Zebeck v. Metris Companies, Inc.: A Cautionary Tale

by Abigail S. Crouse

A recent Minnesota Court of Appeals decision provides some scary and important lessons for employment lawyers throughout the country. In *Zebeck v. Metris Companies, Inc.*, (No. A07-0756) (Minn. Ct. App. 2008), the Minnesota Court of Appeals affirmed a $33 million jury verdict and an $11 million attorney fee award in a case involving a terminated executive's right to severance under a change in control agreement. The court affirmed this large verdict despite the fact that the executive was terminated approximately three years before a change in control took place and despite the fact that the reasonable value of the plaintiff's attorneys' time, on an hourly basis, was less than $1.6 million. The Court's decision provides a general cautionary reminder of the importance of clearly spelling out the parties' intentions when drafting a contract. It also provides two tangible and specific take-away lessons: (1) if compensation or benefits are to be paid upon the occurrence of a particular event, the contract should carefully define the conditions required for payment, and (2) if a contract contains an attorney's fees provision, the contract should make clear whether it applies to any attorney's fees—hourly <u>or</u> contingency fees—or whether it simply applies to reasonable hourly fees.

The defendant, Metris Companies, Inc., hired the plaintiff, Ronald Zebeck, as its CEO in 1998 and, at that time, Zebeck entered into a Change in Control Severance Agreement. The agreement provided Zebeck with the right to severance benefits if his employment was terminated either at the request of a third party who was effecting a change of control of Metris or "in connection with or in anticipation of" such a change in control, except that severance benefits would not be available if the executive was fired for cause. The agreement also provided that Metris would pay attorneys fees incurred by an executive in a good faith effort to collect severance benefits under the agreement.

Metris grew rapidly between 1998-2000 but, in 2001, that growth began to slow and, by 2002, the company was facing various financial problems. Metris retained two investment bankers, Goldman Sachs and Merrill Lynch, to advise the company on its financial situation and to assist in evaluating, structuring, and negotiating financial alternatives available to the company, including the possible sale of all or part of the company. In September 2002, Goldman Sachs made a presentation to the directors of Metris recommending that the company simultaneously pursue two primary paths (1) "all viable liquidity alternatives," and (2) a structured sale of the company.

On December 12, 2002, two Metris directors met with Zebeck to tell him to resign or be fired. On December 15, 2002, Metris terminated Zebeck's employment and, in the termination letter, Metris stated that it was reserving the right to determine that his termination was for cause. On March 26, 2003, Metris informed Zebeck that it had determined that he had been terminated for cause.

In November of 2005, almost three years after Zebeck's termination, Metris was sold to HSBC Finance Corporation. Zebeck sued Metris to collect the severance benefits under the change in control agreement. The jury found that Metris had not terminated Zebeck "for cause" and that he was entitled to $30,211,716 in severance. Zebeck retained a law firm to represent him in the case on a contingency-fee basis. His attorney fees came to approximately $11.5 million, and the district court ordered Metris to pay the full amount.

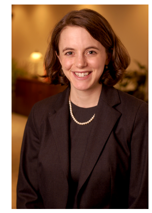
Metris appealed the jury's verdict and the district court's decision on various grounds. One issue on appeal was whether evidence supported the jury's decision that the 2002 firing of Zebeck was "in anticipation of a change in control," thus entitling him to benefits under the Change in Control Agreement. The Court affirmed this jury verdict, even though Metris was not sold until almost three years later in 2005. In affirming the jury verdict, the Court noted that the Change in Control Agreement did not specify any time frame for terminations in anticipation of a change in control. Furthermore, Metris's own expert had testified that including a time frame for anticipatory terminations in a change in control agreement is fairly standard and that the absence of such a time limit indicated that the parties did not intend to include a time limit. Therefore, despite the three year gap in time between Zebeck's termination and the sale of the Company, the Court of Appeals held that the jury's decision that "Zebeck was terminated 'to effect or in anticipation of a change in control' [was] not perverse and palpably contrary to the evidence." *Id.* *4.

This holding provides an important reminder to attorneys who draft change in control and severance agreements—if benefits are to be paid only under certain circumstances, it's important to carefully define those circumstances. The failure of parties to carefully define the term "in connection with or in anticipation of a change in control" gave the jury the opportunity to define this term, to the $30 million detriment of Metris.

Another issue on appeal was whether the change in control agreement's attorney fee provision entitled Zebeck to be paid for the full value of his attorney's contingency fee. The attorney fee provision stated that if an individual "incurs legal fees or other expenses in a good faith effort to obtain benefits" under the agreement, Metris "shall reimburse" the individual "on a current basis for such fees and expenses…" *Id.* at *7. The attorney's fee provision was silent regarding whether it applied to contingency or hourly attorney's fees. Zebeck had entered into a contingency fee arrangement with his attorney, in which he agreed to pay 20% of the first million he recovered and 22.5% of any additional recovery. Because of the large verdict Zebeck won, his attorney fees came to $11,563,454.33. The reasonable value of his attorneys' time on an hourly basis, however, was much less--$1,538,271.00. The Court of Appeals rejected Metris's arguments that it should not be liable for the full amount of the contingency fee. The Court held that under the Change in Control Agreement, Metris was liable for the attorney fee that Zebeck was required to pay. Because Zebeck had elected to compensate his attorney on a contingency basis, Metris was required to pay the contingency fee.

Although this holding is consistent with the plain language of the agreement, the startling amount of attorneys fees awarded provides an important reminder to attorneys to be careful when drafting attorney fee recovery provisions in contracts. In light of this decision, it is likely a good idea to cap any recoverable amount at the reasonable hourly value of the attorney's time (hours worked $\underline{x}$ attorney's normal hourly rate).

The large jury verdict and attorney fees awards in *Zebeck v. Metris Companies* are scary, but attorneys can avoid similar judgments on behalf of their own clients by applying the lessons *Zebeck* has to offer.



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