

1986

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### Recommended Citation

Michael A. Dover, *Contingent Percentage Fees: An Economic Analysis*, 51 J. AIR L. & COM. 531 (1986)  
<https://scholar.smu.edu/jalc/vol51/iss2/6>

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## CONTINGENT PERCENTAGE FEES: AN ECONOMIC ANALYSIS

MICHAEL A. DOVER

**C**ONTINGENT PERCENTAGE FEES<sup>1</sup> represent the primary means of financing personal injury litigation in the United States.<sup>2</sup> Under a contingent percentage fee contract, a client pays his attorney a specified percentage of any recovery obtained.<sup>3</sup> However, the attorney receives no compensation if the litigation proves unsuccessful.<sup>4</sup>

After discussing the development of contingent percentage fees in personal injury litigation,<sup>5</sup> this comment examines the arguments supporting<sup>6</sup> and opposing<sup>7</sup> con-

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<sup>1</sup> Contingent percentage fees are defined as:

[A]n arrangement between attorney and client whereby attorney agrees to represent client with compensation to be a percentage of the amount recovered; e.g. 25% if case is settled, 30% if case goes to trial. Frequently used in personal injury actions. Such fees are often regulated by court rule or statute depending upon the type of action and amount of recovery.

BLACK'S LAW DICTIONARY 553 (5th ed. 1979). The essential distinction between a contingent fee and a certain fee is that payment of a contingent fee is conditioned upon the success of the litigation; i.e. if there is no recovery then the attorney receives no fee. F. MACKINNON, *CONTINGENT FEES FOR LEGAL SERVICES* 3 (1964). Contingent percentage fees are frequently referred to as "contingent fees," however, this comment will use the term "contingent percentage fee" to distinguish this fee from other contingent fees, such as a contingent hourly fee.

<sup>2</sup> Clermont & Currivan, *Improving on the Contingent Fee*, 63 CORNELL L. REV. 529, 531 n.2 (1978). See also F. MACKINNON, *supra* note 1, at 116; Franklin, Chanin & Mark, *Accidents, Money, and the Law: A Study of the Economics of Personal Injury Litigation*, 61 COLUM. L. REV. 1, 22 (1961).

<sup>3</sup> F. MACKINNON, *supra* note 1, at 3.

<sup>4</sup> *Id.*

<sup>5</sup> See *infra* notes 10-58 and accompanying text.

<sup>6</sup> See *infra* notes 59-119 and accompanying text.

tingent percentage fees. Following this examination, several proposed alternatives to contingent percentage fees are critically analyzed.<sup>8</sup> Finally, this comment concludes that the current percentage fee system is acceptable, however, steps should be taken to ensure that potential clients have sufficient information to make an informed decision concerning the choice of an attorney.<sup>9</sup>

## I. THE DEVELOPMENT OF CONTINGENT PERCENTAGE FEES

### A. *English Practice*<sup>10</sup>

Although contingent percentage fees are frequently employed to finance personal injury litigation in the United States, other countries have not embraced contingent percentage fees. For example, contingent percentage fees are permitted in neither Great Britain,<sup>11</sup> nor the English Commonwealth nations.<sup>12</sup> However, in Canada, contingent percentage fees are permitted in all provinces except Ontario.<sup>13</sup> Moreover, West Germany<sup>14</sup> and Spain<sup>15</sup> are the only civil law countries which permit con-

<sup>7</sup> See *infra* notes 123-160 and accompanying text.

<sup>8</sup> See *infra* notes 161-251 and accompanying text.

<sup>9</sup> See *infra* notes 252-262 and accompanying text.

<sup>10</sup> The English legal system strongly influenced the American legal system. A discussion of the English treatment of percentage fees is necessary for a thorough understanding of American practice. See Minish, *The Contingent Fee a Re-examinae*, 10 MANITOBA. L.J. 65, 67 (1979).

<sup>11</sup> *Id.* at 68. See also Thomas, *Contingent Fees: A Case Study for Malaysia*, 10 ANGLO-AM. L. REV. 37, 43-52 (1981); Comment, *Judicial Regulation of Contingent Fee Contracts*, 48 J. AIR L. & COM. 151, 153 (1982) [hereinafter cited as Comment, *Contingent Fee Contracts*]; Comment, *Are Contingent Fees Ethical Where Client Is Able to Pay a Retainer*, 20 OHIO ST. L.J. 329, 334-36 (1959) [hereinafter cited as Comment, *Are Contingent Fees Ethical*].

<sup>12</sup> See Note, *The Contingent Fee: Disciplinary Rule, Ethical Consideration, or Free Competition?*, 1979 UTAH L. REV. 547, 555 n.47.

<sup>13</sup> Kritzer, *Fee Arrangements and Fee Shifting: Lessons From the Experience in Ontario*, 47 LAW & CONTEMP. PROBS. 125, 130 (1984). One distinction between contingent percentage fee contracts in the United States and those in Canada is that Canadian courts may review contingent fee arrangements. *Id.* at 130 n.22.

<sup>14</sup> White, *Contingent Fees: A Supplement to Legal Aid?* 41 MOD. L. REV. 286, 290-91 (1978).

<sup>15</sup> Comment, *Are Contingent Fees Ethical*, *supra* note 11, at 336.

tingent percentage fees.

The long-standing English prohibition of contingent percentage fees results from the medieval doctrines of maintenance,<sup>16</sup> champerty,<sup>17</sup> and barratry.<sup>18</sup> Contingent percentate fees violate the doctrines of maintenance and champerty because the attorney is "maintaining" the client until an award is received,<sup>19</sup> and the attorney is contracting to receive a share of the proceeds of the litigation.<sup>20</sup> In addition, the English have traditionally viewed litigation as undesirable.<sup>21</sup> Thus, English opposition to contingent percentage fees probably results from their desire to discourage litigation.

Another reason contingent percentage fees have not been accepted in Great Britain is the widespread availability of publicly financed legal aid.<sup>22</sup> Legal aid provides im-

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<sup>16</sup> Maintenance is defined as "maintaining, supporting, or promoting the litigation of another." BLACK'S LAW DICTIONARY 859 (5th ed. 1979). The doctrine of maintenance arose during the thirteenth and fourteenth centuries as a means to remedy abuses in the feudal system. F. MACKINNON, *supra* note 1, at 36. See also Radin, *Maintenance by Champerty*, 24 CALIF. L. REV. 48, 64 (1935). Maintenance was prohibited by the Statute of Westminster I in 1275. 3 Edw. I, ch. 25, at 53. This statute sought to prevent powerful feudal lords from injecting themselves into controversies to which they were not parties. F. MACKINNON, *supra* note 1, at 36. The prohibition of maintenance was not originally directed at lawyers, but was intended as a means of reestablishing royal control over the nobility. *Id.* at 36-37.

<sup>17</sup> Champerty is defined as "[a] bargain by a stranger with a party to a suit, by which such third person undertakes to carry on the litigation at his own cost and risk, in consideration of receiving, if successful, a part of the proceeds or subject to be covered." BLACK'S LAW DICTIONARY 209 (5th ed. 1979).

<sup>18</sup> Barratry is the solicitation by non-parties, of persons to engage in litigation. F. MACKINNON, *supra* note 1, at 37.

<sup>19</sup> Minish, *supra* note 10, at 68.

<sup>20</sup> *Id.*

<sup>21</sup> Radin, *supra* note 16, at 66. Radin states that clerical opposition to litigation, particularly secular litigation, together with the feudal system and resistance to capitalism formed the background for the development of the doctrines of maintenance and champerty. *Id.* at 65-66.

<sup>22</sup> Corboy, *Contingency Fees: The Individual's Key to the Courthouse Door*, LITIGATION, Summer 1976, at 27, 32. The English legal aid system pays the legal fees of both parties in an estimated fifty percent of all serious cases. *Id.* "The system compensates attorneys at government expense, to the extent of 90 percent of their non-assisted fees for office consultation and litigation in cases in which the party being represented is indigent in the sense that financing a lawsuit would be burdensome." *Id.* A legal aid committee examines the claimant's financial situation and the merits of the complaint in an attempt to eliminate frivolous lawsuits. *Id.*

poverished plaintiffs with an opportunity to obtain legal representation.<sup>23</sup> Contingent percentage fees serve a similar function in the United States and Canada, by allowing plaintiffs to shift the risk of loss to their attorney<sup>24</sup> and by allowing the plaintiff to pay his attorney from the proceeds of any recovery.<sup>25</sup> For example, in Manitoba, Legal Aid will not handle personal injury cases if representation is available on a contingent percentage fee basis.<sup>26</sup> Similarly, in the United States most local legal assistance programs refuse to handle cases for which representation could be obtained on a contingent percentage basis.<sup>27</sup> Thus, the availability of legal aid in Great Britain allows the British bar to continue to prohibit contingent percentage fees without having to face the possibility of impoverished plaintiffs being unable to obtain legal representation.<sup>28</sup>

#### B. *Contingent Percentage Fees in the United States*

American legal practice has been strongly influenced by English legal traditions,<sup>29</sup> so it is not surprising that several American states initially prohibited contingent percentage fees.<sup>30</sup> However, a number of states, including

<sup>23</sup> *Id.* But see White, *supra* note 14, at 287 (the income limits for legal aid are so low that many individuals with moderate incomes are prohibited from bringing suit in the absence of insurance or trade union support). See also Thomas, *supra* note 11, at 51 (the vast majority of British citizens do not benefit from legal aid).

<sup>24</sup> See *supra* notes 72-77 and accompanying text.

<sup>25</sup> Minish, *supra* note 10, at 71. "The contingent fee is the normal and usual method of compensation for the American lawyer representing a plaintiff in a personal injury action. . . . In England it is normal and usual for the compensation arrangements to be made under the Legal Aid Scheme." Youngwood, *The Contingent Fee — A Reasonable Alternative?*, 28 MOD. L. REV. 330 (1965).

<sup>26</sup> Minish, *supra* note 10, at 71.

<sup>27</sup> *Id.* See also Youngwood, *supra* note 25, at 335 (legal aid will generally not accept cases which may be handled by private attorneys on a contingent fee basis).

<sup>28</sup> See Youngwood, *supra* note 25, at 334. See also Corboy, *supra* note 22, at 32 (a comprehensive legal aid system is necessary to mitigate the harsh effects resulting from a ban on contingent percentage fees).

<sup>29</sup> See *supra* note 10.

<sup>30</sup> See, e.g., *Lafferty v. Jelly*, 22 Ind. 471, 473-74 (1864) (fifty percent contingent percentage fee in a collection suit is champertous); *Roberts v. Yancey*, 94 Ky. 243, 21 S.W. 1047 (1893) (contingent percentage fee contract is champertous and unenforceable in a suit on a note); *Hinckley v. Giberson*, 129 Me. 308, 151 A. 542,

Alabama,<sup>31</sup> California,<sup>32</sup> New Jersey,<sup>33</sup> Ohio,<sup>34</sup> and Texas<sup>35</sup> never prohibited contingent percentage fees. Additionally, the United States Supreme Court explicitly approved contingent percentage fee contracts in *Wyle v. Coxe*,<sup>36</sup> *Taylor v. Bemiss*,<sup>37</sup> and *Stanton v. Embrey*.<sup>38</sup> The American Bar Association ("ABA") officially recognized the validity of contingent percentage fee contracts with the adoption of Canon 13 of the Code of Professional Ethics in 1908.<sup>39</sup> Contingent percentage fee contracts are enforceable in all fifty states,<sup>40</sup> with Maine the last state to recognize the validity of such contracts in the mid-1960s.<sup>41</sup> Many members of the American Bar view contingent percentage fees unfavorably,<sup>42</sup> and, at best, contingent percentage fees have received grudging approval as

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543 (1930) (one-third contingent percentage fee disallowed in a suit in equity); *Backus v. Byron*, 4 Mich. 535 (1857) (a contingent percentage fee was disallowed in a ejectment proceeding); *Butler v. Legro*, 62 N.H. 350, 352 (1882) (an agreement which provides that an attorney is to recover \$1000 regardless of the amount of time spent on the case is champertous); *Wallis v. Laubat*, 2 Denio 607, 607-08 (N.Y. 1845) (a contingent percentage fee disallowed in a suit to compel specific performance).

<sup>31</sup> *Ex parte Wilkinson*, 220 Ala. 529, 126 So. 102, 106 (1930) (an attorney's lien to collect a contingent fee is enforceable in equity).

<sup>32</sup> *In re Cohen's Estate*, 66 Cal. App.2d 450, 152 P.2d 485, 489 (1944) (California never adopted the common law doctrines of maintenance and champerty).

<sup>33</sup> *Hughes v. Eisner*, 8 N.J. Super. 351, 72 A.2d 901, 902 (1950) (New Jersey courts rejected the doctrines of maintenance and champerty as early as 1792).

<sup>34</sup> *Reese v. Kyle*, 49 Ohio St. 475, 31 N.E. 747 (1892) (a fifty percent contingent fee for a suit to collect a debt was held not to be champertous).

<sup>35</sup> *Bentinck v. Franklin*, 38 Tex. 458, 471 (1873) (there is no law forbidding champerty in Texas, therefore, contingent fees are not prohibited).

<sup>36</sup> 56 U.S. (15 How.) 415, 418-20 (1853) (plaintiff's attorney permitted to recover a five percent contingent fee).

<sup>37</sup> 110 U.S. 42, 46 (1884) (fifty percent contingent fee is not extortionate).

<sup>38</sup> 93 U.S. 548, 566-67 (1876) (approved contingent percentage fee in a case involving a claim against the United States).

<sup>39</sup> As originally adopted, Canon 13 provided: "Contingent fees where sanctioned by law, should be under the supervision of the court, in order that clients may be protected from unjust charges." CANONS OF PROFESSIONAL ETHICS, CANON 13, 33 ABA REP. 80, 579 (1908), quoted in DEFENSE RESEARCH INSTITUTE, A STUDY OF CONTINGENT FEES IN THE PROSECUTION OF PERSONAL INJURY CLAIMS 7 (1966).

<sup>40</sup> DEFENSE RESEARCH INSTITUTE, *supra* note 39, at 8.

<sup>41</sup> ME. REV. STAT. ANN. tit. 17-A, § 516 (1983) (validity of contingent percentage fee recognized by excluding contingent fee percentage fee contracts from the definition of champerty).

<sup>42</sup> Youngwood, *supra* note 25, at 333.

a "necessary evil."<sup>43</sup>

Several reasons have been suggested to explain why American jurisdictions have declined to follow the English practice with respect to contingent percentage fees. Perhaps the most frequently cited rationale for American acceptance of contingent percentage fees is that the industrial revolution created a new class of industrial accident victims who had a need for effective legal representation.<sup>44</sup> Without contingent percentage fees, many industrial laborers would have had insufficient financial resources to obtain counsel to represent them in their personal injury actions against large, industrial defendants.<sup>45</sup> However, this argument fails to explain the distinction between American and English practice, since the industrial revolution presumably created a similar class of accident victims in both Great Britain and the United States.<sup>46</sup>

Another rationale offered to explain the acceptance of contingent percentage fees in the United States is that litigation is not disfavored in the United States.<sup>47</sup> Litigation,

<sup>43</sup> *Id.* Youngwood states:

Despite its widespread use in the United States the contingent fee is, nevertheless, viewed in many if not most American quarters as a necessary evil. As a general rule it is — if it might be so phrased — the lower class of lawyers, rather than the acknowledged leaders of the Bar, whose practice is mainly on a contingent fee basis. It is not really clear whether the contingent fee in America is looked at with some disdain by the elite of the profession because of something inherent in that form of compensation or because the professional elite look down upon being a plaintiff's tort lawyer, and it is as a plaintiff's tort lawyer from which most contingent fees arise.

*Id.* at 333-34.

<sup>44</sup> Comment, *Contingent Fee Contracts*, *supra* note 11, at 156.

<sup>45</sup> Corboy, *supra* note 22, at 30. "[T]he contingent fee contract developed as a tool of law practice in direct response to the industrial revolution and the transportation boom, which visited on our working-class ancestors a previously unknown incidence of industrial injury and death." *Id.*

<sup>46</sup> See *Id.* at 30-31. Corboy suggests that the American Bar is more democratic and more responsive to a broader range of clients than its English counterpart. *Id.*

<sup>47</sup> See Hughes, *The Contingent Fee Contract in Massachusetts*, 43 B. U. L. REV. 1, 6 (1963) (litigation is not a vice when the claim is supported by law). See also *Zauderer v. Office of Disciplinary Counsel*, 105 S. Ct. 2265 (1985). In *Zauderer* the court stated:

at best, is considered to be a necessary evil in Great Britain<sup>48</sup> and as such is discouraged.<sup>49</sup> In the United States, litigation is not considered a social evil,<sup>50</sup> and a majority of Americans favor a legal system which provides an aggrieved party access to the judicial system.<sup>51</sup> Because contingent percentage fees aid clients in obtaining financing and representation of counsel,<sup>52</sup> contingent percentage fees have received approval by the American Bar as a means of providing access to the judicial system.<sup>53</sup>

Contingent percentage fees are widely employed in the United States and play a major role in financing a large variety of litigation.<sup>54</sup> In addition to the traditional use of contingent percentage fees by plaintiff's attorneys in personal injury litigation, contingent percentage fees are employed in stockholder derivative suits,<sup>55</sup> antitrust suits,<sup>56</sup> and worker's compensation cases.<sup>57</sup> In addition, contingent percentage fees are occasionally used by defense attorneys.<sup>58</sup>

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There is no cause for consternation when a person who believes in good faith and on the basis of accurate information regarding his legal rights that he has suffered a legally cognizable injury turns to the courts for a remedy: "we cannot accept the notion that it is always better for a person to suffer a wrong silently than to redress it by legal action."

*Id.* at 2278, quoting *Bates v. State Bar of Arizona*, 433 U.S. 350, 376 (1977).

<sup>48</sup> Minish, *supra* note 10, at 71.

<sup>49</sup> Radin, *supra* note 16, at 68. The English view is based upon the medieval and Christian position that litigiousness is a vice and litigation should be avoided whenever possible. *Id.*

<sup>50</sup> F. MACKINNON, *supra* note 1, at 41.

<sup>51</sup> See Hughes, *supra* note 47, at 6.

<sup>52</sup> See Corboy, *supra* note 22, at 28-29. See *infra* notes 59-67 and accompanying text for a discussion of how contingent percentage fees aid a plaintiff in financing litigation.

<sup>53</sup> See Comment, *Contingent Fee Contracts*, *supra* note 11, at 155.

<sup>54</sup> See F. MACKINNON, *supra* note 1, at 4; Comment, *Of Ethics and Economics: Contingent Percentage Fees for Legal Services*, 16 AKRON L. REV. 747 (1983).

<sup>55</sup> See, e.g., *Marine Midland Trust Co. v. Forty Wall Street Corp.*, 13 A.D.2d 118, 213 N.Y.S.2d 689 (1961).

<sup>56</sup> See, e.g., *International Travel Arrangers, Inc. v. Western Airlines, Inc.*, 623 F.2d 1255 (8th Cir. 1980).

<sup>57</sup> See, e.g., *Thatcher v. Indust. Comm.*, 115 Utah 568, 207 P.2d 178 (1949).

<sup>58</sup> See Comment, *Toward a Valid Defense Contingent Fee Contract: A Comparative Analysis*, 67 IOWA L. REV. 373 (1982); Annot., 9 A.L.R. 4TH 191 (1981).

## II. THE CASE FOR CONTINGENT PERCENTAGE FEES

Perhaps the strongest argument in favor of contingent percentage fees is that contingent percentage fees provide plaintiffs with an affordable means of prosecuting their claims.<sup>59</sup> Without contingent percentage fees, a plaintiff of modest means might be unwilling or unable to employ an attorney to protect his legal rights.<sup>60</sup> Additionally, many attorneys are reluctant to handle a case, particularly a personal injury case, on an hourly fee basis unless the plaintiff has sufficient assets to guarantee payment of the attorney's fees.<sup>61</sup> Under a contingent percentage fee system, a claimant with a legitimate claim generally will have few problems in obtaining representation.<sup>62</sup>

Judge Richard Posner of the United States Court of Appeals for the Seventh Circuit argues that the contingent percentage fee enables litigants to protect their claims by permitting lawyers to loan their services to the claimant in exchange for a share of the claim.<sup>63</sup> Although it is frequently argued that contingent percentage fees are excessive,<sup>64</sup> the contingent percentage fee must be higher than the hourly fee for the services, because the contingent percentage fee compensates the attorney for both the legal services rendered and for the loan value of those services.<sup>65</sup> The percentage (in effect, the interest rate on

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<sup>59</sup> Corboy, *supra* note 22, at 28.

<sup>60</sup> Cf. R. POSNER, *ECONOMIC ANALYSIS OF LAW* 448 (2d ed. 1977) (where the costs of litigation are high, the plaintiff may be unable to finance the litigation himself. Contingent percentage fees enable the plaintiff to prosecute his claim by loaning the plaintiff the lawyer's services necessary to the action).

<sup>61</sup> See generally Corboy, *supra* note 22, at 34.

<sup>62</sup> *Merritt v. Faulkner*, 697 F.2d 761, 769-71 (7th Cir. 1983) (Posner, J. dissenting). Judge Posner dissented from the appointment of counsel to represent a prisoner in a personal injury suit. Posner states "that a prisoner who has a good damages suit should be able to hire a competent lawyer and that by making the prisoner go this route we subject the probable merit of his case to the test of the market." *Id.* at 769.

<sup>63</sup> R. POSNER, *supra* note 60, at 448.

<sup>64</sup> See *infra* notes 126-137 and accompanying text.

<sup>65</sup> R. POSNER, *supra* note 60, at 448-49.

the loan of the services)<sup>66</sup> is high because the risk of default is considerably higher than with ordinary loans.<sup>67</sup> Thus, contingent percentage fees provide an effective means for plaintiffs to obtain legal representation.

Additionally, without representation by counsel, an injured plaintiff is in an inferior bargaining position in seeking compensation from the defendant.<sup>68</sup> This is particularly true when the plaintiff has suffered an injury which significantly reduces his earning capacity, and the defendant is a large corporation.<sup>69</sup> Under such circumstances, effective representative by counsel is a necessity if the plaintiff is to deal at arms length with the corporate defendant.<sup>70</sup> Contingent percentage fees provide plaintiffs with a means of obtaining effective counsel to mitigate the effects of the plaintiff's inferior bargaining position.<sup>71</sup>

All litigation involves some risk of failure.<sup>72</sup> Contingent percentage fees arguably enable risk averse plaintiffs to proceed with litigation by shifting the risk of loss from the client to the attorney, because the attorney will lose the

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<sup>66</sup> *Id.*

<sup>67</sup> *Id.* However, it may be argued that this "interest rate" is excessive since there is little risk of default in many personal injury cases. Comment, *supra* note 54, at 751.

<sup>68</sup> Corboy, *supra* note 22, at 28.

<sup>69</sup> *Id.* Corboy states:

The theory is that, in most instances, the plaintiff sues specifically because he is unable to continue leading his life in the same manner as he did before the incident which injured him. In that situation, he is less likely than at any other time in his life to be able to afford to retain and pay legal counsel on an hourly basis. He must obtain representation without a requirement that he pay for it out of already depleted resources. Without counsel, he is unable to overcome the usually superior bargaining position of the defendant and may go uncompensated or settle his claim for far less than would be awarded to him in court.

*Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Id.* at 33. "[T]here is a cogent argument that, absent the contingent fee, a great many plaintiffs with inadequate financial resources would be forced by defendants employing purposeful delay to settle for very small sums in cases in which they would stand an excellent chance of full compensation in court." *Id.*

<sup>72</sup> See generally R. POSNER, *supra* note 60, at 448.

value of his services if the litigation is unsuccessful.<sup>73</sup> An attorney will accept a case only if he determines that the expected recovery<sup>74</sup> is greater than the anticipated expenses of the litigation.<sup>75</sup> An experienced attorney is in a better position than the plaintiff to determine if the expected recovery exceeds the expected litigation expenses.<sup>76</sup> Thus, a risk averse plaintiff is more likely to prosecute his claim on a contingent percentage fee basis, because the plaintiff is not required to risk his personal assets.<sup>77</sup>

By shifting the risk of loss to the attorney,<sup>78</sup> contingent percentage fees tend to discourage the filing of frivolous lawsuits.<sup>79</sup> An attorney working under a contingent percentage fee contract presumably will not accept a case unless he believes that he can make a profit from that case,

<sup>73</sup> Schwartz & Mitchell, *An Economic Analysis of the Contingent Fee in Personal-Injury Litigation*, 22 STAN L. REV. 1125 (1970). Some contingent percentage fee contracts do not entirely shift the risk of loss to the attorney by requiring the plaintiff to pay litigation expenses (e.g., filing fees, deposition costs). *Id.* However, many attorneys do not attempt to collect these expenses unless the litigation is successful. Clermont & Currivan, *supra* note 2, at 572 n.118.

<sup>74</sup> Expected recovery equals the potential award discounted for the probability of success. Clermont & Currivan, *supra* note 2, at 564 n.84. The expected recovery represents the value of the claim. R. POSNER *supra* note 60, at 448.

<sup>75</sup> See Schwartz & Mitchell, *supra* note 73, at 1153. The costs of litigation to the attorney include the direct expenses (e.g. filing fees) as well as the opportunity cost of the attorney's time. *Id.* The opportunity cost of the attorney's time represents the amount the attorney could earn working on another project. *Id.* at 1134. Thus, the revenue from other projects which the attorney must forego in order to accept the personal injury case represents an important consideration for the attorney. *Id.* at 1133-36.

<sup>76</sup> Clermont & Currivan, *supra* note 2, at 572.

<sup>77</sup> See Corboy, *supra* note 22, at 27.

<sup>78</sup> See *supra* note 73 and accompanying text.

<sup>79</sup> Clermont & Currivan, *supra* note 2, at 571. Clermont & Currivan state: "since [the] contingency makes [the attorney's] fee depend on the outcome, the lawyer would shy away from any case with a probability of success so low that it makes the case a poor investment." *Id.* In addition, contingent percentage fees increase the attorney's influence over actions brought by the client. Under an hourly fee, the burden of screening the merits of the claim is placed more heavily upon the client, who is not as capable as an attorney of determining the merits of a claim. *Id.* at 571-72. See also Corboy, *supra* note 22, at 32. Corboy states: "the actual result of using the contingent fee is more probably that meritorious but difficult suits will have to be declined than that groundless actions will be brought." *Id.*

that is, the attorney's percentage of the expected recovery exceeds the expected litigation expenses.<sup>80</sup> Contingent percentage fees will not prevent the filing of nuisance suits,<sup>81</sup> however, attorneys have an ethical responsibility to avoid bringing vexatious litigation.<sup>82</sup>

Freedom of contract is another argument supporting contingent percentage fees.<sup>83</sup> The right of autonomous individuals to contract on whatever terms they agree upon is a basic premise of the free enterprise system.<sup>84</sup> Generally, freedom to contract allows individuals to enter into agreements which are beneficial to the individual.<sup>85</sup> This is particularly true when the contract is negotiated by parties in a competitive market.

In a competitive market,<sup>86</sup> an efficient allocation of re-

<sup>80</sup> See Schwartz & Mitchell, *supra* note 73, at 1153 for a hypothetical example of cases an attorney will accept using economic analysis.

<sup>81</sup> Nuisance suits are defined as unmeritorious cases brought with the intention of securing a settlement from the defendant since "the defendant's unrecoverable attorney fees could run higher than the amount the plaintiff will accept to settle the case." Rowe, *Predicting the Effects of Attorney Fee Shifting*, 47 LAW & CONTEMP. PROBS. 139, 150 (1984). See also Clermont & Currivan, *supra* note 2, at 573 (no evidence that contingent fees encourage nuisance suits).

<sup>82</sup> MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-109 (1982). DR 2-109 states:

(A) A lawyer shall not accept employment on behalf of a person if he knows it is obvious that such a person wishes to: . . .

(2) Present a claim or defense in litigation that is not warranted under existing law, unless it can be supported by good faith argument for an extension, modification, or reversal of the existing law.

*Id.* A detailed discussion of an attorney's ethical duty to decline frivolous cases is beyond the scope of this comment. For a detailed discussion see Cann, *Frivolous Lawsuits — The Lawyer's Duty to Say "No"*, 52 U. COLO. L. REV. 367 (1981). The most efficient fee system for avoiding frivolous lawsuits would be a fee recoupment system similar to the one employed in Great Britain, since, defendants would be able to recover their attorney fees from the unsuccessful plaintiff. See *infra* notes 207-208 and accompanying text.

<sup>83</sup> See generally, Note, *Contingent Fee Contracts: Validity, Controls, and Enforceability*, 47 IOWA L. REV. 942, 943 (1962).

<sup>84</sup> See M. FRIEDMAN & R. FRIEDMAN, *FREE TO CHOOSE* 20-21 (1979) (voluntary exchange is a prerequisite for the free enterprise system to function properly).

<sup>85</sup> *Id.* at 5. "[I]f an exchange between two parties is voluntary, it will not take place unless both believe they will benefit from it." *Id.*

<sup>86</sup> The economic model of perfect competition, with its assumptions of (1) a large number of firms, (2) a perfectly homogeneous product, (3) perfect mobility of all resources, and (4) perfect knowledge by all market participants, C. FERGUSON & S. MAURICE, *ECONOMIC ANALYSIS THEORY AND APPLICATION* 278-79 (1978),

sources will be achieved when individuals are permitted to reach mutually acceptable agreements.<sup>87</sup> Since each market participant acts in his self interest, resources are allocated to the person who values the goods or services most highly.<sup>88</sup> In order for a market to operate competitively, several conditions must be met. First, there must be a sufficiently large number of competitors in the market so that

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represents a theoretical abstraction from reality. D. GREER, *INDUSTRIAL ORGANIZATION & PUBLIC POLICY* 43 (1980). Greer offers the concept of "workable competition" and a set of operational standards by which the market may be judged.

*Structural Norms*

1. The number of traders should be at least as large as scale economies permit.
2. There should be no artificial inhibitions on mobility and entry.
3. Where appropriate, there should be moderate and price-sensitive quality differentials in the products offered.
4. Buyers should be well informed about prices, quality, and other relevant data.

*Conduct Criteria*

5. Some uncertainty should exist in the minds of rivals as to whether price initiatives will be followed.
6. Firms should strive to achieve their goals independently, without collusion.
7. There should be no unfair, exclusionary, predatory, or coercive tactics.
8. Inefficient suppliers and customers should not be shielded permanently.
9. Sales promotion should not be misleading.
10. Persistent, harmful price discrimination should be absent.

*Performance Criteria*

11. Firms' production operations should be efficient.
12. Promotional expenses should not be excessive.
13. Profits should be at levels just sufficient to reward investment, efficiency, and innovation.
14. Output levels and the range of qualities should be responsive to consumer demands.
15. Opportunities for introducing technically superior new products and processes should be exploited.
16. Prices should not intensify cyclical instability or inflation.
17. Success should accrue to sellers who best serve consumer wants.

*Id.* at 46-47. This comment uses the more reasonable standard of "workable competition" rather than the theoretical perfect competition in analyzing the competitiveness of the legal market for personal injury litigation.

<sup>87</sup> Cf. M. FRIEDMAN & R. FRIEDMAN, *supra* note 84, at 5-19.

<sup>88</sup> A free market directs goods or services to those persons who value the goods or services at the market price or higher. Individuals who value the goods or services at less than the market price will purchase other products which they value more highly. For a detailed discussion of the role of the price system see C. FERGUSON & S. MAURICE, *supra* note 86, at 123-68.

no one competitor dominates the market.<sup>89</sup> Second, sellers must be offering a reasonably similar or homogeneous product or service.<sup>90</sup> Third, new buyers and sellers must be able to enter the market, and established market participants must be able to exit the market.<sup>91</sup> Finally, consumers must have sufficient information about the price and quality of the goods or services offered by sellers in order to make an informed decision.<sup>92</sup>

Applying the above described model to the legal market, the first requirement is satisfied as there are many attorneys in the United States who handle personal injury litigation. Second, each personal injury attorney offers a similar service, although there are variations in the quality of the services rendered.<sup>93</sup> Additionally, it is possible for attorneys to enter or exit from personal injury practice depending upon what the attorney believes to be in his best interest.<sup>94</sup> There are no artificial barriers to entry in personal injury practice imposed by bar associations or governments.<sup>95</sup>

The lack of adequate information concerning the legal market presents a problem.<sup>96</sup> This lack of information is usually manifested in one of two situations: (1) potential clients are unable to determine which lawyer is competent

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<sup>89</sup> *Id.* at 278.

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> The existence of quality differentials in attorney services points out the need for greater consumer information about the personal injury market. *See infra* notes 100-111 and accompanying text.

<sup>94</sup> There are barriers to entry to the legal profession as a whole, such as the requirements that attorneys be graduates from an ABA approved law school and pass a state bar examination. However, there are no restrictions on entry into personal injury practice *per se*. For a discussion of the effects of occupational licensing on the price system see M. FRIEDMAN, *CAPITALISM AND FREEDOM* 137-160 (1962).

<sup>95</sup> However, an attorney may not hold himself out to the public as a specialist unless he meets the requirements established by the state bar for specialists. *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-105 (A)(3) (1982).

<sup>96</sup> *See* Schuck, *Consumer Ignorance and Legal Advertising*, 43 *INS. COUNS. J.* 568 (1976); Grady, *Some Ethical Questions About Percentage Fees*, *LITIGATION*, Summer 1976, at 20, 25-26.

to handle their case,<sup>97</sup> and (2) potential clients overestimate the cost of seeking legal assistance, and this overestimation leads individuals to seek legal counsel to a lesser extent than if they had reliable fee information.<sup>98</sup> One survey suggests that lack of adequate information regarding the price and quality of legal services is a major reason why people do not seek legal advice.<sup>99</sup>

The adequacy of information provided to consumers affects the efficiency of the legal market.<sup>100</sup> Efficiency is rewarded only if the efficiency is made known to the public.<sup>101</sup> If consumers of legal services do not have adequate information about the price and quality of legal services, then they may pay more than necessary for legal services.<sup>102</sup> Additionally, the lack of market information may place consumers in an inferior bargaining position with attorneys, because the consumer may be unaware that the same service is available elsewhere at a lower price.<sup>103</sup>

Advertising provides an effective means of conveying market information to consumers.<sup>104</sup> Prior to the United States Supreme Court's holding in *Bates v. State Bar of Arizona*,<sup>105</sup> advertising by lawyers was strictly prohibited.<sup>106</sup>

<sup>97</sup> Schuck, *supra* note 96, at 568.

<sup>98</sup> *Id.* Schuck argues that the organized bar's responses to the information problem, lawyer referral services and use of lawyer lists, such as the Martindale-Hubbell Legal Directory, have been largely ineffective, since these sources do not supply the consumer with a significantly greater amount of information. *Id.* at 568-69.

<sup>99</sup> *Id.* at 568. Eighty percent of those surveyed by the American Bar Foundation thought that many people do not seek legal advice because of the difficulty of indentifying competent lawyers. *Id.*

<sup>100</sup> *Id.* at 569.

<sup>101</sup> *Id.*

<sup>102</sup> C. FERGUSON & S. MAURICE, *supra* note 86, at 279.

<sup>103</sup> Grady, *supra* note 96, at 25-26. Most personal injury lawyers do not inform their clients that representation is available on a basis other than a percentage basis, such as a certain hourly fee. *Id.*

<sup>104</sup> See *Bates v. State Bar of Arizona*, 433 U.S. 350, 374 (1977) (advertising provides consumers with at least some relevant information necessary to reach an informed decision).

<sup>105</sup> 433 U.S. 350 (1977).

<sup>106</sup> *In re R.M.J.*, 455 U.S. 191, 193 (1982).

In *Bates*, the Court held the First Amendment guarantees attorneys the right to advertise routine legal services.<sup>107</sup> Following *Bates*, the ABA enacted DR 2-101 which lists twenty five categories of information which attorneys are permitted to advertise.<sup>108</sup> The Supreme Court has recently held that all attorney advertising which is not misleading is entitled to First Amendment protection,<sup>109</sup> calling into question the continued validity of the advertising restrictions listed in DR 2-101.<sup>110</sup> Thus, the recent availability of advertising has provided consumers with significantly greater information about the price and quality of legal services.<sup>111</sup>

It is frequently argued that contingent percentage fees result in plaintiff's attorneys receiving excessive fees.<sup>112</sup> If contingent percentage fees result in excessive fees, then this is evidence that consumers have insufficient market information.<sup>113</sup> If attorney's fees are greater than equilibrium rate and there is adequate market information,<sup>114</sup> then an attorney could increase his profits by lowering his fee, because the attorney would attract more clients by publicizing his lower fee.<sup>115</sup> However, the attorney's prof-

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<sup>107</sup> *Bates*, 433 U.S. at 367-68.

<sup>108</sup> MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-101(b)(1-25) (1982). The Model Code permitted attorneys to advertise contingent fee rates. *Id.* at D.R. 2-101(b)(22).

<sup>109</sup> *In re R.M.J.*, 455 U.S. at 203. For a discussion of regulation of attorney advertising see Stoltenberg & Whitman, *Direct Mail Advertising by Lawyers*, 45 U. PITT. L. REV. 381 (1984); Note, *In re R.M.J. : The Scope of Lawyer Advertising Expands*, 1983 UTAH L. REV. 99.

<sup>110</sup> See *Zauderer v. Office of Disciplinary Counsel*, 105 S. Ct. 1165, 2280-84 (1985) (use of accurate and not misleading illustrations in lawyer advertising is protected commercial speech under the First Amendment).

<sup>111</sup> See *supra* notes 104-109 and accompanying text.

<sup>112</sup> See *infra* notes 126-137 and accompanying text.

<sup>113</sup> Adequate market information is a requirement for the efficient functioning of a competitive market. See *supra* notes 96-103 and accompanying text.

<sup>114</sup> The equilibrium price is the price established by the interaction of market supply and demand in a competitive market. R. DORFMAN, *PRICES AND MARKETS* 23-25 (1978).

<sup>115</sup> See C. FERGUSON & S. MAURICE, *supra* note 86, at 46-49. "When price is above the equilibrium price, quantity supplied exceeds quantity demanded. The resulting excess supply induces sellers to reduce price in order to sell the surplus." *Id.* at 49.

its would not increase unless consumers are able to learn about the lower fee.<sup>116</sup> Thus, the availability of adequate market information plays a key role in the efficient functioning of the legal market.

The majority of the arguments favoring contingent percentage fees focus the advantages resulting from the contingent nature of the fee.<sup>117</sup> Thus, these arguments would apply equally to any contingent fee, including a contingent hourly fee<sup>118</sup> or a combination contingent hourly-percentage fee.<sup>119</sup>

### III. THE CASE AGAINST CONTINGENT PERCENTAGE FEES

Objections to contingent percentage fees may be broken down into two categories. Objections may be made to either the contingent or the percentage nature of the fee.

#### A. *Objections Based on Contingent Nature of the Fee*

"Overreaching" by the attorney in setting the fee is one problem resulting from the contingent nature of the fee.<sup>120</sup> Because the percentage is set in advance of the trial or settlement and is contingent on recovery, the plaintiff may not carefully consider the size of the fee.<sup>121</sup> However, this problem could be alleviated by the free market if consumers have enough information to allow the plaintiff to choose an attorney who charges a reason-

<sup>116</sup> Schuck, *supra* note 96, at 569. "The market only rewards efficiency if the efficient can make their efficiency known to consumers." *Id.*

<sup>117</sup> Those arguments favoring contingent percentage fees which emphasize the contingent nature of the fee are: (1) providing plaintiffs of moderate resources access to the legal system, (2) shifting risk of loss to the attorney, and (3) discouraging the filing of frivolous lawsuits. See Clermont & Currivan, *supra* note 2, at 569-73.

<sup>118</sup> See *infra* notes 181-187 and accompanying text for a discussion of contingent hourly fees.

<sup>119</sup> See *infra* notes 188-206 and accompanying text for a discussion of the proposed contingent hourly-percentage fee.

<sup>120</sup> Clermont & Currivan, *supra* note 2, at 569.

<sup>121</sup> *Id.*

able fee.<sup>122</sup>

Another frequently encountered argument against the contingent nature of fees is that the speculative nature of contingent fees downgrades the legal profession to a mere business.<sup>123</sup> It is argued that contingency fees cause the attorney to abandon his role as a counselor and assume the position of a partner in the litigation.<sup>124</sup> These arguments ignore the realities of modern legal practice. An attorney is engaged in a business; attorneys practice law not only to provide a service to the public but also to make money.<sup>125</sup>

### B. *Arguments Based on the Percentage Nature of the Fee*

The strongest argument against percentage fees is that percentage fees may be excessive under some circumstances.<sup>126</sup> Attorneys are prohibited from charging a "clearly excessive fee."<sup>127</sup> A fee is considered clearly ex-

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<sup>122</sup> See *supra* notes 86-111 and accompanying text. If the legal market was competitive, competing suppliers (attorneys) would bid the percentage down to the equilibrium price. See *supra* notes 111-118 and accompanying text.

<sup>123</sup> Clermont & Currihan, *supra* note 2, at 570. These arguments are based upon the medieval view of attorneys as public servants and of attorney's fees as a voluntary honorarium. See Comment, *Are Contingent Fees Ethical*, *supra* note 11, at 334-35.

<sup>124</sup> See White, *supra* note 14, at 292. White argues that it is not necessarily bad for an attorney to have an interest in the outcome of litigation since the client retains an attorney in order to win. If providing the attorney with an interest aids the client in obtaining victory, then the practice is beneficial. *Id.* at 292-93.

<sup>125</sup> See *Id.* at 291. "Any attempt to deny the commercial aspects of the practice of law in 1978 must be condemned as unreal. No longer can it be pretended that fees are mere honoraria for a service to justice. Lawyers are in business and run their practices in the main as businesses." *Id.*

<sup>126</sup> See Grady, *supra* note 96, at 24-25.

<sup>127</sup> MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-106 (1982). DR 2-106 provides eight factors which should be considered in determining if a fee is reasonable:

- (1) The time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly.
- (2) The likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer.
- (3) The fee customarily charged in the locality for similar legal services.

cessive when "a lawyer of ordinary prudence would be left with a definite and firm conviction that the fee is in excess of a reasonable fee."<sup>128</sup>

The Arizona Supreme court recently held a contingent percentage fee contract to be a "clearly excessive fee" suspended the attorney for six months.<sup>129</sup> The attorney agreed to represent the plaintiff for a contingent percentage fee of thirty-three percent.<sup>130</sup> The defendant's insurance company agreed to settle for the full policy limit and the attorney was not required to file a lawsuit.<sup>131</sup> The at-

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- (4) The amount involved and the results obtained.
  - (5) The time limitations imposed by the client or by the circumstances.
  - (6) The nature and length of the professional relationship with the client.
  - (7) The experience, reputation, and ability of the lawyer or lawyers performing the services.
  - (8) Whether the fee is fixed or contingent.

*Id.*

Rule 1.5 of the Model Rules of Professional Conduct requires a lawyer's fee to be reasonable. The reasonableness of the fee is to be determined by reference to the same factors as listed above. The official comments to Rule 1.5 suggest that an attorney should provide the client with alternative fee arrangements if there is any doubt concerning the appropriateness of a contingent fee. MODEL RULES OF PROFESSIONAL CONDUCT RULE 1.5 (1983). The Model Rules were adopted by the ABA in 1983 to replace the Model Code. The Model Code is important, however, since the disciplinary rules of most states are based upon the Model Code provisions. As of this writing five states have adopted the Model Rules.

<sup>128</sup> MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-106 (1982). A number of courts have held that trial courts must consider the factors enumerated in DR 2-106 and Rule 1.5 in determining the reasonableness of an attorney's fee. *See, e.g.,* Shutts v. Phillips Petroleum Co., 235 Kan. 195, 679 P.2d 1159, 1182 (1984) (factors listed in DR 2-106 are to be considered in determining reasonable attorney's fees in a class action suit); *Murphy v. Grisham*, 625 S.W.2d 215, 217 (Mo. App. 1981) (trial court required to consider factors similar to those contained in the code); *Alan D. Nicholson, Inc. v. Cannon*, 674 P.2d 506, 508 (Mont. 1984) (factors enumerated in DR-2-106 are to be considered, although other factors may also be considered); *Pyle v. Pyle*, 11 Ohio App.3d 31, 403 N.E.2d 98, 104 (1983) (factors listed in the code of professional responsibility are to be applied in determining if attorney fees are reasonable); *Ewell v. Ewell*, 279 S.C. 601, 310 S.E.2d 436, 438 (1983) (factors similar to those listed in DR 2-106 are to be considered in determining reasonableness); *Adams v. Mellen*, 618 S.W.2d 485, 489 (Tenn. App. 1981) (listed several factors similar to those contained in the code which must be considered in determining reasonableness).

<sup>129</sup> *In re Swartz*, 141 Ariz. 266, 689 P.2d 1236 (1984).

<sup>130</sup> *Id.* at 1239.

<sup>131</sup> *Id.*

torney received one-third of the plaintiff's total recovery (\$50,000) as compensation under the contract.<sup>132</sup> The Arizona Supreme Court held this fee "clearly excessive" because (1) there was no contingency (liability was admitted);<sup>133</sup> (2) the damages were limited to the policy limits;<sup>134</sup> (3) Swartz was not required to file a lawsuit to force the settlement;<sup>135</sup> and (4) the policy limits were known almost immediately.<sup>136</sup> The court concluded that an attorney has a duty to reduce a percentage fee to a reasonable percentage and to collect no more than a reasonable amount in light of the time and effort he devoted to the case.<sup>137</sup>

The Colorado Supreme Court recently suspended an attorney for six months for charging a "clearly excessive fee" in *People v. Nutt*.<sup>138</sup> In *Nutt*, the attorney entered into a contract under which his compensation was based upon a percentage of any oil and gas royalties received by his client.<sup>139</sup> The court held that the attorney violated Disciplinary Rule 2-106 because the attorney's services were valued at no more than \$18,272.78 during his period of employment, even though the attorney was willing to accept as much as \$200,000 as compensation under the terms of the fee arrangement.<sup>140</sup> Thus, the court concluded that there was no relation between the services provided by the attorney and the fee charged.<sup>141</sup>

It is argued that contingent percentage fees are frequently excessive in disaster litigation in which an attorney represents several plaintiffs.<sup>142</sup> An attorney's fixed costs in representing one plaintiff are high. However, be-

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<sup>132</sup> *Id.* at 1240.

<sup>133</sup> *Id.* at 1243.

<sup>134</sup> *Id.*

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> *Id.* at 1244.

<sup>138</sup> 696 P.2d 242 (Colo. 1984).

<sup>139</sup> *Id.* at 244.

<sup>140</sup> *Id.* at 248.

<sup>141</sup> *Id.* at 243.

<sup>142</sup> Grady, *supra* note 96, at 21-22.

cause in disaster litigation, many of the legal and factual issues are the same for a number of potential plaintiffs, an attorney's marginal costs in representing each additional plaintiff is low.<sup>143</sup> Thus, because the attorney charges the same percentage fee to each plaintiff, a potential for excessive profits exists.<sup>144</sup>

A related argument against percentage fees is that percentage fees "measure poorly both the cost to the lawyer and the value to the client of the legal services rendered."<sup>145</sup> Under a percentage fee contract, the extent of the client's injuries determines the attorney's fee.<sup>146</sup> The amount of time expended by the attorney does not enter into the calculation of the fee.<sup>147</sup>

Unquestionably, percentage fees are generally higher than hourly fees.<sup>148</sup> This higher fee essentially has two components: (1) a risk premium, that is the attorney must be compensated for assuming the risk of failure;<sup>149</sup> and (2) interest on the loan of the attorney's services.<sup>150</sup> Additionally, if the legal market is competitive, and if attorney fees are excessive, then additional attorneys can be expected to enter into personal injury practice and drive down the percentage charged.<sup>151</sup> However, because increased market entry has not been observed, either the fees charged by personal injury attorneys are not exces-

<sup>143</sup> *Cf. id.* (In disaster litigation, the same general facts will apply to each plaintiff's, case thus, the attorney's costs are unlikely to be increased substantially by representing additional plaintiffs).

<sup>144</sup> *Id.* For example, if cases are accepted on a one-third contingency, then the attorney will receive one-third of the award to each accident victim he represents. The attorney's costs will not be substantially increased by the additional plaintiffs, thus the attorney's profits from the litigation will be increased.

<sup>145</sup> Clermont & Currihan, *supra* note 2, at 573.

<sup>146</sup> Grady, *supra* note 96, at 21.

<sup>147</sup> The formula for contingent percentage fees is  $F = XS$ ; where F is the attorney's fee, X is the percentage, and S is the settlement or award.

<sup>148</sup> See R. POSNER, *supra* note 60, at 448.

<sup>149</sup> *Id.* at 448-49.

<sup>150</sup> *Id.* It is also argued that the percentage fee is a better estimate of the actual cost of the litigation than is an hourly fee because an hourly fee considers only the value of the attorney's time, and does not take risk into account. See *supra* notes 63-67 and accompanying text.

<sup>151</sup> See *supra* note 115.

sive or consumers have insufficient information to determine that legal services are available at lower prices.<sup>152</sup>

Additionally, some critics contend that contingent percentage fees result in a conflict between the economic interests of the attorney and those of the client.<sup>153</sup> Because the attorney's compensation is *not* a function of the number of hours worked,<sup>154</sup> the attorney has an incentive to reach a reasonable settlement as quickly as possible.<sup>155</sup> Similarly, because the client is not required to compensate the attorney on an hourly basis, the client will want the attorney to work the number of hours necessary to maximize his recovery.<sup>156</sup> This conflict of interest occurs because percentage fees fail to take the attorney's time into account in determining the fee; the size of the fee is entirely determined by the size of the client's recovery.<sup>157</sup>

Additionally, other critics contend that contingent percentage fees result in larger awards by juries.<sup>158</sup> This argument states that juries tend to give higher awards because it is commonly perceived by jurors that a substan-

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<sup>152</sup> See *supra* notes 96-103 and accompanying text.

<sup>153</sup> Clermont & Currivan, *supra* note 2, at 534.

<sup>154</sup> See Schwartz & Mitchell, *supra* note 73, at 1133-34. The attorney's fee is equal to the percentage times the recovery.

<sup>155</sup> Clermont & Currivan, *supra* note 2, at 543-46. Every case has a maximum value regardless of how many hours an attorney works. Schwartz & Mitchell, *supra* note 73, at 1129. The recovery increases rapidly with the first few hours the attorney works, however, as the maximum value is approached, the amount of increase declines. *Id.* at 1130, figure 1. An attorney employed on a percentage basis maximizes his profits at the point where his share of the recovery exceeds his usual hourly fee by the largest amount. Clermont & Currivan, *supra* note 2, at 544, figure 3.

<sup>156</sup> Clermont & Currivan, *supra* note 2, at 536. Clermont and Currivan state:

Because the client's net recovery varies directly with the gross recovery, and because the client must pay a fixed percentage fee without regard to the number of hours worked, the client's economic interests are best served when the lawyer devotes a very large number of hours to ensure the maximum settlement or judgment. However, . . . the lawyer optimizes his own economic position by working a much smaller number of hours; direct economic incentive prods him to obtain a respectable settlement with relatively slight effort, thus securing for himself the maximum profit.

*Id.*

<sup>157</sup> Grady, *supra* note 96, at 21.

<sup>158</sup> Thomas, *supra* note 11, at 42.

tial portion of the plaintiff's recovery will go to the payment of attorney's fees.<sup>159</sup> There is, however, no empirical evidence to support the argument that contingent percentage fees lead to inflated awards by juries.<sup>160</sup>

#### IV. PROPOSED ALTERNATIVES TO CONTINGENT PERCENTAGE FEES

Several proposed alternatives to the customary contingent percentage fee are examined in this section. The relative advantages and disadvantages of each proposed alternative will also be examined.

##### A. *Non-Contingent Hourly Fees*

An obvious alternative to contingent percentage fees are hourly fees which are not contingent upon the outcome of the litigation.<sup>161</sup> Hourly fees are commonly employed in commercial litigation and in defending personal injury actions because most commercial clients are able to pay for legal services on an hourly basis. However, personal injury plaintiff's attorneys seldom employ hourly fees, because many personal injury plaintiffs are unable to guarantee payment on noncontingent hourly basis.<sup>162</sup>

The principal advantage of non-contingent hourly fees is that such fees base the attorney's fee upon the number of hours the attorney has actually worked.<sup>163</sup> An hourly fee avoids the problems resulting from having the fee dependent upon the size of the award, rather than the efforts of the attorney.<sup>164</sup> Additionally, it is frequently argued

<sup>159</sup> *Id.* Thomas states: "[I]n the USA juries are said to recognize that a substantial part of any award must be paid to the lawyer and compensate by increasing the amount of their award." *Id.*

<sup>160</sup> Kalven, *The Jury, the Law, and the Personal Injury Damage Award*, 19 OHIO ST. L. J. 158, 176-77 (1958).

<sup>161</sup> Clermont & Currivan, *supra* note 2, at 532-33.

<sup>162</sup> F. MACKINNON, *supra* note 1, at 4.

<sup>163</sup> See Clermont & Currivan, *supra* note 2, at 568. The formula for computing an hourly fee is  $F=WH$ , where  $F$  is the amount of the fee,  $W$  is the attorney's hourly rate, and  $H$  is the number of hours worked. *Id.* at 547-50.

<sup>164</sup> See *supra* notes 153-157 and accompanying text for a discussion of the problems associated with the computation of percentage fees.

that hourly fees more accurately reflect the cost of the attorney's services than percentage fees.<sup>165</sup> However, this argument ignores two elements of the percentage fee, the risk premium and the interest feature.<sup>166</sup> Thus, it is an unanswered question whether hourly fees actually represent a more accurate reflection of the cost of the attorney's services.<sup>167</sup>

The principal disadvantage of hourly fees in personal injury litigation is that such fees may discourage risk averse individuals from seeking legal counsel.<sup>168</sup> The client assumes the entire risk of loss when litigation is conducted on a hourly fee basis.<sup>169</sup> Many accident victims would be unable to afford to retain counsel on an hourly fee basis because they may have incurred significant medical expenses and may face a reduced earnings potential.<sup>170</sup> In addition, risk averse clients may be unwilling to face this risk of loss.<sup>171</sup> Moreover, attorneys generally seek assurance of payment before agreeing to perform

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<sup>165</sup> See Clermont & Currivan, *supra* note 1, at 577. An hourly fee provides a good measure of the cost to the attorney of providing the services, although it provides an imperfect measure of the value of the attorney's services to the client, since the results of the litigation also enter into the client's valuation of the attorney's services. *Id.* It is sometimes argued that the size of the plaintiff's recovery should not be considered in determining the attorney's fee since the amount of the recovery is largely the fortuitous result of the extent of the plaintiff's injuries. Grady, *supra* note 96, at 21-23.

<sup>166</sup> R. POSNER, *supra* note 60, at 448-49.

<sup>167</sup> See *supra* notes 63-67 and accompanying text.

<sup>168</sup> Clermont & Currivan, *supra* note 2, at 567.

<sup>169</sup> *Id.* Under a non-contingent hourly fee the plaintiff assumes the risk of loss because if the litigation is unsuccessful, the client must pay his attorney for services rendered.

<sup>170</sup> See Corboy, *supra* note 22, at 28. Corboy argues that an injured plaintiff is unlikely to be able to afford an hourly fee since "he [the client] is unable to continue leading his life in the same manner as he did before the accident which injured him." *Id.*

<sup>171</sup> Schwartz & Mitchell, *supra* note 73, at 1150. "Particularly for clients with low financial resources, the risk of losing money after already having sustained the initial injury may prevent them from pursuing the case." *Id.* Corboy suggests that non-contingent hourly fees result in most clients basing their decisions on the prospects of having to pay the attorney regardless of the outcome. Corboy, *supra* note 22, at 34. See also Clermont & Currivan, *supra* note 2, at 567 n.92 (arguments concerning availability of legal services to the poor apply equally to risk averse clients).

any services, and many accident victims have inadequate financial resources to provide such an assurance.<sup>172</sup> Thus, an hourly fee is not as effective as a contingent fee<sup>173</sup> in providing access to the legal system for lower and middle income claimants.<sup>174</sup>

Another problem associated with hourly fees is that an economic conflict of interest may exist between the attorney and client.<sup>175</sup> This conflict of interest presents the opposite situation from the conflict described for contingent percentage fees.<sup>176</sup> Because the attorney's fee increases by equal increments with each hour worked, the attorney is indifferent as to the number of hours he should work.<sup>177</sup> However, the client wants the attorney to work only the number of hours necessary to maximize his net recovery.<sup>178</sup> The client's net recovery is maximized when the difference between the gross recovery and the attorney's fee is greatest.<sup>179</sup> Since the attorney's fee is based solely on the number of hours worked, the attorney does not have a direct economic incentive to work the number of

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<sup>172</sup> Clermont & Currivan, *supra* note 2, at 567 (poor clients, even if willing to accept the risk of loss, may have insufficient resources to provide the attorney with assurance of payment).

<sup>173</sup> The term contingent fee is used generically to include any fee which is dependent upon the attorney securing a recovery for the client.

<sup>174</sup> See *supra* notes 59-77 and accompanying text.

<sup>175</sup> Clermont & Currivan, *supra* note 2, at 534-35. Clermont & Currivan identify two potential conflicts of interest: (1) The attorney may not have a direct economic incentive to work for the client's victory since the attorney's fee is unrelated to the outcome of the case, and (2) the lawyer does not have an incentive to work the number of hours necessary to maximize the client's recovery since the lawyer's profits may be maximized by working a different number of hours. *Id.* at 534. Both of these potential conflicts exist under a certain hourly fee arrangement. In contrast with a contingent fee, the attorney has a direct economic incentive to work for the client's victory.

<sup>176</sup> See *supra* notes 153-157 and accompanying text. Under a contingent percentage fee arrangement the attorney has an incentive to work fewer hours than desired by the client.

<sup>177</sup> See Clermont & Currivan, *supra* note 2, at 542-43. Since the attorney receives the same amount for each hour worked, he has no direct incentive to work the number of hours required to maximize the client's net recovery. *Id.*

<sup>178</sup> *Id.* at 540-42.

<sup>179</sup> *Id.* at 542. At the point where the client's net recovery is maximized, an additional hour of work by the attorney would increase the recovery by an amount equal to the attorney's fee. *Id.*

hours desired by the client.<sup>180</sup>

### B. *Contingent Hourly Fees*

A contingent hourly fee is an hourly fee, the payment of which is conditioned upon the outcome of the case.<sup>181</sup> A contingent hourly fee retains those advantages of the contingent percentage fee which result from the contingent nature of the fee.<sup>182</sup> Additionally, a contingent hourly fee retains the major benefit of non-contingent hourly fees; the time actually expended by the attorney enters into the calculation of the fee.<sup>183</sup>

The major disadvantage associated with contingent hourly fees is that this fee arrangement is rarely offered by attorneys.<sup>184</sup> Additionally, the problems of overreaching<sup>185</sup> and promotion of speculation by attorneys,<sup>186</sup> inherent in any contingent fee are also present with the contingent hourly fee. Moreover, the same economic conflict of interest present in non-contingent hourly fees still exists because the attorney does not have a direct economic incentive to work the number of hours necessary to maximize the client's net recovery.<sup>187</sup>

### C. *Contingent Hourly-Percentage Fee*

Professors Clermont and Currivan propose a hybrid fee

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<sup>180</sup> *Id.* at 543.

<sup>181</sup> Schwartz & Mitchell, *supra* note 73, at 1125. An attorney working on a contingent hourly basis would charge a risk premium and an interest charge for the loan of the attorney's services. See R. POSNER, *supra* note 60, at 448-49.

<sup>182</sup> Specifically, the contingent nature of the fee would allow the plaintiff to shift the risk of loss to the attorney and thus would not discourage lower income plaintiffs from seeking legal counsel. See *supra* notes 59-71 and accompanying text.

<sup>183</sup> See *supra* notes 163-167 and accompanying text.

<sup>184</sup> See Kritzer, *supra* note 13, at 130. "One would be hard pressed in the United States to find a lawyer who would accept a contingency arrangement for an hourly fee calculation." *Id.*

<sup>185</sup> See *supra* notes 123-125 and accompanying text.

<sup>186</sup> See *supra* notes 175-180 and accompanying text. The attorney has an incentive to work the number of hours necessary for the client to prevail, since the attorney receives no fee if the client receives no recovery. See Clermont & Currivan, *supra* note 2, at 534-35.

<sup>187</sup> Clermont & Currivan, *supra* note 2, at 534.

arrangement, the contingent hourly-percentage fee,<sup>188</sup> designed to eliminate many of the problems associated with both the contingent percentage and hourly fees.<sup>189</sup> The contingent hourly-percentage fee would be computed by taking the sum of (1) the attorney's hourly rate times the number of hours worked and (2) "a percentage . . . of the amount by which the gross recovery exceeds that time charge."<sup>190</sup> For example, if the gross settlement is \$25,000, the attorney's usual hourly fee is fifty dollars, the attorney worked thirty hours, and the applicable percentage is ten percent, then the attorney's fee would be \$3850.<sup>191</sup>

The contingent hourly-percentage fee combines the advantages of both hourly<sup>192</sup> and percentage fees.<sup>193</sup> Accordingly, the contingent hourly-percentage fee provides a good measure of both the costs to the lawyer of providing the service and of the value of the attorney's services to the client.<sup>194</sup> The hourly component of the fee provides a good estimate of the cost to the attorney because it represents the attorney's opportunity cost in providing

<sup>188</sup> *Id.* at 537.

<sup>189</sup> *Id.* at 598. Clermont & Currivan argue that:

This contingent hourly-percentage fee largely solves the problem of economic conflict of interest between lawyer and client, a problem that exists under both the certain hourly fee and the contingent percentage fee. It also solves or minimizes many of the other problems associated with these two basic fee systems. Because of its contingency the proposed fee facilitates access by the poor to legal services. Moreover, it measures well the cost to the lawyer and the value to the client of the legal services rendered — certainly better than does either a pure hourly or a pure percentage fee.

*Id.*

<sup>190</sup> *Id.* at 549. The contingent hourly-percentage fee may be expressed mathematically as  $F = WH + X(S - WH)$  where  $F$  equals the fee,  $W$  is the attorney's hourly fee,  $H$  is the number of hours worked,  $X$  is the applicable percentage, and  $S$  is the gross settlement.

<sup>191</sup>  $(50 \times 30) + .10(25,000 - (50 \times 30)) = \$3850$ .

<sup>192</sup> See *supra* notes 163-167 and accompanying text for a discussion of the advantages of hourly fees.

<sup>193</sup> See *supra* notes 59-118 and accompanying text for a discussion of the advantages of percentage fees.

<sup>194</sup> Clermont & Currivan, *supra* note 2, at 578-79.

the service.<sup>195</sup> The percentage feature measures the value to the client, which is the amount recovered.<sup>196</sup>

Additionally, the contingent hourly-percentage fee reduces the economic conflict of interest between the attorney and client.<sup>197</sup> The attorney has an incentive to work the number of hours which will maximize his profit,<sup>198</sup> while the client wants the attorney to work the number of hours that maximize his net recovery.<sup>199</sup> The attorney's profit will be maximized when his marginal revenue (the increase in fee from working one additional hour)<sup>200</sup> equals the marginal cost (the hourly rate) of working an additional hour.<sup>201</sup> The client's net recovery is maximized when the difference between the gross recovery and the attorney's fee is greatest.<sup>202</sup> Under contingent hourly percentage fee arrangements, these figures tend to coincide.<sup>203</sup>

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<sup>195</sup> The opportunity cost represents what must be given up in order to produce the services. See R. DORFMAN, *supra* note 114, at 74-75. This comment will assume that the opportunity cost of the lawyers services is the lawyer's usual hourly rate.

<sup>196</sup> Clermont & Currivan, *supra* note 2, at 569.

<sup>197</sup> *Id.* at 598.

<sup>198</sup> *Id.* at 598-99. The attorney's profits are maximized when the difference between the fee provided by the contingent hourly-percentage fee and the attorney's hourly fee is greatest. *Id.*

<sup>199</sup> *Id.* at 541-42. The client's net recovery is maximized when the difference between the gross recovery and the attorney's fee is greatest. *Id.*

<sup>200</sup> See *id.* at 549 n.47.

<sup>201</sup> Marginal cost is defined as the change in cost when one additional unit (e.g. one additional hour of lawyer services) is produced. See C. FERGUSON & S. MAURICE, *supra* note 86, at 240.

<sup>202</sup> See *supra* note 199.

<sup>203</sup> Clermont & Currivan, *supra* note 2, at 550. Table I provides a hypothetical example demonstrating the superiority of the proposed contingent hourly-percentage fee in aligning the economic interests of the attorney and the client. Table I assumes a claim in which the maximum recovery is \$10,000. Additionally, the attorney's usual hourly fee is \$50. Under a contingent hourly fee, the client's net recovery is maximized when the attorney works fifteen hours, while the attorney's profit is maximized by working seventeen hours. Under a contingent percentage fee arrangement of thirty-three percent, the client's net recovery is maximized when the maximum recovery is obtained, thus the client is indifferent as to the number of hours the attorney works. However, the attorney's profits are maximized when he works thirteen hours. The contingent hourly fee has the same problem as the non-contingent hourly fee, the attorney's profit is maximized when he works seventeen hours, the client's net recovery is maximized when the attorney works thirteen or fourteen hours. Under the contingent hourly-percent-

TABLE I

HR	S	HRF	NR	33%	P	NR	CH	NR	CHP	P	NR
1	0	50	-50	0	-50	0	0	0	0	-50	0
2	0	100	-100	0	-100	0	0	0	0	-100	0
3	0	150	-150	0	-150	0	0	0	0	-150	0
4	0	200	-200	0	-200	0	0	0	0	-200	0
5	2500	250	2250	825	575	1675	500	2000	475	225	2025
6	4600	300	4300	1518	1218	3082	600	4000	730	430	3870
7	6400	350	6050	2112	1762	4288	700	5700	905	555	5495
8	7300	400	6900	2409	2009	4891	800	6500	1090	690	6210
9	8100	450	7650	2673	2223	5427	900	7200	1215	765	6885
10	8800	500	8300	2904	2404	5896	1000	7800	1330	830	7470
11	9300	550	8750	3069	2519	6231	1100	8300	1425	875	7875
12	9600	600	9000	3168	2568	6432	1200	8400	1500	900	8100
13	9800	650	9150	3234	2584	6566	1300	8500	1560	915	8235
14	9900	700	9200	3267	2567	6633	1400	8500	1620	920	8280
15	9960	750	9210	3287	2537	6673	1500	8460	1671	921	8289
16	10000	800	9200	3300	2500	6700	1600	8400	1720	920	8280
17	10000	850	9150	3300	2450	6700	1700	8300	1765	915	8235

Legend: HR=hours worked; S=settlement or award; HRF=usual hourly fee(\$50); NR=client's net recovery (S-attorney's fee); P=attorney's profit (attorney's fee-attorney's usual hourly fee [attorney's opportunity cost]); CH=contingent hourly fee (\$100, includes risk of loss from unsuccessful litigation); CHP=contingent hourly-percentage fee.

The chief disadvantage of the contingent hourly-percentage fee is the difficulty in implementing such a scheme.<sup>204</sup> Clermont and Curriven recognize this difficulty when they state that the proposed fee would probably have to be introduced in court-awarded attorney's fees.<sup>205</sup> Additionally, the proposed fee contains some of the same disadvantages as any contingent fee such as "overreaching" and making the attorney a partner in the litigation.<sup>206</sup>

#### D. *Fee Shifting*

Fee shifting, or requiring the defeated party to pay the attorneys fees of the prevailing party, has been suggested as an alternative to contingent percentage fees.<sup>207</sup> In the United States, the prevailing party is generally not entitled to recover his attorney's fees from the losing party.<sup>208</sup> "The United States is virtually alone among the industrialized democracies in having as its basic rule that each side pays its own lawyer, win or lose."<sup>209</sup> For example, in Great Britain the defeated party pays the attorney fees in-

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age fee, both the client's net recovery and the attorney's profits are maximized when the attorney works fifteen hours. Thus, the contingent hourly-percentage fee best aligns the economic interests of the attorney and the client because both parties want the attorney to work the same number of hours.

<sup>204</sup> Contingent percentage fees have been the traditional method of financing personal injury litigation and it is unlikely that the plaintiff's bar would adopt the contingent hourly-percentage fee voluntarily. Clermont & Currivan suggest that the new fee be implemented by bar associations or by courts. Clermont & Currivan, *supra* note 2, at 584.

<sup>205</sup> *Id.* at 384 n.185.

<sup>206</sup> See *supra* notes 120-125 and accompanying text.

<sup>207</sup> See Corboy, *supra* note 22, at 33-34.

<sup>208</sup> See *Alyeska Pipeline Co. v. Wilderness Society*, 421 U.S. 240, 247 (1975) (prevailing party is not entitled to recover attorney fees in the absence of a statutory authorization or unless an exception to the American Rule, such as bad faith, is applicable). See Leubsdorf, *Toward a History of the American Rule on Attorney Fee Recovery*, 47 LAW & CONTEMP. PROBS. 9 (1984) for a discussion of the development of the American rule. For discussion of the exceptions to the American Rule see Comment, *Theories of Recovering Attorney's Fees: Exceptions to the American Rule*, 47 UMKC L. REV. 566 (1979).

<sup>209</sup> Rowe, *supra* note 81, at 139.

curred by the prevailing party.<sup>210</sup>

Two types of fee shifting systems are currently employed.<sup>211</sup> A "two-way" fee shifting system requires the losing party to pay the attorney fees of the prevailing party.<sup>212</sup> An example of a "two-way" fee shifting system is that employed in Great Britain.<sup>213</sup> Alternatively, a "one-way" system, which favors one party to the litigation may be used.<sup>214</sup> Frequently, these "one-way" fee shifting arrangements favor plaintiffs, that is, only the defeated defendant must pay the prevailing plaintiff's attorney's fees.<sup>215</sup> The Texas Deceptive Trade Practices Act<sup>216</sup> provides an example of a one-way fee shifting system.<sup>217</sup>

"Two-way" fee shifting tends to discourage the filing of nuisance suits.<sup>218</sup> Fee shifting discourages nuisance litigation because the plaintiff is liable for the defendant's attorney's fees if the litigation is unsuccessful.<sup>219</sup> Additionally, a defendant would have an incentive to litigate nuisance claims, because he could recover his litigation expenses from the unsuccessful plaintiff.<sup>220</sup>

Additionally, fee shifting encourages plaintiffs to bring small, meritorious cases.<sup>221</sup> These small claims might not

<sup>210</sup> See Pfennigstorf, *The European Experience with Attorney Fee Shifting*, 47 LAW & CONTEMP. PROBS. 37 (1984).

<sup>211</sup> Rowe, *supra* note 81, at 140-41.

<sup>212</sup> *Id.* at 141. Great Britain employs a "two-way" fee shifting arrangement. Additionally, Alaska has adopted a general "two-way" fee shifting scheme. ALASKA R. CIV. P. 82. See Comment, *Award of Attorney's Fees in Alaska: An Analysis of Rule 82*, 4 UCLA-ALASKA L. REV. 129 (1974) for a discussion of the effects of fee shifting in Alaska.

<sup>213</sup> See Corboy, *supra* note 22, at 31.

<sup>214</sup> Rowe, *supra* note 81, at 141.

<sup>215</sup> See, e.g., TEX. BUS. & COM. CODE ANN. § 17.50(d) (Vernon Supp. 1985) (Under Texas Deceptive Trade Practices-Consumer Protection Act, a prevailing consumer is entitled to recover reasonable attorney's fees). However, "one-way" fee shifts systems could favor defendants rather than plaintiffs. Rowe, *supra* note 81, at 141 n.8.

<sup>216</sup> TEX. BUS. & COMM. CODE ANN. §§ 17.41-17.62 (Vernon Supp. 1985).

<sup>217</sup> *Id.* § 17.50(d).

<sup>218</sup> Rowe, *supra* note 81, at 150-53.

<sup>219</sup> *Id.* at 151.

<sup>220</sup> *Id.*

<sup>221</sup> *Id.* at 148-49. *Contra* Corboy, *supra* note 22, at 34 (fee shifting would discourage claimants from bringing meritorious suits).

be prosecuted otherwise, because the plaintiff's attorney's fees may exceed the recovery.<sup>222</sup> In fact, the enforcement of small claims is one rationale offered for "one-way" fee shifting statutes.<sup>223</sup>

The major disadvantage of fee shifting lies in its effect upon the claims of individuals with moderate incomes.<sup>224</sup> "Two-way" shifting provides both an incentive and disincentive to the plaintiff.<sup>225</sup> The prospect of an undiluted recovery serves as an incentive to the plaintiff,<sup>226</sup> while the risk of suffering a considerably larger loss provides a strong disincentive.<sup>227</sup> For example, a potential plaintiff might be deterred from filing suit against a large corporate defendant, such as General Motors, if the plaintiff fears paying the defendant's substantial legal fees. Although there is no clear empirical evidence demonstrating which of these two effects is stronger,<sup>228</sup> fee shifting would probably deter moderate income individuals from pressing their claims.<sup>229</sup>

### E. *Statutory Regulation*

The regulation of percentage fees by statute or court rule offers another possible alternative to contingent per-

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<sup>222</sup> See Rowe, *supra* note 81, at 149 n.47. "Two-way" shifting would allow the plaintiff to press small strong claims since the plaintiff could recover his litigation expenses from the defendant. *Id.* at 149.

<sup>223</sup> *Id.* at 149 n.42. See also TEX. BUS & COM. CODE ANN. § 17.50(d) (Vernon Supp. 1985).

<sup>224</sup> Rowe, *supra* note 81, at 153. It is frequently asserted that fee shifting deters individuals with reasonable, but not clearly meritorious, claims since a risk of substantial loss exists if the litigation is unsuccessful. *Id.*

<sup>225</sup> *Id.*

<sup>226</sup> *Id.* The chief advantage of fee shifting is that it provides the plaintiff with an undiluted recovery. Corboy, *supra* note 22, at 33-34.

<sup>227</sup> Rowe, *supra* note 81, at 153.

<sup>228</sup> See Pfennigstorf, *supra* note 210, at 76-77 (careful studies comparing the effects of the American Rule and European fee shifting have not been conducted).

<sup>229</sup> Rowe, *supra* note 81, at 153. Two factors contribute to this effect. First, moderate income individuals are generally risk averse. Second, fee shifting shifts the risk of loss from the attorney (as is the case with contingent fees) to the client. *Id.* See also Kritzer, *supra* note 13, at 133-38 (survey indicates that the effect of fee shifting in Ontario is to discourage litigation).

centage fees.<sup>230</sup> The twenty-five percent limitation imposed by the Federal Tort Claims Act<sup>231</sup> provides an example of a legislatively imposed fee restriction, while the adjustable scale found in New Jersey Court Rule 1:27-7(c) illustrates limitation of fees by court rule.<sup>232</sup> Both approaches demonstrate attempts by bar associations, legislative bodies, and the courts to prevent attorneys from charging excessive fees.<sup>233</sup>

Neither of these limitations offers an economically attractive alternative to contingent percentage fees.<sup>234</sup> Fee ceilings do little to reduce the problems associated with percentage fees.<sup>235</sup> Additionally, a fee ceiling which sets attorney's fees below market rates will have the effect of discouraging attorneys from accepting certain cases.<sup>236</sup> An attorney is unlikely to accept a case unless his fee

<sup>230</sup> Schwartz & Mitchell, *supra* note 73, at 1144-45.

<sup>231</sup> 28 U.S.C. § 2678 (1982). Section 2678 provides:

No attorney shall charge, demand, receive, or collect for services rendered, fees in excess of 25 per centum of any judgment rendered pursuant to section 1346(b) of this title, or . . . in excess of 20 per centum of any award, compromise, or settlement made pursuant to section 2672 of this title.

*Id.* This statute places a *ceiling* on fees; courts are not required to award these percentages. See, e.g., Schwartz v. United States, 381 F.2d 627, 630 (3d Cir. 1967).

<sup>232</sup> N.J. Ct. R. 1:21-7(c), *reprinted in* American Trial Lawyers Ass'n v. New Jersey Supreme Court, 66 N.J. 258, 330 A.2d 350, 351 n.3 (1974). Rule 1:21 7(c) states:

In any matter where a client's claim for damages is based upon the alleged tortious conduct of another, including products liability claims, and the client is not a subrogee, an attorney shall not contract for, charge, or collect a contingent fee in excess of the following limits:

- (1) 50% on the first \$1000 recovered;
- (2) 40% on the next \$2000 recovered;
- (3) 33 1/3 % on the next \$47,000 recovered;
- (4) 20% on the next \$50,000 recovered;
- (5) 10% on any amount recovered over \$100,000.

N.J. Ct. R. 1:21-7(c).

<sup>233</sup> Grady, *supra* note 96, at 25.

<sup>234</sup> See Clermont & Currihan, *supra* note 2, at 593-94.

<sup>235</sup> *Id.* See *supra* notes 126-160 and accompanying text.

<sup>236</sup> Schwartz & Mitchell, *supra* note 73, at 1144. However, Schwartz and Mitchell argue that if the lowered percentage exceeds the attorney's hourly rate, then the attorney would still accept the case. *Id.* This argument ignores the risk premium component and the interest component contained in the unregulated contingent percentage. See R. POSNER, *supra* note 60, at 448-49.

equals or exceeds his hourly rate plus a risk premium and the interest on the loan of the attorney's services.<sup>237</sup> Thus, if a fee ceiling is set too low, it will be difficult for some plaintiffs to secure representation.<sup>238</sup>

An adjustable rate fee ceiling presents other problems. These fee schedules provide the largest recovery for the smallest claims.<sup>239</sup> While a large percentage may enable the plaintiff to secure representation in a small case,<sup>240</sup> these cases frequently do not require a great deal of attention from the attorney and a fifty percent share may be a clearly excessive fee.<sup>241</sup>

Additionally, maximum fees interfere with the operation of the free market.<sup>242</sup> If a one-third percentage fee is excessive, other attorneys would lower their fees to attract new clients.<sup>243</sup> Economist Milton Friedman states: "market competition, when it is permitted to work, protects the consumer better than do the alternative governmental mechanisms that have been increasingly superimposed on the market."<sup>244</sup> Thus, fee regulations deprive the market of its opportunity to work to protect the interests of both consumers and attorneys.<sup>245</sup>

#### F. *Legal Aid*

Publicly financed legal aid has been proposed as an alternative to contingent percentage fees.<sup>246</sup> Under such a legal aid system, the government would compensate the attorney for the reasonable value of his services in repre-

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<sup>237</sup> See *supra* notes 63-67 and accompanying text.

<sup>238</sup> Schwartz & Mitchell, *supra* note 73, at 1144.

<sup>239</sup> Corboy, *supra* note 22, at 36.

<sup>240</sup> Clermont & Currivan, *supra* note 2, at 594.

<sup>241</sup> See Grady, *supra* note 96, at 22.

<sup>242</sup> By imposing a price ceiling, maximum fee schedules obstruct the normal operation of the legal market. For a discussion of the effects of price ceilings on the operation of markets see C. FERGUSON & S. MAURICE, *supra* note 86, at 314-18.

<sup>243</sup> See *supra* notes 112-118 and accompanying text.

<sup>244</sup> M. FRIEDMAN & R. FRIEDMAN, *supra* note 84, at 212.

<sup>245</sup> *Id.* at 179-217. A free market has flaws, however it works better than government regulations since it allows individuals to take action to protect their interests.

<sup>246</sup> See, e.g., Minish, *supra* note 10, at 71-72.

senting an indigent client.<sup>247</sup> A legal aid system would allow indigent plaintiffs to obtain counsel to represent them, thus allowing the plaintiffs to press their claims, and satisfying one of the principle justifications for contingent percentage fees.<sup>248</sup>

The chief disadvantage of a publicly financed legal aid system is that such a system would call for a substantial expenditure by governments to provide a service which is already available through the private market.<sup>249</sup> Additionally, legal aid would have substantial administrative costs because a screening agency would be required to prevent frivolous lawsuits.<sup>250</sup> Moreover, the independence of members of the bar participating in the legal aid system would be restricted because these attorneys would become virtual employees of the government.<sup>251</sup>

## V. CONCLUSION

Although contingent percentage fees have a number of problems,<sup>252</sup> these problems can not be solved by implementing artificial restrictions on the fees which attorneys may charge. The best solution to the problems presented by percentage fees would be to provide the public with as much information as possible about the legal market.<sup>253</sup> All restrictions upon the content of attorney advertising

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<sup>247</sup> See Youngwood, *supra* note 25, at 334. For example, under the English legal aid system, the government pays ninety percent of the attorney's fees for office consultations and litigation. *Id.* See *supra* notes 22-28 and accompanying text.

<sup>248</sup> Youngwood, *supra* note 25, at 334.

<sup>249</sup> *Cf. Merritt v. Faulker*, 697 F.2d 767, 769 (7th Cir. 1983) (Posner, J. dissenting, government should not be required to appoint an attorney to prosecute a personal injury claim for a prisoner; if the prisoner's claim is meritorious, then representation is available from the private market on a contingent fee basis).

<sup>250</sup> See Youngwood, *supra* note 25, at 334. In Great Britain a Legal Aid Committee examines the applicant's financial resources and the merits of the claim in order to determine if the applicant is entitled to legal aid. *Id.*

<sup>251</sup> See Hughes, *supra* note 47, at 8 (legal aid has propelled the English Bar into a virtual "handmaiden of the welfare state", with fees from assigned cases payable from public funds).

<sup>252</sup> See *supra* notes 120-160 and accompanying text.

<sup>253</sup> See *supra* notes 83-111 and accompanying text.

should be removed.<sup>254</sup> Additionally, consumer groups and bar associations should provide consumers with as much information as possible about attorney fees and quality.<sup>255</sup> If contingent percentage fees are excessive, attorneys will have an incentive to reduce their percentage, especially if consumers have sufficient information to become aware of these reductions.<sup>256</sup> Thus, through improved market information, percentage fees could be reduced to the true market rate (if such fees are currently excessive).<sup>257</sup>

Of the proposed alternatives, the contingent hourly-percentage fee<sup>258</sup> and attorney fee shifting<sup>259</sup> warrant the greatest additional study. Despite the complicated calculations involved with the contingent hourly-percentage fee, such a fee does offer such sufficient advantages<sup>260</sup> to suggest that it should be tried, at least for court awarded fees. Fee shifting warrants further study because it requires litigants to account for the probability of success before bringing litigation.<sup>261</sup> Fee shifting would also discourage frivolous lawsuits to a greater extent than contingent percentage fees.<sup>262</sup>

The use of hourly fees for plaintiff's personal injury cases is not desirable because hourly fees may prevent some plaintiff's from obtaining adequate representation.<sup>263</sup> Additionally, the use of hourly fees does not cure the economic conflict of interest between plaintiffs con-

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<sup>254</sup> Cf. M. FRIEDMAN & R. FRIEDMAN, *supra* note 84, at 314-15 (even misleading advertising is better than no advertising or government controlled advertising). Additionally, attorneys would have an incentive not to engage in deceptive practices since this is not a sound way to develop a satisfied clientele. *Id.* at 212. Moreover, an attorney could face a malpractice suit for engaging in deceptive practice.

<sup>255</sup> Schuck, *supra* note 96, at 569.

<sup>256</sup> See *supra* notes 112-118 and accompanying text.

<sup>257</sup> See *supra* note 115.

<sup>258</sup> See *supra* notes 188-206 and accompanying text.

<sup>259</sup> See *supra* notes 207-229 and accompanying text.

<sup>260</sup> See *supra* notes 192-204 and accompanying text.

<sup>261</sup> See *supra* notes 218-229 and accompanying text.

<sup>262</sup> See *supra* notes 76-82 and accompanying text.

<sup>263</sup> See *supra* notes 168-174 and accompanying text.

tained in contingent percentage fees.<sup>264</sup> Statutory regulation is undesirable because such price ceilings may be set below market rates and thus diminish the supply of legal services.<sup>265</sup> The primary disadvantage of legal aid is its expense. Additionally, the services provided by a legal aid system are currently provided by contingent percentage fees.<sup>266</sup>

Of the proposed alternatives, fee shifting is the most likely to be adopted in the United States. However, considerable debate should be expected on the issue of whether the fee shifting system should be "one-way"<sup>267</sup> or "two-way".<sup>268</sup> Most plaintiff's lawyers probably will prefer "one-way" systems, while most defense lawyers would favor "two-way" systems.

The contingent hourly percentage fee is unlikely to be adopted due to its complicated formula. Many attorneys and clients would be adverse to a fee system employing such a complicated formula. Additionally, expanded legal aid would probably not find great support in this era of high budget deficits. Thus, the contingent percentage fee will likely continue being the dominant means of financing personal injury litigation.

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<sup>264</sup> See *supra* notes 175-180 and accompanying text.

<sup>265</sup> See *supra* notes 230-245 and accompanying text.

<sup>266</sup> See *supra* notes 246-251 and accompanying text.

<sup>267</sup> See *supra* notes 212-213 and accompanying text.

<sup>268</sup> See *supra* notes 214-217 and accompanying text.