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THE ENGLISH RULE WITH CLIENT-TO-LAWYER RISK SHIFTING: A SPECULATIVE APPRAISAL

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INTRODUCTION

In America, parties to civil litigation generally bear their own attorney fees. This system, known as the American rule, has come under periodic criticism from supporters of the competing English rule, a system under which the loser pays the winner's attorney fees.[1] In recent years, supporters of the English rule have been found even in the highest reaches of the American government.

This Article explores a variant of the English rule in which the tort plaintiff is permitted to shift to her lawyer the risk of an adverse fee award.[2] Part I reviews some of the major arguments for and against the English rule. Part II discusses the mechanics of combining the English rule with client-to-lawyer risk shifting. Part III considers whether client-to-lawyer risk shifting would solve the arguable problems and preserve the arguable benefits of the English rule. Part IV considers whether client-to-lawyer risk shifting would unacceptably exacerbate lawyer-client conflict of interest in the settlement process. The Article concludes with a cautious endorsement of the English rule with client-to-lawyer risk shifting as an alternative to the English rule proper.

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1. *See, e.g.*, Albert A. Ehrenzweig, *Reimbursement of Counsel Fees and the Great Society*, 54 CAL. L. REV. 792 (1966); Michael F. Mayer & Wayne Stix, *The Prevailing Party Should Recover Counsel Fees*, 8 AKRON L. REV. 426 (1975). For a dispassionate overview, see Philip J. Mause, *Winner Takes All: A Reexamination of the Indemnity System*, 55 IOWA L. REV. 26 (1969).

2. Commentators who have previously considered such a system have largely confined themselves to the issue of what effect it might have on the settlement rate. *See* John J. Donohue III, *The Effects of Fee Shifting on the Settlement Rate: Theoretical Observations on Costs, Conflicts, and Contingency Fees*, 54 LAW & CONTEMP. PROBS. 195 (Summer 1991); Bradley L. Smith, Note, *Three Attorney Fee-Shifting Rules and Contingency Fees: Their Impact on Settlement Incentives*, 90 MICH. L. REV. 2154 (1992). This Article focuses on other issues.

I. THE ENGLISH RULE: FOR AND AGAINST

The English rule[3] has been supported on several grounds. Some believe that it is a fairer method of distributing the burden of attorney fees than the American rule. Arguably, as between the party adjudged in the right and the party adjudged in the wrong, the party adjudged in the right should bear no fee burden and the party adjudged in the wrong should bear the entire fee burden.[4]

Other arguments for the English rule focus on its incentive effects. It is sometimes conjectured that the English rule, if adopted in America, would reduce the total volume of litigation by promoting settlement. Commentators have not been unanimous on this issue.[5]

Commentators do agree, however, as to one type of incentive effect. The English rule, more than the American rule, tends to encourage a risk-neutral party to pursue litigation about which it is optimistic and tends to discourage such a party from pursuing litigation about which it is pessimistic.[6] If a risk-neutral party operating under the English rule is optimistic, the opportunity of a favorable fee shift will outweigh the risk of an adverse fee shift, increasing the expected value of the case.[7] If a risk-neutral party is pessimistic, the risk of an adverse fee shift will outweigh the opportunity of a favorable fee shift, decreasing the expected value of the case.

3. The "European rule" might be a more accurate term than the "English rule," as two-way fee shifting is the norm not only in Great Britain, but in Europe as a whole. *See* Werner Pfennigstorf, *The European Experience With Attorney Fee Shifting*, 47 LAW & CONTEMP. PROBS. 37 (Winter 1984). However, the "English rule" has a nice archaic ring to it.

4. According to Pfennigstorf, the most popular justification for two-way fee shifting in Europe is along these lines: "[A] claimant who is forced to resort to court action to enforce his claim against a reluctant debtor is entitled to recover the full value of the claim and should not be expected to be satisfied with a lesser amount because of the necessity of suing. Likewise, one who successfully defends himself against an unjustified claim raised by another person should come out of the experience without financial loss." *Id.* at 66-67.

Some have suggested that the fairest system of fee apportionment is actually one-way pro-plaintiff fee shifting, as only the victim of a legal wrong deserves to be made whole. I have previously expressed my disagreement with this position. *See* Mark S. Stein, *Is One-Way Fee Shifting Fairer than Two-Way Fee Shifting?*, 141 F.R.D. 351 (1992). For a discussion of the various rationales for one-way fee shifting, see Harold J. Krent, *Explaining One-Way Fee Shifting*, 79 VA. L. REV. 2039 (1993).

5. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 537-40 (3d ed. 1986); Donohue, *supra* note 2; John C. Hause, *Indemnity, Settlement, and Litigation, or I'll be Suing You*, 18 J. LEGAL STUD. 157 (1989); Steven Shavell, *Suit, Settlement and Trial: A Theoretical Analysis under Alternative Methods for the Allocation of Legal Costs*, 11 J. LEGAL STUD. 55 (1982).

6. POSNER, *supra* note 5, at 540; Shavell, *supra* note 5, at 59.

7. I will assume here, and for the remainder of this Article, that court-awarded fees would be identical for a victorious plaintiff and a victorious defendant. For a study of contrary examples, see Shavell, *supra* note 5.

Litigant optimism and litigant pessimism may both generally have some basis in reality. If so, the English rule, more than the American rule, may tend to encourage litigation that is likely to succeed and may tend to discourage litigation that is likely to fail.[8] Arguably, litigation that is likely to succeed is good litigation, while litigation that is likely to fail is bad litigation. If one accepts this characterization, and the entire line of reasoning that preceded it, one might say that given risk neutrality, the English rule tends to encourage good litigation and discourage bad litigation to a greater extent than the American rule.

The grounds for supporting the English rule sketched above are not incontestable. In this Article, however, I do not contest them. I assume that the English rule is in some sense fairer than the American rule, and that given risk neutrality, the English rule would encourage good litigation and discourage bad litigation to a greater extent than the American rule.[9]

Even under these assumptions, however, there are objections to the English rule that could make one waver in one's support. First, the English rule, in its most direct effects, tends to hurt those who feel it most and help those who need it least. An individual litigant of moderate means—a tort plaintiff, for example—could be completely ruined if she were forced to pay her adversary's attorney fees. By contrast, the benefit to a plaintiff who recovered attorney fees on top of her judgment would be less substantial. In its most direct effects, then, the English rule arguably tends to decrease aggregate well-being.[10]

Also, it is unrealistic to assume that individual litigants facing the threat of complete ruin will be risk neutral. As several commentators have observed, such litigants will more likely be highly risk averse.[11]

8. For the plaintiff, encouragement will mean added incentive to bring a case or to demand a higher settlement; discouragement will mean lessened incentive to bring a case or to demand a higher settlement. For the defendant, discouragement will mean added incentive to avoid possible litigation or to offer a higher settlement; encouragement will mean lessened incentive to avoid possible litigation or to offer a higher settlement. This Article will for the most part focus on incentives facing the plaintiff.

9. The reader who is moved to protest at this point can be assured that I will be equally superficial in accepting as true the following criticisms of the English rule.

10. I am not ignoring the direct effects of the English rule on tort defendants; I am assuming those effects would cancel out.

11. *See* Thomas D. Rowe, Jr., *Predicting the Effects of Attorney Fee Shifting*, 47 LAW & CONTEMP. PROBS. 139, 148-49, 153 (Winter 1984); Shavell, *supra* note 5, at 58. Reporting on the operation of the English rule in England itself, Kritzer relays the view of an English judge that "for the ordinary citizen unqualified for Legal Aid, a lawsuit is quite out of the question." Herbert M. Kritzer, *The English Rule: Searching for Winners in a Loser Pays System*, 78 A.B.A. J. 54, 55 (Nov. 1992) (quoting Judge Patrick Devlin).

If a litigant is risk averse, the English rule can discourage her not only from pursuing litigation about which she is pessimistic, but also from pursuing litigation about which she is fairly optimistic.[12] Arguably, then, the English rule tends to discourage risk-averse individual litigants from pursuing good litigation. It could also be argued that by discouraging risk-averse individual litigants from pursuing litigation generally, the English rule unfairly distorts the balance of litigation incentives confronting individual and institutional litigants.

If the English rule is too hard on litigants of moderate means, it is also, arguably, not hard enough on litigants with no means at all. Many tort plaintiffs have few or no assets out of which an adverse fee shift could be satisfied. In a case involving a poor plaintiff, the English rule effectively becomes a system of one-way fee shifting. The plaintiff will recover fees if she wins, but the defendant will not. Such a system is arguably unfair to defendants.[13]

Moreover, the incentive effects of the English rule may not operate properly if both litigants do not have the means to pay their adversaries' potential attorney fees. A poor litigant may be completely impervious to the threat of fee liability, especially if such liability can be discharged in bankruptcy. A poor litigant may therefore have no hesitation about bringing a suit that is unlikely to succeed, as long as she can find a lawyer who will take the case on a contingency basis. The failure of the English rule to increase the significance of pessimism among poor litigants is not necessarily a reason to reject the English rule in favor of the American rule. Nevertheless, the problem of poor litigants shows that the purported benefits of the English rule may not always materialize.[14]

Not everyone will be troubled by the foregoing criticisms of the English rule. Some, for example, will anticipate with equanimity, or even with relish, the English rule's effects on individual litigants of moderate means. As to the disproportionate burden that the English rule would impose on individual litigants who are actually forced to pay their adversaries' fees, some will say there should be no cause for

12. Shavell, *supra* note 5, at 61-62.

13. Or so I have argued, at least. *See* Stein, *supra* note 4.

14. Kritzer reports that "in court actions involving personal injury, only about 40 percent of English plaintiffs are subject to the downside risk of the English rule. . . ." Kritzer, *supra* note 11, at 55. In their examination of Florida's brief experiment with two-way fee shifting for medical malpractice cases, Snyder and Hughes report a complaint among defendants that the system was evolving into one-way pro-plaintiff fee shifting. Edward A. Snyder & James W. Hughes, *The English Rule for Allocating Legal Costs: Evidence Confronts Theory*, 6 J.L. ECON. & ORGANIZATION 345, 356 (1990).

sympathy; in the legal system, we distribute according to entitlement rather than according to need.[15] As to the English rule's incentive effects on individual litigants, particularly tort plaintiffs, some will say that the current American tort system provides tort plaintiffs with far too much incentive to sue. Therefore, risk aversion among tort plaintiffs should be welcomed; it is precisely through such risk aversion that the English rule would reduce the volume of litigation.

My own view is that the English rule's possible effects on individual litigants of moderate means are indeed a cause for concern. I will not, however, attempt to justify this view. Rather, just as I have assumed that the English rule would be a good thing, given risk neutrality, so I will also assume that its effects on risk-averse litigants would be objectionable.

II. Fundamentals of Risk Shifting

There may be a way, at least as to tort plaintiffs, to ameliorate the English rule's arguably objectionable effects while preserving its arguably positive features. The American tort plaintiff gains access to court through a contingent-fee contract. A contingent-fee contract is a risk-shifting device: In exchange for a percentage of any recovery the plaintiff may obtain, the plaintiff's lawyer accepts the risk that her services will be uncompensated if the plaintiff obtains no recovery. Logically, if the English rule were instituted in the United States, the risk shifting of the contingent-fee contract could be extended to cover also the risk of an adverse fee shift. The plaintiff's lawyer could be allowed, with suitable compensation, to assume that risk. The remainder of this Article examines this idea of combining the English rule with client-to-lawyer risk shifting.

A. Background Rules

Certain background rules would be necessary to the operation of the English rule with client-to-lawyer risk shifting, and others can usefully be postulated in order to determine how the system would work. First, in adopting the English rule, the United States must not also import a prohibition against contingent-fee contracts under which the lawyer receives a percentage of the plaintiff's recovery. Such contracts are theoretically prohibited in most countries that operate

15. This argument has some force, but it would be more persuasive if made against the background of established rules rather than in a debate over what the rules should be.

under the English rule.[16] Although contingency arrangements often exist in practice,[17] a *sub rosa* existence would be insufficient for the formal system of client-to-lawyer risk shifting proposed in this Article.

Second, ethical codes must permit lawyers to extend the contingent-fee contract so as to assume the risk of an adverse fee shift. As Rowe observes, some states have codes that prohibit a lawyer from assuming the client's obligation to pay the costs and expenses of her own lawsuit;[18] presumably these codes would also prohibit the lawyer from assuming the risk of an adverse fee shift. However, it is not too imaginative to postulate an amendment of lawyer ethical codes in a way that will extend freedom of contract between lawyer and client to permit risk shifting. After all, we are already postulating the abolition of a system of fee allocation so ingrained in American legal culture that it is called the American rule. We might as well go a little farther.

Under the English rule with risk shifting, the tort plaintiff would not only face the risk of an adverse fee shift; she would also be entitled, if she should recover a judgment, to a favorable fee shift. As the plaintiff would not be paying her lawyer on an hourly basis, there might be a question as to how to calculate recoverable fees. One method would be to award the plaintiff a percentage of her recovery as fees, though not necessarily as high a percentage as contained in her contingent-fee contract. I will assume, however, that the favorable fee award will be based on the hours the plaintiff's attorney has spent on the case multiplied by a "reasonable" hourly rate. Furthermore, there will be no "contingency bonus" or multiplier. This is after all how fee awards are calculated under the various federal statutes that currently provide for one-way, pro-plaintiff fee shifting.[19]

B. Treatment of Poor Plaintiffs

An optional feature of client-to-lawyer risk shifting is that it can bring some mutuality to the English rule's treatment of poor plaintiffs. Unfortunately, mutuality cannot be established merely by making risk shifting available to poor plaintiffs. A very poor plaintiff may well decide that she has no fear of an adverse fee shift and thus no need for risk shifting. She may choose to litigate under a traditional contin-

16. Pfennigstorf, *supra* note 3, at 59.

17. *Id.* at 60-61.

18. Rowe, *supra* note 11, at 153-54. There has been some movement away from this prohibition. Illinois, for example, now permits the lawyer to pay expenses on a contingent basis. ILLINOIS RULES OF PROFESSIONAL CONDUCT ANNOTATED Rule 1.8(d) (1991).

19. *See* City of Burlington v. Dague, 505 U.S. 557 (1992) (no contingency bonus).

gency arrangement in which her lawyer does not assume the risk of an adverse fee shift. If mutuality is to be restored, the poor plaintiff must be prohibited from bringing suit unless she has obtained her lawyer's agreement to assume the risk of an adverse fee shift.

One way to effect this prohibition would be to require all tort plaintiffs who do not sue under a risk-shifting arrangement to post an interest-bearing deposit that would cover some part of the defendant's expected attorney fees. A deposit requirement would force poor plaintiffs, and some middle-class plaintiffs, to sue under a risk-shifting arrangement or not at all. As a result, some cases would be kept out of court. But if a case is so unattractive that no lawyer is willing to accept it under a risk-shifting arrangement, perhaps it deserves to be kept out of court.[20] In any event, this system of rationing access to court would be effectively similar to the way access is now rationed under the American rule. As matters currently stand, if no lawyer is willing to take a tort plaintiff's case on a contingency basis, the plaintiff is unlikely to sue *pro se* or engage a lawyer under an hourly fee; she will most likely not sue at all.

C. Compensation Arrangements

If lawyers operating on a contingent fee were permitted to assume the risk of an adverse fee shift, they would want additional compensation for doing so. One method of compensation would be for the lawyer who assumes the risk of an adverse fee shift to receive the benefit of any favorable fee shift. Thus, if the plaintiff should win, the plaintiff's lawyer would receive the regular contingent fee—say one-third of damages—and in addition would receive the amount awarded to the plaintiff as attorney fees. If the plaintiff should lose, the lawyer would receive no fee from the plaintiff, in accordance with the contingent-fee agreement, and in addition would be obligated to pay the opposing lawyer's fees that were assessed against the plaintiff. The lawyer would have assumed both the additional risk and the additional opportunity presented by two-way fee shifting. I will call this compensation system Full Fee compensation.

Another method of compensation would be for the lawyer to receive a higher percentage of the plaintiff's recovery—higher than the usual one-third, for example. The higher percentage could apply both

20. Some countries operating under the English rule have deposit requirements that apply only to non-citizens. Pfennigstorf, *supra* note 3, at 64 n.169. Client-to-lawyer risk shifting makes it possible and palatable to extend such requirements to citizen plaintiffs who do not sue under a risk-shifting arrangement.

to settlements and trial recoveries, or only to recoveries at trial. Or, there could be a higher percentage for settlement recoveries and an even higher percentage for trial recoveries.

Theoretically, the higher percentage fee could be the lawyer's sole compensation for assuming the risk of an adverse fee shift; she could be barred from receiving any part of a favorable fee shift. It does not seem realistic, however, that the opportunity of a favorable fee shift would be wholly excluded as an element of compensation. More likely would be a hybrid arrangement, in which the lawyer was entitled to a given percentage of both damages and court-awarded fees. It is also likely that court-awarded fees would be a floor under lawyer compensation. Hypothetically, then, the lawyer might contract to receive 50% of both damages and court-awarded fees *or* the total amount of court-awarded fees, whichever was greater. I will call this second type of arrangement Higher Percentage compensation.

Under a third possible arrangement, the lawyer would take a higher percentage of any recovery and would *also* receive the full benefit of any favorable fee shift. Obviously, this third arrangement would be more favorable to the plaintiff's lawyer than Full Fee compensation; depending on the percentage fee agreed to, it might also be more favorable to the lawyer than Higher Percentage compensation. I will call this third possible arrangement Full Fee plus Higher Percentage compensation.

It is likely that something like one or all of these compensation arrangements would emerge if risk shifting were permitted.[21] Therefore, it is prudent to examine whether one arrangement is superior to the others and, if so, whether it should be mandated as the only available compensation arrangement. Part III considers how the various arrangements might affect the selection of cases for litigation. Part IV considers how the various arrangements might bear on attorney-client conflicts in the settlement process.

III. Can Risk Shifting Solve the Problems and Preserve the Benefits of the English Rule?

A. Solving the Problems

Under the English rule with client-to-lawyer risk shifting, there would be no danger of complete ruin for a plaintiff of moderate

21. Donohue hypothesizes two compensation arrangements that are similar to those I have described, but somewhat less generous to the plaintiff's lawyer. Donohue, *supra* note 2, at 213 n.63.

means. If the case were lost, the defendant's fees would be paid not by the plaintiff, but by the plaintiff's law firm, which presumably could better bear the burden. Moreover, with the risk of ruin removed, middle-class plaintiffs would not be deterred by their risk aversion from bringing and pursuing meritorious claims. Some mutuality could even be restored to cases involving a poor plaintiff, especially if such a plaintiff were prevented from suing unless she could obtain a risk-shifting arrangement. Clearly, then, risk shifting could solve some of the arguable problems of the English rule. A more complicated question is whether risk shifting could preserve the arguable benefits of the English rule.

B. Preserving the Benefits?

1. Selection of Cases for Litigation

One of the arguable benefits of the English rule *without* risk shifting is that given risk neutrality, it tends to encourage "good" litigation and discourage "bad" litigation. As suggested above, if a hypothetical risk-neutral plaintiff were optimistic, she would be more likely to sue under the English rule than under the American rule; if she were pessimistic, she would be less likely to sue under the English rule than under the American rule.[22] Can the English rule with risk shifting achieve similar results in the real world of risk-averse plaintiffs?

Before attempting to answer this question, it is necessary to distinguish between two possible standards of success for a system of risk shifting. Under one view, the English rule with risk shifting should discourage unpromising cases and encourage promising cases to the same extent as the English rule proper as applied to a hypothetical risk-neutral plaintiff. Under a second view, the English rule with risk shifting need only discourage unpromising cases and encourage promising cases to a *greater* extent than the American rule. I will assume here that the second standard applies. On that assumption, the English rule with risk shifting can indeed preserve the English rule's advantage of deterring "bad" litigation to a greater extent than the American rule, especially if the only permitted compensation system is Full Fee compensation. It is less clear whether the English rule with risk shifting can encourage "good" litigation to a greater extent than the American rule.

22. Once again, I am assuming throughout this Article that fees recoverable by both sides would be identical.

i. Unpromising Case

Consider first an unpromising case, one as to which both plaintiff and lawyer believe that should the lawyer agree to represent the plaintiff and bring suit, the plaintiff will more likely lose than win. If the only available compensation system is Full Fee compensation, the lawyer will contemplate assuming both the risk of an adverse fee shift and the opportunity of a favorable fee shift. In view of the lawyer's pessimism, the risk of an adverse fee shift will outweigh the opportunity of a favorable fee shift. Therefore, the lawyer will be less likely to accept the plaintiff's case under the English rule with risk shifting than under the American rule. If the plaintiff cannot find a lawyer who will represent her, she probably will not bring suit; the risk-averse individual plaintiff will not want to sue *pro se* and assume herself the risk of an adverse fee shift. Thus, by using the lawyer as gatekeeper, the English rule with risk shifting will have accomplished the objective of discouraging unpromising litigation to a greater extent than the American rule.[23]

The situation is less clear if one of the other two compensation systems is used: Higher Percentage or Higher Percentage plus Full Fee. It is possible that a pessimistic plaintiff's lawyer would be *more* willing to accept a case under one of these compensation systems than under the American rule, especially if the lawyer were only slightly pessimistic and if damages were high relative to the size of the possible adverse fee shift.

Suppose, for example, that the lawyer thought the plaintiff had a 60% chance of losing and a 40% chance of recovering $100,000. Furthermore, settlement is, for some reason, impossible. Under the American rule, assuming a one-third contingent fee, the expected value of the case to the lawyer would be $13,333.33,[24] minus the lawyer's costs, such as the opportunity cost of the lawyer's time.

Now, suppose the English rule with risk shifting were in effect. Suppose further that the adverse fee shift in the event of a loss would be only $10,000; the favorable fee shift in the event of a win also

23. Introducing the possibility of settlement does not affect the inequality established here, but it can reduce the extent to which the English rule with client-to-lawyer risk shifting diverges from the American rule. If the plaintiff's lawyer is pessimistic, we can assume that the defendant will likely be optimistic. From the defendant's perspective, the opportunity of a favorable fee shift will outweigh the risk of an adverse fee shift, reducing the defendant's expected loss and thereby also reducing the settlement value of the case. But while only the plaintiff's lawyer is subject to the risk of an adverse fee shift, both lawyer and plaintiff will likely share in the reduced settlement value of an unpromising case.

24. .4 × 1/3 × $100,000.

would be $10,000. If the compensation system were Full Fee compensation, the expected value of the case to the lawyer would be $11,333.33[25] minus the lawyer's costs, probably less than under the American rule.

But now suppose that the compensation system were Higher Percentage plus Full Fee compensation, with the lawyer receiving 50% of damages and the entire fee shift if the plaintiff wins. The expected value to the lawyer would then be $18,000[26] minus the lawyer's costs—possibly higher than the expected value under the American rule of $13,333.33 minus costs.[27] Therefore, compensation systems other than Full Fee compensation can actually *encourage* the litigation of unpromising cases to a greater extent than the American rule.

This feature of compensation systems other than Full Fee compensation becomes even more realistic if lawyers are permitted to take a higher percentage of both settlement and trial recoveries. In the above example, the adverse fee shift of $10,000 was only one-tenth of the $100,000 judgment, and the lawyer's estimated probability of winning—40%—was not very pessimistic. Assume instead that the adverse fee shift were $20,000 and the estimated probability of winning were 35%. The expected value to the lawyer under the same Higher Percentage plus Full Fee compensation arrangement would then be $11,500[28] minus costs, around the same as the expected value under the American rule of $11,666.66[29] minus costs.

Now, however, introduce the possibility of settlement. Assume, as before, that the plaintiff has only a 35% chance of winning if the case goes to trial, but further assume that there is a 90% probability under the American rule that the case will settle for $35,000, and a 90% probability under the English rule with risk shifting that the case will settle for $29,000.[30] If the compensation system under the English rule with risk shifting is Higher Percentage plus Full Fee Compensation, the lawyer will once again receive 50% of any recovery, including

25. (.4 × 1/3 × $100,000) + (.4 × $10,000) − (.6 × $10,000).

26. (.4 × .5 × $100,000) + (.4 × $10,000) − (.6 × $10,000).

27. We cannot say for certain that the expected value would be higher under the Higher Percentage plus Full Fee compensation system than under the American rule because the introduction of the English rule with risk shifting might raise the minimum cost of lawyer time, eliminating marginal lawyers. *See infra* text accompanying note 35.

28. (.35 × .5 × $100,000) + (.35 × $20,000) − (.65 × $20,000).

29. .35 × 1/3 × $100,000.

30. In each case, the stipulated settlement amount is the expected judgment to be paid by the defendant under the plaintiff's lawyer's litigation estimates.

settlement recoveries. There will be no fee shift as part of a settlement.[31]

Under these circumstances, the expected value of the case to the lawyer under the American rule would be $11,666.66[32] minus costs, which is the same as before. The expected value under the English rule with Higher Percentage plus Full Fee compensation would be $14,200[33] minus costs—possibly higher than under the American rule.

Most supporters of the English rule could not accept a system that sometimes encouraged the litigation of unpromising cases to a greater extent than the American rule. Therefore, if the English rule with risk shifting were instituted, it would be logical to prohibit compensation arrangements that allowed the plaintiff's lawyer to take a higher percentage of the plaintiff's recovery in exchange for assuming the risk of an adverse fee shift. In order to effect such a prohibition, the regulatory authority would of course have to specify the maximum percentage rate of the "normal" contingent fee.

ii. Promising Case

Now consider a promising case, one as to which lawyer and plaintiff believe that the plaintiff would more likely win than lose. Lawyers may be unwilling to accept some promising cases under the American rule because the plaintiff's damages are too low. How would such small promising cases be affected under the English rule with risk shifting?

In venturing an answer to this question, I will initially make three unrealistic assumptions. First, all plaintiffs' lawyers will be completely risk neutral. Second, the introduction of the English rule with risk shifting will not affect the organization of the plaintiff's personal injury bar. Third, there will be no possibility of settlement. Under these unrealistic assumptions, the English rule with risk shifting can encourage "good" litigation to a greater extent than the American rule.

If the compensation system is Full Fee compensation, the lawyer will once again contemplate assuming both the risk of an adverse fee shift and the opportunity of a favorable fee shift. Now, however, as the lawyer is both optimistic and risk neutral, the opportunity of a favorable fee shift will outweigh the risk of an adverse fee shift. Ac-

31. For a hypothetical scenario involving an imputed adverse fee shift as part of settlement, see *infra* text accompanying note 42.

32. (.9 × 1/3 × $35,000) + (.035 × 1/3 × $100,000).

33. (.9 × .5 × $29,000) + (.035 × .5 × $100,000) + (.035 × $20,000) − (.065 × $20,000).

cordingly, the lawyer will be more willing to represent the plaintiff under the English rule with risk shifting than she would be under the American rule.

If the compensation system is Higher Percentage compensation, the result will be essentially the same. It will be remembered that the arrangement we are calling Higher Percentage compensation is actually a hybrid arrangement, one under which the lawyer is assured of receiving at least the entire amount of any favorable fee shift.[34] If the plaintiff's damages are low, this "floor" makes Higher Percentage compensation functionally equivalent to Full Fee compensation. True, with Full Fee compensation, the lawyer will receive the entire favorable fee shift *plus* one-third of damages. But in a promising low damages case, the lawyer's right to receive one-third of damages will be relatively insignificant; the lawyer will basically depend for her compensation on the likelihood of a favorable fee shift.

It therefore appears that under the unrealistic assumptions advanced above, lawyers would be more willing to accept small promising cases under the English rule with risk shifting than under the American rule. However, if we reintroduce the issues thus far evaded—effect on the organization of the plaintiff's bar, risk aversion among lawyers, and the possibility of settlement—this conclusion is no longer evident.

One likely effect of the English rule with risk shifting would be greater concentration among plaintiffs' personal injury lawyers. Solo practitioners and some members of small firms would be reluctant to risk a large adverse fee shift. Over time, there would be fewer and larger plaintiff-side firms.[35] These firms would not allow their lawyers to accept cases that could only generate a small amount of revenue per unit of time invested.

To see the effect of this phenomenon on the litigation of small promising cases, assume that the plaintiff's damages are so small that the plaintiff's lawyer must depend for compensation solely on the possibility of a favorable fee shift. Obviously, then, the plaintiff's lawyer would not accept the case if the cost of her time was higher than the hourly rate to be applied in calculating a favorable fee award. Indeed, the plaintiff's lawyer's cost of time must be significantly lower than the rate to be awarded before she will be willing to accept the case: She

34. *See supra* text accompanying note 21.

35. I am here assuming that the English rule with risk shifting would be adopted nationwide or in an entire state, and not just in federal diversity cases, as has sometimes been proposed.

cannot be certain of a favorable fee shift, and there is some possibility, however small, of an adverse fee shift. By reducing the number of marginal plaintiff's lawyers whose cost of time is low, greater concentration among the plaintiff's bar would make it harder for plaintiffs with small promising cases to find a lawyer.

Another factor that would operate in the same direction—reducing the willingness of lawyers to accept small promising cases—is risk aversion among lawyers. It can safely be assumed that lawyers would be less risk averse than their clients. Nevertheless, it would be a mistake to assume that lawyers would be completely risk neutral, even after the new system led to greater concentration among plaintiff-side tort lawyers. Some degree of risk aversion, on average, would remain.

A final factor that could reduce the willingness of lawyers to accept small promising cases is the possible unavailability of favorable fee shifts in cases that settle. As noted below, there is some reason to limit a lawyer's ability to characterize part of a settlement recovery as attorney fees, lest the lawyer improperly characterize too much of the settlement recovery as attorney fees. If lawyers could not characterize any part of settlement proceeds as fees, or even if (as suggested below) such a characterization required court approval, lawyers would have even more reason not to accept strong small cases.[36]

Thus, the English rule with risk shifting cannot necessarily encourage strong small claims to a greater extent than the American rule. However, that is not a reason to favor the English rule without risk shifting over the English rule with risk shifting. The English rule without risk shifting also cannot guarantee the encouragement of strong small claims, since it would operate against the background of risk-aversion among middle-class tort plaintiffs.

In presenting an arguable rationale for the English rule, I have so far given equal weight to the twin objectives of encouraging "good" litigation and discouraging "bad" litigation. In actuality, however, proponents of the English rule do not really seem to be motivated equally by these objectives: They are more interested in the English rule's tendency to increase the significance of pessimism than in its more questionable tendency to increase the significance of optimism.

36. In deciding whether to accept a promising small case, plaintiff's lawyers might also be apprehensive that they could be forced by their clients to accept a settlement that fully compensates the client, but compensates them only partially or not at all. The same problem currently faces lawyers who accept small cases or injunctive claims under one-way, pro-plaintiff fee-shifting statutes. Some lawyers have attempted to deal with this problem by incorporating in their fee agreements a provision that prohibits the client from accepting, against the lawyer's wishes, a settlement under which the lawyer's fees are waived.

Their reasoning, to the extent that they are not merely interested partisans of potential defendants, seems to be something like the following. Under some grand utilitarian calculus, there is too much litigation, and in particular too much tort litigation. The volume of litigation should therefore be reduced. However, this reduction should not be *ad hoc*. The least socially beneficial litigation should be eliminated, and the most socially beneficial litigation should be retained. The least socially beneficial cases are those in which the plaintiff and her lawyer are most pessimistic. Since the English rule increases the significance of pessimism, it can reduce the volume of litigation by eliminating the least socially beneficial cases.

Under this modified rationale for the English rule, it is far more important to discourage large weak claims than it is to encourage small strong claims. As the English rule with risk shifting can discourage large weak claims to a greater extent than the American rule, its possible failure to encourage small strong claims may not matter.

2. Shifting for Fairness

Aside from its incentive effects, the English rule has been advocated on the ground that it results in a fairer distribution of the fee burden than the American rule because it places the entire burden on the party adjudged in the wrong, and no burden on the party adjudged in the right. As to this arguable advantage, there might seem to be an objection to the English rule with risk shifting. Like the English rule proper, the English rule with risk shifting would make the litigation experience costless for the victorious *defendant*. The experience, however, would not be costless for the victorious plaintiff. The plaintiff's lawyer would not be paid solely out of fees recovered from the defendant; the lawyer would still receive a percentage of the plaintiff's damages recovery in addition to some or all of the fees recovered.

Nevertheless, this result is not a reason to bar risk shifting. If plaintiffs opt for risk shifting, as I assume they would, it is because they prefer being made less than whole to running the risk of an adverse fee shift. Plaintiffs who are less concerned about the risk of an adverse fee shift can seek a traditional contingency arrangement, one in which the lawyer assumes neither the risk of an adverse fee shift nor any offsetting compensation.[37]

37. Admittedly, such an arrangement might be less feasible if the deposit requirement suggested above were instituted.

Also, there is a certain tension between arguments for the English rule based on formalistic notions of fairness and the actual effects of the English rule on the behavior of potential plaintiffs. If it is unfair for a plaintiff who prevails at trial to receive less than full compensation for a wrongful injury, surely it is even more unfair if the same plaintiff is deterred from suing and therefore receives no compensation whatsoever for her wrongful injury.

3. More English Than the English Rule?

Up to now it has seemed that the English rule with risk shifting can fairly well serve the arguable purposes of the English rule proper. When we consider again the effect of risk shifting on poor plaintiffs, the English rule with risk shifting shows promise of serving those purposes better than the English rule proper. I have suggested above that poor plaintiffs can be compelled, through a deposit requirement, to sue under a risk-shifting arrangement or not at all.[38] Such a regime would mean that of the poor plaintiffs who would have sued and lost under the English rule, some will sue and lose under a risk-shifting arrangement and some will not sue because no lawyer is willing to assume the risk of an adverse fee shift. As to those poor plaintiffs who sue and lose under a risk-shifting arrangement, the English rule with risk shifting will have removed the fee burden from the victorious defendant, something that the English rule proper could not have done. As to those poor plaintiffs who do not sue at all, the English rule with risk shifting will have deterred an unpromising case that the English rule proper could not have deterred. In a sense, then, the English rule with risk shifting could be more English than the English rule proper.

IV. Lawyer-Client Conflict of Interest in the Settlement Process

Client-to-lawyer risk shifting should not automatically be endorsed even if it would solve the arguable problems of the English rule while preserving the arguable benefits of the English rule. One must also consider whether risk shifting would cause problems of its own. This Part examines what I consider the most serious type of problem that risk shifting may cause: the exacerbation of lawyer-client conflict of interest in the settlement process, possibly leading to exploitation of the client by the lawyer.

38. *See supra* text accompanying note 20.

A. *Mischaracterization of Settlement Proceeds as Fees*

Under the English rule with risk shifting, the plaintiff's lawyer might be able to claim an unfairly large share of settlement proceeds by mischaracterizing part of those proceeds as fees. If the lawyer has fully assumed both the risk of an adverse fee shift and the opportunity of a favorable fee shift (i.e., Full Fee compensation), it will be in the lawyer's interest to characterize as much as possible of the settlement proceeds as fees. Such a characterization, however, may not be fair to the plaintiff. Assume that the defendant is willing to pay a certain amount in settlement and does not care how it is characterized. Assume further that both the defendant and the plaintiff's lawyer believe the plaintiff has a 50-50 chance of winning at trial. Under these circumstances, the lawyer's opportunity of a favorable fee shift should have no settlement value at all; it should be completely counterbalanced by the risk of an adverse fee shift. However, if the lawyer controls the characterization of the settlement proceeds, she can label part of the proceeds as fees and take that full amount in *addition* to taking a percentage of the part characterized as damages.

Conflict over the characterization of settlement proceeds does not require client-to-lawyer risk shifting or even the English rule. Such conflict can also be generated by a one-way, pro-plaintiff, fee-shifting statute under which the winning plaintiff recovers fees but the winning defendant does not. One-way fee-shifting statutes are not uncommon in American litigation, and in some areas, such as employment discrimination, they are pervasive.[39] When an employment discrimination case is settled, some part of the proceeds will be characterized as attorney fees. As it is the plaintiff's lawyer who negotiates the settlement, she has the opportunity to aggrandize herself unfairly. For example, she can agree to discount the plaintiff's back pay claim by 50%, but demand full fee compensation for herself.

The potential for unfair aggrandizement, however, could be far greater under the English rule with client-to-lawyer risk shifting. Under a one-way fee-shifting statute, the lawyer's claim for attorney fees will always have at least some value, and it will always be appropriate to characterize some part of the settlement proceeds as fees. Under the English rule with risk shifting, by contrast, the lawyer's claim for fees will often have no settlement value, because it will be

39. *See, e.g.*, 42 U.S.C. § 2000e-5(k) (1970) (Title VII of the Civil Rights Act of 1964); 42 U.S.C. § 1988(b) (1993) (claims under 42 U.S.C. §§ 1981-1985).

balanced by the risk of having to pay the defendant's fees if the plaintiff should lose.

Mischaracterization of settlement proceeds as fees would be less likely to occur if the compensation arrangement between client and lawyer were Higher Percentage compensation rather than Full Fee compensation, and if the higher percentage applied also to settlement recoveries. Under Higher Percentage compensation, the lawyer would be entitled to a higher percentage (say 45%) of both damages and attorney fees recovered. She would then not care whether settlement proceeds were characterized as damages or attorney fees.

However, Higher Percentage compensation would not completely eliminate the potential for mischaracterization of settlement proceeds as fees. As suggested above, even under Higher Percentage compensation, the lawyer would always receive at least the amount awarded as fees; for example, she would effectively receive 45% of the recovery or total fees, whichever was greater. In a case with relatively low damages and high fees, therefore, it could still be in the lawyer's interest to mischaracterize settlement proceeds as fees.

One solution to the mischaracterization problem would be to prohibit the parties from ever characterizing any part of settlement proceeds as fees. A complete prohibition, however, would greatly reduce the plaintiff's lawyer's incentive to take promising low damages cases. Probably a better course would be to require court approval before any part of settlement proceeds were characterized as attorney fees. To obtain such approval, the plaintiff's lawyer would have to demonstrate that the plaintiff had substantially more than a 50% chance of prevailing at trial. This requirement of court approval would probably ensure that in most cases no part of settlement proceeds would be characterized as fees.

B. Pessimism by the Plaintiff's Lawyer

Another way that client-to-lawyer risk shifting can exacerbate lawyer-client conflict of interest is by giving the lawyer added incentive to settle when it would be in the plaintiff's interest to go to trial. In addressing this problem, it is once again useful to distinguish between the various compensation arrangements under consideration.

Assume first that the compensation arrangement is Full Fee compensation: The plaintiff's lawyer assumes fully both the risk of an adverse fee shift and the opportunity of a favorable fee shift. If the plaintiff's lawyer is pessimistic, the prospect of trial, as opposed to set-

tlement, will be doubly unattractive to her. First, the lawyer will have to put additional time into the case, time that will not likely be compensated. Second, and even more daunting, the lawyer will likely have to pay all of the defendant's attorney fees. The pessimistic plaintiff's lawyer can avoid both these risks by settling rather than going to trial. Because the plaintiff does not share in these risks, it will sometimes be in the lawyer's interest to accept a settlement that is not in the plaintiff's interest. Thus, to the extent that the pessimistic plaintiff's lawyer controls settlement decisions, she may disserve the plaintiff's interest by settling too "cheap."

The problem of lawyers settling against the plaintiff's interest can also exist under the American rule. As several commentators have observed, the lawyer in a contingent fee case brought under the American rule bears a cost in going to trial, while the plaintiff bears no cost. This variance in cost can cause a conflict of interest regarding settlement.[40] However, this conflict is potentially greater under the English rule with risk shifting: There, the pessimistic plaintiff's lawyer must consider not only her own additional cost of going to trial, but also the probability of paying *all* of the defendant's fees.

The problem could be even more serious if the compensation arrangement is Higher Percentage compensation, and if the higher percentage applies also to settlement recoveries. Assume that the percentage rate under Higher Percentage compensation is 45%. The lawyer will then receive 45% of the plaintiff's recovery even if there were a settlement. If there is a trial and the plaintiff wins, the lawyer will once again receive 45% of the plaintiff's recovery, including 45% of any favorable fee award. If there is a trial and the plaintiff loses, the lawyer will pay 100% of the defendant's fees. From the lawyer's perspective, then, the difference between settlement and trial is that trial adds the risk of paying 100% of an adverse fee shift and the opportunity of receiving only 45% of a favorable fee shift. Under these circumstances, even a lawyer who is not pessimistic may favor a settlement that is against the plaintiff's interest.[41]

The problem would not be as severe if the higher percentage in Higher Percentage compensation applied only to trial recoveries. The

40. *See* Geoffrey Miller, *Some Agency Problems in Settlement*, 16 J. LEGAL STUD. 189 (1987); Terry Thomason, *Are Attorneys Paid What They're Worth? Contingent Fees and the Settlement Process*, 20 J. LEGAL STUD. 187 (1991).

41. A similar point is made in Smith, *supra* note 2, at 2166, regarding a hypothetical system in which the lawyer receives no compensation whatsoever for assuming the risk of an adverse fee shift.

lawyer's trial and settlement incentives under Higher Percentage compensation would then probably be similar to her incentives under Full Fee compensation. The lawyer would not necessarily have an incentive to settle against the plaintiff's interest in the average case, but she would likely have such an incentive if she were pessimistic.

Donohue has suggested that a sophisticated and knowledgeable plaintiff could protect her interests, vis-à-vis a pessimistic lawyer, by agreeing to settle only on the condition that the lawyer reduce her percentage fee.[42] Technically, such a demand by a plaintiff would be analogous to an *optimistic* lawyer's demand that some part of settlement proceeds be characterized as attorney fees received from the defendant. But it is questionable whether many plaintiffs would be sophisticated enough to make such a demand.

How big a problem is it that the pessimistic plaintiff's lawyer may disserve the plaintiff's interest by settling rather than going to trial? Though some would undoubtedly disagree, I do not believe the problem is enormous. First, the English rule is *supposed* to increase the significance of pessimism; it is supposed to depress the settlement value of a suit that is likely to fail. It is not obvious, therefore, that in the conflict of interest over whether to settle or go to trial, the interest of the pessimistic plaintiff's lawyer should be totally subordinate to that of the plaintiff.

It is true that under client-to-lawyer risk shifting, the lawyer may be willing to accept a settlement that would be unacceptable to a hypothetical risk-neutral plaintiff operating under the English rule. Even apart from the cost of going to trial, the negative expected value of court-awarded fees will loom larger for the lawyer because this value will be balanced against a smaller share of expected damages. But even if we accept that the normative perspective is that of a hypothetical risk-neutral plaintiff operating under the English rule proper, the *defendant* should usually be willing to offer a settlement that would satisfy such a plaintiff.[43] From the defendant's perspective, the settlement/trial decision will not be very different from that which would exist under the English rule proper. True, if the defendant believes that the plaintiff's lawyer is pessimistic, the defendant may seek

42. Donohue, *supra* note 2, at 211.

43. As demonstrated by Shavell, there should be a settlement under any fee apportionment system unless "the plaintiff's estimate of the expected judgment exceeds the defendant's estimate by at least the sum" of their estimated costs of going to trial. Shavell, *supra* note 5, at 63-65. Although the condition for trial may be more likely under the English rule than under the American rule, noone has suggested that it will occur, under any system, in more than a minority of cases.

to exploit that pessimism by insisting on a settlement lower than that which it would otherwise offer. However, an obvious bargaining strategy for the pessimistic plaintiff's lawyer will be to disclaim any control over settlement decisions, even if she controls such decisions completely. Thus, even if the pessimistic plaintiff's lawyer is willing to settle "too cheap," she usually should not have to do so.

C. Optimism by the Plaintiff's Lawyer

Optimism by the plaintiff's lawyer could also exacerbate lawyer-client conflict of interest, especially if the lawyer faced a rule limiting the compensation she could receive in the event of settlement. Suppose, for example, that lawyers were permitted to take a higher percentage of trial recoveries but not settlement recoveries, or that lawyers were absolutely prohibited from characterizing settlement proceeds as attorney fees. In the face of such rules, the optimistic lawyer might be motivated to avoid a settlement beneficial to the plaintiff, hoping to receive substantially higher compensation after winning at trial.

This problem provides another reason to allow the parties, possibly with court approval, to characterize some settlement proceeds as fees. It also provides another reason to prohibit higher percentage compensation arrangements entirely, instead of restricting such arrangements to trial recoveries.

Exacerbation of lawyer-client conflict of interest is a serious potential problem of the English rule with risk shifting. Once again, however, this problem is not necessarily a reason to reject the English rule with risk shifting in favor of the English rule proper. The English rule proper could also exacerbate lawyer-client conflict of interest, as compared with the American rule. Under the English rule proper, the plaintiff alone faces the risk of an adverse fee shift. As the lawyer does not share this risk, she can disserve the plaintiff's interest by rejecting or sabotaging a settlement, thereby subjecting the plaintiff to possible ruin. This scenario is arguably more troubling than all of the conflict scenarios previously discussed.

CONCLUSION

The essential difference between the English rule proper and the English rule with risk shifting is that the English rule with risk shifting allows more freedom of contract between the tort plaintiff and the tort plaintiff's lawyer. Given the opportunity, the tort plaintiff will

shift to her lawyer the risk of an adverse fee award and will be quite willing, in return, to anticipate a reduced recovery. The issue, then, is whether the plaintiff should be prohibited from making such a contract. If one accepts this Article's assumptions regarding the benefits and burdens of the English rule, risk-shifting contracts should not be prohibited.

There is a rationale, however, for regulating the compensation the plaintiff's lawyer receives in exchange for assuming the risk of an adverse fee award. Of the various compensation arrangements considered here, Full Fee compensation seems superior to arrangements under which the lawyer receives a higher percentage of the plaintiff's recovery. The key defect of higher percentage arrangements is that they do not necessarily deter unpromising cases to a greater extent than the American rule.

Finally, a note of caution. The English rule with risk shifting is not in operation anywhere in the world. It would be presumptuous to advocate too confidently a system that has never been tried; maybe there is a good reason why it has never been tried. In theory, though, the English rule with risk shifting looks at least as good as the English rule without risk shifting.