the Valuation of Units and actual number of outstanding shares.

Plaintiffs' further suggestion that the clause was only intended to protect Committee members from personal liability with respect to discretionary matters as to which participants should receive units, or the number of units each should receive, is without merit. The clause specifically lists Bancorp, in addition to the Committee and various other parties, as a beneficiary of the immunity. Likewise, the immunity extends to any action or determination with respect to the Plan, and with respect to any Valuation or award, not merely to actions or determinations invoking the discretionary provisions of the Plan.

Finally, plaintiffs argue that an interpretation of the clause that would allow the breach of a contractual term would render the entire Plan meaningless and unenforceable. However, the clause does not excuse any breach, but only those that result from something other than good faith. The requirement of good faith is thus a significant limitation on the scope of the exculpatory clause, as it prohibits Bancorp from deliberately violating or disregarding the provisions of the Plan. While, of

course, the clause could be invoked as a pretext to justify a breach actually committed in bad faith, that possibility would not render the contract unenforceable. It would simply raise a factual question of good faith to be resolved under the clause itself.

I also resolve that question in favor of the defendants. Although the record reflects that there was, at first, a debate within Bancorp over whether the additional notional shares could be used in the calculation of awards under the Plan, there is no evidence that the ultimate determination to use the higher number was made in bad faith. The members of the Committee were disinterested, and their recommendation to continue to employ the valuation methodology utilized by Bancorp over the multi-year life of the Plan after consultation with the Designated Investment Bank, Morgan Stanley, was well within their discretion.

As I noted at the conclusion of the trial, it does not appear that the Board ultimately acted, under section 6.1 or 9.1, upon the Committee's recommendation to formally amend the section 2.13 definition of "Stock" to reflect the use of notional shares. The evidence demonstrates, however, that Bancorp acted in good faith reliance on counsel's advice that the Plan was "fine as is" and that the amendment was merely administrative and unnecessary because the Plan already authorized Bancorp to make the valuations, as it historically had, using a methodology using notional shares. In this connection, I note that plaintiffs

benefitted from other recommendations of the Committee that were not approved by the Board or added to the Plan by amendment, such as the right to defer payments into a "Rabbi" trust. The fact that the determination to do so fell outside the literal terms of the Plan is not evidence of bad faith, but, like the use of notional shares, well within the discretion afforded in section 8.2 to "construe the Plan and make all other determinations and take all other actions deemed necessary or advisable for the proper administration of the Plan."

Accordingly, it is

ORDERED, that complaints in these actions are dismissed, with costs and disbursements to defendants as taxed by the Clerk of the Court, and it is further

ORDERED that the Clerk is directed to enter judgment accordingly.

Dated: June 26, 2002

ENTER:

J.S.C.

IRA GAMMERMAN