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LITIGATING ON A CONTINGENCY: A MONOPOLY OF CHAMPIONS OR A MARKET FOR CHAMPERTY?

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Two of the most divisive issues in current debate over civil litigation are whether there should be limitations on lawyers’ contingent fees and whether losing parties should be required to pay winners’ legal expenses. Proponents of litigation reform urge both measures,¹ but opponents argue that some “reforms” would be unfair to plaintiffs and would make litigation unaffordable for most people.² However, both debates hinge on a broader issue: how and when lawyers should share the risks of litigation. This Article examines the economic and ethical implications of such risk sharing by lawyers and their clients. In particular, this Article discusses whether the market for risk sharing

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1. See Private Securities Litigation Reform Act, 15 U.S.C.A. § 77z-1(c) (West Supp. 1996) (requiring mandatory review by the court for attorney compliance with Rule 11(b) of the Federal Rules of Civil Procedure, mandatory sanctions for violation of Rule 11(b), and a presumption in favor of attorneys’ fees and costs as the sanction for failure to comply with Rule 11(b)) [hereinafter SLRA]. An earlier draft of the SLRA had gone even further in seeking to impose attorneys’ fees as a sanction for unmeritorious suits. See H.R. 1058, 104th Cong., 1st Sess. § 20B(c) (1995) (stating that a court shall award attorneys’ fees to the prevailing party if “(A) the position of the losing party was not substantially justified, (B) imposing fees and expenses on the losing party or the losing party’s attorney would be just, and (C) the cost of such fees and expenses to the prevailing party is substantially burdensome or unjust”). The SLRA requires that attorneys’ fees be a “reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class,” 15 U.S.C.A. § 77z-1(a)(6) (West Supp. 1996), and that any proposed settlement agreement disseminated to a class of shareholders shall state the attorneys’ fees applied for, including calculation of those fees on a per share basis and a brief explanation of the basis for the application. Id. § 77z-1(a)(7). Similar provisions were included in a bill in the House of Representatives, covering diversity suits and suits over products liability. See H.R. 10, 104th Cong., 1st Sess. § 101 (1995). A proposal to require losing plaintiffs to pay defendants’ legal expenses in securities lawsuits was defeated in the California March 26, 1996, primary election. See B. Drummond Ayres, Jr., Cougars and Lawyers Come out Ahead in Propositions on California Ballot, N.Y. Times, Mar. 28, 1996, at A11. For discussion of proposals to limit lawyers’ contingent fees, see infra text accompanying notes 17-20.

by lawyers is competitive and whether there are feasible alternatives to that market, such as insuring litigation costs with third parties.

Charging on a contingency is most prevalent in the personal injury arena, but has spread to antitrust litigation, shareholder derivative suits, patent litigation, mergers and acquisitions, securities litigation, and even lobbying. This practice remains unique to the

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3. Ninety-five percent of personal injury cases are taken on a contingency. Note, Settling for Less: Applying Law and Economics to Poor People, 107 HARV. L. REV. 442, 448 n.23 (1993) (citing JAMES S. KAKALIK & NICHOLAS M. PACE, COSTS AND COMPENSATION PAID IN TORT LITIGATION 37 (1986)). Although contingent fees traditionally are charged by plaintiffs' lawyers, defense lawyers occasionally charge "reverse contingent fees," which are an agreed upon percentage of the amount the client saves. See Carrie Menkel-Meadow, Culture Clash in the Quality of Life in the Law: Changes in the Economics, Diversification and Organization of Lawyering, 44 CASE W. RES. L. REV. 621, 655 n.163 (1994) (discussing Aetna Insurance Company's policy of requesting "blended" value-billing from its lawyers, including a contingent fee with "reverse bonus for low settlement rates in defense work"). The ABA Standing Committee on Ethics and Professional Responsibility has concluded that in civil cases as long as the fee arrangement realistically estimates the risk involved in a case, the fee is consistent with the Model Rules. See ABA Comm. on Ethics and Professional Responsibility, Formal Op. 373 (1993).

4. See Milton Handler, The Shift from Substantive to Procedural Innovations in Antitrust Suits—The Twenty-Third Annual Antitrust Review, 71 COLUM. L. REV. 1, 9-10 (1971). In derivative suits, as in securities class actions, attorneys' fees are actually paid under the "common fund" doctrine that allows a named plaintiff who creates a fund for the benefit of other injured investors to recover attorneys' fees from the fund. See George D. Hornstein, The Counsel Fee in Stockholder's Derivative Suits, 39 COLUM. L. REV. 784, 786 (1939). Judge Ralph K. Winter observes that "[t]he real incentive to bring derivative actions is usually not the hope of return to the corporation but the hope of handsome fees to be recovered by plaintiffs' counsel." Joy v. North, 692 F.2d 880, 887 (2d Cir. 1982), cert. denied, 460 U.S. 1051 (1983).

5. See Andrea Gerlin, Patent Lawyers Forgo Sure Fees on a Bet, WALL ST. J., June 24, 1994, at B1. Patent lawyer Gerald Hosier of Aspen, Colorado, used contingency-fee agreements and then settled many claims "by striking licensing deals valued at about $450 million with alleged infringers. [His] contingency-fee agreement ... entitled him to a portion of the proceeds. In 1992, he earned an estimated $150 million." Id.


United States; most other jurisdictions, including England and Scotland, prohibit contingent fees in many circumstances.\(^{10}\)

A substantial body of academic literature discusses whether contingent fees are ethical and the effect such fees have on both settlement discussions and litigation. Critics argue that contingent fees encourage litigation, inflate jury verdicts, overcompensate lawyers, and encourage unethical practices.\(^{11}\) Lawyers working for contingent fees also may have incentives to pressure clients for quick settlements in order to collect a fee and move on to other cases.\(^{12}\) Proponents


9. T.R. Goldman, *Contingent-Fee Lobbying Draws Fire*, LEGAL TIMES, Apr. 4, 1994, at 1; *see* Muschany v. United States, 324 U.S. 49, 64 (1945) (noting that "[c]ontingent fee contracts to secure Government business for the employer of the recipient" are "generally held invalid as against public policy").

10. *See* MARY A. GLENDON, *A Nation Under Lawyers* 54 (1994); *infra* text accompanying notes 61-66. "But the countries that have outlawed contingent fees generally address their citizens' legal needs by regulating legal fees, or by providing broad-based legal assistance, comprehensive social insurance, or some combination thereof." *GLENDON*, *supra*, at 54. Furthermore, growing political sentiment to encourage lawyers to undertake litigation without recourse to legal aid funds is leading to expansion of allowed contingency arrangements in some countries. For example, Scotland's Law Reform Act of 1990 (Miscellaneous Provisions), § 36 creates § 61A of the Solicitors Act of 1980, which allows a solicitor and her client to agree that if litigation is successful the "solicitor's fee will be increased by a percentage" that "shall not exceed limit[s]" set forth in the Act of Sederunt, SI 1992/1879 (for the sheriff court) and SI 1992/1898 (Rule of Court 350A for the Court of Session) (circumstances under which a solicitor's fee may be increased, although by not more than 100%). Walter G. Semple, *Fees in Speculative Actions*, J.L. SOC'Y SCOTLAND, Feb. 1994, at 57, 57.

In 1990, Parliament authorized "conditional fee agreements" in certain "specified proceedings" to be designated by order of the Lord Chancellor. Courts and Legal Services Act, (1990) (c 41), § 58(3) & (4). The Lord Chancellor is also to "prescribe the maximum permitted percentage [above the lawyer's usual fee] for each description of specified proceedings." *Id.* § 58(5). On July 4, 1995, the Lord Chancellor "signed the statutory instruments which will bring into force s.58 of the Courts and Legal Services Act of 1990, allowing lawyers to act on a conditional fee basis in personal injury cases, insolvency actions, and cases before the European Court of Human Rights." Lord Mackay, *Reducing Risks for Clients—The Introduction of the Conditional Fee Scheme in England and Wales Should Benefit Clients and Widen Access to Justice*, LAW SOCIETY'S GAZETTE, July 5, 1995, at 10. The Lord Chancellor set the maximum "uplift" (amount by which a lawyer could increase his fee in a conditional fee case) at 100% and observed that

\[\text{Id.}\]

The Lord Chancellor noted that "[t]he uplift in any particular case should be related to a realistic estimate of the chances of success in that case." *Id.*


12. Forty-six of the victims of the 1989 chemical explosion at a Phillips Petroleum plant in Houston have challenged the settlement of their lawsuits against Phillips, alleging that their own lawyers from Umphrey, Burrow, Reaud, Williams & Bailey sold out client interests in order to
instead argue that contingent fees assure that plaintiffs who cannot afford lawyers have access to the courts.\textsuperscript{13} Contingent fees may also give lawyers incentives to work more diligently for their clients.\textsuperscript{14} Many commentators believe that, while contingent fees should be permitted, they can easily become excessive.\textsuperscript{15} It is difficult, however, to determine when contingent fees are excessive and when they are not.\textsuperscript{16}

Some reform proponents suggest capping allegedly excessive contingent fees. Most notably, Lester Brickman, Michael Horowitz, and Jeffrey O'Connell propose that, when a defendant makes an early settlement offer that is subsequently rejected by a plaintiff, the plaintiff's lawyer should be permitted to charge only an hourly rate on work done before the settlement offer plus a percentage of any recovery in excess of the offer (hereinafter referred to as the Brickman Proposal).\textsuperscript{17} The Brickman Proposal is supported by several prominent members of the bench and bar,\textsuperscript{18} but has drawn predictably sharp crit-

obtain a quick settlement and their legal fees. The lawyers, who received a contingent fee of $65 million, allegedly negotiated for the plaintiffs as a group instead of individually and pressured individual plaintiffs to accept settlement. Peter Passell, \textit{Challenge to Multimillion-Dollar Settlement Threatens Top Texas Lawyers}, \textit{N.Y. Times}, Mar. 24, 1995, at B6. For further discussion of contingent-fee lawyers' incentives and the extent such incentives may diverge from the interests of their clients, see \textit{infra} text accompanying notes 208-22.

\textsuperscript{13} Patricia M. Danzon, \textit{Contingent Fees for Personal Injury Litigation} 39 (1980); Jay, \textit{supra} note 11, at 813.

\textsuperscript{14} See ABA Comm. on Ethics and Professional Responsibility, Formal Op. 389, at 12 (1994); \textit{see also infra} text accompanying note 202.


\textsuperscript{17} Lester Brickman et al., \textit{Rethinking Contingency Fees} 28 (1994).

\textsuperscript{18} Ninth Circuit Judge John T. Noonan, Jr., and Derek Bok, former President of Harvard University, wrote a Foreword and Preface respectively for the Brickman Proposal. \textit{Id} at 3.
icism from the plaintiffs' bar\(^1\) and has even gained a mixed reception from the insurance industry and other likely defendants.\(^2\)

Furthermore, the debate over contingent fees could be shaped by the outcome of the debate over whether to adopt the English rule, which requires the loser to pay both parties' fees as costs of suit,\(^2\) in place of the American rule, which requires each party to bear its own legal expenses, regardless of who wins.\(^2\) The English rule has received substantial attention in academic literature, including several articles in this Symposium\(^2\) and has recently been embraced by a sig-

19. "The [Brickman Proposal's] effort to revamp the legal profession's contingency-fee structure...is another effort to sell Americans on the notion that lawyers who represent injured consumers all have their briefcases lined with gold.

The contingent fee—or payment based on a percentage of the award of settlement—is truly an American's key to the courthouse door." Stephan H. Peskin, *Lobby for Insurers*, N.Y. TIMES, Feb. 25, 1994, at A28 (letter to the editor from the President of the New York State Trial Lawyers Association). A proposal similar to the Brickman Proposal limiting contingent fees was narrowly defeated in the California March 26, 1996, primary election. Ayres, supra note 1, at A11.

20. Aetna, one of the largest property casualty insurers in the United States, believes that any abuses of the contingency fee system are best addressed through marketplace solutions (full disclosure to potential clients of the hours likely to be spent on the case, probability of success, probable recovery and alternative fee arrangements) and, when necessary, reduction of excessive fees by the courts. We do not support regulating fees. Judyth W. Pendell, *Fees in the Marketplace*, N.Y. TIMES, Mar. 1, 1994, at A30 (letter to the editor from the Vice President of Law and Regulatory Affairs, Aetna, Hartford). Although it is conceivable that lower contingent fees, if made known to jurors and judges, could lead to lower overall judgments against insured parties, insurance companies are unlikely to benefit therefrom unless the market for insurance itself is uncompetitive. In a competitive market, insurance companies would be forced to lower their premiums to account for lower payments on behalf of their insureds. Indeed, insurers in a competitive market are most likely to be concerned not about the level of damage awards, but whether insurance premiums can be accurately assessed because such awards are predictable. Unpredictable aspects of the tort system such as punitive damages are thus more likely to be opposed by the insurance industry than a fee system that allows plaintiffs' lawyers to take a portion, usually one-third to one-half, of each judgment for themselves.


22. American courts' refusal to include attorneys' fees in judgments for costs is based on concern that penalizing plaintiffs for losing decreases access to the courts. See Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 247-71 (1975) (discussing case law and underlying rationale for the American rule). But see Dawson, supra note 15, at 1598. "No adequate historical explanation for the [American] departure has ever been advanced, and in any event, the reasons commonly given—the spirit of individualism in frontier societies, the conception in earlier times of lawsuits as sporting contests, and the widespread hostility toward lawyers—are not persuasive now." Id.

significant number of legislators, particularly in connection with the Republican Party’s *Contract With America*. Although legislative agendas have so far focused on the English rule, regulation of contingent fees might be a politically more acceptable measure because it is aimed, at least on its face, at plaintiffs’ lawyers rather than at plaintiffs themselves. If the English rule fails in the legislative process, a second wave of litigation reform proposals could center around the Brickman Proposal and others like it.

If, on the other hand, an English rule were to be adopted, customary contingent-fee arrangements might actually be expanded as plaintiffs ask lawyers not only to work on a contingency, but also to assume potential liability for paying opponents’ counsel. In exchange, the agreed upon percentage of a judgment going to the lawyer might be higher than if English-rule liability were not factored into the


26. Such an arrangement may be prohibited under the ABA Model Rules of Professional Responsibility, which prohibits a lawyer from providing “financial assistance to a client in connection with pending or contemplated litigation” other than an advance of court costs and litigation expenses. Rule 1.8(e)(1) (1995). Although liability for opposing counsel’s fees could possibly be described as an “expense of litigation,” this rule, and several others, would have to be revised to facilitate lawyer-client arrangements designed to insure against English-rule liability. *See infra* text accompanying notes 285-87.
This Article explores whether lawyers would be prepared to share this risk for a reasonable charge. If so, a competitive market for contingent fees could allow plaintiffs to insure against liability for opponents' fees under an English rule.

Another issue that this Article addresses is whether lawyers should dominate the market for risk sharing in lawsuits, which is essentially a market for champerty by lawyers. Champerty—paying for a lawsuit in return for a portion of the proceeds—at common law was barred to lawyers and lay persons alike. However, lawyers in the United States take cases on a contingency, while common law still restricts champerty by persons other than lawyers. Third parties thus rarely offer to share the risks of litigation by agreeing to pay plaintiffs' expenses. These restrictions on nonlawyer entrants into the market for champerty increase lawyers' market power and may result in higher fees for clients. The authors of the Brickman Proposal perceive just such noncompetitive pricing and suggest restrictions on what they believe to be lawyers' abuse of market power.

The Brickman Proposal, however, does not address whether lawyers' almost exclusive domination of the market for champerty is eco-

27. A contingent fee in the English system would be of limited use if it did not also account for opposing counsel's costs. "[I]f contingency fees were to be allowed here, it would either be necessary for the plaintiff to risk having to bear the defendant's costs, while escaping his own, or for his lawyer to undertake that in the event of failure he would not only forgo his own fee but would also pay the costs of the successful defendant." One rationale the Commission advanced for opposing contingent fees was that the lawyer would charge too much for such a contingency: "[t]o guard against [liability under the English rule], he would wish for a contingent fee amounting to a large proportion of the damages, giving an excessively high reward if the claim succeeded." Id. However, such a high surcharge might not be justified, because contingent-fee lawyers under an English-style fee-shifting rule would recover higher amounts if successful (legal fees from opponents as well as a percentage of damages from clients). For lawyers who are successful at least half of the time, payments and receipts of attorneys' fees should balance out. See infra text accompanying note 319.

28. Charles W. Wolfram, Modern Legal Ethics 490 (1986); see Max Radin, Maintenance by Champerty, 24 Cal. L. Rev. 48, 65-69 (1936); see also Arthur L. Kraut, Contingent Fee: Champerty or Champion?, Clev. St. L. Rev., May 1972, at 15, 16 (Despite the nonexistence of Ohio statutes prohibiting champertous agreements, "it was established . . . that [such agreements] would not be enforced by the Ohio courts.").


31. See infra text accompanying note 100.

32. Brickman et al., supra note 17, at 13-14.

33. The market power of plaintiffs' lawyers and its affect on pricing are discussed more fully in Part III of this Article.
nomically necessary or even desirable. Put another way, the question remains whether lawyers are more efficient providers of champerty than other persons would be and are therefore likely to provide clients with the best terms. If the answer to this question is "no" or "not always," then perhaps the market should be opened to other participants. Although regulation can be a useful way to combat abuse of market power, so is injecting more competition into the marketplace. This Article discusses circumstances in which nonlawyer investors might share the risks of litigation on better terms than plaintiffs' lawyers.

Although plaintiffs' legal-cost insurance is already available in several countries in return for periodic premiums, this Article focuses on legal-cost insurance that could be purchased after a claim arises in return for a portion of any judgment. In a less restricted market for champerty, nonlawyer litigation insurers could offer to pay a plaintiff's legal fees and other expenses in advance (and even assume her potential liability under an English rule) while accepting in return a sum to be paid out of any recovery. Lawyers and litigation insurers are already experimenting with such arrangements for cases

34. Alternative methods of paying for litigation have proliferated in Great Britain, where lawyers largely cannot charge contingent fees. Legal-cost insurance of various types is used to cover approximately 2% of cases, approximately 28% of plaintiffs receive legal aid, and about 29% of accident cases are paid for by trade unions that retain lawyers for their members. Other plaintiffs apparently self-insure or simply do not pay the other party's legal expenses if they lose. See Kritzer, Statement, supra note 23, at 3. Legal-cost insurance schemes also are prevalent in Germany, where insurers are sometimes blamed for litigiousness. See Alan Cowell, In Battle of Beer Garden, Bavaria Bares Its Soul, N.Y. Times, May 23, 1995, at A4 (beer garden owner sued by neighbors objecting to noisy patrons; defendant and his patrons blame insurance companies that offer policies covering the costs of litigation). German industry groups, like their American counterparts, complain of growing litigiousness. "There are people in Bavarian villages who've started court proceedings because cocks crowed too loud, cow bells were too noisy and church bells rang too early for them." Id. (quoting Ursula Seebock, President of Germany's Association to Promote the Culture of Beer Gardens).

35. The Royal Commission's Report on Legal Services observes that "insurance companies have begun offering legal-cost insurance to individuals as well as to companies, in addition to the more traditional insurance cover for personal injury and damage to property." ROYAL COMMISSION, supra note 27, at 179. The Commission concludes that, although such insurance should not be funded out of public funds, it may "prove a useful supplement to legal aid in some cases." Id. Legal-cost insurance schemes have proliferated in England since the Lord Chancellor on July 4, 1995, signed statutory instruments to allow "conditional fee agreements" under § 58 of the Courts and Legal Services Act 1990. See Conquest Sets up Rival PI Helpline, LAWYER, Jan. 9, 1996, at 3 (describing scheme offered by the Litigation Protection Insurance Company that "will cost clients £175, plus tax, for a minimum £25,000 cover" of litigation expenses). To assist law firms representing clients in conditional fee agreements, Johnson & Higgins and Lexington Insurance Company of New York "will offer an insurance policy to 1,350 law firms that handle personal injury cases and belong to Accident Line, a division of the Law Society." Sarah Goddard, U.K. Law on Legal Fees Will Spur Injury Suits; Could Also Encourage Settlements, Bus. Ins., Aug. 14, 1995, at 35. These insurance policies cover "expenses awarded against the plaintiff if they lose." Id.
on appeal\textsuperscript{36} and are not doing so merely to engage in speculation. If this legal-cost insurance market were extended to cases before trial, insurers would evaluate potential claims and set "legal-cost insurance premiums" either in fixed amounts (e.g., the first $100,000 of any judgment) or in percentages (e.g., 20\% of any judgment).\textsuperscript{37} Insurers would hold diversified portfolios of legal-cost insurance contracts,\textsuperscript{38} and plaintiffs could shop for the best terms either by negotiating directly with litigation insurers or by consulting litigation agents who, like insurance agents, could inquire about facts of potential suits, including plaintiffs' choice of counsel, and then obtain insurance quotes on the market. A litigant might or might not choose the same person to be her "champion" in court and her champertor to insure the litigation's success.\textsuperscript{39}

Although such pretrial legal-cost insurance has not been discussed in academic literature, numerous commentators have discussed the sale of tort claims. For example, Professor Cooter has suggested creation of a market for "unmatured tort claims" based on accidents

\begin{itemize}
\item[(i)] the judgment amount is $300,000 or greater, excluding interest and costs;
\item[(ii)] the judgment debtor has 'deep pockets' or has posted an appeal bond, or other financial undertaking, sufficient to assure payment of the judgment in full, if sustained on appeal;
\item[(iii)] the amount assigned will not exceed 50\% of the judgment; and
\item[(iv)] the judgment creditor has a commitment to vigorously defend the judgment and the funds needed are earmarked for payment of qualified counsel.
\end{itemize}

\textit{Id.} at 3. The JPC program also can be used by attorneys who want to share with JPC the risks of contingent-fee arrangements. "JPC's Program also provides attorneys the opportunity to receive a cash advance on their contingent fee interest in the judgment on appeal or their costs recovery rights." \textit{Id.} at 1; \textit{see also} \textit{Cash Paid Up Front For Appeal Judgments}, CAL. L. BUS., Apr. 3, 1995, at 1 (discussing the JPC program).

\textsuperscript{36} Judgment Purchase Corporation (JPC), a San Francisco based company, researches lawsuits to determine which cases are likely to succeed on appeal and then offers plaintiffs cash in advance in return for a percentage of the judgment if the judgment is upheld (for example, $1,200 cash for a $1,500 interest in the judgment). If the plaintiff loses on appeal, JPC does not get repaid. See \textit{Judgment Purchase Corporation, A White Paper Discussing Non-Recourse Financing For Money Judgments On Appeal} 2 (1995) [hereinafter JPC \textit{WHITE PAPER}]. JPC will "invest" in a state or federal trial court money judgment on appeal that meets the following criteria:

\textit{Id.} at 3. The JPC program also can be used by attorneys who want to share with JPC the risks of contingent-fee arrangements. "JPC's Program also provides attorneys the opportunity to receive a cash advance on their contingent fee interest in the judgment on appeal or their costs recovery rights." \textit{Id.} at 1; \textit{see also} \textit{Cash Paid Up Front For Appeal Judgments}, CAL. L. BUS., Apr. 3, 1995, at 1 (discussing the JPC program).

\textsuperscript{37} Although it is conceivable that litigation insurers could demand control over the litigation, lawyers and clients are unlikely to accept such a condition. JPC's advances against judgments on appeal do not include legal advice from JPC and "[c]ontrol of the case rests with the client and attorney." JPC \textit{WHITE PAPER, supra} note 36, at 3. For discussion of the agency costs that arise in the context of insuring litigation controlled by a plaintiff and her attorney and a comparison with the already very significant agency costs that arise in the context of a contingent-fee arrangement, see \textit{infra} text accompanying notes 272-79.

\textsuperscript{38} Unlike a conventional insurance contract in which an insurer agrees to risk responsibility for potential losses in return for a fixed premium, a litigation insurer would agree to pay counsel fees as they accrue and to post any bond required under an English rule for opposing counsel's fees in return for a share of the judgment or settlement, if any. See \textit{infra} text accompanying notes 267, 317-18.

\textsuperscript{39} The two choices would not be entirely independent—choice of lawyers would probably affect champerty terms available on the market.
that may occur in the future. Professor Goetz, however, correctly points out that he is "more skeptical of the practical success of such markets for [unmatured tort claims] than for matured claims where the tort has already occurred." Also, even a market for matured tort claims might not be practical outside of a context ideally suited for evaluation and pricing of such claims. This Article seeks to explore the feasibility of one such context—albeit a context more limited than that envisioned by either Cooter or Goetz—a market for legal-cost insurance.

Other commentators have suggested lawsuit syndication through securities offerings as a method of raising money to cover litigation expenses. In a few instances, this technique has been tried, with varying degrees of success. However, securitization is difficult and costly because of federal and state registration and disclosure require-

40. See Robert Cooter, Towards a Market in Unmatured Tort Claims, 75 VA. L. REV. 383, 383 (1989). Such a market, he argues, would allow potential plaintiffs to sell tort rights connected with wealth-neutral events (such as pain and suffering) while buying better insurance for wealth-implicating events (such as lost wages). See id. at 384-85.

41. Charles J. Goetz, Commentary on "Towards a Market in Unmatured Tort Claims": Col-lateral Implications, 75 VA. L. REV. 413, 422 (1989); see also CHARLES J. GOETZ, CASES AND MATERIALS ON LAW AND ECONOMICS 43 (1984).

A plausible argument might be that assignability would produce a more objective valuation of claims by people who are specialists in such evaluations. After all, if the present holder of a claim placed an unduly low value on it, there would be money to be made from detecting this fact and purchasing the claim for a figure closer to its real value. Indeed, a market-like valuation of one's claim might induce a downward revaluation by one who overvalues his cause of action.

Id.


43. See infra text accompanying notes 91-92, 97-99. One such attempt was the registration in 1974 of 480,000 shares of common stock in a corporation headquartered in Larchmont, New York, to raise capital for its Prepaid Legal Services Program, a scheme essentially similar to legal-cost insurance plans now available in Great Britain, see ROYAL COMMISSION, supra note 27, at 129, and for its Litigation Division, which would pursue class actions believed to be in the public interest. Attorneys interested in filing class actions would arrange for the Division to pay legal fees and other expenses in return for a share of the recovery if the suits were successful. Public Equity Corp., Preliminary Prospectus, at 28-30 (Dec. 5, 1974) (copy on file with author; original on file with the SEC). The Corporation does not appear to have contemplated funding suits by individual plaintiffs, at least at the outset. The "Certain Risk Factors" section of the preliminary prospectus discloses that the contemplated lawsuit funding scheme might be chancypertous, but the registrant took the position that most of these restrictions were void because they were against public policy and/or unconstitutional. Id. at 7-13. However, the Corporation's actual potential for profit was perhaps best described in Part B of the "Risk Factors" section, which stated that "[t]he successful public underwriting and operation of this Corporation de-pend, in large part, on the active 'social consciousness' of a significant bloc of ordinary American citizens." Id. at 13.
LITIGATING ON A CONTINGENCY

In most litigation, legal fees are not sufficient to justify a public offering or even a private placement of securities. This Article suggests a switch from the securitization paradigm to an insurance paradigm that replicates for litigants the multitude of insurance contracts that facilitate transactions in other areas of the economy.

Part I of this Article discusses how both the common law and ethics codes reinforce lawyers' dominant position in the market for champerty, as well as legal and practical hurdles confronted when parties seek to finance litigation outside of the contingent-fee paradigm. Part II discusses case law, ethics rules, and statutes governing reasonableness of contingent fees and summarizes the debate over whether contingent fees should be regulated. Part II further suggests that current thinking on what fees are reasonable might have to change if an English rule were to be adopted and lawyers were willing to insure their clients against liability for opponents' legal fees. Part II finally concludes that regulation of contingent fees, whether by the courts on a case-by-case basis or through a more formal structure such as the Brickman Proposal, is needed to protect litigants from excessive fees. However, such regulation is a poor substitute for a competitive market, and this Article suggests that in at least some areas of litigation a competitive market for nonlawyer legal-cost insurance might be sensible.

Part III discusses how contingent fees are currently priced in a market where lawyers are the only providers of legal-cost insurance

44. For example, see registration requirements under § 5 of the 1933 Securities Act, 15 U.S.C. § 77f (1994).

45. See Abraham, supra note 42, at 1298-99 (urging that the champerty doctrine be repealed and that syndicated lawsuits be exempted from registration under securities laws). Securities laws most likely would not apply to the legal-cost insurance contracts discussed in this Article. See SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946) (defining an “investment contract,” for purposes of the definition of a security under § 2(1) of the 1933 Securities Act, to mean an agreement, “transaction or scheme whereby a person invests money in a common enterprise and is led to expect profits solely from the efforts of [others]”). There is no common enterprise, and thus no investment contract or security, where an arrangement is pursuant to private negotiations between parties and there is no offering to the public. See Marine Bank v. Weaver, 455 U.S. 551, 559-60 (1982). A private arrangement between a plaintiff and a litigation insurer, like most other insurance contracts, would likely fall within this exception.

46. Although this Article adopts the insurance paradigm for risk spreading in litigation, it is not necessary, or even particularly desirable, that insurance companies perform this function, as opposed to other institutional investors. Insurance companies would face obvious conflicts of interest in selling legal-cost insurance to plaintiffs suing their own insureds or the insureds of other insurance companies. The risk of insurers colluding to manipulate settlement negotiations and even the prosecution of lawsuits is substantial if a relatively small group of insurance companies is given a critical role on both sides of tort litigation. See infra text accompanying note 275.

47. See infra text accompanying notes 270-71.
for most plaintiffs. The prevalent pricing pattern reveals some of the characteristics of tie-in arrangements where sellers require customers to purchase one product (for example, legal-cost insurance) in order to purchase another (for example, legal services). Lawyers who charge a flat contingent rate rather than discount fees for cases likely to result in substantial judgments also may be using price discrimination, a common practice in markets, such as those for airline tickets or college tuitions, that are not fully competitive. The essence of price discrimination is that buyers are charged different amounts according to what they can afford to pay and/or what a particular product or service is worth to them, rather than according to the marginal cost of the seller. Some buyers thus pay more than they would in a more competitive market.

Part IV examines both economic and ethical costs and benefits incurred by litigants, lawyers, and society when litigants use lawyers, instead of nonlawyer litigation insurers, to finance and insure litigation. Costs of lawyer-insured litigation include (i) perverse incentives for lawyers to engage in unethical conduct directed at winning large judgments, a cost primarily imposed on participants in the legal system and on consumers who purchase tort liability insurance; (ii) perverse incentives for lawyers to use litigation and settlement strategies that do not maximize client welfare, a cost primarily imposed on clients; (iii) perverse incentives for clients to evade contingent-fee arrangements and for lawyers to engage in opportunistic conduct vis-a-vis their partners in sharing contingent fees, a cost imposed on lawyers themselves; and (iv) costs imposed on lawyers because they are poor

48. See infra text accompanying notes 163-82.
49. See Davidson Goldin, Increasingly, Those Paying Full Tuition Aid Poorer Peers, N.Y. Times, Mar. 22, 1995, at B7. Although college tuition pricing has been described as "an income transfer from those who can afford to pay tuition to those who can't," id. (quoting Charles Lenth of the Education Commission of the States), in many instances there is no such transfer. Rather, discriminatory pricing is used to charge each student what they can afford to pay, just as different passengers are often charged different prices on airlines. In most instances, student loan proceeds and student cash contributions allow colleges to recover their marginal cost of educating a student (or the increase in the college's costs due to educating that student). For a discussion of price discrimination, see infra text accompanying notes 183-94. Although a college could always abandon discriminatory pricing in favor of need-based admissions (admitting a pool of applicants with a higher demand curve allowing all or most to be charged full tuition), this alternative is not without costs to the college in terms of both the academic qualifications and diversity of its student body.
51. Although there can be abuses when lawyers represent a single client, see infra text accompanying notes 201-22, some of the greatest abuses are in product liability class actions. See Barry Meier, Fistfuls of Coupons, N.Y. Times, May 26, 1995, at D1 (criticizing settlements where plaintiffs' lawyers get cash and plaintiffs get near worthless coupons toward purchase of additional products from the defendant).
diversifiers of risks from contingent-fee litigation. Concerning this last point, Part IV also discusses the concept of diversifiable risk as it is used in the Capital Asset Pricing Model (CAPM) and concludes that much of lawyers' risk from contingent-fee litigation is potentially diversifiable, but that lawyers are poor diversifiers of litigation risk. The third and fourth above mentioned costs of lawyer-insured litigation may be passed by lawyers on to clients in the form of higher contingent fees.

These costs of using lawyers as litigation insurers are counterbalanced by some benefits. One benefit to clients of using their lawyers to insure litigation is economies of scope: lawyers already become familiar with facts underlying a claim in order to litigate the claim and usually can evaluate the claim to fix a contingent fee without substantial additional expenditure of time and effort. Other litigation insurers would have to evaluate the claim themselves, making champerty for them more expensive. Another possible benefit of using lawyer instead of nonlawyer litigation insurers is that contingent fees may encourage lawyers to work harder to obtain higher judgments for clients, making lawyers' services more valuable. However, these positive incentives must be weighed against perverse incentives created when contingent-fee lawyers' interests diverge from their clients' interests.

In sum, there are both costs and benefits of using lawyers instead of nonlawyers to share the risks of litigation. Furthermore, these costs and benefits vary depending on the circumstances of each legal repre-

52. The ABA correctly points out that lawyers are better risk diversifiers than most clients. See ABA Comm. on Ethics and Professional Responsibility, Formal Op. 389, at 11 (1994) ("The contingent fee system essentially shifts the risk of litigation or other legal endeavor from a risk averse client to the lawyer who may be more risk neutral because of his ability to recoup his losses through his handling of other legal matters on a contingent basis."). Nonetheless, lawyers practicing alone or in smaller firms are poor risk diversifiers when compared with outside litigation insurers. See infra text accompanying notes 238-61.

53. One obvious alternative, conducting contingent-fee litigation in large law firms, is a relatively unattractive diversification strategy, in part because partners' pay in many firms is still tied to partners' individual billings and in part because contingent fees increase the likelihood of opportunistic conduct of partners toward each other. See infra text accompanying notes 223-37.


55. However, a closer look at the "evaluation" by lawyers of claims that precedes contingent-fee arrangements reveals that often relatively little effort is expended. If so, economies of scope enjoyed by lawyers should be relatively insignificant. See infra text accompanying notes 263-68.

56. Areas in which contingent-fee lawyers' interests may diverge from the interests of their clients include settlement negotiations and alternative dispute resolution. See infra text accompanying notes 210-20.
sentation. This Article suggests that the best approach is to allow clients to choose the arrangements they prefer after they have been informed of the full range of choices available to them in a competitive market. As an alternative, or in addition, to regulating contingent fees, the legal system should facilitate efforts by nonlawyers to make legal-cost insurance available to plaintiffs.

Part V discusses how, if nurtured by some revisions to codes of professional responsibility and allowed to develop free of common law constraints, the market might reduce the cost to plaintiffs of legal-cost insurance. Because third-party investors could be better diversifiers of risk than most plaintiffs' lawyers, risk premiums built into contingent fees might fall. This Article suggests, however, that a competitive market for legal-cost insurance will function well only if lawyers are required to cooperate with third-party litigation insurers and perhaps also to inform clients that they should obtain several quotes on the market before entering into a contingent-fee arrangement.

Finally, Part VI revisits the English rule and discusses how a competitive market for legal-cost insurance might alleviate some of the inequity inherent in requiring losers to pay winners' legal expenses. Without passing judgment on the alleged advantages and disadvantages of the English rule, this Article concludes that such a rule could more effectively accomplish at least one of its alleged objectives, sorting out claims that should be litigated from claims that should not, if defendants and plaintiffs alike could obtain legal-cost insurance. Risks of losing would affect insurance rates (the portion of any judgment demanded by the insurer), and insurance might not be available for the weakest cases. Parties thus would have incentives to settle or abandon cases they are unlikely to win, but would not be handicapped in the civil litigation system on account of their aversion to risk. Redistribution among litigants of costs of commencing and defending liti-

57. Regulation may still be needed in situations where a competitive market for champerty does not succeed in making more options available to plaintiffs or if plaintiffs are not adequately informed of those options.

58. As JPC points out in its promotional materials, "[a]ttorneys sometimes find themselves in need of cash. An outstanding contingent fee interest in a judgment on appeal or substantial illiquid costs advanced claim can create tremendous financial pressure on an attorney, a law practice and a family." JPC WHITE PAPER, supra note 36, at 2. JPC, presumably a better diversifier of risk than most plaintiffs' lawyers, offers to "convert this interest in the money judgment into immediate cash, safe from the risks of a court reversal. Like the plaintiff, if the case is ultimately lost and there is no recovery, the attorney keeps the money and JPC receives nothing." Id.

59. Alleged advantages and disadvantages of the English rule have already been discussed extensively in academic literature. See supra note 23.
gation would be possible without tilting the legal playing field toward the risk neutral and well-to-do.

I. Evolution of Lawyers' Market Power in Champerty

A. The Common Law of Champerty and the Exception for Lawyers in the United States

Legal-cost insurance, such as that provided in a contingent-fee arrangement, is essentially a form of champerty. Champerty\textsuperscript{60} is a bargain by which a "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 sought to be recovered."\textsuperscript{61} Champerty was prohibited at common law in England.\textsuperscript{62} Similar prohibitions were aimed at maintenance\textsuperscript{63} and barratry.\textsuperscript{64} In England, champerty laws still prohibit contingent fees,\textsuperscript{65} and alleged champertors, as well as their accusers are usually lawyers.\textsuperscript{66}

Gradually, lawyers' contingent fees were excepted from the doctrine of champerty in the United States. New York's Field Code of 1848 "repealed the statutes regulating lawyers' fees" and thereby contributed to "legitimization of contingent fees."\textsuperscript{67} Later revisions of the Code provided that fees would be governed by lawyer-client agree-

\textsuperscript{60} "Champerty" was derived from "Champart," \textit{campi pars} or \textit{campi partus}, a type of medieval feudal tenure consisting of "a grant in which the \textit{reddendum} was a specified quota of the actual produce of the land granted." Radin, \textit{supra} note 28, at 61. "The tenant by champart then was only a partial owner of the land he held. He was bound to share its rents and profits with the grantor." \textit{Id.}

\textsuperscript{61} \textit{BLACK'S LAW DICTIONARY} 209 (5th ed. 1979) (citing Schnabel v. Taft Broadcasting Co., 525 S.W.2d 819, 823 (Mo. Ct. App. 1975)).

\textsuperscript{62} Under the Statute of Westminster I of 1275, Chapter 15, no royal officer "shall maintain pleas 'for lands, tenements or other things, for to have part or profit thereof . . . ."" Radin, \textit{supra} note 28, at 62 (quoting 4 HALSBURY'S \textit{STATUTES OF ENGLAND} (1929) 261; 3 EDW. I c. 25).

\textsuperscript{63} Maintenance, "the support given by a feudal magnate to his retainers in all their suits," was unlawful under the Star Chamber Act of 1487 and the Statute of Liveries of 1504. Radin, \textit{supra} note 28, at 64 (citing 3 HENRY VII, c. 1 \textit{STATUTES OF THE REALM} ii, 509; 19 HENRY VII, c. 14; \textit{STATUTES OF THE REALM} ii, 658).

Maintenance may be said to be the last flaring up of feudalism. It contained echoes of the system of private war and constituted the last of the attempts of feudal landowners to create within the limits and the framework of the \textit{regnum}, a continuance of the centrifugal tendencies inherent in the feudal theory. \textit{Id.} at 65.

\textsuperscript{64} Barratry, or habitual maintenance, was a criminal offense in England. See Radin, \textit{supra} note 28, at 65 (citing 8 COKE'S REP. 36b; Statute of 34 EDW. III. c.1.).


\textsuperscript{66} Radin, \textit{supra} note 28, at 66.

ment "which is not restrained by law." Many of these developments occurred at a time when the Industrial Revolution gave rise to accidents in which working-class plaintiffs had legitimate claims, but no money to pay lawyers. By 1877, the United States Supreme Court observed that "[t]he proposition (i.e., that contingent fees are legal) is one beyond legitimate controversy."

The common law also forbids, in addition to champerty, assignment of all or part of a cause of action. It is true that the modern legal system provides many exceptions to this rule. Contract claims are generally assignable as are many types of tort claims for property damage. Although personal injury claims generally cannot be assigned, there is an exception for subrogation by a claimant to an interested third party, usually her insurance company. When permitted, assignment of an entire action is a risk-shifting device under which the assignee assumes all the risk of litigation and the plaintiff assignor forgoes a potential judgment in return for a fixed payment. Assignment of part of an action is a risk-sharing device where part of the potential award from a lawsuit is exchanged for money or services. Such a partial assignment of course occurs when a lawyer charges a contingent fee, and this assignment is permitted despite the prohibi-


70. Radin, supra note 28, at 71 (quoting Stanton v. Embrey, 93 U.S. 548, 556 (1877)).

71. The purchase of a lawsuit was forbidden under Roman law and, according to Diocletian, "was against public policy, contra bonos mores." Radin, supra note 28, at 54 (citing COD. JUST. 2, 12, 15). Modern tort law also prohibits purchase or sale of most tort claims. See Sprung v. Jaffee, 147 N.E.2d 6, 8-9 (N.Y. 1957); N.Y. JUD. LAW §§ 488, 489 (McKinney 1983).

72. GOETZ, supra note 41, at 39 (citing Harold R. Weinberg, Tort Claims as Intangible Property: An Exploration from an Assignee's Perspective, 64 KY. L.J. 49 (1975); 6 AM. JUR. 2D Assignments §§ 34-45 (1963)). A judgment, even a judgment on appeal, generally can be assigned. See discussion of the JPC WHITE PAPER, supra note 36.

73. GOETZ, supra note 41, at 39. Sometimes, the assignment is to a hospital, doctor, or some other party that incurred expense because of the tort in question. See Richard v. National Transp. Co., 285 N.Y.S. 870, 872 (Mun. Ct. 1936) (injured party may assign claim to a hospital). Subrogation often allows an insurer to recover from a person committing a tort against its insured. See generally, Spencer L. Kimball & Don A. Davis, The Extension of Insurance Subrogation, 60 MICH. L. REV. 841, 841 (1962). The legal-cost insurance discussed in this Article is different in that the insurer usually is disinterested in the case prior to the assignment and the insured assigns to the insurer a percentage of her claim instead of a fixed amount from the claim. Furthermore, this assignment is the insured's "premium" on a new legal-cost insurance contract, not a mechanism by which an insurer seeks to recover from a tortfeasor amounts paid out under a preexisting contract.
tion on many other assignments of tort claims\textsuperscript{74} and despite the fact that a lawyer is prohibited from otherwise acquiring an interest in the subject matter of her litigation.\textsuperscript{75}

Allowance of lawyers' contingent fees in the United States, however, did not bring about the demise of prohibitions on other forms of champerty, maintenance, and assignment. Rather, there is significant variation among jurisdictions as to the extent to which these doctrines are enforced. Some states, such as Florida,\textsuperscript{76} Illinois,\textsuperscript{77} Kansas,\textsuperscript{78} Missouri,\textsuperscript{79} Pennsylvania,\textsuperscript{80} South Dakota,\textsuperscript{81} and Wisconsin\textsuperscript{82} bar champerty. Connecticut avoids a categorical approach and inquires into


\textsuperscript{75} ABA Model Rule 1.8 (j) reads:

A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

(1) acquire a lien granted by law to secure the lawyer's fee or expenses; and

(2) contract with a client for a reasonable contingent fee in a civil case.

Model Rules Rule 1.8(j); see Model Code EC 5-7 (1981) ("The possibility of an adverse effect upon the exercise of free judgment by a lawyer on behalf of his client during litigation generally makes it undesirable for the lawyer to acquire a proprietary interest in the cause of his client or otherwise to become financially interested in the outcome of the litigation.").


\textsuperscript{77} "[T]here are two essential elements in every champertous agreement: First, there must be an undertaking by one person to defray the expenses, in whole or in part, of another's suit; second, an agreement or promise on the part of the latter to divide with the former the proceeds of the litigation in the event the prosecution was successful." Brush v. City of Carbondale, 82 N.E. 252, 255 (Ill. 1907) (agreement whereby appellant contracted with the City of Carbondale to pay expenses of City's appeal of case alleging illegal sale of intoxicating liquors, although not champertous because second element was not met, could not be enforced insofar as it might prevent the City from settling or discontinuing suit).

\textsuperscript{78} Boettcher v. Criscione, 299 P.2d 806, 811 (Kan. 1956) (agreement between genealogists and intestate heir whereby former would pay litigation expenses in return for one-quarter of the heir's recovery from estate was champertous, and thus unenforceable).

\textsuperscript{79} See Schnabel v. Taft Broadcasting Co., 525 S.W.2d. 819, 824-25 (Mo. 1975) (although "the law of champerty and maintenance is in force in Missouri," \textit{id.} at 823, an agreement whereby manager of radio station agreed with replacement worker hired during strike to pay all attorneys' fees and costs of litigation for defamation suit by worker against union was found to be valid because the employer believed it had an interest in the litigation).

\textsuperscript{80} Belfonte v. Miller, 243 A.2d 150, 151-52, 154 (Pa. Super. Ct. 1968) (invalidating contract in which a realtor hired an appraiser to appraise real estate to assist in obtaining damages in an eminent domain proceeding, and appraiser was to receive a percentage of the recovery).

\textsuperscript{81} McKellips v. Mackintosh, 475 N.W.2d 926, 929 (S.D. 1991) (agreement under which bank officer would lend litigants $3,000 to bring trademark infringement lawsuit in exchange for percentage of the award and/or settlement held "champertous and void as against public policy").

\textsuperscript{82} See D'Angelo v. Cornell Paperboard Prods., 120 N.W.2d 70, 74 (Wis. 1963). The Wisconsin Supreme Court held that the agreement where an injured party and his workman's compensation insurer assigned their causes of action against an automobile liability insurer to a comprehensive liability insurer was against public policy insofar as the agreement assigned amounts in excess of amounts already paid by the assignee to the injured party. \textit{id.}
whether a transaction violates public policy.\(^{83}\) California,\(^ {84}\) Arizona,\(^ {85}\) New Jersey,\(^ {86}\) New York,\(^ {87}\) and Louisiana\(^ {88}\) avoid champerty and similar doctrines. Although limited inroads have been made by way of third-party financing of legal expenses,\(^ {89}\) the common law continues to cast a shadow over schemes that might challenge lawyers' dominant position in the market for champerty.

One such challenger was New York attorney Carl Person. In the 1970s, Person sued several New York bar associations alleging that New York's Judiciary Law, Appellate Division Rules, and Lawyer's Code of Professional Responsibility forbade transfer for value of shares in a lawsuit. These prohibitions, he claimed, unconstitutionally stifled fair trial of antitrust cases and other costly litigation.\(^ {90}\) The

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83. "The common law of champerty and maintenance has never been adopted in this state as applied to civil actions, and the true and exclusive inquiry ... is whether the transaction relied upon is opposed to public policy." Bongaret v. Lampasona, 282 A.2d 580, 581 (Conn. 1971) (maintenance of suit that had been assigned by plaintiff to her insurance company did not violate public policy).

84. See Muller v. Muller, 23 Cal. Rptr. 900, 901 (Dist. Ct. App. 1962) (the doctrines of "champerty and maintenance" are not recognized in California).

85. See Strahan v. Haynes, 262 P. 995, 996-97 (Ariz. 1928) (holding that assignee's complaint for specific performance of real estate purchase contract, clearly demonstrating champerty and maintenance, should not be subject to demurrer because the court believed the doctrines did not apply in Arizona).


87. "In New York champerty and maintenance is not a viable defense except as provided by statute. . . ." Lost Lots Assoc's. v. Bruyn, 415 N.Y.S.2d 99, 100 (App. Div. 1979). The Court held that § 489 of New York's Judiciary Law prohibits only purchase of choses in action, claims, or demands and does not prohibit transfer of a real property deed to a corporation owned by three lawyers who agreed to prosecute an action to establish title and share with transferor the proceeds from settlement or subsequent sale of the property. \(\text{id.}\) at 101.

88. Hawthorne v. Humble Oil & Refining Co., 210 So. 2d 110, 112 (La. Ct. App. 1968) (A "litigious right" is transferred when a complaint and answer are filed and then transferred; under the Louisiana Civil Code, a person "against whom a litigious right has been transferred, may get himself released by paying to the transferee the real price of the transfer, together with interest from its date.").

89. For the discussion of the JPC scheme for purchase of an interest in judgments on appeal, see supra note 36. Arguably, the JPC scheme is not champertous because JPC is purchasing an interest in a judgment rather than a lawsuit yet to go to trial.

90. Person v. Association of Bar of New York, 414 F. Supp. 139, 140-42 (E.D.N.Y. 1976), rev'd, 554 F.2d 534 (2d Cir.), cert. denied, 434 U.S. 924 (1977). Among the more significant prohibitions alleged to impede Person's scheme to syndicate an antitrust suit were the Model Code's DR 2-103(D) (restricting a lawyer from assisting an organization that promotes use of the lawyer's services) and DR 3-102 ("[A] lawyer or law firm shall not share legal fees with a nonlawyer."); the Appellate Division's First Department Rules § 603.18 (Champerty and Maintenance) and Second Department Rules § 691.15, which forbid, among other things, a lawyer "giving in his own or in another's name, before or after suit, a promise of anything of value ... to induce the placing of a claim in his hands or in the hands of another for the purpose of suing on it or defending against it"); and the Judiciary Law §§ 479, 481, and 482 "mak[ing] it unlawful for any [person] to solicit or procure through solicitation a retainer for an attorney or to make a business of doing so . . . ."

\(\text{Person, 414 F. Supp. at 141.}\)
District Court examined Person’s scheme to finance an antitrust suit through a public offering, and it held that he was sufficiently unlikely to be in violation of these provisions that his motion for a ruling on their constitutionality should be denied. Nonetheless, the Court did not endorse Person’s scheme and did not define the extent of New York’s prohibitions on third-party funding of lawsuits.

Uncertainty surrounding champerty and related doctrines thus has a chilling effect on the market for nonlawyer financing and insurance of lawsuits. The fact that lawyers usually will not encourage such arrangements when they can work for contingent fees instead also makes nonlawyer legal-cost insurance an unrealistic alternative. Investors are unlikely to fund lawsuits without the cooperation of, and particularly adequate information from, plaintiffs lawyers, and lawyers, with a few exceptions like Carl Person, have no incentive to favor unorthodox methods to finance their own fees outside of the contingent-fee paradigm.

B. Commercial Claims

Large commercial claims, unlike claims by most individual plaintiffs and small businesses, are often de facto, if not de jure, exempt from restrictions on champerty and assignment. The reason is simple: claim holders can incorporate or form partnerships, ostensibly to develop business opportunities related to the subject matter of the claim (for example, to develop and market a patent). Interests in the newly formed entity can then be sold to investors and the proceeds used to finance litigation (for example, a patent infringement suit). The investors then expect to receive a share of any judgment or settlement in capital appreciation or future dividends. Alternatively, lawyers can

91. Person sought to use the proceeds of a public stock offering to finance litigation costs of an antitrust suit against Parker Brothers and General Mills seeking $32 million in damages. Cox, supra note 42, at 154-55. Although Person promised to return investors’ principal without interest if the lawsuit did not succeed, the offering was a failure. Id. at 155-56.

92. The Court held that the issues involved did not require convening a three-judge district court because there [did] not appear to be any threat of action to prevent partial assignments of the rights or action sued on, and there [was] no basis, simply for that reason, for seeking to enjoin state officers from enforcing statutes and rules of, at best, doubtful applicability and in advance of their infraction.

Person, 414 F. Supp. at 142.

93. In federal courts, antitrust claims generally may be assigned. Jefferson County Pharmaceutical Ass’n v. Abbott Labs., 656 F.2d 92, 98 (5th Cir. 1981).

94. Lawyers in Great Britain, where contingent fees are generally not available, by contrast have even contemplated a contingency fund somewhat similar to the legal-cost insurance suggested in this Article. See infra note 298 and accompanying text.

95. See infra text accompanying note 269.
receive a share in a plaintiff corporation in exchange for their services. Patent cases are sometimes funded in this manner, as are some suits on promissory notes. Only if litigants directly sell interests in a lawsuit itself, or create confusion about who controls a lawsuit, do they run afoul of prohibitions on champerty and assignment.

Such arrangements, however, are not practical or even available for a wide range of litigation, including claims for personal injury, for civil rights violations, on behalf of defrauded investors, or by persons injured by defective consumer products. Thus, for many litigants, lawyers' domination of the market for champerty is an unavoidable fact of life. Although this market domination does not reach the point of monopoly unless lawyers in a particular geographic or practice area collude to act as a single firm, pricing in such a market is likely to be less competitive than it would be in a less exclusive market for champerty.

II. THE PROBLEM OF CONTINGENT FEES

A. Existing Law on Contingent Fees

The Model Code and the Model Rules set few specific guidelines for contingent fees, or for fees in general, except to state that lawyers' fees must be reasonable. Using somewhat circular language, the


97. Patent claimant Gordon Gould, the inventor of the optic laser, transferred part of his interest in laser patents to Patlex Corporation. Patlex spent $300,000 litigating his claim and then sold shares of its own stock to finance the litigation. After a string of court victories, Patlex earned about $7 million annually in royalties and licensing fees. Cox, supra note 42, at 156-57.

98. In 1981, Micro/Vest Corporation was formed by investors to buy a convertible promissory note written by William Millard, "the founder of Computerland," in favor of Marriner & Co., a venture capital firm which had provided him with seed money. Micro/Vest then sued on the note and sold its own shares to investors to pay for the lawsuit. A one percent share of Micro/Vest was estimated to be worth $5 million after Micro/Vest was awarded an equity interest in Computerland and punitive damages and fees of $141.5 million. Id. at 157-58.


100. A monopoly exists if (1) one firm produces a good or service, (2) the monopolist does not have rivals or competitors, and (3) new firms cannot enter the market. S. CHARLES MAURICE ET AL., MANAGERIAL ECONOMICS: APPLIED MICROECONOMICS FOR DECISION MAKING 496-503 (4th ed. 1992).

101. ABA Model Rule 1.5(a)-(d) reads:
Model Code states that a fee is excessive when an ordinarily prudent lawyer would regard it to be excessive.\textsuperscript{102} Under the Model Rules, so long as her fee is reasonable, a lawyer not only may devote time to a case, but "may advance court costs and expenses of litigation, the re-

payment of which may be contingent on the outcome of the matter . . . ."\textsuperscript{103} Although contingent fees are allowed in a wide variety of circumstances, they are prohibited in some forms of litigation, including criminal\textsuperscript{104} and divorce\textsuperscript{105} cases. Apart from contingent fees, "[a]
lawyer shall not acquire a proprietary interest in the cause of action."\textsuperscript{106}

Furthermore, a contingent fee must be appropriate under the circumstances. Ethical Consideration 5-7 of the Model Code requires: "[B]ecause [the lawyer] is in a better position to evaluate a cause of action, [the lawyer] should enter into a contingent fee arrangement only in those instances where the arrangement will be beneficial to the client."\textsuperscript{107} At first, it might be difficult to imagine how a billing arrangement could be "beneficial to the client" without making the lawyer worse off. \textit{Ex-post}, after conclusion of litigation, either the client or the lawyer will be better off because a contingent fee was used instead of an hourly rate; the other will be worse off. \textit{Ex-ante}, however, when the arrangement was made, both lawyer and client might expect to be better off with the contingent fee. The lawyer might anticipate higher earnings and fewer collection difficulties, and the client might benefit from shifting some of her risk of losing to a lawyer better able to diversify against that risk. Nonetheless, such will not always be the case, and Ethical Consideration 5-7 suggests that a client who can bear her own risk of litigation should probably be billed at an hourly rate instead.\textsuperscript{108}

The comments to the Model Rules and Model Code for the most part address procedural fairness, that is, whether clients are informed of their options before agreeing to contingent fees—rather than substantive fairness, and whether a fee is excessive. According to the Comment to Model Rule 1.5, "[w]hen there is doubt whether a contingent fee is consistent with the client's best interest, the lawyer should offer the client alternative bases for the fee and explain their implications."\textsuperscript{109} Ethical Consideration 2-19 of the Model Code states that "[i]t is usually beneficial to reduce to writing the understanding of the parties regarding the fee, particularly when it is contingent."\textsuperscript{110}

\textsuperscript{106} See Model Rules Rule 1.8(j).
\textsuperscript{107} Model Code EC 5-7.
\textsuperscript{108} Enforcing this standard would be difficult because hourly and contingent fees are difficult to compare (the expected value of the contingency is usually higher \textit{ex-ante} on account of the risk involved, but can be higher or lower than the hourly fee \textit{ex-post}). Perhaps because this comparison is so difficult, EC 5-7 is an ethical consideration instead of a disciplinary rule. However, it is important to note that some courts apply ethical considerations "as if they were mandatory in character." Brickman, \textit{Contingent Fees}, supra note 15, at 51 n.88.
\textsuperscript{109} Model Rules Rule 1.5 cmt.; see also ABA Comm. on Ethics and Professional Responsibility, Informal Op. 1521 (1986) ("[W]hen there is any doubt whether a contingent fee is consistent with the client's best interest, [and the client is able to pay a reasonable fixed fee,] the lawyer must offer the client the opportunity to engage counsel on a reasonable fixed fee basis before entering into a contingent fee arrangement.").
\textsuperscript{110} See Model Rules Rule 1.5(c) (requiring that the agreement be in writing).
Case law expands on standards in the Model Rules and Model Code, but there is no bright-line test to determine when contingent fees are excessive. A contingent fee may exceed a fixed fee for the same work, particularly "in a case where there is very little chance of a successful verdict." On the other hand, when a case is virtually certain to result in a large verdict, when both liability and great damages are easy to prove, the small chances of nonrecovery or of a small award can justify a correspondingly smaller increase in the attorney's fee. Courts often take into account the unequal bargaining power between lawyer and client; a lawyer usually has the burden of proving that his fee is reasonable, and some courts impose a fiduciary standard on a lawyer when he negotiates compensation with his clients. As Professor Hazard has observed, "A contract for a fee is, under general principles of law, a contract between a fiduciary and his pro-

111. For example, in In re Swartz, 686 P.2d 1236, 1239, 1244 (Ariz. 1984), the Supreme Court of Arizona determined that a contingent fee of one-third of a client's recovery was excessive. In addition to the factors listed in DR 2-106, the Court considered "a number of factors, including: . . . the degree of uncertainty or contingency with respect to liability, amount of damages which may be recovered, or the funds available from which to collect any judgment . . . ." Id. at 1243.

112. Rosquist v. Soo Line R.R., 692 F.2d 1107, 1114 (7th Cir. 1982). Recognizing that "chances of success in this case varied on the different parts of the claim," the Court held that "it was not erroneous to calculate the fee separately for the different plaintiffs sharing the judgment." Id.; see McKenzie Constr. v. Maynard, 823 F.2d 43, 45, 49 (3d Cir. 1987) (contingent fee not unreasonable where attorney earned $790 per hour rather than his normal hourly rate of $60).

113. Rosquist, 692 F.2d at 1114; see also Horton v. Butler, 387 So. 2d 1315, 1317 (La. Ct. App. 1980) (one-quarter contingent fee unreasonable where lawyer's only actions to collect insurance were contacting insurer and accepting a check); Anderson v. Kenelly, 547 P.2d 260, 260-61 (Colo. Ct. App. 1975) (one-third contingent fee unreasonable where lawyer's only action to assist widow in collection of claim from life insurance company was to inform insurer of the correct date her deceased husband enlisted in the Air Force). At least in the view of the ABA, some form of contingent fee can still be appropriate in cases where liability is certain. See ABA Comm. on Ethics and Professional Responsibility, Formal Op. 389, at 15 (1994) ("[T]he [Standing] Committee [on Ethics and Professional Responsibility] concludes that as a general proposition contingent fees are appropriate and ethical in situations where liability is certain and some recovery is likely. . . . That having been said, there may nonetheless be special situations in which a contingent fee may not be appropriate. For example, if in a particular instance a lawyer was reasonably confident that as soon as the case was filed the defendant would offer an amount that the client would accept, it might be that the only appropriate fee would be one based on the lawyer's time spent on the case . . . .").

114. McKenzie Constr., 823 F.2d at 45. The Third Circuit looks for reasonableness both ex-ante and ex-post. "Although reasonableness at the time of contracting is relevant, consideration should also be given to whether events occurred after the fee arrangement was made which rendered a contract fair at the time unfair in its enforcement." Id.

115. Nolan v. Foreman, 665 F.2d 738, 739 n.3 (5th Cir. 1982) ("The fiduciary relationship between an attorney and his client extends even to preliminary consultations between the client and the attorney regarding the attorney's possible retention."); Archer v. Griffith, 390 S.W.2d 735, 739 (Tex. 1964) ("The relation between an attorney and his client is highly fiduciary in nature, and their dealings with each other are subject to the same scrutiny, intendments and imputations as a transaction between an ordinary trustee and his cestui que trust.").
ected dependent. As such, it is unenforceable unless its terms are fair to the client."116

In addition to determining reasonableness on a case-by-case basis, some jurisdictions limit contingent-fee percentages by rules of court.117 A few federal statutes impose similar limits.118 However, some scholars point out that lawyers respond to such "caps" not by charging less for their work, but by working less.119 This same criticism could be directed at any attempt, whether by regulation or case law, to establish an explicit or implicit cap on contingency percentages.120 Clearly, regulation of contingent fees, whether by rules of ethics, case law, or statutes, is an imprecise and ineffective substitute for a competitive market.

Furthermore, introduction of an English rule could alter contingent-fee structures if lawyers agree to assume clients' potential liability for opponents' fees in addition to their own. Lawyers probably would demand compensation for such additional exposure to loss, although it should be kept in mind that lawyers also would benefit under an English rule when they win and collect the value of their work (presumably at an hourly rate) from opposing counsel as well as a percentage of the judgment from their client. Nonetheless, courts reviewing fees probably would adjust upwards their view of what percentage fee is reasonable if the lawyer agreed to assume liability under an English rule. The fee schedules established by statutes or rules of court might be more resistant to such arrangements whereby lawyers insure their clients against fee-shifting liability.

117. See N.J. R. Ct. 1:21-7(c) (West 1995) (schedule of contingent fees allows "(1) 33⅓% on the first $250,000 recovered; (2) 25% on the next $250,000 recovered; (3) 20% on the next $500,000 recovered"; and on all additional amounts a reasonable fee by application to the court); American Trial Lawyers Ass'n v. New Jersey Supreme Court, 330 A.2d 350, 355 (N.J. 1974) (New Jersey Supreme Court had constitutional authority to establish fee schedule).
119. Kevin M. Clermont & John D. Currivan, Improving on the Contingent Fee, 63 CORNELL L. REV. 529, 535 (1978). "[S]uch rate ceilings are largely cosmetic, keeping the final fee at what seems a reasonable level to the outside observer, while still permitting the lawyer covertly to pick and then milk (through underwork) the lucrative cases." Id. at 581. If percentage fees are limited, attorneys will simply work fewer hours on each case. See Murray L. Schwartz & Daniel J.B. Mitchell, An Economic Analysis of the Contingent Fee in Personal-Injury Litigation, 22 STAN. L. REV. 1125, 1144-45 (1970).
120. The Brickman Proposal may mitigate this problem because instead of capping percentages it requires percentages to be based on the difference between recovery and the first settlement offer. See infra text accompanying note 131. A lawyer who does not work hard to get a favorable judgment presumably will not have a large difference between settlement offer and verdict on which to calculate his contingent fee.
B. The Contingent-Fee Debate

Lester Brickman's research has focused on market failures that have led to excessive pricing of contingent fees. Brickman has argued that "many contingent fees are invalid as a matter of ethics, policy, and law since they are often used in situations where there is either no contingency or, although a contingency exists, the contingent fee far exceeds any legitimate risk premium for the anticipated effort." Professor Brickman's proposed remedy is "a contingent fee percentage calculus which consists of four main elements: The lawyer's anticipated effort; estimated risk of nonrecovery; settlement value of the case; and the risk premium . . . to compensate for the risk the lawyer undertakes." Professor Brickman recommends that these elements be "incorporated into a standardized form which should be submitted to the client and to the court."

Kevin Clermont and John Curriivan have proposed a "contingent hourly-percentage fee," a lodestar approach under which a fee in no event exceeds a plaintiff's recovery, but within this limitation equals the sum of (i) an hourly charge and (ii) "a percentage . . . of the amount by which the gross recovery exceeds that time charge." If the client recovers less than her lawyer's hourly charge, the lawyer forgoes the difference. If the client recovers more, the lawyer charges a percentage of the excess. Presumably, this arrangement encourages a lawyer to further her clients' interests by compensating the lawyer for investing more time in a case. This proposal, however, does not completely resolve conflicts of interest between lawyers and clients and does not fully address the most common criticism of contingent

121. Brickman, Contingent Fees, supra note 15, at 32. "On the other hand, contingent fees in excess of fifty percent, which are typically precluded by court rule, statute or custom, should be upheld in cases where the risks of nonrecovery and greater effort than anticipated are high." Id. at 34.

122. Id. at 34.

123. Id.

124. Clermont & Curriivan, supra note 119, at 537. Professor Brickman criticizes this proposal on the ground that it "either seeks to supplant bargaining with a judicially fixed percentage [if the second part of the fee is fixed by a court], or allows for bargaining but does not respond to overreaching" by the attorney who takes too high a percentage. Brickman, Contingent Fees, supra note 15, at 135. Professor See proposes that the charge should "be the basic hourly charge . . . plus a per-hour charge for risk." Harold See, An Alternative to the Contingent Fee, 1984 UTAH L. REV. 485, 500.

125. This arrangement would presumably overcome incentives lawyers have to spend less time working on contingent-fee cases than would be optimal from the vantage point of their clients. See infra text accompanying notes 208-11.

126. Professor Jay has criticized this proposal on a number of grounds, including the likelihood that lawyers' incentives will be skewed if their hourly rate is different than it would be under a straight hourly contract and the proposal's failure to address lawyers' and clients' often differing attitudes toward risk. Jay, supra note 11, at 863-66.
fees, i.e., that lawyers may take an excessive percentage of their clients’ recovery relative to the amount of risk involved.

Professor Herbert Kritzer disputes the necessity for such schemes and the argument that contingent-fee lawyers are overpaid, at least on average. He points out that plaintiffs’ lawyers incur risk when they invest time and energy in a portfolio of contingent-fee cases and that on the whole they do not earn excessive returns, particularly when this risk is taken into account. “Typical returns from contingent fee work,” he observes, “are very similar to what would be expected working on standard hourly rates.” Otherwise, more lawyers would accept contingent-fee work and “drive down the fees to market levels.” Furthermore, Kritzer cites a “nonscientific survey” indicating “that some market forces may be working because the percentage charged for contingent fee work seems to vary rather than being fixed at a simple 33%.”

127. HERBERT M. KRITZER, RHETORIC AND REALITY . . . USES AND ABUSES . . . CONTINGENCIES AND CERTAINTIES: THE POLITICAL ECONOMY OF THE AMERICAN CONTINGENT FEE (1995) (paper published by Wisconsin Institute for Legal Studies). From [reports from various state bar associations conducting economic surveys of their membership], I find that the median incomes for personal injury plaintiffs lawyers ranges from a low of $63,000 in New Hampshire (1990) to a high of $108,000 in Texas (1992). Based on these figures, plus the others I had available, my best estimate of the median income of personal injury attorneys is $70,000 to $80,000. Id. at 20-21.

However, market conditions may allow some lawyers working on a contingency to charge too much while others, perhaps even a majority, are forced to take cases with such low chances of recovery that even the standard 33% contingency barely provides a living wage. By analogy, a survey of average profits of drugstores nationwide would reveal little about whether some drugstores have sufficient market power to charge excessive prices (indeed, a statistic that mixes stores on the verge of failure in with alleged monopolists would only confuse the picture). As Professor Brickman observes, “The reveal/conceal quotient of ‘averages’ can vary considerably.” Brickman, Contingent Fees, supra note 15, app. B at 133.

Another critical factor in any empirical survey of lawyer billing practices is the geographic area surveyed. If the objective of a survey is to assess whether plaintiffs’ lawyers are charging too much for contingent fees, it makes sense to survey states where the underlying industry—tort litigation—is most prevalent (measured perhaps by the number of bodily injury claims per 100 automobile accidents). Surveys of states like Wisconsin are helpful if those states have a high number of bodily injury claims, but less helpful if those states do not. Lester Brickman is working on a response that criticizes Kritzer’s surveys for focusing too much on low injury-to-accident states like Wisconsin and not focusing enough on large urban areas, such as Philadelphia and Los Angeles, where bodily injury claims are the highest (a curious phenomenon as lower speed limits in urban areas would presumably lead to fewer claims, assuming the speed of road traffic and not of courtroom traffic is the determining factor). Telephone Interview with Lester Brickman (Aug. 28, 1995).


129. Id.

130. Id. Kritzer suggests that this is “[o]ne other issue the data suggest for further investigation.” Id. at 26.
C. The Brickman Proposal

The Brickman Proposal is designed for personal injury litigation, although with some modification, it could apply to other tort cases as well. As set forth in the outline preceding the proposal, its five principal features are:

1. Contingency fees may not be charged against settlement offers made prior to plaintiffs' retention of counsel.

2. All defendants are given an opportunity to make settlement offers covered by the proposal, but no later than 60 days from the receipt of a demand for settlement from plaintiffs' counsel. If the offer is accepted by the plaintiff, counsel fees are limited to hourly rate charges and are capped at 10% of the first $100,000 of the offer and 5% of any greater amounts.

3. Demands for settlement submitted by plaintiffs' counsel are required to include basic, routinely discoverable information designed to assist defendants in evaluating plaintiff claims. In turn, to assist plaintiffs in evaluating defendants' offers, discoverable material "in the . . . [defendant's] possession concerning the alleged injury upon which [the defendant] relied in making his offer of settlement" must be made available to plaintiffs for a settlement offer to be effective.

4. When plaintiffs reject defendants' early offers, contingency fees may only be charged against net recoveries in excess of such offers.

5. If no offer is made within the 60 day period, contingency fee contracts are unaffected by the proposal.131

Although the Brickman Proposal enjoys the support of some prominent members of the bench and bar,132 its critics extend beyond the plaintiffs' bar. Professor Kritzer disputes the underlying premise of the Brickman Proposal that contingent fees do not correspond to risk.133 Professor Charles Silver questions the view that contingent-fee lawyers are overpaid, particularly in view of the risks and difficul-

131. Brickman et al., supra note 17, at 27-28 (citations omitted). The ABA Standing Committee on Ethics and Professional Responsibility (the "Standing Committee") takes the position that the Model Rules do not require contingent-fee lawyers to solicit early settlement offers from defendants and that a contingent fee may be charged against the amount of a settlement. See ABA Comm. on Ethics and Professional Responsibility, Formal Op. 389, at 37 (1994). But see Letter from Thomas D. Morgan to David Isbell, Chair of the Standing Committee (Nov. 30, 1994) ("[A] plaintiff's lawyer is professionally obligated to determine what the case is worth after very little investment of lawyer time. The client should then have the opportunity to accept or reject the offer. The lawyer may charge a standard contingent fee for anything recovered in excess of that offer, but only a much lesser amount for the sum that did not require the lawyer's effort or skill.")

132. See supra note 18.

133. Brickman et al., supra note 17, at 20-23; Kritzer, supra note 127, at 1-2.
ties of their practice. Silver suggests that plaintiffs' lawyers do compete with each other and that "uniform percentage fees also may be desirable products of competition" because uniformity sometimes benefits lawyers and clients by lowering bargaining costs and "equalizing lawyers' incentives across caseloads." He suggests that regulating contingent fees, if done at all, should be done in a way that will not create new problems, possibly including a "shortage of personal injury lawyers" and a decline in "the quality of representation."

It thus is hotly debated whether the limits on contingent fees set forth in the Brickman Proposal are needed in the first place. If the market for lawyer-provided champerty already is competitive, such limits could restrict rather than expand options available to consumers. If, on the other hand, the existing market is not competitive, regulation such as that contemplated by the Brickman Proposal may be needed if case-by-case scrutiny of contingent fees by courts is ineffective at protecting consumers from price gouging. However, it may also be possible to make the market more competitive by encouraging nonlawyer litigation insurers to increase the number of options available to litigants.

The empirical data on contingent fees has been studied by several legal scholars and will not be re-examined exhaustively in this Article. Although not all empirical studies suggest lack of competition among lawyers, the economic models discussed in Part III below may help explain those empirical studies that do show competition to be lacking. If further empirical data supports this conclusion, measures

134. Charles Silver, Control Fees? No, Let the Free Market Do Its Job, NAT'L L.J., Apr. 18, 1994, at A17, A18. Professor Silver points out that personal injury lawyers incur high costs (including advertising and malpractice insurance), enjoy low professional prestige, have little administrative support, handle many clients with little repeat business and get into many fights with clients. "In Texas, a state denigrated as a haven for personal injury lawyers," the approximate $23,000 per year difference between their average income and that of all lawyers in Texas has not caused other lawyers to join the plaintiff's bar. Id. at A17.

135. Id. at A18. "The [Manhattan Institute] report thus fails to show that percentage fees are either inefficient or the result of constrained competition." Id.

136. Id. Professor Silver's extensive scholarship on fee awards focuses on a number of issues, including awards to plaintiffs' counsel in class actions and under fee-shifting statutes. See Charles Silver, Incoherence and Irrationality in the Law of Attorneys' Fees, 12 REV. LITIG. 301 (1993); Unloading the Lodestar: Toward a New Fee Award Procedure, 70 TEX. L. REV. 865 (1992); A Restitutionary Theory of Attorneys' Fees in Class Actions, 76 CORNELL L. REV. 656 (1991).

137. Price controls can harm not just the supplier, but also consumers. For a detailed discussion on the effects of price controls, see EDGAR K. BROWNING & JACQUELENE M. BROWNING, MICROECONOMIC THEORY AND APPLICATIONS 284-301 (3d ed. 1989). One option that price controls might preclude for consumers of legal services is retention of a lawyer willing to devote a substantial amount of time to a contingent-fee case. See supra note 119.

138. See supra text accompanying notes 121-30.
such as the Brickman Proposal might help curb abuse of market power by plaintiffs' lawyers. However, the discussion in Part IV of economic and ethical costs of lawyer champerty suggests that, whether or not there is adequate competition among contingent-fee lawyers, nonlawyers sometimes could share the risks of litigation at substantially less cost to themselves and to society. If so, the legal system should remove impediments to nonlawyer legal-cost insurance.

III. The Market for Lawyer Champerty

A. Components of a Contingent Fee

A lawyer working on a contingent fee is selling three products combined into one. The first product is legal services. The second is credit—postponing payment until the client collects on a judgment. The third is legal-cost insurance—agreeing to waive payment for legal services that do not achieve favorable results (for example, the value of legal services in excess of one-third of a judgment) in return for a premium payment for legal services that do achieve favorable results (for example, a surcharge equal to the amount by which one-third of a judgment exceeds the value of the legal services). A fourth product might be sold by some lawyers in connection with an English rule—agreeing to assume a client's potential liability for opposing counsel's fees in return for a larger percentage of any judgment obtained.

Contingent-fee lawyers extend credit to their clients, but so do hourly rate lawyers who are not fully paid in advance. Although lawyers customarily bill on a monthly or quarterly basis, there is significant variance as to when lawyers actually get paid. Some clients, of course, do not pay at all. Whereas contingent-fee lawyers extend credit until litigation ends (with recourse only against proceeds of the litigation itself), hourly rate lawyers generally extend credit only until their bill is due (with recourse against the client personally). The hourly rate lawyer's risk also is a credit risk rather than an insurance risk; the client is obligated to pay, but perhaps because of losing his case, the client is unable or unwilling to pay. Because this credit risk can be substantial, an hourly rate lawyer working without a retainer may charge more for her services or give fewer discounts, particularly if the client is a poor credit risk.

140. Id.
Recently, nonlawyer intermediaries have joined lawyers in extending credit for legal services. One California company has introduced "Lawcard," a credit card on which clients can charge legal fees. Lawyers are “guaranteed that [they will] be paid regularly and in full, minus a service charge” of ten to thirty percent of the total fee. The service charge is withheld from the lawyer and varies with the client’s “credit rating”—which in turn is based on the client’s financial standing and the type of case. The lawyer for a well-to-do plaintiff in a patent case might be charged ten percent of her fee whereas the lawyer for a middle income client seeking a divorce might be charged thirty percent. A lawyer whose client uses Lawcard might or might not pass the service charge on to the client in the form of a higher fee.

A pure credit arrangement (under which a client would ultimately be liable for the full value of legal services), however, does not accommodate a client’s low tolerance for the substantial risks of litigation. A client incurs risk in allowing her claim to be handled by a particular lawyer; the client may recover less because of the lawyer’s incompetency, inexperience, or poor judgment. The client thus assumes the risk of finding out *ex-post* that she chose a lawyer less effective than another lawyer might have been. Furthermore, there is risk inherent in litigation itself—almost every claim, no matter how good, has some chance of being lost or resulting in a low recovery, whether because of a statute of limitations or other technicality, an unsympathetic jury or judge, or witnesses who collapse under cross examination. Finally, some claims simply are better than others, and a client may want to insure against the risk that her claim is a poor one.

The third component of a contingent-fee arrangement meets this need for insurance because contingent-fee lawyers not only extend credit, but also share risks with their clients. Just as a merchant or a credit card company may insure a buyer's purchase against loss or

141. Jan Hoffman, *The Credit Card That Pays Legal Bills*, N.Y. TIMES, July 29, 1994, at B7. Although lawyers usually may accept payment by conventional credit card, legal fees would exceed many clients' credit lines. Lawcard is a separate credit line for services rendered by a lawyer approved by the card issuer. *Id.*

142. *Id.*

143. Most of the ethical issues involved with Lawcard arise because lawyers act as agents of the card issuer when giving the Lawcard application to clients who depend upon the lawyers for disinterested advice. Furthermore, Lawcard could violate prohibitions on lawyers splitting fees with third parties. For discussion of these prohibitions, see ACLU/Eastern Missouri Fund v. Miller, 803 S.W.2d 592, 594-95 (Mo.), cert. denied, 500 U.S. 943 (1991) (assignment by lawyers to ACLU of fee in civil rights lawsuit violated prohibition on lawyers sharing fees with laypersons); *Stephen Gillers, Regulation of Lawyers: Problems of Law and Ethics* 805 (2d ed. 1995).
damage, a lawyer may insure a client against the contingency that legal services will not provide substantial benefit; the insurance premium is the lawyers’ share in the proceeds if the suit is successful and the payout is a waiver of attorneys’ fees if it is not. If lawyers were to sell the insurance component without the credit component (which almost none do), they would bill clients at higher than normal hourly fees and agree to reimburse all or part of such fees if recovery were lower than expected. Instead, almost all contingent-fee lawyers sell the credit component in addition to the insurance component and postpone payment during the pendency of litigation.

Such risk sharing by lawyers and clients obviously increases the likelihood that plaintiffs will prosecute their claims. More cases will be litigated if legal-cost insurance is available to plaintiffs than if it is not. This is true even if hourly rate lawyers or other lenders, like Lawcard, advance credit to plaintiffs for costs of litigation; some plaintiffs simply will not assume the risk of litigating without insurance. It is obvious why contingent fees are not favored by likely defendants in lawsuits.

B. Competition—Is There or Isn’t There?

Bar admission requirements limit the supply of lawyers, and in a number of contexts lawyers are alleged to use their market power to violate antitrust laws. Indeed, the practice of law is sometimes de-
scribed as a monopoly granted to lawyers by the state. However, law practice is not monopolized by a single provider the way utilities, railroads, and other industries sometimes are. Lawyers can and do compete with each other for business. Thus, the mere fact that lawyers dominate the market for legal services or champerty of litigation does not necessarily make pricing anticompetitive.

If lawyers compete against each other, they may drive prices down to competitive levels. Alternatively, lawyers may collude to set prices at higher than competitive levels or litigants may not have opportunities to compare lawyers and their prices. Thus, a critical empirical question for most scholarship in this area has been the extent to which lawyers compete against each other when they price contingent fees. This Article does not analyze available empirical data that has already been exhaustively analyzed by scholars. Rather, this Article discusses three economic models that may explain peculiarities in the pricing of contingent fees: a model in which sellers compete primarily with respect to a single variable (quality of service), a model featuring tie-ins where purchase of one product (legal-cost insurance) is required to purchase another (legal services), and a price discrimination model in which sellers charge different amounts for the same service according to the value that each individual buyer places on that service. This Article also discusses ways in which each of these three models differs from a model of perfect competition.


149. For a detailed discussion on resource cartels such as labor monopolies, see Jack Hirshleifer, Price Theory and Applications 380-83 (3d ed. 1984); see also Ian Ayres, How Cartels Punish: A Structural Theory of Self-Enforcing Collusion, 87 Colum. L. Rev. 295 (1987).

150. Lack of competition in the market for legal services has been noticed by courts as well as commentators. Chief Justice Burger observed in 1986 that, "[i]n multiple disaster cases . . . the transaction between an experienced lawyer and inexperienced lay survivors in negotiating a contract for professional services is not an arm's length transaction." Michael Horowitz, Making Ethics Real, Making Ethics Work: A Proposal for Contingency Fee Reform, 44 Emory L.J. 173, 179 n.26 (1995) (citing James H. Rubin, Chief Justice Urges Look at Limits on Lawyer's Fees, Associated Press News Release, May 13, 1986). Justice O'Connor observed that "it would be unrealistic to demand that clients bargain for their services in the same arm's-length manner that may be appropriate when buying an automobile or choosing a dry cleaner." Shapero v. Kentucky Bar Ass'n, 486 U.S. 466, 489-90 (1988) (O'Connor, J., concurring in part and dissenting in part).

151. See Kritzer, supra note 127; Brickman, Contingent Fees, supra note 15; Clermont & Currivan, supra note 119; Schwartz & Mitchell, supra note 119.

152. See Kritzer, supra note 127; Brickman, Contingent Fees, supra note 15.
1. The Fixed-Variable Competition Model

In a competitive market, different lawyers would charge the same litigant different amounts for the first product they sell, their services. A lawyer's expected fee thus would be an amount equal to the market value of lawyer time that she expected to devote to the litigant's case. For example, a client should pay a higher fee for a skilled litigator or settlement negotiator willing to devote substantial time to a case. Alternatively, low opportunity costs often cause less experienced lawyers to charge less (perhaps by taking a very risky case for a reasonable contingent fee).

In addition to the fee for services (the underlying fee), a contingent-fee lawyer also charges her client a premium for providing credit and insurance. This premium equals the amount by which the lawyer's expected recovery from a case (the total fee) exceeds the underlying fee. In deciding what premium she will accept for taking a case on a contingency, the lawyer might consider factors unique to her practice such as her ability to diversify against the risk of losing. For example, cases which require substantial time investment may pose a level of risk that is unacceptable to solo practitioners and smaller firms. A lawyer also will take into account compensation disputes that a fee arrangement may cause within her law firm, a factor often weighing against larger firms taking cases on a contingency.\textsuperscript{153}

However, a perfectly competitive market would tend to force premiums for contingent fees to levels demanded by the lowest-cost providers. High-cost providers would find market premiums to be unattractive and switch to working at an hourly rate instead. Thus, individual tolerance for risk and compensation politics of individual firms would not affect premiums, and premiums instead would vary primarily with factors unique to the case at hand: the expected return on investment of lawyer time and how long a lawyer would have to wait for that return. Lawyers who stay in the market would charge similar premiums for financing and insuring similar cases just as, in a perfectly competitive market for auto insurance, insurers would charge similar rates to insure the same car and driver.

The total fee (premium plus underlying fee) can be an enhanced hourly rate, payment of which is contingent on recovery. Alternatively, the total fee can be a percentage of any judgment or settlement obtained, in which case, two variables, the size and strength of the

\textsuperscript{153} See infra notes 226-37 and accompanying text.
claim, determine the premium. Thus, in a competitive market the percentage charged should be identical for similar claims (in size and risk) to which lawyers of similar skill devote similar amounts of time. Differences in any of these variables should cause variation in the percentage charged.

While it is true that variations in these factors could balance each other out, a competitive market in which fees consistently are the same percentage of judgment or settlement (for example, thirty-three percent) would be unusual. Theoretically, it is possible that all lawyers could charge the same percentages and compete with respect to the quality of their services (skill and expenditure of time). In this scenario, the better cases would simply go to the better lawyers. It is unlikely, however, that perfect, or anything near perfect, competition among lawyers would settle into such an equilibrium in which plaintiffs are charged the same percentage fee regardless of the size and strength of their cases. Indeed, competition only with respect to quality of service, not price, is characteristic of markets subject to external restraints on competition. Examples include the market for airline tickets prior to deregulation of the airlines in the late 1970s and the market for stock brokers’ commissions prior to abolition of fixed

154. To some extent, there is competition among lawyers, with the better cases going to the better lawyers. However, it is lawyers, not plaintiffs, who usually benefit from this competition, because lawyers who try contingent-fee cases often get those cases on referral from other lawyers. The lawyer who signed up a client and the trial lawyer may negotiate in a competitive market for different shares. In this scenario, the legal profession allocates within itself the benefits of competition while the plaintiff pays a fee that is often uniform (i.e., thirty-three percent) regardless of the strength or size of the case.

The Model Code prohibits unaffiliated lawyers from dividing a fee except in proportion to the work that they actually perform for the client. MODEL CODE DR 2-107(A). The practical effect of the Model Code restrictions is to prohibit fees for “referral.” However, many jurisdictions have chosen the more liberalized approach in Model Rule 1.5(e), which allows a fee division so long as “the division is in proportion to the services performed by each lawyer” or “by written agreement with the client, each lawyer assumes joint responsibility for the representation.” As Comment 4 to Rule 1.5 points out, this Rule “permits the lawyers to divide a fee on either the basis of the proportion of services they render or by agreement between the participating lawyers if all assume responsibility for the representation as a whole and the client is advised and does not object.” Such an arrangement is used by a lawyer who initiates a contingent fee representation and passes the case on to another lawyer, often more experienced in trial work, keeping for themselves a “finder’s” fee consisting of a percentage of any judgment obtained.

The liberalized fee-splitting rule in Model Rule 1.5 broadens the range of allowed contractual arrangements between lawyers and their clients. Allowing a portion of a fee to go to the lawyer who originates a representation may encourage lawyers to refer cases that can more competently be handled by other lawyers.

155. For discussion of the single variable quality-focused competition in the airline industry prior to its deregulation, see Stephen Breyer, Regulation and Its Reform 36-82 (1982).
commissions in 1975. In a competitive market, lawyers, like other suppliers of goods and services, should compete with respect to both price and quality.

As is often the case, however, the real world does not conform to the model of perfect competition. As Professor Brickman points out, “[t]he existence of a standard one-third contingent fee itself indicates the absence of competitive pricing,” particularly where “[t]he likelihood of success in prosecuting personal injury and other claims ranges from zero to one hundred percent.” Other evidence that “[c]ontingent fee lawyers are charging monopoly rents” includes the fact that, over a twenty-five-year period, the standard one-third fee has survived a “doubling of the success rate at trial” and “a very substantial increase in the average inflation-adjusted tort award.” Furthermore, the historical development of contingent fees has shown that courts and states, not market forces, have been the predominant force in fixing prices at their current level. Although lawyers may compete for the better cases, with less experienced lawyers getting smaller cases with lower chances of recovery, in a perfectly competitive market lawyers would compete with respect to the percentage charged as well as quality of service. No one price formula would predominate the way the one-third contingent fee does today.


157. Brickman, Contingent Fees, supra note 15, at 106. Professor Brickman points out that “[c]laims with a very low likelihood of success or a low anticipated return are typically rejected by lawyers, so that the claims which actually gain legal representation usually reflect success likelihoods ranging from twenty to one hundred percent.” Id. For the cases that are taken, however, it is also true that “[u]nder competitive conditions the same percentage fee would not be charged for both [high value and low value] cases.” Schwartz & Mitchell, supra note 119, at 1139-40.

158. Brickman, Contingent Fees, supra note 15, at 105.

159. Id.

160. Id.

161. Id. at 106-07. When contingent fees climbed to around fifty percent, statutes and rules were used to drive them down. Id. at 107 & n.314 (citing New York State Legislative An- nual 131-32 (1985), which amended the contingent-fee schedule in New York, Judiciary Law § 474-a (McKinney 1983)).

162. Professor Brickman also points out that in the one arena in which lawyers bid against each other, aviation accident cases, contingent fees have dropped from thirty-three percent to around fifteen to twenty percent. Competition is enhanced because the identities of victims are publicly available shortly after a crash and because many lawyers bid for these cases. Id. at 109-10 & n.325.
2. The Tie-in Model

One way a seller can use market power is to construct a tie-in between two products. Customers buying the "tying" product, often find that the "tied" product is overpriced. A tie-in thus can be used to take advantage of market power and capture more of the value that a buyer places on a product. A tie-in, however, does not itself give a seller market power; the seller can only charge what buyers will pay for the two products combined. Rather, the tie-in is an instrument by which a seller who already has market power extracts higher prices.

Thus, in a perfectly competitive market, a tie-in would be useless as a pricing strategy and would not be used. The tie-in could not extract consumer surplus because other sellers willing to sell for a smaller share of consumer surplus would enter the market. Tie-ins thus are ineffective at raising prices unless there are market aberrations, such as price controls, or market power that allows a seller to extract a share of consumer surplus. Buyers who do not want the tied product have ample opportunities to go elsewhere.

For example, because a retailer with substantial sales would presumably value its leased premises more than a retailer with smaller sales, many commercial landlords charge rents that are a percentage of a renter's retail sales. "This tie-in of rent to sales might be a way for the owner to capture more of the renter's value of the premises, but it might also be a way of sharing risk in the value of the premises." The renter thus buys "leasehold-value insurance" from the landlord in much the same way a client buys legal-cost insurance from

163. A tie is "an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier." 9 PHILLIP E. AREEDA, ANTITRUST LAW 4 (1991) (quoting Northern Pac. Ry. v. United States, 356 U.S. 1, 5-6 (1958)).

164. "In a tie-in, then, the prices of the items are separately meaningless. Only the sum of the two prices is relevant, and only that is compared to the buyer's total personal valuation for the two items." ARMEN ALCHIAN & WILLIAM R. ALLEN, EXCHANGE & PRODUCTION: COMPETITION, COORDINATION, & CONTROL 251 (3d ed. 1983).

165. This value attributed to a good or service by the buyer is represented by the area under the demand curve showing how much buyers are willing to pay. See id. at 17-18; see also diagram, infra note 187.

166. "Of course, antitrust law is surely concerned with the oppression of buyers that results from reducing the vitality of competition in either the tied or tying market. However, the interference with buyer choice, standing alone, is a doubtful ground for objecting to tie-ins." AREEDA, supra note 163, at 9-10.

167. "During price controls on gasoline, sellers often required that to get gasoline you had to buy a lube job." The sellers thus "captured more of the value of the gasoline." ALCHIAN & ALLEN, supra note 164, at 252.

168. Id.
a contingent-fee lawyer. Whether the risk-sharing arrangement also allows the owner to capture more of the renter's value of the premises, however, depends on whether there is a competitive market. If the market is competitive, the renter with substantial sales can avoid losing this value by negotiating a more favorable lease elsewhere. The owner thus could not insist that every renter pay the same percentage of sales.

Because tie-ins indicate concentrated market power, they can run afoul of the antitrust laws. However, because tie-ins usually are a means of using or "leveraging" market power, rather than its source, antitrust laws generally target the market power rather than the tie-in itself. Furthermore, tie-ins are rarely even acknowledged, much less contested, in contexts where buyers, and government regulators, commonly believe that only a single product is being sold. For example, the tie-in often goes unnoticed in the case of a commercial lease priced so as to effectively require the renter to buy leasehold-value insurance as well as a lease.

Instead of a mandatory tie-in, a seller may use a nonmandatory tie-in that gives buyers a choice of whether to buy the second product, sometimes coupled with some form of coercion or aggressive marketing. Although the second product may be needed to use or to pay for the first, such as software for a computer or financing for a car, in other instances the second product is unnecessary and not even particularly desirable. Perhaps the most widely known example of a non-mandatory tie-in is insurance designed to insure against loss, damage, 

169. It is unlawful under § 3 of the Clayton Act for any contract for the "sale of goods, wares, merchandise, machinery, supplies, or other commodities" (but not services) to prohibit dealings with a competitor "where the effect . . . may be to substantially lessen competition or tend to create a monopoly in any line of commerce." AREEDA, supra note 163, at 10 n.21 (quoting 15 U.S.C. § 14 (1982)).

170. "The original, continuing, and most fundamental concern about tying is 'leverage.'" Id. at 6. "'Leverage' is loosely defined . . . as a supplier's power to induce his customer for one product to buy a second product from him that would not otherwise be purchased solely on the merit of that second product." Id. (quoting Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 14 n.20 (1984)).

171. Professor Areeda identifies "'bundled' products or services," provided by a seller that "engages in further processing or otherwise performs internally a service that customers might have purchased from others." Examples include a hospital that denies independent sellers of goods and services access to the premises, a seller that "bundles installation charges into the price of a product," and a nursing home that includes the price of meals in a monthly charge. Id. at 231.

172. Although it is frequently said that "coercion" of some type must be present for a tie to exist, "a tie may be present without 'coercion' in the lay sense." Id. at 12. For example, a monopolist may sell a tying product at a lower price to customers who buy a second product. Id.

or inability to use a product. Buyers of many products, including television sets, computers, and cars, are often inundated with requests to purchase a manufacturer's service warranty. Such warranties are often overpriced.\textsuperscript{174} Credit card companies often aggressively market "credit insurance" plans to cardholders to insure against setbacks that could lead to nonpayment of unpaid balances, and these credit-insurance plans generate very high profits for the insurers and the credit card company.\textsuperscript{175} However, such high profits would not exist absent deficiencies in market competition or in consumer information about the insurance contract and about the need for insurance.

Sellers who have a fiduciary relationship with their buyers are in a particularly advantageous position to sell a tied product, although ethical and legal issues arise when a fiduciary relationship is used to direct a selling effort at the beneficiary.\textsuperscript{176} The beneficiary may be led to believe that he needs the tied product when in fact he does not, or may be told that one or both products are fairly priced, when in fact they are not. However, even in the fiduciary context, where a buyer is likely to believe that the seller is looking after the buyer's own interests, a market with perfect competition and perfect information will put buyers on notice. Aggressive selling of unnecessary or overpriced products simply will not work.

Lawyers utilize a mixture of the mandatory tie-in and the non-mandatory tie-in when they sell clients legal-cost insurance by way of a contingent fee. Although lawyers should explain to clients different payment options, and the more ethical practice is to make payment at an hourly rate available to clients who can afford to do so,\textsuperscript{177} it is common for plaintiffs' lawyers to insist on taking cases on a contin-


\textsuperscript{175} See Mike Hudson, \textit{Viewpoints; Credit Insurance: Overpriced and Oversold}, \textit{N.Y. Times}, July 3, 1994, § 3, at 8.

\textsuperscript{176} A lawyer may argue that a fiduciary relationship does not begin until after the lawyer is formally retained, which usually occurs after her fee is agreed upon. This argument is probably unfounded. Brickman, \textit{Contingent Fees, supra} note 15, at 51-53 nn.87-88, 66; see HAZARD, \textit{supra} note 116, at 99.

\textsuperscript{177} See Model Code EC 2-20 ("Although a lawyer generally should decline to accept employment on a contingent fee basis by one who is able to pay a reasonable fixed fee, it is not necessarily improper for a lawyer, where justified by the particular circumstances of a case, to enter into a contingent fee contract in a civil case with any client who, after being fully informed of all relevant factors, desires that arrangement."); The American Lawyer's Code of Conduct ch. 5 cmt. (Roscoe Pound—American Trial Lawyers Found., Revised Draft 1982), reprinted in Thomas D. Morgan & Ronald D. Rotunda, Selected Standards on Professional Responsibility 244 (1994) ("When a contingent fee is proposed by an attorney, it is desirable, although it is not required, that a reasonable retainer arrangement be offered in the alternative.").
Even if lawyers do not insist on working on a contingency, the lawyer-client relationship is particularly prone to aggressive marketing. Clients consult lawyers for advice, and it is all too easy for advice to be coupled with salesmanship.

Furthermore, the "tied" product, legal-cost insurance, can only be obtained from the lawyer providing the legal services. Market conditions, created in part by enforcement of the champerty doctrine and in part by the fact that lawyers may refuse to cooperate with outside litigation insurers, effectively preclude insuring a lawsuit with someone other than the lawyer trying the case. Even other lawyers, unless they assume responsibility for the litigation, cannot advance expenses in return for participation in the contingent-fee arrangement.

It is important to recognize that the tie-in of legal-cost insurance to legal services is not itself the cause of the client's injury. A lawyer's market power may be the cause of injury, and, if so, the lawyer could use that power to extract consumer surplus from the client whether or not the tie-in arrangement were available (market power allows a seller to charge an excessive price for services sold separately as well as together). However, aggressive use of, and often insistence on, the tie-in by lawyers suggests that such market power exists and is being used.

3. The Price Discrimination Model

Because contingent fees usually vary with the size of jury awards or settlements, lawyers expect to earn more from some cases than
from others. Lawyers' expected returns on their time investment thus vary depending on the anticipated value of legal services to particular clients; clients expected to benefit more from legal representation by winning big judgments are charged more while others are charged less.183

Such is price discrimination, a widespread practice whereby producers of goods and services extract higher prices from buyers who value a product more or who can afford to pay more.184 The most widely known instance of discriminatory pricing is in the airline industry where business travelers, presumably on expense accounts and traveling on pretax dollars, are charged fares substantially higher than leisure travelers forced to adhere to rules unacceptable to most business travelers (two-week advance purchase, Saturday night stay, etc.). Another example is pricing by colleges of tuition according to each admitted student's ability to pay.185 Similar pricing schemes are used by utilities and entertainment providers.186

The power of discriminatory pricing to increase output and revenue in a less than fully competitive market is apparent from comparison with a seller who, having some monopoly power, sells to all buyers at the same price.187 Even if the marginal cost of selling an extra unit of product is close to zero (as it is for a seat on an airplane already

183. For a discussion of Lester Brickman's research, see supra text accompanying notes 121-23.
184. AREEDA, supra note 163, at 119.
185. See supra note 49; see also Unprecedented Press Release Attacked MIT, DEP'T JUST. ALERT, Feb. 7, 1994, at 3; DOJ Defends Handling of Ivy League Case, DEP'T JUST. ALERT, July 1992, at 9 (investigation into collusion in the amount of student aid offered to individual students at MIT and other Ivy League Schools).
187. The profit maximizing output for a firm with monopoly power is where the marginal cost curve intersects the marginal revenue curve. For a more detailed discussion, see ARTHUR THOMPSON, JR., ECONOMICS OF THE FIRM: THEORY AND PRACTICE 358-64 (5th ed. 1989).

The difference between a nondiscriminating and a discriminating monopolist is shown by Professor Areeda with a graph similar to the following:
scheduled to fly), a seller charging a uniform price will not sell the extra unit if, in order to do so, she must reduce the price on all other units sold to such an extent that her total revenue decreases on account of sale of the extra unit (in other words, her marginal revenue from the unit is negative). If the marginal cost of selling an extra unit is higher than zero, as is true for a lawyer selling time that could be devoted to other work or to leisure, the effect of uniform pricing is even more pronounced: the seller will not sell an extra unit if, taking into account reduction of prices charged on all other units, total revenue does not increase by more than total costs (in other words, marginal revenue from the extra unit fails to exceed marginal cost). Even if the seller would have sold the extra unit alone at a price that some buyer was willing to pay, the seller charging a uniform price will prefer to let it go unsold.

Discriminatory pricing, on the other hand, allows a lower price to be charged only to buyers who would not pay a higher price. If other buyers can still be charged a higher price, the extra unit can be sold at any price that does not exceed the marginal cost of producing the unit. Marginal revenue will be increased by revenue from the additional sale, but not decreased by reduction of the price on all other units sold. A lawyer using discriminatory pricing, for example, might charge $80 an hour to a client seeking to recover a few thousand dollars in a slip and fall case, but not charge the same low rate to another client suing for, and likely to win a million dollar judgment. The latter client might still be billed at $250 an hour. The lawyer will take the lower paying client so long as the marginal cost of an additional hour of the lawyer's time is less than $80.

Instead of charging $80 and $250, two easily distinguishable hourly rates, the lawyer in the above example could disguise the difference by using a uniform rate (perhaps $150/hour) coupled with premium billing of one client and discounts or write-offs of billable

D is the demand curve; MR is the marginal revenue curve; and C is the cost curve, which is assumed to also describe marginal costs. Under perfect competition, firms would sell output $Qi at price $Pi, where D and C intersect. A nondiscriminating monopolist would sell output $Qi at price $Pi. A "perfectly discriminating monopolist" would sell $Qi at prices ranging from $Pi to $Pi according to each buyer's position on the demand curve. For a similar diagram and analysis, see Areeda, supra note 163, at 124 n.18.

188. Several corporate law firms bill clients by transaction size and results rather than on an hourly basis. See Designer Billing, A.B.A. J., Nov. 1989, at 38. The Model Rules of Professional Responsibility actually condone such fees by specifying as a factor to be considered in determining whether a fee is reasonable, "the amount involved and the results obtained." Model Rules Rule 1.5(a)(4); see Model Code DR 2-106; Committee on Professional Responsibility, Regulation of Contingent Fees, Including Alternative Contingent Fee Arrangements, 45 Rec. Ass'n B. Cty N.Y. 637, 647-48 (1990).
hours for the other. Alternatively, the lawyer could use a contingent fee. Such an arrangement is indeed a perfect device for disguising discriminatory pricing because both clients may appear to be charged the same rate (thirty-three percent), whereas the expected hourly rate (expected recovery × .33 ÷ expected hours) actually could be much higher for the client with the larger claim than for the client with the smaller claim. Regardless of whether the discriminatory pricing appears in a contingent fee or otherwise, the lawyer can accept the lesser paying client's case whereas, if both clients had to be charged the same rate, the client only willing to pay $80 an hour might get turned down.

Apologists for occasional "overcharging" in contingent-fee cases typically assert that lawyers "undercharge" in other cases. Critics argue that undercharging some clients is no excuse for overcharging others. These arguments and rebuttals, however, presume that a significant number of clients are "undercharged," when in fact the discriminatory pricing model suggests that clients are charged what a lawyer's services are worth to them. A lawyer takes some cases for fees that she expects only to exceed slightly her marginal costs because she can still charge higher fees to other clients. Charging some clients less than others—whether directly or through a projected hourly rate hidden in a contingent fee—allows the lawyer to accept

189. Part of the difficulty of the problem of judging the fairness of the contingent fee system in personal injury litigation arises from the existence of two different principles of "fair" pricing. On one hand, if the fee in the individual case is examined according to the usual methods of measuring the value of legal services, any recovery by the lawyer over that value is "unfair" . . .

On the other hand, when the mass of cases is taken as a whole, the idea of using overcharges to some clients to offset undercharges to others does not seem an unfair way to support a system of providing competent legal services to clients who need them, assuming there is no feasible alternative system.

Mackinnon, supra note 148, at 182.

190. As Professor Brickman points out, "[s]uccess or failure in other cases is irrelevant to the fiduciary and ethical issues." Brickman, Contingent Fees, supra note 15, at 32 n.5. This overcompensation argument is a variation of "robbing Peter to pay Paul," which "[a]s George Bernard Shaw noted . . . always meets with the approval of Paul." Lester Brickman & Lawrence A. Cunningham, Nonrefundable Retainers Revisited, 72 N.C. L. Rev. 1, 36 n.133 (1993) (citing Thoughts on Business Life, Forbes, Apr. 23, 1984, at 176). Furthermore, the discriminatory pricing model suggests that Professor Brickman is right that Paul is not another client, but the lawyer.

191. Unless a lawyer intends to work pro bono, intentional "undercharging" of a client will not occur regardless of how much money the lawyer makes elsewhere (a profit-seeking lawyer will not accept a case for which he expects his marginal revenue to be less than his marginal cost in time and effort). The real issue is whether fiduciary and ethical standards permit a lawyer to implement a discriminatory pricing strategy that extracts consumer surplus from clients with larger and stronger claims. Although this question probably can be answered in the affirmative, such is not the point of this Article; modification of inefficient market conditions that allow such discriminatory pricing to occur is.
low-fee cases and still increase her profits. It is true that lawyers sometimes undercharge (work partially or completely pro bono) by taking cases even when they expect marginal revenues will not exceed marginal costs, but even when lawyers do not undercharge, discriminatory pricing allows lawyers to charge lower fees to litigants whose claims are worth less.

It is important, however, to recognize that in a perfectly competitive market such discriminatory pricing cannot occur. The price charged to any client would be at or close to the marginal cost of providing services to that client—a client charged more would simply find another lawyer. If, in the above example, the marginal cost of a lawyer's time is eighty dollars an hour, that lawyer will take business from lawyers of similar skill charging any of their clients more. Thus, absent some market failure, discriminatory pricing is impossible; a provider cannot charge more to one group of buyers simply because they can afford to pay. 192

Discriminatory pricing in the market for legal services indicates that the market is not perfectly competitive. Competition is frustrated primarily by logistical difficulties with comparison shopping. Furthermore, comparison shopping on the basis of price is particularly difficult because premiums for credit and legal-cost insurance are "bundled" with underlying fees into flat percentage fees. 193 Two lawyers, whether charging the same or a different percentage fee, may be charging different premiums, or they may be charging different underlying fees because they have considerably different legal talents and intend to do considerably different amounts of work on a case. The client may have little way of knowing. 194 Competitive pressures thus being limited, discriminatory pricing can increase lawyers' total revenue, and lawyers can implement such a pricing structure by charging most of their clients the same percentage contingent fee (for example, thirty-three percent). The value of the lawyer's services to the client, rather than the marginal cost of those services to the lawyer, is thus the significant determinant of the lawyer's fees. While this price discrimination does not price legal services beyond clients' ability to pay,

192. If firms in a perfectly competitive market earn excessive profits, then other firms enter the market until profits decline to normal levels. See Thompson, supra note 187, at 275-99.
193. See supra note 171 (Professor Areeda's analysis of bundling in the tie-in context).
194. Indeed, one of the most significant advantages that nonlawyer litigation insurers have over lawyers is that their rates are far easier to compare (a client only need obtain quotes from two or more litigation insurers on insuring the same case handled by the same lawyer).
it does mean that some clients pay more than they would in a more competitive market.

IV. The Economics and Ethics of Lawyer and Nonlawyer Champert

Apart from whether lawyers take advantage of less than perfect competition among themselves to overcharge for contingent fees, there is another issue: whether lawyers are the lowest cost providers of credit and legal-cost insurance in the first place. Lawcard has already shown that nonlawyers can efficiently provide credit for legal services, presumably at lower cost than lawyers themselves would incur. Could the same be true for legal-cost insurance? The practice of combining the first product a lawyer sells (legal services) in a package with a second (credit) and a third (legal-cost insurance) may or may not be more cost-effective than selling these products separately. An arrangement whereby a single provider sells the entire package (a lawyer’s contingent-fee arrangement) incurs both costs and benefits for the lawyer, her clients, and society. These costs and benefits, discussed more completely below, sometimes balance out so that contingent fees are more beneficial (from the vantage point of both private and social welfare) than credit and legal-cost insurance provided by nonlawyers. Sometimes, however, they do not.

A. Costs of Lawyer-Provided Champert

1. Perverse Incentives Favoring Unethical Conduct

It is no secret that a lawyer paid on a contingency has more incentive to do whatever is needed to obtain a judgment than a lawyer working at an hourly rate. The Royal Commission on Legal Services, in rejecting proposals to allow contingent fees in Great Britain, observed,

[to]he fact that the lawyer has a direct personal interest in the outcome of the case may lead to undesirable practices including the construction of evidence, the improper coaching of witnesses, the use of professionally partisan expert witnesses (especially medical witnesses), improper examination and cross-examination, groundless legal arguments designed to lead the courts into error and competitive touting.196

195. See supra text accompanying notes 141-43.
196. ROYAL COMMISSION, supra note 27, at 176-77.
This parade of horribles is no doubt exaggerated and even includes some practices, such as using professionally partisan expert witnesses and touting (aggressive solicitation of clients), that are allowed and even encouraged in the United States. Nonetheless, a contingent fee increases a lawyer's monetary reward for any action, whether ethical or unethical, that increases the size of a client's judgment or settlement. Although this monetary reward is counterbalanced by risk of professional sanction if the lawyer is caught in unethical conduct, a lawyer will sometimes be tempted to take this risk, even at the expense of her future reputation. Also, such temptation becomes proportionately greater as the financial stakes in a case increase.

Furthermore, lawyers who bill on a contingency have a perverse incentive to exploit whatever market power they have to overcharge. This incentive arises because contingent fees can disguise overcharging and because comparison shopping by plaintiffs is difficult. There are obvious logistical difficulties with obtaining quotes from several different lawyers, particularly for a plaintiff who has suffered bodily injury. As already pointed out, it also is difficult to discern what premium a lawyer is charging for the credit and insurance components of a contingent fee and what underlying fee the lawyer is charging for her services. If a lawyer demands a thirty-three percent contingent fee instead of twenty-five percent charged by a lawyer across the street, is the first lawyer charging more for credit and legal-cost insurance or more for her services, which may in fact be more valuable than the services of the lawyer charging less? Because these products are sold together at a single price, it is difficult conceptually to unbundle the transaction and discern the price of each.

By contrast, nonlawyer litigation insurance rates are far easier to compare (a client only need obtain quotes from two or more insurers on the same case handled by the same lawyer). Although the lawyer for a client with such third-party legal-cost insurance can still use whatever market power she has to charge an excessive hourly rate, the fact that she is doing so will be more obvious both to the client and to any court or disciplinary authority that reviews her fee.

198. See Box, supra note 50, at 142.
199. See supra text accompanying notes 193-94.
200. See supra text accompanying notes 193-94.
2. Perverse Incentives Favoring Litigation and Settlement Strategies That Do Not Maximize Client Welfare

As pointed out above, the first, and most important, product sold by lawyers is their own services.\textsuperscript{201} One hotly debated issue is whether fees that vary with clients' proceeds from litigation cause lawyers to do better work than fees based on an hourly rate. Are contingent-fee lawyers' incentives more closely aligned with the interests of their clients?

Although contingent fees may induce lawyers to work more diligently for clients,\textsuperscript{202} contingent fees are not a prerequisite for good lawyering. Many high quality law firms do not work on a contingency,\textsuperscript{203} and lawyers, as repeat players in the litigation arena, have a significant amount to lose from slacking off, regardless of how they are paid. Reputation for skills that create value for clients, such as litigation and negotiation skills, effective interaction with opposing counsel,\textsuperscript{204} and veracity,\textsuperscript{205} determines how much a lawyer can charge for his services. Indeed, “reputational capital” is the single largest asset of many lawyers,\textsuperscript{206} and such capital will increase or decrease in value depending on how effectively a lawyer works. For plaintiffs' lawyers, win-loss records and the size of judgments obtained are probably the most influential factors determining reputation in the profes-

\textsuperscript{201} See supra text accompanying note 139.

\textsuperscript{202} See Walter Olson, Sue City: The Case Against the Contingency Fee, POL'Y REV., Winter 1991, at 46, 49 (paying lawyers on a contingency induces more effort out of them); Saundra Torry, Area Firms Test the Waters of Value Billing, WASH. POST, Oct. 12, 1992, at F5 (Contingent fees “reward creativity and speed, judgment and performance. Lawyers would share the risk in legal matters, because they would suffer financially if they failed to do the job in the time originally allotted.”).

\textsuperscript{203} See David B. Wilkins, Who Should Regulate Lawyers?, 105 Harv. L. Rev. 799, 826 n.102 (1992) (citing Alberta I. Cook, Hourly Rates Still the Key, NAT'L L.J., Nov. 7, 1988, at S2 (corporate lawyers bill clients based largely on hourly fee)).

\textsuperscript{204} Professors Gilson and Mnookin have observed that lawyers' reputations for cooperative conduct in litigation can translate into benefits for clients and thus for lawyers themselves. Ronald J. Gilson & Robert H. Mnookin, Disputing Through Agents: Cooperation and Conflict Between Lawyers in Litigation, 94 Colum. L. Rev. 509, 522-23, 525 (1994).

\textsuperscript{205} Even lawyers with a reputation for disclosing client misconduct may be more valuable to their clients when interacting with third parties. Richard W. Painter, Toward A Market for Lawyer Disclosure Services: In Search of Optimal Whistleblowing Rules, 63 Geo. Wash. L. Rev. 221, 266-68 (1995).

sion. With or without contingent fees, hard work will be rewarded by future clients willing to pay high fees.207

Furthermore, contingent fees in some situations may cause lawyers' and clients' interests to conflict. Professors Schwartz and Mitchell have developed an economic model demonstrating that "[t]he contingent fee does not necessarily put the lawyer on the client's side or automatically lead him to do what the client would desire if the client could understand the nature of his case and the intricacies of litigation."208 In some situations, a contingent fee may lead lawyers— who know that each additional hour worked comes at the expense of work on other cases—to work fewer hours on a case than a fully knowledgeable client paying an hourly rate would choose to have the lawyer work.209

There is also a very real possibility that a lawyer's and her client's interests will diverge when it comes to settling a case if the lawyer is working for a contingent fee. Accepting a settlement offer benefits the lawyer in a way that it does not benefit the client—the settlement avoids investment by the lawyer of additional time in the case.210 Alternatively, rejecting a settlement offer may cost both the lawyer and client a certain recovery, but forces the lawyer alone to increase her investment in the case.211 Particularly where a judgment of some sort


209. Schwartz & Mitchell, supra note 119, at 1139; see Daniel J.B. Mitchell & Murray L. Schwartz, Theoretical Implications of Contingent Legal Fees, 12 Q. REV. ECON. & BUS. 69, 71, 73 (1972). For expansion and refinement of the Schwartz and Mitchell model, see Clermont & Currivan, supra note 119, at 534 ("[A] lawyer may not have a direct economic incentive to work the number of hours necessary to maximize the size of his client's net recovery, if any, because to maximize his own profit the lawyer may have to work a different number of hours."); see also Brickman, Contingent Fees, supra note 15, at 48; Patricia M. Danzon, Contingent Fees for Personal Injury Litigation, 14 BELL J. ECON. 213, 213-14, 223 (1983); Jay, supra note 11, at 854 ("[T]here comes a point when the marginal return for the lawyer from additional work is not worth the effort. That moment occurs when the lawyer could devote those additional hours to some other matter that would earn a greater return."); Stuart S. Nagel, Attorney Time Per Case: Finding an Optimal Level, 32 U. FLA. L. REV. 424, 428-32 (1980).


211. Ironically, the better the lawyer, the more powerful is this perverse incentive to settle. The lawyers' reputations may "suggest that there is a high opportunity cost to their time, which may correlate inversely with their willingness to put effort into the litigation and hence with the probability of winning." In re Oracle Sec. Litig., 132 F.R.D. 538, 542 n.9 (N.D. Cal. 1990); William J. Link, The Courts and the Market: An Economic Analysis of Contingent Fees in Class-Action Litigation, 19 J. LEGAL STUD. 247, 255 (1990).
is all but certain at trial, the client may have little to lose by litigating. The lawyer, however, may prefer a quick settlement in order to free up time for another case and may use pressure tactics to coerce the client into going along with his decision to settle.  

In different circumstances, a lawyer may go to the opposite extreme and urge a client to reject a settlement offer in order to enhance her reputation with defendants as a litigator. Big wins in high profile cases might induce settlement of future cases on more favorable terms and also might impress potential future clients. Enhanced "reputational capital" built up by litigating thus may help the lawyer, but does little for a client whose case is put at risk in the meantime. However, a client who does not pay by the hour may be less likely either to request settlement or to believe that her lawyer is acting selfishly in refusing settlement.

Finally, lawyers' cash flows and risk preferences might be radically different from those of their clients, causing lawyers to prefer settlement where clients would prefer litigation or vice versa. Lawyers litigating on a contingency often have very uneven cash flows and thus may prefer settlement, although lawyers with more diversified portfolios of cases may be more willing to take risks. Impecunious clients, or clients in need of cash to pay medical bills, will be more risk averse than clients without money problems. Where lawyers' cash needs and risk preferences do not match those of their clients, lawyers may give advice that does not adequately take clients' interests into account.

These conflicts of interest spill over from settlement negotiations into the related, and increasingly important, arena of alternative dis-

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212. Such is exactly what is alleged to have occurred in the litigation over the Phillips Petroleum disaster in Houston. See supra note 12.

213. JEFFREY O'CONNELL, THE INJURY INDUSTRY 46 (1971). On the defense side, insurance companies sometimes have similar incentives that diverge from the interests of their insureds. "It is certainly plausible that a repeatedly litigating insurance company might pursue a different bargaining strategy to minimize claims costs than would a person defending herself against a single claim." Kent D. Syverud, The Duty to Settle, 76 VA. L. REV. 1113, 1160 (1990).

214. Jay, supra note 11, at 855.

215. See Susan Beck, Playing the Percentages, AM. LAW., Mar. 1992, at 66; Joel A. Rose, Factors That Affect Profit, N.Y. L.J., July 7, 1992, at 4. JPC has recognized this problem and offered to purchase lawyers' interests in contingent fees at a discount while cases are on appeal. See supra note 36.

216. These lawyer-client agency costs would be reduced the most with a contract under which the lawyer "purchased" the cause of action from the client by promising a fixed recovery to the client. See Schwartz & Mitchell, supra note 119, at 1154; Steven Shavell, Risk Sharing and Incentives in the Principal and Agent Relationship, 10 BELL J. ECON. 55, 59 (1979). However, sale of a cause of action to the lawyer would remove any incentive for the plaintiff to cooperate with prosecution of the case.
Professor Lisa Bernstein has observed that a contingent-fee lawyer not only “always has an incentive to encourage his client to settle,” but, because the value of his services prior to arbitration will probably be small, also “has a strong incentive to encourage his client to accept an arbitration award.” A lawyer paid at an hourly rate also has interests that may conflict with his clients’ interests, although in the opposite direction; fees from discovery and trial give him an incentive to encourage a client to litigate. These incentives affect not only advice given to clients, but also affect lawyers’ entire outlook on ADR. In at least one state, a recent study showed that plaintiffs’ lawyers, working mostly for contingency fees, were strongly in favor of a court-connected ADR program, while defense lawyers, paid by the hour, were strongly against it.

In at least some circumstances, therefore, the contingent fee can undermine one of the most fundamental roles of a lawyer, her role as a fiduciary for a client. As a fiduciary, the lawyer is bound to consider her client’s interests, not her own, when making decisions about such things as litigation strategy, settlement, and alternative dispute resolution. Difficulties arise, however, when the way in which a lawyer acts in matters connected with the fiduciary relationship affects how much she gets paid or whether she gets paid at all. It is true that such difficulties also can arise in an hourly billing arrangement (partic-
ularly insofar as there is an incentive to prolong litigation), but diver-
gences between lawyer and client interests can be particularly serious
when a lawyer expects to recover less than the client does from each
additional hour of lawyer time invested in a case. Thus, separating the
fiduciary relationship between a lawyer and client from the contrac-
tual relationship between a litigant and litigation insurer should in
some situations encourage the lawyer's adherence to her fiduciary du-
ties. Loyal adherence to fiduciary duties in turn makes the lawyer's
services more valuable.

3. Perverse Incentives for Opportunistic Conduct by Clients and
Law Firm Partners

Contingent fees can create perverse incentives for opportunistic
conduct both by clients toward their lawyers and by law firm partners
toward each other. First, a client may discover in the midst of litiga-
tion that his case is a lot stronger than he and his lawyer at first be-
lieved and that another lawyer is willing to take the case either for an
hourly fee or for a lower percentage of judgment or settlement.
Although the first lawyer may be winning her bet on the contingency,
the client dismisses her and moves on. As Professor Wolfram cor-
rectly observes, "[t]he rule, which is now recognized in almost every
state . . . is that a client's discharge of a lawyer ends the lawyer's right
to recover on the contract of employment."\(^{223}\) Most jurisdictions
award the attorney *quantum meruit* recovery for the value of her ser-
vices rendered,\(^{224}\) although in some jurisdictions the lawyer and client
may agree that the lawyer shall be paid a contingent percentage fee.\(^{225}\)

223. *Wolfram*, supra note 28, at 546. An exception might exist where an attorney is dis-
charged very close to the end of the litigation. See *Fracasse v. Brent*, 494 P.2d 9, 14 (Cal. 1972)
(When the "discharge occurs 'on the courthouse steps,' where the client executes a settlement
obtained after much work by the attorney, the factors involved in a determination of reasonable-
ness would certainly justify a finding that the entire fee was the reasonable value of the attor-
ney's services.").

224. *Wolfram*, supra note 28, at 546. This rule can be unfair to a client who discharges a
contingent-fee attorney. *Brickman, Setting the Fee*, supra note 145, at 368 (recommending that
clients who employ an attorney under a contingent-fee arrangement not be forced to pay a *quan-
tum meruit* fee upon discharge of the attorney unless the suit succeeds).

225. Under New York law,

[w]hen a client discharges an attorney without cause, the attorney is entitled to recover
compensation from the client measured by the fair and reasonable value of the services
rendered whether that be more or less than the amount provided in the contract or
retainer agreement. . . . As between them, either can require that the compensation be
a fixed dollar amount determined at the time of discharge on the basis of *quantum meruit*. . . . Or, in the alternative, they may agree that the attorney, in lieu of a pres-
ently fixed dollar amount, will receive a contingent percentage fee determined either at
the time of substitution or at the conclusion of the case.

In any event, the lawyer is likely to be paid less than she would have been if she had completed the representation.

Second, a lawyer may act opportunistically toward her partners by leaving her firm and encouraging one or more contingent-fee clients to follow. The temptation for a lawyer to do so is particularly high when it becomes obvious that a case is likely to result in a substantial judgment or settlement. This problem is complicated by rules of professional conduct that allow clients to hire and fire lawyers at their will, regardless of previous contractual arrangements with a firm.\textsuperscript{226} As Professor Hillman observes, ethical rules can act as "aids to grabbing and leaving."\textsuperscript{227}

\textit{Rosenfeld, Meyer & Susman v. Cohen}\textsuperscript{228} illustrates just the type of opportunistic conduct most feared by lawyers when their partners are working on a contingency. Cohen and Riorden, two partners in a law firm with seventeen partners, spent five years working for Rectifier Corporation, the plaintiff in a major antitrust case. Rectifier was to pay the firm a contingent fee of one-third of recovery. Cohen and Riorden earned very little by way of fees for the firm during those five years, yet were paid their shares of the firm's profits under the partnership agreement. Then, as the antitrust case neared settlement, Cohen and Riorden demanded to be paid double their share of profits from the antitrust suit. When the other partners refused, Cohen and Riorden resigned and formed a new firm. They asked Rectifier to fire their old firm and instead hire the new firm, which would take the case for a reduced 83/4\% contingent fee. One year later, the litigation settled for $33 million.\textsuperscript{229}

The court observed that Cohen and Riorden had breached their duty to their partners both in wrongfully dissolving the old firm and in failing to complete Rectifier's case for the dissolved firm.\textsuperscript{230} Nonetheless, the court also observed that Rectifier had the right to terminate its contract with the old firm and to hire the new one.\textsuperscript{231} This case is important not for its result, which in the end curtailed Cohen's and Riorden's opportunistic conduct, but as an illustration of the difficul-

\textsuperscript{226}. \textit{See} \textit{Model Rules} Rule 1.16(a)(3) (providing that a lawyer shall not represent a client and shall withdraw from a representation that has commenced, if the lawyer is discharged by the client); \textit{Model Code} DR 2-110(B)(4); \textit{Restatement of Law Governing Lawyers} § 44(1) (Tentative Draft No. 5, 1992) ("A client may discharge a lawyer at any time.").

\textsuperscript{227}. ROBERT W. HILLMAN, HILLMAN ON LAWYER MOBILITY § 2.3 (1994).

\textsuperscript{228}. 194 Cal. Rptr. 180 (Ct. App. 1983).

\textsuperscript{229}. \textit{Id.} at 184-86.

\textsuperscript{230}. \textit{Id.} at 191.

\textsuperscript{231}. \textit{Id.} at 185.
ties that confront a firm that tries to control grabbing and leaving. Ethical rules prohibit the most obvious method of controlling such conduct, an agreement whereby the client agrees not to change lawyers. Furthermore, fiduciary duties under a partnership agreement turn on facts specific to each case, making it difficult for either party to obtain summary judgment.

Most courts seek to discourage such opportunism by interpreting the Uniform Partnership Act, as the Court of Appeals of California did in *Jewel v. Boxer* to require that attorneys' fees received on cases in progress upon dissolution of a law partnership are to be shared by the former partners according to their right to fees in the former partnership, regardless of which former partner provides legal services in the case after the dissolution. The fact that the client substitutes one of the former partners as attorney of record in place of the former partnership does not affect this result.

Unfortunately, such a rule is not always easy to apply. *Jewel* involved a four-partner firm that split into two two-partner firms. What if a client instead were to dismiss a law firm from a contingency case and substitute another firm consisting of one of the former partners of the old firm and several other lawyers not associated with the old firm? Treating the contingency case as the unfinished business of the old firm clearly would not make sense if lawyers in the new firm, who had no association with the old firm, do a significant amount of work on the case. The client, after all, retains the right to discharge her lawyers and hire new lawyers of her own choosing, and precluding the new firm from a share of the contingency clearly would interfere with her right to do so. Scenarios such as this one create uncertainty, and uncertainty in turn creates fertile ground for both lawyer and client opportunism.

Incentives to act opportunistically grow with the size of the case involved. It is the rare personal injury case that will make it worthwhile for a lawyer to leave his partners (often in a bitter separation), even if the lawyer can get away with it. Larger cases, however, present greater temptation. Furthermore, incentives to grab and leave intensify at larger firms where successful contingent-fee lawyers must

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234. *Id.* at 15; *accord* Resnick v. Kaplan, 434 A.2d 582, 588 (Md. Ct. Spec. App. 1981) (Although a client has the right to choose her own attorney, this does not mean "that the fees thereafter earned by the partner chosen by the client are not subject to division in accordance with the partnership agreement.").
share the fruits of their victories with more partners. Intrafirm opportunism is probably a very significant reason why many large firms do not accept cases on a contingency.

The risk of opportunism in all of these scenarios, and the inadequate measures the law applies to deal with it, make contingent fees all the more contingent. Lawyers will charge higher premiums for contingency cases not only because of risk that a case will be lost, but also because of risk that a client may use his right to discharge the lawyer to cheat her out of her share. Likewise, law firms will charge higher premiums for contingency cases or refuse to take such cases at all, because the contingency exposes the firm not only to opportunistic clients, but also to opportunistic partners who grab and leave. Finally, even absent client or lawyer opportunism, a client's decision to change lawyers in a contingent-fee case is bound to create disputes between incoming and outgoing attorneys over the proper fee to be awarded to each. The anticipated cost of such disputes and their uncertain outcome is likely to be factored into the premium charged for the contingency.

Although the relationship between a litigation insurer and a litigant is prone to its own brand of opportunism and agency costs, there are significant advantages to separating the insurance component of a contingent fee from the underlying fee for legal services. While there are good policy reasons for preserving a litigant's right to hire and fire counsel at her choosing, there are no such policy reasons for failing to enforce a contract between a litigant and a litigation insurer. Once the insurer has paid an advance or assumed a potential liability in return for a percentage of proceeds from litigation, absent fraud or misrepresentation on the part of the insurer, the litigant should be required to pay over the specified percentage of the proceeds upon conclusion of the case. Although the litigant should be free to bargain with other insurers for future advances, there would be no such thing as “firing” an insurer and requiring it to accept, instead of the agreed upon percentage, a quantum meruit recovery (probably a meaningless term when applied to an insurance premium). Separating the fiduciary relationship of lawyer and client from the contractual

235. See ABA Comm. on Ethics and Professional Responsibility, Formal Op. 389, at 19 (1994) (“The lawyer is also being compensated for the risk she assumes that the client will fire the lawyer, a right the client might exercise at any time.”) (citing Covington v. Rhodes, 247 S.E.2d 305 (N.C. Ct. App. 1978); Hiscott & Robinson v. King, 626 A.2d 1235 (Pa. Super. Ct. 1993); Model Code DR 2-110(B)(4); Model Rules Rule 1.16(a)(3) cmt.).


237. See infra notes 272-79 and accompanying text.
relationship between litigant and insurer creates certainty in the latter. Certainty helps control opportunism and thus lowers the cost of the insurance.

4. Costs from Poor Risk Diversification

Much of the rhetoric justifying lawyers' high incomes from contingent fees points to the risks they assume. As Justice Blackmun observed, "lawyers charge a premium when their entire fee is contingent on winning. . . . The premium added for contingency compensates for the risk of nonpayment if the suit does not succeed." Lawyers investing time and effort in litigation, like other investors, thus adhere to a basic precept of portfolio theory: higher risk requires higher return. Most investors are risk averse, and, if the return that they actually realize from an investment is likely to deviate significantly from their expected return, they will demand ex-ante a higher expected return. In exchange for risking loss of their investment, they expect to make more. In like manner, many lawyers working on a contingency demand an expected return higher than what they would demand from working on an hourly basis.

Much of the debate over contingent fees centers on exactly how much risk lawyers incur when they take a case on a contingency. Professor Brickman and others contend that risk premiums charged are often excessive relative to the amount of risk that lawyers incur. The plaintiffs' bar, and some academic commentators, insist that the risks lawyers incur are substantial and as a result they deserve to be well compensated. Inherent in this debate is the assumption that

238. "While some personal injury awards are large, there's never a guarantee of success in front of a judge or jury. . . . The [Brickman Proposal] chooses to ignore cases in which the lawyer walks away without a dime after having invested considerable time, staff and money preparing the case." Peskin, supra note 19, at A28.


241. Expected return is the sum of all possible returns weighted by the probability that they will occur. For a lawsuit with a 90% chance of a $100 return and a 10% chance of no return, the expected return would be .90 x $100 + .10 x $0 = $90. For a lawyer working on a 33.3% contingency, the expected return from this lawsuit would be $30.


243. See Brickman, Contingent Fees, supra note 15, at 31-32.

244. "[T]he size of the [contingent] fee is designed to be greater than the reasonable value of the services in the individual case, the difference reflecting the fact that the lawyer will realize no return for his investment of time and office expenses in the cases he loses." Mackinnon, supra note 148, at 28. "[T]he contingent fee is directly related to and reflects the highly 'contingent'
investors in a portfolio, including lawyers investing in lawsuits, will receive a higher return in a competitive market when they incur higher risk.\textsuperscript{245}

However, portfolio theory does not attribute a higher return to all types of risk. Some risk, known as unsystematic risk, is easily avoidable through diversification.\textsuperscript{246} For example, there is a risk that fuel prices might go up and adversely affect the stock of an airline, but such risk is not systematic to the stock market as a whole—some stocks, perhaps stocks in oil companies, will go up because of the same contingency. Such unsystematic risk can be diversified by choosing a variety of investments.\textsuperscript{247} An investor cannot demand, and an efficient market will not give, a higher expected return on account of this unsystematic risk that can so easily be eliminated. Other risk, known in portfolio theory as systematic or \textit{beta} risk,\textsuperscript{248} is characteristic not of particular companies but of the market as a whole. Risk of a downturn in the economy, for example, is difficult to diversify away because it will affect most or all investments. The Capital Asset Pricing Model (CAPM) predicts that the expected return on an investment should vary with the investment’s \textit{beta}, or its sensitivity to systematic risk affecting the market as a whole. Unsystematic risk, because it can be diversified away, is presumed to have little or no effect on expected return.\textsuperscript{249}

Turning from the efficient markets of the CAPM to the much less efficient market for investment in litigation, it appears that most of the risks of litigation are unsystematic. Unforeseen developments that adversely affect a lawsuit are usually specific to the particular lawsuit involved, or at most the subject matter of the lawsuit, and are not likely to affect the outcome of other litigation not closely related in the parties or subject matter. The fact that one plaintiff cracks up on the witness stand and admits that he drove his Ford Pinto at 50 mph into a brick wall before the gas tank exploded does not mean that another plaintiff will testify so poorly. Even developments affecting a nature of the claim itself.” Kenneth B. Hughes, \textit{The Contingent Fee Contract in Massachusetts}, 43 B.U. L. Rev. 1, 11 (1963).

\textsuperscript{245} Professor Kritzer uses portfolio theory to analyze contingent-fee arrangements. \textit{See Kritzer, supra} note 127, at 7-9.

\textsuperscript{246} \textit{See} Modigliani & Pogue, \textit{supra} note 240, at 76.


\textsuperscript{248} \textit{Malkiel, supra} note 247, at 229.

\textsuperscript{249} \textit{Id.} at 231.
whole class of plaintiffs, such as new evidence showing that Pintos actually had safer gas tanks than other models built at the same time, will not affect litigation brought on behalf of other plaintiffs, such as users of the Dalkon Shield. Some risks, perhaps the risk that antiplaintiff judges will be appointed or that legislatures will pass bills hostile to plaintiffs,250 do affect a wide range of litigation, but these systematic risks (risks that affect the entire litigation system) are few relative to the unsystematic risks inherent to each case.

The point is that persons who assume risks associated with litigation can, if they have a diverse enough portfolio of cases, eliminate much of this risk. The problem for the average trial lawyer is that such diversification is difficult to achieve.251 While many cases may be brought into a law office, most take up relatively little time, and are usually settled for relatively low amounts. A handful of cases may absorb most of a lawyer's time, and wins or losses in these "big" cases can have a substantial effect on the lawyer's income.252 Lawyers working in large firms, if partners split fees regardless of individual wins or losses, can more easily diversify than lawyers working in small firms.253 However, profit distribution schemes that allow partners to "eat what they kill," and the tendency of large firms to sink even more time and money into even larger cases, undermine diversification. Furthermore, bringing contingent-fee litigation into a large firm is not without its own risks to the firm's internal stability.254

Lawyers thus incur unsystematic risks in contingent-fee litigation that, for them, are more theoretically than realistically diversifiable. For bearing these risks, lawyers demand compensation.255 Where the

250. For example, see the litigation reform legislation cited in supra note 1.

251. Professor Coffee uses portfolio theory to explain how plaintiffs' counsel may be better diversified and therefore less risk averse than defendants or defense counsel. John C. Coffee, Jr., Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions, 86 COLUM. L. REV. 669, 704-12 (1986). "[T]he 'diversified' plaintiff's attorney should behave like a risk neutral investor . . . ." Id. at 705. Professor Coffee also observes that "[i]n reality, however, matters may not be as simple as the foregoing theoretical analysis suggests" and that on account of the small size of most plaintiffs' law firms "it is doubtful that plaintiff's attorneys can achieve full diversification." Id. at 705-06.


253. Professors Schwartz and Mitchell suggest that "[a] lawyer working with a larger practice would be in a position analogous to an insurance company. He could pool the risks of his many cases so his income stream over the year would be relatively smooth, despite unexpected outcomes in particular cases." Schwartz & Mitchell, supra note 119, at 1150-51.

254. See supra text accompanying notes 226-37.

255. Lawyers who do not take enough cases to become relatively indifferent to risk will "require a risk premium (an extra margin of expected profit) to handle personal-injury cases." Schwartz & Mitchell, supra note 119, at 1153. Professors Schwartz and Mitchell point out that,
market for legal-cost insurance, whether by operation of the champ- perty doctrine or otherwise, excludes providers—such as institutional investors—who could diversify a portfolio of lawsuits more easily than lawyers, lawyers will demand, and collect, a premium for at least some of their unsystematic risks. For this same reason, if more efficient risk diversifiers could enter the market for legal-cost insurance, some lawyers probably would be forced to lower their risk premiums or switch to billing by the hour instead.

The appearance of Lawcard mentioned earlier is explained by just this phenomenon—Lawcard’s issuer is a better diversifier of the risk associated with financing legal fees than most individual lawyers. Lawyers, therefore, pay the issuer to assume the risk of nonpayment. Theoretically at least, legal-cost insurance as well as litigation financing could be sold to clients in much the same manner. In return for a higher service charge, probably a share of the proceeds from a lawsuit, Lawcard’s issuer could agree to extend credit to the client with recourse only against the lawsuit itself. Selling such legal-cost insurance, however, might cause Lawcard to run afoul of champerty laws in at least some jurisdictions.

Thus, regardless of where one comes down in the debate over whether lawyers are overcharging for risks they incur in contingent fees, lawyers incur more risk than would more effective risk diversifiers. Lawyers who charge for unsystematic risk they incur—and much of the risk in contingent-fee litigation is unsystematic—charge more than they would receive if more effective diversifiers were allowed to compete in the market.

B. Benefits of Lawyer-Provided Champerty

The critical issue considered in this Article is whether market participants other than lawyers can be effective competitors in financing and insuring lawsuits on a contingent basis. There are some benefits to financing and insuring litigation with lawyers instead of nonlawyers,
and these benefits are more important in the context of some legal representations than in others.

1. Lower Information Costs

Anyone insuring lawsuits against loss or low recovery will incur costs of acquiring, processing, and verifying information about underlying claims before making an investment decision. It is here that economies of scope\textsuperscript{262} give lawyers an advantage over third parties. Lawyers already evaluate cases to prepare for litigation and are unlikely to incur substantial additional costs evaluating cases to set contingent fees. On the other hand, third-party litigation insurers must duplicate investigative work already done by the lawyers whose fees they are paying.

The amount of investigative work required to fix terms for legal-cost insurance, whether a contingent fee or third-party insurance, will depend on the particular case. Because a lawyer working on a contingency usually charges a standard percentage rate,\textsuperscript{263} the investment decision made by the lawyer in most situations is whether to accept or reject a case. Occasionally, the lawyer also will consider adjusting (usually upwards) his customary percentage fee. A lawyer working on a contingency, however, usually reaches a fee agreement with a client quite early in a representation, often after spending only a few hours evaluating the facts of a case and possibly researching some relevant legal issues. Presumably, at a cost of a few hours of their time, third-party litigation insurers with sufficient legal expertise could do the same thing if given similar access to client information.\textsuperscript{264}

A more difficult decision is how much lawyer time should be invested in a case. Although lawyers working on a contingency have an ethical obligation to represent their clients zealously,\textsuperscript{265} the fact is that they exercise wide discretion over litigation strategies (such as discovery requests and motions) that directly determine the extent of their investment. Other decisions, such as whether or not to settle, are made by the client after consultation with the lawyer.\textsuperscript{266} Lawyers

\textsuperscript{262} "Economies of scope reflect the reduction in production costs that result from the joint production of a number of different products." See Gilson, supra note 54, at 298.

\textsuperscript{263} See supra text accompanying notes 157-62.

\textsuperscript{264} Litigation insurers, like other persons auxiliary to a case, would have to be included in the circle of persons entitled to confidential client information without destroying the attorney-client privilege. See infra text accompanying note 295.

\textsuperscript{265} MODEL CODE Canon 7.

\textsuperscript{266} For discussion of conflicts of interest that can arise in this context, see supra text accompanying notes 210-16.
have an advantage over third-party litigation insurers in that information already acquired by the lawyer in the course of trial preparation and trial itself can be used to make these decisions as well.

Third-party legal-cost insurance shifts the locus of these investment decisions from the litigant and lawyer to the litigant and litigation insurer. The insurer probably would negotiate with the litigant for advances toward legal costs at different stages of the litigation. For example, a litigation insurer might agree to fund a plaintiff's first $10,000 in legal fees in return for 8% of a judgment or settlement; when that money runs out, the client would have to bargain away more of the judgment (perhaps another 8%) for the next $10,000, and so on.267 Later rounds of financing could come from the same or a different litigation insurer (the shrewd litigant probably at each stage would get a quote from at least two).268 In order to make each investment decision, a litigation insurer would have to get up to speed on the case and its chances for success. The insurer thus would have to learn for itself everything the lawyer already knows from preparing and trying the case.

It is, however, conceivable that third-party litigation insurers could rely instead on the lawyers themselves for the relevant information. Information provided by lawyers to insurers is likely to be reliable so long as lawyers and insurers have ongoing working relationships with each other. Because both insurers and lawyers would be repeat players in this game,269 lawyers who convey overly

267. Alternatively, the plaintiff could give the insurer a flat amount from any judgment. For the discussion of the JPC's arrangement to purchase an interest in judgments on appeal, see supra note 36. The arrangement might or might not give the insurer control of the litigation, which would allow the insurer to decide how much to spend on legal fees. Most defendants have just such an arrangement with their own insurers whereby the insurer pays legal fees and has control over the litigation. See Syverud, supra note 213, at 1118-19. Courts address the agency problems that arise in such arrangements by imposing liability on insurers that unreasonably refuse to settle a case within the limits of a policy. Id. at 1120-26. On the plaintiff's side, agency costs also arise in the settlement context if a lawyer works for a contingent fee. See supra text accompanying notes 210-16.

268. If the case is going well, both the litigant and the litigation insurer will have an incentive to continue, making it more likely that they will each negotiate the next round of financing in good faith. The litigant can always control opportunistic behavior on the part of the insurer by going to another insurer for the next round of financing. It is true that the litigant could behave opportunistically toward the insurer by threatening to withdraw the case unless the insurer finances the next round at an artificially low contingency rate. However, such behavior is easy to control; once an insurer shows a willingness to drop such a case at a loss, few if any litigants will try the same strategy in the future.

269. David Kreps's work illustrates how game theory "suggests ways in which promises and threats are credible, because the promise-maker stakes his or her reputation on fulfillment." David M. Kreps, Game Theory and Economic Modeling 65 (1990). In the context of a cooperative relationship between a lawyer and litigation insurer, the lawyer promises an honest and complete evaluation of cases to the insurer, and the insurer threatens not to insure future
optimistic factual or legal evaluations of cases to insurers in order to obtain fee advances for clients would not have their fees financed and insured at favorable rates in the future. Indeed, litigation insurers might keep track of how much money they have won or lost insuring cases tried by particular lawyers and adjust their rates accordingly. Insurance for litigation would be priced according to not only the lawyer’s trial and negotiation skills, but also a lawyer’s thoroughness and integrity in conveying information about cases to litigation insurers. Lawyers, as repeat players representing clients who buy legal-cost insurance, thus would have a powerful incentive to represent facts accurately to their clients’ chosen insurers.

Indeed, lawyers and insurers play exactly this type of game already, although, instead of working for plaintiffs, these lawyers and insurers work for defendants. Liability insurers have perfected the acquisition and verification of information about contingencies to an exact science. When catastrophe hits, acquisition and verification of information about litigation contingencies is also a well-practiced art. Insured defendants often are represented by lawyers chosen by the insurer, and these lawyers know that they must not only try their cases well, but also convey accurate information and advice to the insurer that in turn must make intelligent decisions about trial strategy and settlement negotiations. Lawyers who give poor advice in such cases handled by that lawyer, or to raise its rates for such cases, if the lawyer’s promise turns out not to be credible (information provided by the lawyer is consistently wrong and errs against the insurer).

270. Insurance companies often protect themselves from reliance on false information by verifying facts, such as an insured’s driving record, and by contracting to nullify or reduce the payout on an insurance policy in the event an insured’s representations are incorrect. A litigation insurer could similarly conduct its own investigation of facts and also could insist on contractual provisions that increase the price of the insurance or deny coverage if statements made by a litigant or his lawyer prove to be false.

271. Although a defendant insurance company might value the case by multiplying the probable verdict, should plaintiff win, by the probability of a plaintiff’s victory, many insurers will use the more detailed approach described by Professor Syverud:

A defendant whose lawyer has attended a seminar on litigation risk analysis might employ a more sophisticated technique, such as a decision tree that identifies key uncertainties at trial (“will our expert be impeached?”; “will their ‘smoking gun’ document be admitted?”). The defendant will assign conditional probabilities to the outcomes of each of these events and identify the damages that probably will follow from each outcome. The defendant then will assign a probability to each of the resulting possible verdicts. The value of the case (the “expected judgment”) is simply the weighted sum of these discrete verdicts, with the weight for each verdict being its probability.

regard or who mislead the insurer in order to bill more hours are not likely to work for the same insurer for very long.

In like manner, plaintiffs' litigation insurers could minimize their costs of information acquisition and verification by obtaining information from plaintiffs' lawyers. Nonetheless, in some legal representations, litigation insurers would have to do significant due diligence of their own before making an investment. If so, it may be cheaper for the client to finance and insure the litigation with his own lawyer by paying a contingent fee.

2. Avoidance of Agency Costs

Financing and insuring litigation through a third party may increase agency costs because the lawyer-client agency relationship\(^\text{272}\) has been complicated by the presence of the third party. In some situations, financing and insuring with the lawyer thus may simplify the relationship and keep agency costs low. In other situations, however, the third-party litigation insurer may actually reduce agency costs by monitoring the lawyer's performance.\(^\text{273}\)

A third-party litigation insurer must be privy to, and trusted with, client secrets and confidences. Although in most scenarios it would be unlikely that a litigation insurer would use or improperly disclose a client's confidential information, such conduct is always possible. Litigation insurers who disclose or misuse information would expose themselves to substantial liability and also are likely to acquire a bad reputation among the plaintiffs' bar that would significantly diminish any future business they might have.

Nonetheless, the potential for abuse is sufficient to justify concerns about using liability insurance companies as litigation insurers for plaintiffs. Obviously, the same insurance company could not be allowed to have an interest on both sides of a case. However, even a different insurance company might be tempted to "trade" information about a plaintiff's case in return for similar information from the defendant's insurer about another case. The risk of insurers colluding to


manipulate settlement negotiations and even the litigation itself is significant if a relatively small group of insurance companies is given a critical role on both sides of tort litigation. For this reason, while it is true that economies of scope may make liability insurance companies cost-effective insurers of plaintiffs' litigation, the potential conflicts are probably too great.

Finally, there is the risk that a litigation insurer and lawyer together could collude to act opportunistically toward the lawyer's client. As pointed out above, many litigation insurers will have ongoing relationships with plaintiffs' lawyers. Such relationships may conflict with a lawyer's primary duty of loyalty to her client. For example, the lawyer could steer a client's business toward a particular insurer in return for a kickback. Moreover, the lawyer and insurer could collude to push for settlement of litigation that should go forward in order to get the insurer quick collection of its premium. Alternatively, the lawyer and insurer might push to litigate a case because the insurer can diversify against unsystematic risk, although the client cannot. These potential conflicts of interest can translate into significant agency costs for the client, but should be viewed in perspective; many of these same conflicts already exist between contingent-fee lawyers and their clients.

Indeed, the presence of a third-party litigation insurer may mitigate rather than exacerbate agency costs in the lawyer-client relationship. In today's litigation environment, many plaintiffs are at a disadvantage because they must enter agency relationships with lawyers without the advantage of being repeat players. Unlike defendants or defendants' insurers, plaintiffs do not have incentives to accumulate information about lawyers' trial preparation, performance, integrity, and good judgment. Because third-party litigation insurers, as repeat players, have incentives to acquire this information and to signal such information to plaintiffs by pricing legal-cost insur-

274. See supra note 54.

275. See supra text accompanying note 269.

276. For discussion of systematic and unsystematic risk and diversification, see supra text accompanying notes 246-54. Insurers' greater tolerance for risk than their insureds is one reason for a plaintiff not to turn control of litigation over to an insurer.

277. For discussion of conflicts of interest between lawyers and clients in a contingent-fee arrangement, see supra text accompanying notes 208-20.


ance accordingly, their presence actually may decrease the likelihood that a plaintiff's lawyer will act opportunistically toward his client.279

V. NURTURING AN EFFICIENT MARKET FOR LEGAL-COST INSURANCE

A. Abolition of the Champerty Doctrine

As pointed out above, the champerty doctrine and related prohibitions on maintenance, barratry, and assignment of claims, are enforced in some jurisdictions but not in others. Often, they are enforced sporadically.280 It is time for these doctrines to be abolished, at least insofar as they interfere with plaintiffs' ability to insure against fruitless expenditure on litigation. While there might still be public policy reasons for not allowing assignment of all or part of a claim for a cash payment to the assignor,281 there are equally strong policy reasons for allowing a plaintiff to assign a portion of his claim as a premium for legal-cost insurance. Forbidding this option forces the plaintiff to buy such insurance from a single provider, his own lawyer, in a market that may not come close to perfect competition.282

B. Inclusion of Liability for Opposing Counsel's Fees in Lawyer-Provided Legal-Cost Insurance

With the increasing political pressure to adopt an English-style loser-pays rule in many jurisdictions283 and the already significant number of circumstances in which plaintiffs already can be held liable for successful defendants' fees,284 plaintiffs may soon require inclusion of such liability in legal-cost insurance, including that provided by their own lawyers' charging contingent fees. Would plaintiffs' lawyers be ready to respond?

Several rules of professional conduct would need to be revised to allow contingent-fee arrangements to include insurance against liability under an English-type rule. The first of these is Model Rule 1.8, which provides that "[a] lawyer shall not provide financial assistance

279. There is also a small risk of opportunism directed by the plaintiff's lawyer at the litigation insurer. The lawyer could refuse to continue a case in which the insurer has invested a substantial amount, unless paid a higher hourly fee. However, such conduct is unlikely in a market where both the litigation insurer and lawyer are repeat players able to retaliate against each other for opportunism. See supra note 269.

280. See supra notes 76-88 and accompanying text.

281. But see Cooter, supra note 40; Goetz, supra note 41.

282. See supra text accompanying notes 147-94.

283. See supra note 1; see also infra note 316.

284. See infra text accompanying notes 305-09.
to a client in connection with pending or contemplated litigation, except that: (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter.\textsuperscript{285} The Model Code is even more stringent and requires that the client ultimately be responsible for costs and expenses.\textsuperscript{286} Jurisdictions using rules modeled after either of these provisions would need to amend those rules to allow lawyers to pay bonds into court to cover their clients' potential liability under an English rule and/or to agree to pay such amounts at the conclusion of litigation. Absent such changes, lawyers effectively could be precluded from participating in a market for legal-cost insurance covering English-rule liability.

Close attention also should be given to rules governing attorney-client transactions, although these rules, at least as drafted by the ABA,\textsuperscript{287} would not require revision to accommodate insurance against English-rule liability. As is generally the case for lawyers negotiating contingent-fee contracts with their clients, lawyers negotiating legal-cost insurance arrangements should recognize that they are fiduciaries for their clients, and may not self-deal at the expense of their clients.\textsuperscript{288} A court reviewing a lawyer-client transaction, including a legal-cost insurance contract, would likely examine its overall fairness.\textsuperscript{289} Although a lawyer would be entitled to some additional compensation for taking on the additional risks of an English-rule regime, this premium should be reasonable in relation to the risks involved.\textsuperscript{290}

\textsuperscript{285} See Model Rules Rule 1.8(E)(1).

\textsuperscript{286} “[A] lawyer may advance or guarantee the expenses of litigation, including court costs, expenses of investigation, expenses of medical examination, and costs of obtaining and presenting evidence, provided the client remains ultimately liable for such expenses.” Model Code DR 5-103(B); see Findlater, supra note 103, at 1667.

\textsuperscript{287} Model Rule 1.8 provides in relevant part:

(a) A lawyer shall not enter into a business transaction with a client . . . unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client;

(2) the client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and

(3) the client consents in writing thereto.

Model Code DR 5-104 provides in relevant part:

(A) A lawyer shall not enter into a business transaction with a client if they have differing interests therein and if the client expects the lawyer to exercise his professional judgment therein for the protection of the client, unless the client has consented after full disclosure.

\textsuperscript{288} See Maksym v. Loesch, 937 F.2d 1237, 1241 (7th Cir. 1991).

\textsuperscript{289} Any “fiduciary has the burden of justifying self-dealing transactions.” Frankel, supra note 222, at 824-25.

\textsuperscript{290} This premium should be relatively modest because the lawyer can expect to recover reasonable compensation for his services from the opposing party, in addition to the agreed
Furthermore, attorney-client transactions can involve abuse of client information. Model Rule 1.8(b) thus provides that a lawyer shall not "use attorney information relating to representation of a client to the disadvantage of the client unless the client consents after consultation."291 A lawyer's use of information about the merits of a case and the risk of English-rule liability to negotiate a contingent fee favoring the lawyer could violate this rule if the information and its significance are not first discussed with the client. Also, the lawyer should adhere to the admonition of Ethical Consideration 5-7 that, because he is in a better position to evaluate the cause of action, he should "enter into a contingent fee arrangement only in those instances where the arrangement will be beneficial to the client."292

C. Requiring Lawyers to Cooperate with Litigation Insurers

A market for legal-cost insurance should allow a litigant to choose between insuring with her lawyer through a contingent fee or with a third-party insurer. Because this choice should be the client's and not the lawyer's, a lawyer should always allow a client to pay by the hour, so long as the client has sufficient assets to self-insure or has insured with a reputable insurer.

Mandatory tie-ins of contingent fees to legal services are improper at least in principle,293 and rules prohibiting such tie-ins should be enacted and enforced. Refusal to deal with a customer who purchases another product from a competitor is prohibited under the antitrust laws in many circumstances,294 and such practices likewise should not be tolerated in the legal profession once alternative suppliers of legal-cost insurance enter the market. Indeed, prior to taking any case on a contingency, a lawyer should be required to explain to her client not only the availability of an hourly billing arrangement, upon share of the judgment from the client, if he wins. Payments and receipts of attorneys' fees theoretically should balance out. See infra text accompanying note 319.

291. "[A]ttorneys at law, in dealing with their clients, are required to exercise the highest order of good faith and to disclose to clients all information in their possession" arising out of the attorney-client relationship. Huston v. Schohr, 146 P.2d 730, 734 (Cal. Ct. App. 1944) (promissory note from client to attorney enforceable where attorney had dealt with client in good faith).

292. MODEL CODE EC 5-7.

293. See MODEL CODE EC 2-20 ("lawyer . . . may enter into a contingent-fee contract in a civil case with any client who, after being fully informed of all relevant factors, desires that arrangement"); see also Jay, supra note 11, at 823 (a lawyer should not be able to insist on representing a client on a contingent-fee basis).

294. For the discussion of refusal to deal in the tie-in context, see AREEDA, supra note 163, at 12.
but also the availability of legal-cost insurance and where such insurance can be obtained.

Furthermore, a lawyer should be required to cooperate with third-party insurers when requested to do so by a client. Although market incentives also will encourage lawyers to cooperate with litigation insurers, ethics rules should prohibit a lawyer who is asked by a client to share information with an insurer from engaging in dilatory tactics and other conduct aimed at frustrating the insurer. Finally, the attorney-client privilege should be extended to include within the zone of confidentiality those insurers designated by the client. Courts have long recognized that some third parties are needed to facilitate lawyer-client communications, and their presence usually will not destroy the privilege. Litigants and their lawyers likewise should be permitted to communicate in confidence with third parties needed to finance and insure litigation, and the attorney-client privilege should protect such communications.

D. Creation of a Public Contingency Legal Aid Fund

What if private insurers are unwilling to enter the market for legal-cost insurance? Alternatively, what if so few private insurers enter the market that these few acquire market power that can be used to extract monopoly rents from litigants? One answer to both of these problems, if they arise, would be to establish a public fund, either through the Legal Services Administration or otherwise, to finance litigation on more favorable terms. Indeed, the proposal in this

295. Perhaps the most common way the privilege is lost is by showing a privileged document to a third person or allowing a third person to sit in on a private conversation between an attorney and her client. Once this happens, the privilege is lost and anybody with a proper purpose can subpoena the document or demand testimony from the lawyer or client on the content of the document or conversation. Westinghouse Elec. Corp. v. Republic of Phil., 951 F.2d 1414, 1424 (3d Cir. 1991) ("[W]hen client voluntarily discloses privileged communications to third party the privilege is waived."); International Honeycomb Corp. v. Transtech Serv. Network, No. 90-CV3737, 1992 WL 314897, at *1 (E.D.N.Y. Oct. 9, 1992). Although JPC has access to trial records and thus does not require access to privileged client information, JPC White Paper, supra note 36, at 3, insurers of cases at the pretrial stage would probably insist on access to at least some information ordinarily kept within the attorney-client privilege.

296. See United States v. Kovel, 296 F.2d 918, 921-22 (2d Cir. 1961) (privilege covered communications to an accountant needed for a legal matter) ("[I]n contrast to the Tudor times when the privilege was first recognized, the complexities of modern existence prevent attorneys from effectively handling clients' affairs without the help of others . . . "); see also State v. Rickabaugh, 361 N.W.2d 623, 625 (S.D. 1985) (statements made to polygraph test administrator at attorney's request privileged); Rodriguez v. Superior Court, 18 Cal. Rptr. 2d 120, 123-24 (Ct. App. 1993) (statements made to psychologist at attorney's request privileged).

297. But see Linde Thomson Langworthy Kohn & Van Dyke v. Resolution Trust Corp., 5 F.3d 1508, 1515 (D.C. Cir. 1993) (no privilege for statements made by insured to insurer other than for the purpose of obtaining legal advice).
Article could be implemented if a government agency were to pay the fees of plaintiffs' lawyers and then tax judgments and settlements on a sliding scale of rates based on how much was spent on the lawyers.

In its review of "Alternatives and Supplements to Legal Aid," Great Britain's Royal Commission on Legal Services considered a number of options including a contingency legal aid fund proposed to be set up under the control of a small number of independent administrators. Initially, financing would have to be provided by the Government, though the intention of the proposal is that the fund should in time become self-supporting. . . . The arrangement made with prospective plaintiffs would be that in the event of success the plaintiff would contribute to the fund a proportion of the damages awarded to him, his legal costs being paid, in accordance with the usual practice, by the losing side. If the plaintiff lost his case, the fund would guarantee to pay his costs and those of the successful defendant.298

The Royal Commission recognized that such a fund would have many of the advantages of a contingent-fee system.299 Nonetheless, the Commission recommended that such a fund not be established, in part because of fears that the fund would constantly need government subsidies. Plaintiffs with good chances of success would not use the fund, whereas fund managers would under political pressures "give assistance in cases where the plaintiff attracted strong sympathy but where the prospects of success were not great."300

The first of these problems, self-selection of good risks out of the insurance pool, will undermine any insurance scheme, public or private, if it is practical to self-insure and if insureds have more information about risks than do insurers.301 Few litigants, however, have the tolerance for risk that would make them want to self-insure against fruitless expenditure on legal fees, much less liability for opposing counsel's fees. Furthermore, just as a tort lawyer usually knows more about the value of a particular case than her client, a litigation insurer should know more than a prospective plaintiff about risks involved in

298. ROYAL COMMISSION, supra note 27, at 177-78.
299. The proposed fund "would avoid some of the disadvantages inherent in a contingency fee system [because] the lawyer conducting a case supported by the fund would have no personal interest in the amount of damages awarded but would receive his normal fee whether the case was won or lost." Id. at 178.
300. Id.
301. Insureds who know that the premium is too high will opt-out while those who know that the premium is too low will purchase the insurance, and the fund will lose money. However, if the insurer has equal or superior access to information about the relevant risks, it can adjust premiums to reflect its own risk assessments, and the insurer's errors (insurance sold for too little) at least will be offset by errors on the part of its insureds (insurance bought for too much).
litigation. Although most plaintiffs have superior firsthand knowledge of relevant facts, the insurer will in most cases have superior knowledge of relevant law, of lawyer time required to prosecute a case, and of jury awards and settlements for similar cases. The insurer thus has the informational advantage it needs to price insurance attractively from the vantage point of purchasers and yet still make money overall.

The insurer, however, will not make money if its judgment is affected by the second problem identified by the Royal Commission (funding of cases on account of political expediency rather than economics). Just as public pension funds sometimes make investments for political reasons to the detriment of fund beneficiaries, a practice harshly criticized by Professor Roberta Romano and others, a public litigation fund might insure litigation because of its political expediency rather than its likelihood of success. Insurance sold on such a basis is almost certain to be a losing proposition for the insurer, which, as the Royal Commission points out, will constantly need a bailout.

Thus, if fund managers cannot be subject to the disciplines of the private marketplace, and isolated from the political pressures of the public sphere, a public litigation fund is unlikely to be self-sustaining. In an age of tight government budgets, such a fund is not likely to survive. It would, however, be possible to initiate a fund capitalized with public money, perhaps in the form of a loan, and then to require the fund to sustain itself after a relatively brief adjustment period. Once the public money is appropriated, fund managers, if isolated from external influence and given proper incentive compensation, should be motivated by market forces rather than politics.

Furthermore, public capitalization of a fund might not be necessary—this Article has described many reasons why private parties might be lower cost providers of legal-cost insurance than lawyers working on a contingency. If so, private capital should move in to fill

302. Roberta Romano, Public Pension Fund Activism in Corporate Governance Reconsidered, 93 COLUM. L. REV. 795, 801-15 (1993) (criticizing "social investments" made by public pension funds in housing, local industries, and venture capital). If a particular small business or residential project is unable to attract financing from the private sector, it is far more probable that the difficulty is due to the market's efficiently pricing the risk at a cost greater than the project developers are willing to pay, rather than the result of a capital market failure. Id. at 813. The same could be said of a lawsuit that a public litigation fund is willing to fund on more favorable terms than those offered by a contingent-fee lawyer or a private-litigation insurer. As Professor Romano points out, the pressure on a public fund to make such politically motivated investments can be overwhelming. Id. at 801-07.

303. ROYAL COMMISSION, supra note 27, at 178.
LITIGATING ON A CONTINGENCY

693

this need once restrictions on champerty are lifted and lawyers are required to cooperate with nonlawyer litigation insurers.

VI. THE ENGLISH RULE IN AN EFFICIENT MARKET FOR CHAMPERTY

Although the usual "American Rule" is that each party to a lawsuit shall bear its own attorneys' fees, there are many exceptions. Some federal statutes award attorneys' fees to successful plaintiffs. Other statutes allow successful plaintiffs or defendants to recover attorneys' fees. Some state statutes award attorneys' fees to successful plaintiffs, but not to defendants, unless a plaintiff's claim is frivolous. Also, winning parties' attorneys' fees may be allowed against unsuccessful defendants as punitive damages. Furthermore, a lawyer who signs a frivolous or unsubstantiated pleading can be sanctioned and required to pay opposing counsel's attorneys' fees under Rule 11 of the Federal Rules of Civil Procedure. Finally, at-


307. See Lenz v. CNA Assurance Co., 630 A.2d 1082, 1082-83 (Conn. 1993) (employee awarded punitive damages against insurance company for unjustified reduction of state worker's compensation benefits); St. Luke Evangelical Lutheran Church, Inc. v. Smith, 568 A.2d 35, 37, 43 (Md. 1990) (in determining award of punitive damages in defamation action by employee against former employer, a jury may consider award of attorney's fees); Curry v. Big Bears Store Co., 142 N.E.2d 684, 685 (Ohio 1956) ("Where punitive damages are allowed it is proper for the jury to allow a reasonable attorney fee.").

torsneys' fees of the winning party in shareholder derivative suits may be charged to the loser.\(^{309}\) Nonetheless, proponents of the English rule believe that these selective fee-shifting provisions are sporadically enforced and do not go far enough.\(^{310}\)

An advantage of the English rule is that it imposes more of the costs of litigation on the party who may be in the best position to avoid those costs: the plaintiff who brings a lawsuit with a poor chance of winning or the defendant who defends a suit that she should have settled. The American rule thus may encourage frivolous claims and defenses.\(^{311}\) Critics of the American rule also argue that for successful plaintiffs the rule is simply unfair because they are not made whole.\(^{312}\)

A disadvantage of the English rule, however, is that it deprives risk-averse and impecunious litigants of access to the courts. If they lose, such litigants not only must pay their own lawyers, but also must pay their opponents' lawyers. Settlement discussions thus could be influenced by litigants' tolerance for risk as much as by the merits of their respective claims. A large corporate defendant, for example, might have a decided advantage over an individual middle-income plaintiff. Furthermore, making a losing party pay the winner's legal expenses could discourage risk-averse and impecunious plaintiffs from litigating at all; far from screening claims based on their merit, the rule would screen claims based on plaintiffs' ability to pay their opponents' lawyers. Finally, it is by no means certain that an English rule would reduce litigiousness.\(^{313}\) Indeed, an English rule in some circumstances

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309. Revised Model Business Corporation Act §7.46 (Supp. 1995) provides that "[o]n termination of the derivative proceeding, the court may... order the corporation to pay the plaintiff's reasonable expenses" or "order the plaintiff to pay any defendant's reasonable expenses" if the "proceeding was commenced without reasonable cause or for an improper purpose."; see also Revised Uniform Limited Partnership Act §1004 (1995) (court may award reasonable expenses to plaintiff in a derivative action).

310. See supra notes 1, 23 and accompanying text.


312. Judge Posner has argued that the English rule would help rather than harm poor people, as it would other litigants, "who [have] a better than 50 percent chance of prevailing." Id. at 439. A similar argument appears in Ehrenzweig, supra note 23, at 792 (relating that when the author first came to the United States, he sought to sue a mover who took his belongings, but was surprised to learn that he would have to pay his own attorneys' fees).

313. "[I]t is essential to consider the impact of a possible fee shift on both sides' settlement incentives, which can make predictions complex." Rowe, Statement, supra note 23, at 6. Furthermore, the American rule has the advantage of saving transaction costs incurred when courts rule on fee award amounts. Id. at 7. Professor Rowe characterizes the English rule as an imposition of "strict rather than fault liability" on litigants. "[W]hether or not we think you were
could increase the amount of litigation on the part of plaintiffs with strong claims who "can hold out for more." Nonetheless, Congress has considered legislation requiring that attorneys' fees be awarded to prevailing parties in diversity suits and suits over products liability. Some state legislatures also have experimented with the English rule.

If an English rule is adopted, a market for legal-cost insurance would avert many of the distributive injustices of the rule, including the rule's inherent bias toward well-to-do litigants, by allowing plaintiffs to spread the risk of losing. The market would allow risk-averse parties to insure against not only the risk of paying their own lawyers for fruitless litigation, but also the risk of being held responsible for a winner's litigation expenses. Litigation insurers, writing policies on hundreds, perhaps thousands, of lawsuits, could diversify away risk that might have a powerful deterrent effect on individual litigants.

Indeed, both plaintiffs and defendants in tort litigation could be required to post bonds at the outset of litigation to reimburse the successful party's expenses in much the same manner as plaintiffs in corporate derivative litigation are often required to do. Litigation insurers would post the bond and charge the parties therefor in accordance with their likelihood of success on the merits. Insurance premiums could be charged as either fixed dollar amounts or more likely as fixed percentages of judgments if litigation is successful.

How much would such insurance cost under an English rule? Surprisingly, insurance against payment of opposing counsel's fees might not cost much. A high surcharge would not be justified because unreasonable about insisting on your right to trial, if you lose you suffer not only the judgment on the merits against you but must pay what it cost both sides to get the verdict." Id. at 5. Furthermore, Rowe observes that "[t]he loser-pays rule works an especially harsh form of strict liability when costs are likely to be highest and the loser's conduct most reasonable—in closely contested cases." Id.

314. Id. at 7.
315. See supra note 1.
316. Alaska has a modified version of the English rule. See ALASKA R. Civ. P. 82 (unsuccessful plaintiffs must pay twenty to thirty percent of the actual fees "necessarily incurred" by defendants). From 1980 to 1985, Florida had an English rule for medical malpractice lawsuits, but the rule was repealed at the urging of doctors who found that they were often unable to recover from unsuccessful plaintiffs. Rowe, Statement, supra note 23, at 8. Texas has enacted loser-pays statutes for certain types of lawsuits. Maggs & Weiss, supra note 23, at 1921.
318. In the absence of legal-cost insurance, such bond posting requirements can deter litigation. See Findlater, supra note 103, at 1670.
insurers, whether contingent-fee lawyers or private insurers, also would recover higher amounts if litigation under an English-style fee-shifting rule were successful (legal fees recovered from defendants would be added to the percentage of damages premium paid by successful plaintiffs). It is true that some judgments for costs might not be recoverable because defendants cannot or will not pay, but these defendants probably will not pay judgments either, and thus are unlikely targets for lawsuits in the first place. Generally, higher recoveries for winning parties under an English rule should make up for higher payments when cases are lost. In a competitive market, the premium charged for legal-cost insurance under an English rule thus should not be much higher than the premium charged under an American rule.

**Conclusion**

This Article has explored the relationship between a market for legal-cost insurance and recent proposals concerning both the English rule and contingent fees. What legal and economic conditions, if any, would induce lawyer and nonlawyer insurers to agree, in exchange for a percentage of a judgment, to share the risks of litigation? If private parties, for whatever reason, cannot or will not offer such insurance, should public agencies do so instead?

Regardless of the other advantages and disadvantages of the English rule, if legal-cost insurance were available at competitive rates, it would be far more equitable to impose attorneys’ fees on losing parties because access to the courts would not be contingent on litigants’ aversion to risk. Furthermore, contingent fees might be kept at reasonable levels by a competitive market for legal-cost insurance. Alternatively, if lawyers are the only efficient providers of legal-cost insurance and are unwilling to insure their clients against English-rule liability in addition to their own fees at a fair price, adoption of an English loser-pays rule may unacceptably restrict access to the courts. Furthermore, with or without an English rule, some regulation of contingent fees may be desirable to restrict lawyers’ potential abuse of their market power.

Professional conduct rules that accommodate contingent fees, together with lingering prohibitions on champerty by nonlawyers, give plaintiffs’ lawyers a virtual monopoly on champerty of litigation. The

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319. One reason Florida doctors urged repeal of that state’s English rule was that many unsuccessful plaintiffs could not or would not pay. See Rowe, Statement, *supra* note 23, at 8.
Brickman Proposal suggests a check on abuse of this market power. It would, however, be useful to consider the alternative of opening the market for champerty to nonlawyer participants (private litigation insurers, a public litigation insurance fund, or both). A free market for champerty may make legal-cost insurance available to litigants on competitive terms and at the same time allow adoption of an English-style fee-shifting rule without a disparate impact on litigants based on their wealth and aversion to risk.