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The Market for Contingent Fee-Financed Tort Litigation: Is it Price Competitive?

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THE MARKET FOR CONTINGENT FEE-FINANCED TORT LITIGATION: IS IT PRICE COMPETITIVE?

Lester Brickman*

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INTRODUCTION

As tort liability has greatly expanded over the past forty years,¹ the

¹ By expansion of tort liability, I mean, expansion of the scope of tort liability, that is, enlargement of the range of acts that can give rise to tort liability. This process has taken place throughout the twentieth century but it accelerated in the 1960s and 1970s, and quickened in the 1980s. Indeed, thousands of tort claims brought in the 1980s and thereafter, have resulted in defendants' retroactive inculcation for acts occurring in the 1940s and 1950s which were nontortious at the time. See Lester Brickman, *Effective Hourly Rates of Contingency Fee Lawyers: Competing Data And Non-Competitive Fees*, 81 WASH. U.L.Q. at n.1 (forthcoming November 2003) [hereinafter Brickman, *Effective Hourly Rates*]; see also Lester Brickman, *On the Relevance of the Admissibility of Scientific Evidence: Tort System Outcomes are Principally Determined by Lawyers' Rates of Return*, 15 CARDOZO L. REV. 1755 (1994) [hereinafter Brickman, *Tort System Outcomes*]; Adam F. Scales, *Against Settlement Factoring? The Market In Tort Claims Has Arrived*, 2002 WISC. L. REV. 859, 874, 875 n.56 (2002) [hereinafter Scales, *Market For Tort Claims*] (referring to the "profound expansion in tort liability that has occurred during the past few decades" and conjuring up a Rip Van Winkle spouse who time-travels from the 1950s to the present and is "amazed to learn that she had acquired obligations to protect

consequent wealth transferred has increased exponentially.² The impetus for this expansion is multi-faceted and complex.³ In part, the expansion has been a function of changes in substantive tort law favoring liability,⁴ the contraction of defenses to tort liability,⁵ and changes in procedural rules giving plaintiffs' lawyers broad pretrial discovery powers.⁶ The effects of these changes have been magnified by enormously increased asset pools available to plaintiffs seeking compensation for tortious behavior⁷ as well as by the vastly increased

criminal trespassers from harming themselves on her property, warn neighbors of the sexual predations of her spouse, or prevent people from misusing purchases so as to harm themselves"). For further discussion of the expansion in the scope of liability of the tort system, popularly known as "the litigation explosion," see sources cited in Herbert M. Kritzer, *Seven Dogged Myths Concerning Contingency Fees*, 80 WASH. U. L.Q. 739, 739 n.1 (2002) [hereinafter Kritzer, *Seven Myths*].

² Although it is difficult to directly measure the amount of wealth transferred under the tort system, surrogates for the quantum of wealth transfer exist. One such surrogate is total tort system costs. In 1960, U.S. tort system costs totaled \$32.3 billion (adjusted for inflation to year 2001 dollars). In 2001, tort system costs reached \$205.4 billion, an increase of 536% since 1960. See U.S. TORT COSTS: 2002 UPDATE app. 1 (Tillinghast-Towers Perrin, 2002).

³ See Stephen C. Yeazell, *Re-Financing Civil Litigation*, 51 DEPAUL L. REV. 183 (2001) (presenting a remarkable analysis of legal, political, financial, social and economic trends that have aggrandized the power of the plaintiffs' bar and subtended the increase in the scope of tort liability).

⁴ One of the most significant of the many changes in substantive law is the development of the doctrine of strict liability making manufacturers liable for a wide variety of injury-producing products. This, in turn, has led to emergence of plaintiff friendly products liability litigation, which, however, would not have come about without the rise of mass production and distribution. See *id.* at 190-92.

⁵ See *id.* (noting the disappearance of municipal and charitable immunity thus allowing ordinary negligence actions to be brought against, for example, a charitable hospital; and the replacement of the contributory negligence doctrine, which once provided an absolute defense, by comparative fault).

⁶ See *id.* at 194-95. Yeazell argues that modern products liability law is largely derivative of changes in discovery rules. The 1938 changes to the Federal Rules of Civil Procedure armed plaintiffs' lawyers with broad pretrial discovery powers. Ironically, the costs of such discovery were initially daunting for plaintiffs' lawyers but after several decades, they "recapital[ized] themselves to the point where they could take cases deep enough into discovery to realize some of the potential gain from such pretrial preparation." *Id.* at 195. Yeazell then asserts that it was this procedural change that caused much of the substantive change:

Had there not been a regime of pretrial discovery, it would not have been worth developing a law of products liability. Without pretrial access to engineering studies, internal memoranda, and the like, decisions about appropriate safety levels in relation to known technology and cost would have been difficult to make.

Id.

⁷ Those increased asset pools include automobile insurance, the volume of which has grown dramatically due to credit enabled consumer purchases of automobiles and mandatory auto insurance requirements; home owner's insurance, which similarly has grown due to credit enabled access to housing (which is often government sponsored) and the pronounced trend toward home ownership; healthcare provider liability insurance; and increased government funded and employer funded health insurance, which, along with technological advances, leads to greater demand for medical services, which in turn give rise to higher rates of tort claiming. See *id.* at 187-90. Furthermore, since medical costs rise faster than inflation, medical suits have become comparatively more attractive to plaintiffs' lawyers, who are working for a share of the total damage bill. Put another way, insurance and health care research

financial strength of the plaintiffs' bar⁸ and the relative decrease in the financial strength of the defense bar.⁹

While the rate of increase in wealth transfers declined in the past decade, more recently, tort system costs have resumed historic growth rates that prevailed in the 1960-88 period.¹⁰ In fact, projections of future growth indicate a doubling of tort costs over the next ten years.¹¹ The enormity of the quantum of wealth transferred to date and the consequent costs imposed on the economy have spawned the tort reform wars¹² and can only be expected to have an increasing impact on the debate as the costs of the tort system mount.

Virtually all tort claiming is financed by plaintiff lawyers through the medium of contingent fees. Since these fees are assessed against the quantum of wealth transferred, the enormous increases in the amounts of wealth transferred under the aegis of the tort system have redounded

have made tort suits more attractive investments for plaintiffs. Making them more attractive for plaintiffs has made them a growth industry for the insurance industry and for the defense bar. Litigation has achieved a symbiotic relationship with the most significant aspects of the consumer credit market.

Id. at 190. In asbestos litigation, comprehensive general liability policies issued to the manufacturers and installers of asbestos-containing products and their corporate successors were rewritten by judicial fiat to create tens of billions of dollars in insurance coverage. See Lester Brickman, *On The Theory Class's Theories of Asbestos Litigation: The Disconnect Between Scholarship And Reality*, 31 PEPP. L. REV. at nn.57-58 (forthcoming December 2003) [hereinafter Brickman, *Theories of Asbestos Litigation*]. Because some insurers had issued policies that did not set aggregate policy limits, the asset pool thus created may approach or even exceed \$50 billion. See *id.* at n.59. See also Jeffrey O'Connell, *Blending Reform of Tort Liability and Health Insurance: A Necessary Mix*, 79 CORNELL L. REV. 1303, 1306-08 (1994) (demonstrating that expansion of social and private insurance inflates the cost of tort liability and concluding that the likely extension of health insurance to broader segments of the population may be expected to lead to increased wealth transfer under the tort system).

⁸ See Yeazell, *supra* note 3, at 199-205 (noting that specialization has led to both increased retention of intellectual capital and to increased referrals and fee splitting, which in turn helps ensure that a given case will be well financed by making its way to the top of the secondary market in tort claims maintained by the plaintiffs' bar; and noting further that the plaintiffs' bar has gained access to increased lines of credit through traditional banking loans to firms and through firm loans directly to clients). See also Michael Jonathan Grinfeld, *Justice on Loan*, 19 CAL. LAW. 39, 40 (1999) (noting that plaintiffs' firms ability to carry lawsuits through lengthy discovery have been augmented by access to what has become routine bank loans, and that Citibank Private Bank in San Francisco "finances more than 400 firms and 25,000 attorneys nationwide").

⁹ See Yeazell, *supra* note 3, at 197-98 (noting that insurers have closely scrutinized and constrained their defense litigation costs).

¹⁰ See U.S. TORT COSTS: 2002 UPDATE 1 (Tillinghast-Towers Perrin, 2002) ("[T]he growth in tort costs experienced in 2001 is in stark contrast to the moderate rate of growth experienced in the past decade and is more akin to the double-digit growth rates experienced in the decades of the 1950s, 1970s, and 1980s.").

¹¹ The projection for 2000-2005 is based on Tillinghast's estimate of an annual tort cost increase of 9 percent for that period. See *id.* Projections for the period 2006-2010 are based on a phone conversation with Ross Sutter at Tillinghast. Telephone Interview with Ross Sutter, Tillinghast (Nov. 5, 2002).

¹² For a discussion of the tort reform wars, see Brickman, *Effective Hourly Rates*, *supra* note 1, app. E.

to the financial benefit of plaintiff lawyers. Elsewhere, I have estimated that contingent fees in tort cases are generating upwards of twenty-two billion dollars in annual income and are increasing at a substantial rate.¹³ The resultant increased financial capacity of the plaintiff's bar may thus be seen as simply reflecting the success of that bar in vastly enlarging the scope of tort liability. Viewed from this conventional approach, the dynamic relationship between the increases in tort liability and contingent fee incomes is apparent: increasing incomes have enabled lawyers to undertake financing of larger scale tort litigation, thus generating increased revenues which support larger investments in tort claiming.

Few scholars who have addressed the issue of tort litigation have considered whether a major causative element of the expansion in tort liability is the substantially increasing yield from contingent fees realized by the plaintiff's bar. In part, this may be due to a failure to perceive how lucrative contingent fee claiming has become. Over the past forty years, the average effective hourly rate of the contingent fee bar has increased, in inflation-adjusted dollars, by 1000 to 1400%.¹⁴ Moreover, a top tier consisting of approximately 25 to 30 percent of the torts bar is able to obtain effective rates of return of thousands of dollars an hour; when these fees are obtained in cases where the lawyer has undertaken no meaningful risk,¹⁵ they are properly referred to as windfall fees.¹⁶

The enormous increases in the effective hourly rates of the contingent fee bar parallel the enormous expansion of tort liability. While it cannot be gainsaid that the huge profits being generated by contingent fee claiming strongly underpin the process of expansion of tort liability, which is the chicken and which the egg is a proposition of considerable importance to the issue of civil justice reform and, in particular, to tort reform. If the substantial increase in the profitability

¹³ See Brickman, *Effective Hourly Rates*, *supra* note 1, at n.117. Other commentators have calculated that contingent fees in tort cases are significantly higher than \$22 billion, and in fact, total nearly \$40 billion per year. See CENTER FOR LEGAL POLICY AT THE MANHATTAN INSTITUTE, TRIAL LAWYERS INC.: A REPORT ON THE LAWSUIT INDUSTRY IN AMERICA 2003 2 (2003). The Center for Legal Policy at the Manhattan Institute arrived at this total by "multiplying the 19 percent tort cost share of plaintiffs' attorneys times the \$205.4 billion overall tort cost [which includes both self insured, i.e., uninsured, tort costs and insured tort costs]." *Id.* at n.4. This formula was based on a recent Tillinghast-Towers Perrin report on tort system costs, which estimated that plaintiffs' attorneys' fees account for approximately 19 percent of total tort costs. U.S. TORT COSTS: 2002 UPDATE 17 (Tillinghast-Towers Perrin, 2002). Tillinghast-Towers Perrin defined insured tort costs to include "first party benefits (the cost of legal defense and claims handling), benefits paid to third parties (claimants and plaintiffs) or their attorneys, and an administrative, or overhead, component. . . [and] includes costs associated with all claims, not just those that reach the courthouse." *Id.*

¹⁴ See Brickman, *Effective Hourly Rates*, *supra* note 1, app. A.

¹⁵ *Id.* at nn.109, 152 and text accompanying n.124.

¹⁶ *Id.* at n.13.

of contingent fee claiming is a primary factor accounting for the enormous expansion of tort liability and the consequent increases in wealth transferred, as I have argued,¹⁷ then that has profound implications for our civil justice system and for the ongoing tort reform debate.

For example, those who conclude, as a matter of their political calculus, that the quantum of wealth transfer is excessive, may wish to reconsider their current focus on reforming the tort system by changing tort doctrines and rules of civil procedure. Instead, they may be well advised to shift their focus to a consideration of how lawyers have been able to increase their profits from tort claiming by such a substantial margin. Indeed, if it is the profits that are a primary force driving the expansion of tort liability, then the means of financing most tort litigation in the United States requires a far more searching and systematic inquiry than has yet been undertaken, irrespective of where one stands on the issue of tort reform. Any such inquiry must necessarily focus on whether the increased profits reflect increases in opportunity costs or, alternatively, reflect returns above competitive rates, that is, rents¹⁸—a product of a noncompetitive market. If the market for tort claiming services is determined not to be competitive, then the focus of the inquiry must shift to analyzing the factors accounting for the market failure, including identifying structural impediments to the operation of a competitive market and, as well, remediating actions that can be undertaken. Such an inquiry must also focus on whether self-correcting market mechanisms that might otherwise arise are unavailing because of coordinated efforts by lawyers to prevent competition. Such efforts might include collusive actions to maintain uniform pricing and the bar's use of its self-regulatory authority to insulate tort claiming from competitive forces that would otherwise reduce rents. If that inquiry further leads to the conclusion that competitive market conditions cannot arise absent regulatory intervention, then current tort reform efforts may be seen as substantially misdirected because they focus on symptoms rather than causes. In addition, regulatory agencies with authority to investigate and prosecute coordinated efforts by professionals to prevent price

¹⁷ See generally Brickman, *Tort System Outcomes*, *supra* note 1.

¹⁸ Rents or monopoly rents are the earnings yielded by restrictions on competition. See generally ARMEN ALCHIAN & WILLIAM R. ALLEN, *EXCHANGE AND PRODUCTION: COMPETITION, COORDINATION & CONTROL* 189, 293-94 (3d ed. 1983). See also DAVID BEGG, STANLEY FISCHER & RUDIGER DORNBUSCH, *ECONOMICS* 146-48 (4th ed. 1994) [hereinafter BEGG ET AL., *ECONOMICS*] (Monopoly rents, also called supernormal profits or monopoly profits, are the pure profits yielded as a result of the non-competitive nature of monopolies. Whereas the competitive firm maximizes profits at the equilibrium price determined by supply and demand, the monopolist is able to decrease quantity and increase price to a quantity that exceeds its output costs without the threat of losing business to competitors. Monopoly rents equal the residual earnings after deducting the monopoly's output costs from its increased revenue.).

competition would also find their interests implicated.

In this article, I propose to undertake such an inquiry. To set the stage and provide an appropriate context, I set forth below a summary statement of positions I have previously advanced regarding the legitimacy, use and effect of contingency fee financed tort claiming. These propositions include:

1) that contingent fees in personal injury cases are subject to regulatory regimes and that under both ethical codes and fiduciary law, fees are limited to "reasonable" amounts;¹⁹

2) that because contingent fees are designed to compensate lawyers for risk and to therefore yield higher fee payments than hourly rate or fixed fees, the ethical validity of a contingent fee is a function of the existence of meaningful risk being assumed by the lawyer;²⁰

3) that since a substantial component of the standard contingent fee is the premium a lawyer is charging for assuming risk and since existence of a realistic risk regarding compensation is mandated by ethical codes and fiduciary principles, then it follows, *a fortiori*, that if risk is present, then the risk premium must be proportionate to the risk and the anticipated effort that will be put at risk;²¹

4) that contingent fee lawyers charging standard contingent fees are routinely overcharging some claimants because, in many instances, the representation involves no meaningful risk of no or low recovery and therefore the substantial risk premium in these instances yields unearned and unethical windfall fees;²²

5) that these windfall fees often amount to effective rates of thousands of dollars an hour;²³

6) that a hallmark of the gross overcharging that permeates contingency fee practice is the zero-based accounting system whereby lawyers speciously assign all tort claims a value of zero for purposes of applying their contingent fees to recoveries even though many claims have substantial value at the time the lawyer is retained;²⁴

7) that the gross overcharging of tort claimants is not only in the interest of plaintiff lawyers but also benefits defendant lawyers, and has received the imprimatur of the American Bar Association;²⁵

¹⁹ Lester Brickman, *Contingent Fees Without Contingencies: Hamlet Without the Prince of Denmark?*, 37 UCLA L. REV. 29, 44-74 (1989) [hereinafter Brickman, *Contingent Fees*].

²⁰ See *id.* at 70-84.

²¹ See *id.* at 94-99.

²² See *id.* at 70-74; see also Brickman, *Effective Hourly Rates*, *supra* note 1, at n.13.

²³ Brickman, *Contingent Fees*, *supra* note 19, at 73-74, 92-93; see also Lester Brickman, *ABA Regulation of Contingency Fees: Money Talks, Ethics Walks*, 65 FORDHAM L. REV. 247, 280-83 (1996) [hereinafter Brickman, *Money Talks*].

²⁴ See Brickman, *Effective Hourly Rates*, *supra* note 1, at n.11.

²⁵ See Brickman, *Money Talks*, *supra* note 23, at 247-67; Lester Brickman, *The Continuing Assault on the Citadel of Fiduciary Protection: Ethics 2000's Revision of Model Rule 1.5*, 2003 U. ILL. L. REV., text accompanying notes 128-48 (forthcoming 2003) [hereinafter Brickman,

8) that despite the routine violation of ethical rules purporting to limit risk premiums in contingent fee claiming to amounts commensurate with risk, lawyers are virtually never disciplined for violation of these rules;²⁶

9) that contrary to the claims of many tort lawyers, the actual risk level of most contingent fee lawyers' portfolios of cases does not justify the substantial risk premiums that they uniformly charge;²⁷

10) that a principal reason why the actual risk level is far less than that claimed is that contingent fee lawyers carefully screen their cases, and thus prevail in close to 90 percent of the cases they accept and, in addition, obtain reimbursement of close to 100% of all litigation expenses they advance, including expenses incurred in the cases where they do not prevail;²⁸

11) that contingent fee lawyers charge uniform prices—standard contingent fees—varying from thirty-three to 50 percent depending on the jurisdiction;²⁹

12) that charging standard contingent fees in cases of low risk or no meaningful risk is designed to and does yield windfall fees unearned by either risk or effort;³⁰

13) that empirical evidence to the effect that tort lawyers' effective hourly rates are substantially the same as those realized by their hourly rate counterparts is based upon trivial and misleading data and is therefore unreliable and inaccurate;³¹

14) that, nonetheless, this data is widely relied on by torts' scholars to prove the absence of rents, and is cited by opponents of tort reform as justification for their opposition;³²

15) that contrary to this data, effective hourly rates of contingent fee lawyers far exceed those of their hourly rate counterparts and that, in fact, a top tier of contingent fee lawyers comprising approximately 1/4 to 1/3 of that bar, routinely obtains effective hourly rates of thousands of dollars;³³

16) that contingent fee lawyers engage in concerted efforts to hide their effective hourly rates from public view;³⁴

17) that the efforts at concealment of both effective hourly rates

Assault on Fiduciary Protection].

²⁶ See Lester Brickman, *Contingency Fee Abuses, Ethical Mandates and the Disciplinary System: The Case Against Case-by-Case Enforcement*, 53 WASH. & LEE L. REV. 1339, 1357 (1996) [hereinafter Brickman, *Disciplinary System*].

²⁷ See Brickman, *Effective Hourly Rates*, *supra* note 1, text accompanying nn.150-51.

²⁸ See *id.* at n.148, app. H.

²⁹ See *id.* at n.10.

³⁰ See *id.* at n.13.

³¹ See *id.* at nn.39-107.

³² See *id.* at n.17.

³³ See *id.* at n.109.

³⁴ See *id.* at n.15, app. C.

and risk levels incommensurate with risk premiums being routinely charged plays an important if not critical role in the tort reform wars currently being waged;³⁵

18) that while most tort reform proposals that have been advanced including those providing for: limits on punitive damages; restrictions on choosing venue; changes in the collateral source rule, joint and several liability, statutes of limitation, and class action procedures; are attacked by opponents of tort reform on the ground that they contract rights of tort claimants and thus deny "access to justice" for these claimants, other proposals to reform the civil justice system that both implement dormant ethical and fiducial principles and protect consumers of legal services from price gouging by lawyers and which are not susceptible to this usual "sound bite" charge, nonetheless generate similar opposition;³⁶ and

19) that the enormous increase in the effective rate of return realized by tort lawyers from contingent fee claiming has paralleled the simultaneous expansion in the scope of liability imposed under the tort system.³⁷

All of these arguments, propositions, conclusions and proposals set the stage for the question which is the focus of this article: are contingent fees a function of a competitive market? To undertake this inquiry, I first examine the views expressed by scholars and commentators. I then list and analyze features of contingent fee financed tort claiming that are indicia of the existence of a noncompetitive market. In this article, I contend that the principal such indicator is the maintenance of uniform pricing in the form of standard contingent fees, generally ranging from thirty-three to 50 percent, depending on the jurisdiction. However, while I acknowledge that uniform pricing is consistent with the existence of both competitive and noncompetitive markets, I conclude that in the tort claiming market for tort claiming services, the function of uniform pricing is to generate substantial rents. I then examine other indicia of the existence of a noncompetitive market for tort claiming services, including: the absence of price advertising; the enormity of the increases in effective hourly rates over the past forty years which far exceed estimated increases in productivity or competence; the historical derivation of the standard one third (or higher) contingent fee; the absence of economic justification for uniform pricing such as reductions in agency costs or transactional costs; inelasticity in the pricing of tort claiming services in light of highly variable production costs as highlighted by a comparison of the responsiveness of pricing in the tort claiming market to significant

³⁵ See *id.* at text accompanying nn.20-21.

³⁶ See *id.* app. D.

³⁷ See *id.* text accompanying nn.1-6.

differences in the cost of producing specific services with the responsiveness of pricing in the real estate brokerage market to similar instances of highly varying production costs; and the payment of referral fees, a phenomenon which is largely confined to the contingent fee market, and the fact that lawyers who are willing to pay referral fees to other lawyers refuse to share such saved commission costs when they are directly retained by disintermediating clients.

I then examine factors which inhibit the emergence of a price competitive market including: asymmetrical knowledge with respect to the value of claims; the lack of sophistication of most purchasers of tort claiming services; the utility of uniform pricing in misleading consumers as to the risk being assumed by the lawyer; and the signaling functions of uniform pricing including the branding of price cutters as slackers or as inferior in quality.

I then examine the reasons for the persistence of uniform pricing in the face of the predictions of economists applying standard economic theory that some lawyers would undercut standard pricing thereby generating competitive behavior that would more closely align pricing with risk and the variable cost of producing the service. I attribute the persistence of uniform pricing to market failures and analyze the reasons for such failures.

Finally, I examine the actions of the bar designed to prevent a competitive market from emerging. These actions include the maintenance of barriers to entry into the tort claiming market, prohibitions against the outright purchase of tort claims and adoption of rules of ethics effectively prohibiting price competition including prohibitions against providing financial assistance to clients and brokerage of lawyers' services for profit.

I. IS THE MARKET FOR CONTINGENT FEE-FINANCED TORT CLAIMING SERVICES COMPETITIVE: COMPETING VIEWS

Many scholars have advanced the view that the market for contingent fee financed tort claiming services is competitive. For example, Professor Charles Silver has contended that the contingency fee market is "highly competitive" [and] empirical evidence shows that plaintiffs' attorneys compete for business . . . [and] strive to cut costs and risks."³⁸ Professor Herbert Kritzer, a leading empirical researcher,³⁹

³⁸ Charles Silver, *Does Civil Justice Cost Too Much?*, 80 TEX. L. REV. 2073, 2088-89 (2002) [hereinafter Silver, *Civil Justice*]. His statement, undoubtedly correct, does not parry the thrust of the evidence I present in this article that contingency fee pricing is noncompetitive. Lawyers, including contingent fee lawyers, compete with each other for business and strive to become more efficient by reducing both risk and costs. However, as I later argue, they do not compete on the

has argued that the market system is adequate to bring down unreasonably high fees by the "obvious mechanism" of "price advertising"⁴⁰ which would enable clients to obtain relevant information "about fees . . . [to] make more informed choices."⁴¹ Professor Mark Galanter, a leading torts scholar and widely cited opponent of tort reform,⁴² argued, albeit erroneously, that New York's high contingent fees which were in the 50 percent range, but which had dropped to approximately 33 1/3 percent in the early 1960s, had fallen victim to the competitive market for tort claiming services due to an increased supply of lawyers and other competitive "market forces."⁴³ Contrary views have also been advanced.⁴⁴ Moreover, a number of state supreme

basis of price.

³⁹ Professor Herbert Kritzer has published extensively on the effective hourly rates realized by tort lawyers. See, e.g., HERBERT M. KRITZER, RHETORIC AND REALITY . . . USES AND ABUSES . . . CONTINGENCIES AND CERTAINTIES: THE POLITICAL ECONOMY OF THE AMERICAN CONTINGENT FEE (Wisconsin Inst. for Legal Studies Working Paper No. 11-8, 1995); *Contingent Fee Abuses: Hearing Before Senate Comm. on the Judiciary*, 104th Cong., 1st Sess. (1995) (statement of Herbert Kritzer) [hereinafter Kritzer Statement]. See also Herbert M. Kritzer, *The Wages of Risk: The Returns of Contingency Fee Legal Practice*, 47 DEPAUL L. REV. 267 (1998) [hereinafter Kritzer, *The Wages of Risk*]; Kritzer, *Seven Myths*, *supra* note 1. For a critique of Kritzer's data and conclusions, see generally Brickman, *Effective Hourly Rates*, *supra* note 1.

⁴⁰ Kritzer, *The Wages of Risk*, *supra* note 39, at 308.

⁴¹ *Id.* at 307-09. Kritzer had long denied that tort lawyers' effective hourly rates exceeded that of their hourly rate counterparts and is widely cited for that proposition. See Brickman, *Effective Hourly Rates*, *supra* note 1, at n.17. In the face of overwhelming empirical evidence, he has come to concede that some contingent fee lawyers are able to obtain very high and potentially unreasonable fees. See Kritzer, *Seven Myths*, *supra* note 1, at 772; Kritzer, *The Wages of Risk*, *supra* note 39, at 304. His solution, "price advertising," however, fails. As indicated *infra* note 95, contingent fee lawyers do not engage in price advertising.

⁴² See, e.g., Marc S. Galanter, *Anyone Can Fall Down a Manhole: The Contingency Fee and Its Discontents*, 47 DEPAUL L. REV. 457 (1998) [hereinafter Galanter, *Contingency Fee and Its Discontents*]; Marc S. Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (and Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4 (1983); Marc S. Galanter, *The Day After the Litigation Explosion*, 46 MD. L. REV. 3 (1986).

⁴³ See Galanter, *Contingency Fee and Its Discontents*, *supra* note 42, at 470 (hypothesizing that a drop in contingency fees in New York City from 50 percent to 33 percent was a result of "the increase in the supply of lawyers serving individual clients, the increased competition ushered in by the demise of fee schedules, the appearance of advertising, and a gradual increase in the sophistication of clients"). This is patently false. The reason for the drop in contingency fees was not a result of market forces but rather a rule promulgated by the Appellate Division of the New York Supreme Court to limit contingency fees in tort cases essentially to 33 and one-third percent because market forces were ineffective in limiting contingency fees and legislative efforts to fix the runaway pricing were blocked by lawyers who controlled key legislative positions. For more discussion of the origin of New York's rule, see *infra* note 105; see also Brickman, *Contingent Fees*, *supra* note 19, at 106-07. In my judgment, had the New York courts not previously limited contingent fees to a maximum of 50 percent on the supercilious grounds that a fee of 50.1 percent would give the lawyer control over the lawsuit, the prevailing rate for contingent fees in tort cases would have been in the 60 to 75 percent range.

⁴⁴ See, e.g., *In re Synthroid Marketing Litigation*, 201 F. Supp.2d 861, 875-77 (2002) ("[T]he actual market for legal services departs rather sharply from the ideal conditions under which markets are efficient, and therefore in theory conducive to consumer welfare . . . the market for contingent legal services especially among consumers, is highly uncompetitive . . ."); Richard

courts, in the exercise of their authority to regulate the practice of law, have explicitly and implicitly rejected the view that the market for tort claiming services is competitive by imposing price caps on contingency fees.⁴⁵

To resolve these competing views, I offer the following systematic and, to the extent possible, empirically based analysis of the market for tort claiming services.

II. AN ANALYSIS OF THE MARKET FOR CONTINGENT FEE-FINANCED TORT CLAIMING SERVICES

A. *Competitive Markets: A Definition*

Freely competitive markets are characterized by many producers of goods or services which have qualities that are comparable and prices which are published and readily discovered. Consumers are fully informed of the qualities and prices and register their personal preferences through choices based on that perfect information. Producers respond to the consumer demand for information by campaigning aggressively to provide it, an effort that epitomizes interfirm competition. Free entry and exit by firms into and out of the industry is also a necessary component of competitive markets, in order, *inter alia*, to diminish incentives for existing firms to collude.⁴⁶

W. Painter, *Litigating on a Contingency: A Monopoly of Champions or a Market For Champerty?*, 71 CHI.-KENT L. REV. 625, 656-59 (1995) (the predominance of uniform contingent fee rates indicates the relevant market is not competitive); Gillian K. Hadfield, *The Price of Law: How The Market For Lawyers Distorts The Justice System*, 98 MICH. L. REV. 953, 999 (2000):

The market for lawyers is fundamentally noncompetitive. As a consequence of the complexity of legal reasoning and procedure, the profession's derived monopoly on the legitimate use of coercion, and the unification of the profession to serve the diverse needs for access to law, the price of law that emerges from the free market for lawyers is too high.

Id.

⁴⁵ See, e.g., Florida Bar *re* Amendment to the Code of Professional Responsibility (Contingent Fees), 494 So. 2d 960, 961 (Fla. 1986) ("[T]his Court expressed its belief, (possibly, its hope) that lawyer advertising would create greater public awareness regarding attorneys' fees and services and that competition would provide a self-regulator on fees . . . [S]uch does not appear to be the case."); Mark A. Franklin, Robert H. Chanin and Irving Mark, *Accidents, Money and the Law: A Study of the Economics of Personal Injury Litigation*, 61 COLUM. L. REV. 1, 22 (1961) (because the assumption that competition would prevent abuses in setting contingent fees was not borne out, New York's Appellate Division, by rule, found it necessary to set limits on contingent fees). See also *infra* note 105 for a listing of other state rules and statutes limiting contingent fees and for further discussion of the circumstances surrounding promulgation of New York's rules capping contingent fee rates.

⁴⁶ See BEGG ET AL., *ECONOMICS*, *supra* note 18, at 132-34.

B. *The Market For Tort Claiming Services: An Introductory Summary*

While the market for tort claiming services is characterized by many producers of the services, virtually all of the other components necessary for the existence of a competitive market are not present. For example, the information that the consumer of the service requires in order to engage in price comparisons and meaningful bargaining is largely absent. Search costs are simply prohibitive. Consumers typically lack knowledge of the quality of tort lawyers and therefore are unable to make effective choices based upon differing quality levels. In addition, consumers cannot determine the prices that they are being charged in units which are meaningful to them such as (effective) hourly rates and have little knowledge of the value of the claims which they are partly selling to their lawyers, the amount of risk that the lawyer is assuming or the amount of time the lawyer reasonably anticipates devoting to the client's matter. Tort lawyers, who are experts in valuing claims, determining risk and estimating the time to be required to generate a settlement or verdict, take advantage of this asymmetrical knowledge in a number of ways. They decline to advertise competitive pricing and instead act collusively to generate rents by maintaining standard pricing. Lawyers' efforts to impose and maintain standard pricing are augmented by the message that such pricing conveys to consumers. That is, standard pricing signals to claimants that would-be price cutters may anticipate devoting less time to their claims or are inferior in quality and may, in either case, therefore obtain lower settlements. Lawyers' efforts to impose standard pricing are further augmented by an auxiliary function of standard pricing. It is an efficacious system for exaggerating risk and thereby justifying unearned risk premiums. Consumers, who lack sophistication in negotiating prices with lawyers, are therefore deterred from searching out price cutters who deviate from standard pricing and are often misled into believing that the risk being assumed by the lawyer justifies the substantial risk premium that is incorporated into the standard price.

Given the substantial absence of critical factors characterizing freely competitive markets, it appears unlikely that the market for tort claiming services would be price competitive. To confirm or reject this hypothesis, I next examine the tort claiming service market, beginning with a consideration of indicators of the lack of a competitive market.

C. *Indicia Of An Uncompetitive Market For Tort Claiming Services*

1. Uniform Pricing

The dominant feature of the market for contingent fee financed tort claiming services is that pricing of lawyers' services is uniform. Lawyers charge standard contingent fees in all personal injury litigation ranging from 33 1/3 to 50 percent depending on the jurisdiction.⁴⁷ While deviations are not unknown, they are comparatively rare.⁴⁸ This is especially the case when lawyers are presented with tort claims where liability is clear, damages are substantial and the lawyer anticipates having to devote only modest amounts of time to generate a near policy limits settlement offer. In these matters, windfall fees amounting to thousands of dollars an hour are obtained.⁴⁹ Seemingly in defiance of standard economic theory, in the world of contingent fees, the more lucrative the claim, the more inflexible the pricing.⁵⁰

⁴⁷ See Brickman, *Effective Hourly Rates*, *supra* note 1, at n.10.

⁴⁸ In the course of observing contingent fee practices, I have been informed by contingent fee lawyers that they sometimes reduce their standard fees in cases where there are substantial medical expenses and a client's net recovery is, by comparison, inadequate if not paltry. Some lawyers contend they routinely reduce their fees in such circumstances. While such fee reductions do exist, there is no way to determine the frequency of such reductions from currently available data. Moreover, there is anecdotal data that in cases where fees are substantial, lawyers rigidly maintain uniform pricing. See *id.* at n.13.

⁴⁹ See *id.*

⁵⁰ For this conclusion, I rely on personal knowledge of the contingency fee market and on anecdotal evidence amassed over several decades of close inquiry. An illustrative and not untypical example involves an underground steam pipe explosion which spread asbestos across the Gramercy Park area of New York City in 1989. After initially denying the presence of asbestos, the owner of the steam pipe, Con Edison, acknowledged its responsibility. Once the presence of asbestos was confirmed, hundreds of residents in the immediate area had to abandon virtually all of their personal possessions and suffer displacement from their residences for several months. See Mirey A. Navarro, *Gramercy Park's Refugees Long for Home*, N.Y. TIMES, Oct. 6, 1989, at B1 (reporting that Con Edison projected costs for explosion cleanup and reimbursements to displaced Gramercy Park area residents to be in the \$30 to \$40 million range following August 19, 1989 steam pipe explosion which spewed cancer-causing asbestos throughout the neighborhood); see also David E. Pitt, *Con Edison Takes Blame in Steam Blast*, N.Y. TIMES, Sept. 9, 1989, (Saturday, Late ed.) § 1, at 25 (recounting the three deaths caused by the accident, as well as the estimated 176 pounds of asbestos which were sprayed over Gramercy Park). Shortly after the explosion, lawyers descended on hotels and other locations where displaced residents were being housed and offered to represent them in their claims against the utility company. See Daniel Wise, *Lawyers Gear Up to Handle Asbestos Claims; Experts Say Personal Injury, Property Claims Look Good; Outlook Grim for Psychic Trauma*, N.Y.L.J., Sept. 18, 1989, at 1 (stating that shortly following the explosion, "[i]n the race to sign up clients, some lawyers descended upon Gramercy Park 'like locusts' . . . peddling their ability to recover the 'sun, moon and stars'"). Though the utility had admitted liability and the claim process largely consisted of documenting additional living costs, the value of abandoned personal possessions and the like—pretty much what any home owner asserting a claim against a fire insurer would do in the event of a fire—the lawyers charged standard contingent fees of 33 1/3 percent. Fee bargaining occurred in only one instance of which I am aware. In that case, a lawyer who was

It is both a consequence of the lack of a competitive market for tort claiming services and an indictment of our tort system that whenever an egregious and undeniable act of medical malpractice causing severe injury occurs, a tort lawyer will obtain a million dollar or multi-million dollar fee⁵¹ irrespective of the effort anticipated to be required and the value, if any, that the lawyer adds to the value of the claim as existed when he was retained.⁵² That is so because contingent fee percentages, being standard, therefore do not reflect differences in risk or in the anticipated costs for the production of the service being purchased or in the projected returns on the lawyer's investment. A lawyer who undertakes to represent a severely injured claimant rendered paraplegic or quadriplegic where the settlement value of the claim is \$10 million or more, charges the same standard contingent fee as when she represents a less severely injured claimant where the settlement value is only a tenth or twentieth as much though the liability risk and amount of anticipated effort are substantially the same for both claims. The former will usually yield a substantially higher effective hourly rate because pricing is inflexible and does not vary on the basis of differences in risk or the cost of production of the purchased service.

Thus, the existence of a uniform price for tort claiming services may be seen as an anomaly and evidence of a market failure.⁵³ The likelihood of success in prosecuting personal injury claims ranges from zero to 100%. Lawyers, however, do not randomly select their cases from among those offered by claimants. Instead, they carefully screen claims, rejecting more than half, in particular, those claims with a low likelihood of success or low anticipated return on their investments.⁵⁴

among the victims, assembled a group of other victims to join with him in securing legal services. A discounted fee in that case was negotiated. In the other representations, not even economics of scale were shared with claimants in the form of discounted fees. No local bar association ever publicly suggested that it would be improper, let alone unethical to charge standard contingent fees in such circumstances. The Bar Association of the City of New York provided free counseling for residents with regard to their legal rights. I urged the Association that as part of their pro bono services, they inform claimants that the one third "contingent" fee being charged was simply price gouging and that residents should be encouraged to bargain for far lower percentages. I further suggested that the Association state that fees in excess of 10 percent were presumptively unreasonable in light of the purely administrative nature of the claim process and the complete absence of risk. The Bar Association did not act on either recommendation.

⁵¹ For discussion of the frequency of million dollar fees, see Brickman, *Effective Hourly Rates*, *supra* note 1, app. F.

⁵² For discussion of the zero-based accounting system used by tort lawyers to justify assessing their contingent fees against the entire recovery irrespective of whether that recovery includes substantial value that existed prior to any value contributed by the lawyer, see *id.* at n.11.

⁵³ See Richard W. Painter, *supra* note 44, at 657-59 (arguing that in a competitive market the contingency fee charged by attorneys should vary based on differences in the size of claim, the level of risk, the amount of time devoted to the case, as well as the skill of the attorney, and that "a competitive market in which fees consistently are the same percentage of judgment or settlement (for example, 33 percent) would be unusual").

⁵⁴ See Brickman, *Effective Hourly Rates*, *supra* note 1, app. H.

The screening process is so effective that lawyers prevail in 70 to 90 percent of the cases they accept and obtain nearly 100% reimbursement of litigation expenses advanced including expenses advanced in cases in which they do not prevail.⁵⁵ Arguably, if competitive market forces were effectively operational in the contingent fee setting process, the percentages charged by lawyers would come to reflect, albeit roughly, the likelihood of success in each case.⁵⁶ In fact, the percentage fees charged are uniform and differences in the likelihood of success in the cases represented have no impact on the contingent percentage.⁵⁷ With few exceptions, price is unrelated to risk.

Nonetheless, the fact that contingent fees are standardized does not, in itself, indicate that the market for contingent fee financed tort claiming is not competitive. Indeed, the fact of uniform pricing is compatible both with the hypothesis that the market is not competitive and its opposite, that such pricing is the result of a competitive market reaching an equilibrium price.

One argument advanced in support of the competitive market model is that uniform pricing in markets is efficient, because it lowers transactional costs and minimizes agency costs.⁵⁸ For example, in the

⁵⁵ *Id.*

⁵⁶ See Murray L. Schwartz & Daniel J. B. Mitchell, *An Economic Analysis of the Contingent Fee in Personal-Injury Litigation*, 22 STAN. L. REV. 1125, 1139-40 (1970) ("Under competitive conditions the same percentage fee would not be charged for both [high value and low value] cases."). Other factors would also be important, including, for example, the value of the claim, the amount of lawyer time that would be necessary, the amount of litigation expenses that the lawyer would have to advance and thereby put at risk, the lawyer's workload, and whether a quick settlement, even though for a modest sum, were in the offering.

⁵⁷ See *supra* notes 47-52. See also *Hendricks v. Sefton*, 180 Cal. App. 2d 526 (1960) (lawyer quoted his personal injury fee as one-third though he had not met the potential client and was unaware at that point of the facts in the case); F. MACKINNON, *CONTINGENT FEES FOR LEGAL SERVICES: A STUDY OF PROFESSIONAL ECONOMICS & RESPONSIBILITIES* 21-22 (1964); Franklin, Chanin & Mark, *supra* note 45, at 132; John Leubsdorf, *The Contingent Factor in Attorney Fees Awards*, 90 YALE L.J. 473, 491 (1981); Note, *The Contingent Fee: Disciplinary Rule, Ethical Consideration, or Free Competition?*, 1979 UTAH L. REV. 547, 553 n.34.

⁵⁸ See Saul Levmore, *Commissions And Conflicts In Agency Arrangements: Lawyers, Real Estate Brokers, Underwriters, And Other Agents' Rewards*, 36 J. L. & ECON. 503, 505-06 (1991) [hereinafter Levmore, *Commissions and Conflicts*]; Charles Silver, *Control Fees? No, Let The Free Market Do Its Job*, NAT'L L.J., Apr. 18, 1994, at A17:

One should be slow to infer a lack of competition from these facts . . . the first sentence appears in the article after the second sentence that percentages are uniform across geographical areas, and that these lawyers charge the same percentages in all cases even though different cases entail different risk. . . . Those people who understand markets do not usually shout "conspiracy" upon discovering a uniform practice in a trade. They realize that competition often generates uniformity that works to the advantage of buyers and sellers. Uniform percentage fees also may be desirable products of competition. They entail low bargaining costs, they align the interests of lawyers and clients in contexts in which clients have difficulty monitoring lawyers' behavior, and they enhance client confidence by equalizing lawyers' incentives across caseloads.

real estate brokerage market, the contingency fee is a standard commission of 6 percent of the sale price of the house.⁵⁹ Arguably, standard pricing of brokers' services in this market is an efficient way to reduce agency costs, that is, the costs to principals (home owners) of monitoring the efforts of real estate brokers.⁶⁰ If commission rates were individualized, home owners who entered into contracts with real estate brokers for the sale of their homes would be concerned that brokers would devote greater efforts to selling homes of owners who had agreed to pay higher commissions. "Uniformity in rewards mitigates the problem of conflicts among principals because joint revenue maximization is much more certain if an agent receives similar compensation from several principals."⁶¹ In addition, uniform pricing of brokerage services may be seen to minimize transactional costs by displacing more costly individualized bargaining and by reducing search costs borne by home owners.

Nonetheless, there are multiple reasons for concluding that economic justifications for maintenance of uniform pricing in real estate brokerage do not similarly justify uniform pricing in the provision of contingent fee financed tort claiming. If such justifications are not present, that is, the quest for efficiency or maximization of joint welfare is not the underlying basis for the maintenance of uniform pricing by contingent fee lawyers, then the alternative hypothesis that presents itself is that uniform pricing is a quest for rents in the form of a far larger share of the tort claiming pie.

a. Uniform Contingent Fee Pricing Does Not Meaningfully Reduce Agency Costs

Even if it is the case that uniform pricing of real estate brokerage services is efficient, uniform contingency fee rates do not meaningfully

⁵⁹ See Patrick Barta, *Home Rules*, WALL ST. J., Oct. 6, 2001, at R12.

⁶⁰ See Levmore, *Commissions and Conflicts*, *supra* note 58, at 509 n.12. Others see the existence of such uniform pricing as indicative of collusion among real estate brokers. Compare Owen R. Phillips & Henry N. Butler, *The Law and Economics of Residential Real Estate Markets in Texas: Regulation and Antitrust Implications*, 36 BAYLOR L. REV. 623, 641, 649 (1984) (noting that though brokerage commissions are uniform, "[i]t is difficult, nevertheless, to embrace the conclusion that uniform prices are sufficient proof of the existence of collusion," and that "it is not in the interest of one firm to lower prices if it knows that rival firms would follow to maintain their market share [thus it] is in each broker's interest to maintain the status quo"), with Bruce M. Owen, *Kickbacks Specialization, Price Fixing, and Efficiency in Residential Real Estate Markets*, 29 STAN. L. REV. 931, 946-48 (1977) (multiple listing services enable real estate agents to share information and this facilitates maintenance of uniformity of prices by price-fixing and collusion).

⁶¹ Levmore, *Commissions and Conflicts*, *supra* note 58, at 505.

reduce agency costs in the tort claiming services market.⁶² This is so, in part, because contingency fee lawyers, while charging uniform rates, do not apply their time and capital in equal portions to each of their cases. Instead, they allocate their time and capital as if they were charging differential contingency fee rates. Indeed, their behavior may be best understood if one concludes that they are, in reality, charging substantially differentiated fees.

To diversify and control risk and generate predictable income streams, contingency fee lawyers assemble portfolios of cases,⁶³ carefully screening claims⁶⁴ and selecting only those which they expect to generate returns at least equal to their opportunity costs. As part of the selection process, lawyers estimate how much time will be needed and how much capital will have to be advanced for litigation costs.⁶⁵ After selections are made, lawyers constantly reevaluate the cases in their portfolios and rearrange their investments going forward. Cases that appeared more promising at the outset but which depreciated in value as the result of newly discovered information will thereafter have less time and capital appropriated to them.⁶⁶ And conversely, cases which promised profitable but not super profitable returns, which appear later to be more promising, will be allocated additional time and capital.

⁶² For a discussion of agency issues raised by contingent fee litigation, see Geoffrey P. Miller, *Some Agency Problems In Settlement*, 16 J. LEGAL STUD. 189 (1987).

⁶³ See Brickman, *Effective Hourly Rates*, *supra* note 1, at n.149.

⁶⁴ *Id.* app. H.

⁶⁵ Lawyers' screening of claims to determine whether to accept a case is not only a function of the estimated effective hourly rate that it will yield but also of the projected cash flow from, and degree of risk of, the current portfolio. Any portfolio of cases may be evaluated in terms of levels of risk—a measure that is analogous to the "beta" measure of stock portfolios or other measures of stock portfolio or mutual fund volatility. If a prospective case appears likely to generate a high reward but is also high risk, then the decision whether to accept the case is a function of the level of risk of the current portfolio (as well as the lawyer's own level of risk tolerance). A lawyer will have a greater propensity for accepting a case that will require a substantial expenditure of capital and which is high risk relative to the risk level of his portfolio if it offers an at least commensurately high reward and his current portfolio can be expected to generate the necessary cash flow to cover the outlays required by the new case.

⁶⁶ A lawyer who discovers to his dismay that a contingent fee case that he accepted is insufficiently remunerative has incentive to shirk. To be sure, ethical codes require that lawyers zealously advance their clients' interests; shirking is unethical. In reality, however, shirking is commonplace and is only the subject of disciplinary proceedings when a lawyer does it repeatedly and, as well, engages in other egregious behavior that attracts the attention of disciplinary counsel. Client reactions to shirking are well known. They complain that they are unable to contact their lawyer, that she is always "in conference," never available to take their phone calls, does not return phone calls or letters, etc. Clients faced with such behavior sometimes seek out other lawyers. In some jurisdictions, contingency fee lawyers who discover that they have invested in a clunker can not only unload their burden by inducing the client to terminate them for their inaction, but can also then assert a right to a quantum meruit fee even if the claim is abandoned or a second lawyer takes it to trial and there is a defense verdict. See Lester Brickman, *Setting The Fee When The Client Discharges A Contingency Fee Lawyer*, 41 EMORY L.J. 367, 382-85, 393-97 (1992) [hereinafter Brickman, *Setting the Fee*].

Empirical evidence supports this view of lawyers' portfolio strategy. In a series of federal tax cases, the courts analyzed the degree of recovery of litigation expenses that contingent fee lawyers had advanced in cases which they had accepted. In one case,⁶⁷ the Fifth Circuit examined the circumstances and conditions under which the payments were advanced and noted that the lawyers had exercised "a high degree of selectivity" by carefully evaluating the strength of each claim that they were representing and limiting the amounts of expenses advanced to under the expected recovery.⁶⁸ The court noted that "although reimbursement was tied to the recovery of a client's claim, assistance was granted only to those whose claims would in all probability be successfully concluded."⁶⁹ The record revealed that the firm recovered over 96 percent of the litigation expenses that it had advanced.⁷⁰ Other firms' experiences are comparable.⁷¹ In order to recover virtually all of the litigation expenses it advanced, these firms necessarily differentially invested in their portfolios of cases, investing more capital (and presumably time) in those 70 percent or more of cases in which they prevailed than in the 10 to 30 percent in which they did not prevail.⁷²

Effectively then, contingency fee lawyers perceive their cases as generating returns measured, for comparative purposes, in hourly rates. At any and every moment in time, as part of the process of evaluating their portfolios' expected returns, contingent fee lawyers estimate the projected hourly rate to be earned for each case by estimating the amount of time to be required to generate a settlement or take the case to trial, the settlement or trial value of the case (which takes litigation risk into account), the lawyer's share thereof—a function of the uniform percentage charged, and the amount of new capital to put at risk in the

⁶⁷ *Burnett v. Comm'r*, 42 T.C. 9, 12 (1964), *remanded*, 356 F.2d 755 (5th Cir. 1966), *cert. denied*, 385 U.S. 832 (1966).

⁶⁸ *Burnett*, 356 F.2d at 760.

⁶⁹ *Id.*

⁷⁰ *See id.* at 759. On this basis, the court concluded that the advances were nondeductible loans rather than deductible business expenses.

⁷¹ For cases adopting the same approach and reaching the same result as *Burnett*, see *Monek v. Comm'r*, 25 T.C.M. (CCH) 582, 584 (1966), in which a lawyer recovered approximately 98 percent litigation expenses advanced, and *Canelo v. Comm'r*, 53 T.C. 217, 218 (1969), *aff'd* 447 F.2d 484 (9th Cir. 1971) (90 percent recovery). In *Boccardo v. Comm'r*, 56 F.3d 1016 (9th Cir. 1995), the record indicated that the plaintiff firm had prevailed in 70 percent of their cases but recovered 80-90 percent of all expenses advanced including expenses advanced in cases where they did not prevail.

⁷² There is additional evidence in support of the proposition that lawyers differentially invest in cases based on the perceived likelihood of success. *See, e.g.*, website of Advocate Capital, Inc., available at <http://www.advocatecapital.com> (Advocate Capital provides loans to lawyers to cover litigation expenses, using the "case as collateral"). Advocate Capital requires lawyers to repay loans even if the case is lost; however, the website implies that this should not be overly burdensome on attorneys, citing their "experience that a minimal amount of money is invested in cases that are ultimately abandoned." *Id.*

form of advances for litigation costs.

Thus, while contingency fee uniformity has an effect on the calculation of the estimated effective hourly rate value of each case, its effect on minimizing agency costs is marginal. Lawyers have differing levels of incentives to invest time and money in clients' cases and do not devote uniform efforts to advancing their clients' interests.⁷³ Instead, the level of effort is a function of maximization of their effective hourly rates of return. Uniform contingency fee rates are not designed to, and do not maximize, joint revenue.⁷⁴ Rather, they maximize attorneys' rents at their principals' expense.

b. Price Inelasticity in the Face of Highly Variable Production Costs

In freely competitive markets for uniform or easily substitutable goods or services, prices would gravitate towards an equilibrium

⁷³ Cf. Kritzer, *Seven Myths*, *supra* note 1, at 774.

⁷⁴ An alternative argument can be made that while uniform pricing results in overcharging some clients, the excessive fees thus generated subsidize other clients whose claims would not otherwise gain representation. Therefore, while some clients net less, others net sufficiently more so that the cross-subsidization function of excessive fees may be seen to maximize total revenues generated by tort claiming. The overcompensation argument was approved in a once leading but now antiquated book on contingent fees. See FREDERICK B. MACKINNON, *CONTINGENT FEES FOR LEGAL SERVICES* 182 (1964) ("[T]he idea of using overcharges of 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."). We recognize the overcompensation argument as a variation of "robbing Peter to pay Paul." As George Bernard Shaw noted, taking from Peter to pay Paul always meets with the approval of Paul. *Thoughts on Business Life*, FORBES, Apr. 23, 1984, at 174. It is instructive to consider in the contingent fee context just who Peter and Paul are. Peter, of course, is the client being overcharged by attorneys' fees unjustified by the risk borne by the attorney. It may be thought that Paul is a subsequent client with a high risk claim who, but for the lawyer's overcharging Peter, would not gain representation. If his claim prevails, he has surely gained a windfall—but it is a one-time windfall. The lawyer is also a beneficiary, claiming one-third to one-half of the gross amount. But unlike the subsequent client, the lawyer is a repeat beneficiary. His stake in the process far exceeds that of the subsequent client. Moreover, whether or not he accepts a subsequent client's claim is a function of the effective hourly rate he anticipates receiving in *that* case. There is no bookkeeping credit that the lawyer applies to subsidize case two because he overcharged Peter in case one. Accordingly, it is more correct to regard Paul as the attorney who overcharges Peter and who may therefore accept a future higher-risk case that he would otherwise be less likely to have accepted were he not flush with the funds that were mulcted from Peter but who will only do so if he concludes that it will generate a fee at least equal to his opportunity cost. As for the propriety of robbing Peter, an attorney owes each and every client an obligation not to charge that client any more than a fair and reasonable fee. Brickman, *Contingent Fees*, *supra* note 19, at 32 n.5. Moreover, the cross-subsidization argument itself is specious because contingent fee percentages are typically set without regard to risk (and to the extent risk is considered, cases where risk is sufficiently high that a one-third to one-half contingency fee offers insufficient compensation, are simply not taken). In other words, in cases where risks are not commensurate with and do not justify charging standard contingent fee rates, contingent fee lawyers typically "rob" each such client without allocating any of the booty to later clients.

point.⁷⁵ Inefficient producers would tend to be forced out of the market and the costs of production of efficient producers would tend towards uniformity. The market for tort claiming services, however, is quite different. There is enormous variation in the costs of production of, and the rates of return realized from, tort claiming services. One claim may present substantial risk, a need for a high investment level but very high reward possibilities; another may present identical risk and reward probabilities but require only a modest investment. Still another may involve little or no risk, a need for little investment and high promise of reward, thereby generating an anticipated windfall fee. In a competitive market the prices charged by producers of these services would vary on the basis of differences in production costs and anticipated rewards.⁷⁶ However, prices for tort claiming services do not vary. They are standard in a community and generally range from 33 to 50 percent.⁷⁷ Because low cost, very high return claim representation is priced the same as higher cost, lower return claim representation, the former generate substantial rents.

To be sure, levels of risk assumed do not vary over the entire risk continuum. As has been pointed out, in assembling their portfolios of cases, contingent fee lawyers carefully screen claims, rejecting more than half of those offered and selecting only those which they anticipate will yield a return at least equal to their opportunity costs.⁷⁸ That lawyers thus screen out high risk-low reward cases does not detract from the proposition that prices do not vary on the basis of substantial anticipated differences in production costs—as they would, at least to some extent, in a competitive market.

⁷⁵ Equilibrium price is the price at which, in a competitive market, the quantity supplied equals the quantity demanded. When price lies above this equilibrium, sellers must decrease the price in order to increase demand, thereby enabling sale of a quantity for which profits cover output costs. Likewise, when price lies below the equilibrium, demand exceeds supply and sellers are able to increase price until the equilibrium price is reached. See BEGG ET AL., *ECONOMICS*, *supra* note 18, at 32-34. Thus, substantially uniform pricing is a feature of some competitive markets. For example, gasoline prices in a given locality congregate around an equilibrium price. *Id.* When price of a uniform product diverges among competitors, the interaction of supply and demand in the competitive free market provides an incentive to change prices towards the equilibrium price. The competitor that sells at the lowest price will have the greatest demand. However, to meet that demand, it will have to increase supply and in turn increase its output costs. At a certain price below equilibrium, output costs will exceed profit, creating an incentive to decrease supply in order to increase price toward that of the equilibrium. *Id.*

⁷⁶ See *supra* note 56.

⁷⁷ See *supra* note 47 and accompanying text.

⁷⁸ See *supra* notes 63-66.

c. Price Rigidity in the Face of Variable Costs and Rewards: A Comparison of Uniform Pricing in the Tort Claiming Market and the Real Estate Brokerage Market

As with tort claiming services where pricing is uniform, real estate brokers charge a standard contingent fee: a 6 percent sales commission. As considered above, there is some basis for concluding that uniform brokerage service pricing is efficient in that it reduces both agency costs and transactional costs,⁷⁹ even though, as noted, these arguments do not apply to the tort claiming market.⁸⁰ Other differences in the two markets may also be usefully explored. In particular, the considerable differences in the responsiveness of each fee setting process to competitive pressures, and the opportunity in the respective markets to negotiate individualized prices in place of standard ones. If real estate brokerage rates represent an equilibrium price that, on average, provides reasonable compensation to brokers, then a projected rate of return that is substantially higher may result in negotiation of a lower price because the added transactional costs of negotiating a more individualized bargain are thus justified. If uniform contingency fees are not an equilibrium price but are, instead, a collusively maintained price designed to generate market rents, then we would expect lawyers to reject bargaining out of the standard rate even when a substantial rate of return, disproportionate to risk, is anticipated. Both expectations are borne out by industry practices.

In the case of expensive homes, instead of the standard 6 percent brokers' commission, a lower rate, 5 percent and even 4 percent, is usually charged.⁸¹ This reflects the fact that the increased compensation from selling an expensive home for a standard commission may not be justified by any increased amount of work to be done by the broker. Accordingly, the parties bargain for an individualized rate reflective of the specific elements of those transactions. This is decidedly not the case in the tort claiming market. In the comparable case for tort lawyers, that is, where the lawyer's expected return is substantial because of the seriousness of the injury, the absence of meaningful liability risk and the likelihood of settling the claim without the need for a substantial time expenditure, attempts to secure a lower contingency fee are generally rebuffed.⁸² This, too, indicates the absence of a

⁷⁹ See *supra* note 58.

⁸⁰ See *supra* text accompanying notes 61-73.

⁸¹ See Hannah Fons, *Banishing The "B-Word": Your Broker as Selling Partner*, THE COOPERATOR, Nov. 2002, at 18, 19.

⁸² One occasionally finds anecdotal evidence that because of family ties, tort lawyers will discount rates but there is no evidence that this practice is widespread. Moreover, as has been

competitive market.

An additional comparison of the sensitivity of uniform pricing in each industry to competitive pressures further supports this conclusion. In the case of brokers, competitive pressures have significantly impacted commission rates.⁸³ For example, recent developments in the use of the Internet have produced a 25 percent lowering of standard commissions.⁸⁴ Lawyers' standard contingency fee rates, however, remain unaffected by the Internet. Indeed, if contingent fee lawyers were threatened with similar kinds of competitive pressures as are now affecting real estate brokers, they would simply bar the potentially competitive structure.⁸⁵

Contrast the absence of price advertising by contingent fee lawyers⁸⁶ with the following advertisement:⁸⁷

noted, in cases where the client ends up with an insubstantial recovery after payment of substantial medical expenses, lawyers do discount their fees. *See supra* note 48. However, this is not the case when windfall fees are anticipated or obtained. *See text accompanying supra* notes 48-52.

⁸³ Most homes sellers know by now that the traditional 6 percent real estate commission has basically become the "suggested list price" for real estate listings. And while most brokerage firms still push for a 6 percent commission, the amount the seller and broker finally agree upon can end up being considerably less.

Beyond the traditional, full-service brokerage firms, a number of companies now offer their services at a variety of commission levels, fixed charges or some combination of the two. The levels of service vary widely, and may or may not provide inclusion on the local multiple listing service. Competition for the home seller's business is taking many forms.

"Commission price wars between full-service brokerages have infiltrated real estate markets across the country," . . . a Miami real estate consultant, wrote in *Realty Times*, an Internet based real estate journal. "In an effort to garner a larger swath of market, attract attention and annihilate the competition, many brokerages are slashing fees by 25 percent or more."

Jay Romano, *Under 6%, What Do Sellers Get?*, N.Y. TIMES, Dec. 8, 2002, at RE5.

⁸⁴ "Discount real-estate brokerages have been operating on the Web for years. However, their growth has been severely restricted in part because they generally don't have access to the exclusive listings that members of the National Association of Realtors share." Patrick Barta, *Realtors Pressured to Cut Commissions: Low-Cost Competitors Gain Ground, Undercutting Traditional 6% Fee; a Cash Rebate for Buyers*, WALL ST. J., Nov. 12, 2002, at B1. A Web site has been created which has gained access to Multiple Listing Services ("MLS") by hiring local brokers who join local Realtor associations and thus qualify for access to the MLS. This site typically charges sellers no more than 4.5 percent in commission, a 25 percent discount off of the standard rate. Patrick Barta, *Home Rules: Real Estate Listings on the Web are Loosening the Grip Realtors Have Long Had on the Market*, WALL ST. J., Oct. 29, 2001, at R12. The success of this venture is leading to additional such ventures. *See id.* "Many Realtors also are starting to offer 'fee-for-service' plans, in which customers can do some of the home-searching on their own and pay a reduced commission only for the Realtor services they use." *Id.* In addition, a mainstream broker, Coldwell Banker, has recently introduced a web-based brokerage that offers discounted fees in Pennsylvania and Illinois. *See Barta, supra*, Nov. 12., 2002.

⁸⁵ *See infra* section VI.

⁸⁶ *See infra* note 93.

⁸⁷ *See* advertisement posted on a Metro-North commuter train running between New York City and Brewster, N.Y. (last observed on Feb. 19, 2003). *See also* YHD, Advertisement, N.Y. TIMES, Feb. 25, 2003, at 19 (describing "a \$12 million multi-million advertising and marketing

At 6%, are you using your friend in
Real Estate, or are they using you?

REAL ESTATE
2% Commission
1-800-call YHD YHD.COM

Over the course of thousands of advertisements by contingent fee lawyers costing hundreds of millions of dollars, no contingent fee lawyer has ever published even a remotely comparable advertisement. Indeed, contingent fee lawyers do not advertise their prices.⁸⁸

d. Referral Fees As Rents: A Product of Uniform Pricing

Though tort claims are generally not assignable and lawyers are the only permissible partial purchasers,⁸⁹ tort lawyers maintain an exclusive and active secondary market in tort claims. Indeed, many tort lawyers vigorously seek out clients with the intent of selling off the claims to other lawyers who will do the actual negotiating or litigating and who will pay them a portion of the contingent fee.⁹⁰ Commission costs, aka, "referral fees," which typically range from 30 to 50 percent of the

campaign providing maximum exposure for listings").

⁸⁸ See *infra* note 95.

⁸⁹ See *infra* section VI.B.

⁹⁰ See *Matter of Fuchsberg & Fuchsberg*, N.Y.L.J., Oct. 3, 2003, at 21 (indicating that a well known New York plaintiff law firm routinely pays a 50 percent referral fee). A preeminent personal injury law firm has indicated that it pays out 28 percent of its gross fee income to referring lawyers. Andrew Blum, *Big Bucks, But . . . Cash Flow a Problem*, NAT'L L.J., April 3, 1989, at 1; see also *Brillhart v. Hudson*, 169 Colo. 329, (1969); *In re Kaye*, 266 N.Y.S.2d 69 (1966), *vacated*, 386 U.S. 17 (1967); MURRAY TEIGH BLOOM, *THE TROUBLE WITH LAWYERS* 143-46 (1968); JEROME CARLIN, *LAWYERS' ETHICS* 200 (1966); F.B. MACKINNON, *CONTINGENT FEES FOR LEGAL SERVICES* 180-81(1964); DOUGLAS E. ROSENTHAL, *LAWYER AND CLIENT: WHO'S IN CHARGE?* 99-100 (1974); Blackburn, *Referral Fees An Abuse of the Public Trust*, 54 FLA. B.J. 235, 235 (1980) ("In most such arrangements, the referring attorney will do almost nothing to justify any fee, although it will usually be decided in advance that he (she) will eventually receive 40-50 percent of the total attorneys' fees."); John Grady, *Some Ethical Questions About Percentage Fees*, 2 LITIGATION 22-23 (Summer 1976); Frederick N. Halstrom, *Referral Fees Are a Necessary Evil*, 71 A.B.A. J. 40, 40 (1985) ("[Lawyers] customarily divide legal fees in tort actions based on a percentage agreement regardless of each lawyer's comparative efforts and cost disbursements."). See also Yeazell, *supra* note 3, at 203 (contending that the plaintiffs' bar has used referrals and fee splitting to achieve a network of expertise that replicates many of the advantages of larger firms).

contingent fee,⁹¹ far exceed typical commission costs and finders' fees in other commercial endeavors. Were contingent fee pricing subject to competitive forces, the lawyers who purchase the claims in the secondary market could be expected to share some of the saved commission costs with claimants who seek to capture at least some of these commissions by bypassing the business finder and going directly to the lawyer-litigator. Despite the substantial savings realized from disintermediation, lawyer-litigators who routinely agree to pay thirty to 50 percent of their fee when the case is referred to them, just as routinely refuse to discount their standard rates when the claimant comes directly to them. This further evidences the existence of a substantial rents component in the standard contingent fee.⁹²

2. The Absence of Price Advertising

Competitive markets virtually always feature price (and quality) advertising by suppliers of goods and services.⁹³ If the tort claiming market were competitive, we would expect to see lawyers' advertising their prices and offering "special" deals to attract business.⁹⁴ Contingency fee lawyers, however, do not engage in competitive fee advertising. In fact, they simply do not mention price in their advertisements.⁹⁵ They rely instead on general public knowledge that

⁹¹ *Id.*

⁹² Payment of referral fees is a phenomenon largely confined to contingency fee lawyers. Hourly rate lawyers do not pay referral fees to other lawyers who refer clients to them (though they may reciprocate by referring clients to lawyers who have sent them clients). The difference in business practice is accounted for by the rents that contingency fee lawyers obtain. The market for hourly rate fee services, is by comparison, quite competitive.

⁹³ As noted above, a leading empirical researcher on contingent fee pricing has argued that the market system is adequate to curb excessive pricing by the "obvious mechanism of price advertising" so that clients could obtain relevant information "about fees . . . [to] make more informed choices." See Kritzer, *The Wages of Risk*, *supra* note 39, at 308.

⁹⁴ It may be argued as a counter to my argument that physicians also do not advertise prices and that it does not therefore follow that the market for their services is not competitive. However, most physicians' services are paid for by third party insurers. Consumers have become accustomed in such a market to largely ignore price—a condition which is undergoing change. Moreover, and most importantly, most physicians simply do not advertise at all whereas tort lawyers advertise extensively. Those physicians that do advertise, most notably dermatologists and podiatrists, do include the equivalent of price advertising in their ads, namely that they cut their prices by accepting or participating widely in various medical insurance plans. If at some point many physicians do come to widely advertise their services and do not include information about price, then the argument would have more cogency.

⁹⁵ See Jeffrey O'Connell, Carlos M. Brown, & Michael D. Smith, *Yellow Page Ads as Evidence of Widespread Overcharging By The Plaintiffs' Personal Injury Bar—and a Proposed Solution*, 6 CONN. INS. L.J. 423 (1999/2000) (reporting a survey of yellow page phone advertisements which indicates that virtually no price competition exists among attorneys who charge contingency fees). In fact, just a single ad out of the 1,425 studied, or 0.07 percent, gave any indication whatsoever that the advertising attorney would be willing to bargain with potential

fees are standard and amount to one third of the recovery. For those not so informed, a visit to a tort lawyer's office provides the following fee information: we charge the going rate, one third of any recovery; that is the same as what other tort lawyers charge. Though some claimants do shop around for lower pricing, they quickly find out that lawyers are unwilling to bargain over the fee percentage.⁹⁶ As a consequence of tort lawyers' practices, claimants are discouraged from seeking lower prices by price shopping and bargaining because they have learned what lawyers have intended for them to perceive: that there is an industry-wide practice of maintaining standard pricing and price shopping is therefore futile. Indeed, the fact that fees are standard has been cited by a state supreme court as the basis for concluding that a standard contingency fee was fair because it was what all other plaintiff lawyers in the community charged.⁹⁷

3. The Enormous Increase in Effective Hourly Rates

Also belying the existence of a competitive market for tort claiming services is the enormous increase in the effective hourly rates realized by tort lawyers over the past forty years. In the 1960-2001 period, inflation-adjusted hourly rates of tort lawyers have increased 1000% to 1400%,⁹⁸ even as the risk of nonrecovery, though remaining essentially stable, has decreased materially in products liability and

clients with regard to the fee which would be charged. *See id.* at 426-27, 430. *See also* Judyth Pendell, *Price Colluder, Esq.: Plaintiffs' Lawyers Increasingly Advertise but Rarely Compete. And Bar Associations Shy Away from Helping Litigants Shop*, FORBES, July 23, 2001, at 34 (reporting the results of an informal poll conducted by the Manhattan Institute that of six lawyer referral services contacted, which receive approximately 400,000 calls per year, none provide written information about fees).

⁹⁶ It is a common practice among contingent fee lawyers to have the contingent fee percentage included on a pre-printed standard retainer agreement used by that lawyer and to then fill in the client's name, address and a brief description of the nature of the claim on blank lines in the agreement before having the claimant sign it. *See, e.g.*, DAVID CRUMP & JEFFREY B. BREMAN, *THE STORY OF A CIVIL CASE: DOMINGUEZ V. SCOTT'S FOOD STORES, INC.* 8 (3d ed. 2001) (a law school text listing a model contingency fee agreement in a tort claim, which includes a preprinted portion in which the contingent fee is: "ONE THIRD (1/3) . . . [of] amounts received in settlement . . . and FORTY (40 percent) per cent . . . if . . . collected . . . after suit is filed"). Most consumer organizations, for example, Consumers Union which publishes Consumer Reports, that might be expected to represent consumers' interests in the tort claiming process by focusing public attention on lawyers' price gouging and taking the lead in seeking redress in the political arena, do not do so perhaps because of their close ties to plaintiff lawyers.

⁹⁷ *See* Lester Brickman, *A Massachusetts Debacle: Gagnon v. Shoblom*, 12 CARDOZO L. REV. 1417, 1429-30 (1991) (describing how a state supreme court used the fact of standard pricing—and the consequent futility of searching for competitive pricing—to justify the fairness of a standard contingent fee; according to the court, the fact that contingency fees are standard means that they are fair and, presumably, the conclusion that they are fair justifies their uniformity).

⁹⁸ *See* Brickman, *Effective Hourly Rates*, *supra* note 1, app. A.

medical malpractice litigation—areas of practice which generate the highest contingent fees.⁹⁹ To be sure, some component of that increase reflects increases in opportunity costs as well as in the increased competence of the torts bar¹⁰⁰ which merit an increase in the market rate of return. But the increases in effective hourly rates and incomes would appear to well exceed any conceivable earned increase in the market rate of return. To conclude, therefore, that standard contingent fees yield a competitive rate of return today, one would have to conclude that (1) 40 years ago, tort lawyers were being substantially undercompensated for risk, or (2) that there has been a substantial increase in the risk assumed by contingent fee lawyers, justifying a far higher rate of return, or (3) that current pricing of tort claiming services has come to include substantial rents. There is no empirical or other basis for maintaining that tort lawyers were previously significantly undercompensated; moreover, there is a considerable basis for concluding that contingency fee risk has not only not increased but has declined.¹⁰¹ Accordingly, to the extent the enormous increase in effective hourly rates exceeds the competence-merited increased market rate of return of the torts bar, that excess is a function of rent-seeking behavior.

4. The Historical Derivation of the Standard Contingent Fee

The final factor I advance as an indicator that the market for tort claiming services is not competitive is the derivation of the standard contingent fee. If the standard one third fee were an equilibrium price, we would expect to find historical evidence of price fluctuation, both up and down, as the equilibrium point was approached. This is decidedly not the case. Tracing the historical development of the standard one-third contingent fee confirms the conclusion that it did not result from the operation of competitive market forces. For the better part of the approximately 150-year-existence of contingent fees in the United States, the percentages charged by lawyers have varied neither on the basis of competitive pressures nor on the likelihood of success in each case, but on the notion of what lawyers have felt comfortable charging within the confines of a judicial regulatory mechanism that essentially

⁹⁹ *Id.* app. B.

¹⁰⁰ *Cf.* Yeazell, *Re-Financing Civil Litigation*, *supra* note 3, at 201-02 (“A glance at the 1,200-page directory of the American Trial Lawyers Association, with on-line access, fields of specialization, and cross-indexing of members, gives one a glimpse into the expertise and the sub-specialization achieved by what was once a marginal, and marginally competent, group of lawyers.”).

¹⁰¹ *See* Brickman, *Effective Hourly Rates*, *supra* note 1, app. A; *cf. supra* notes 63-71.

capped contingent fees at 50 percent.¹⁰² In their infancy, contingent fee percentages were often moderate and risk reflective, in the 5 to 25 percent range.¹⁰³ They quickly climbed to the 50 percent level and higher, and later receded somewhat in the face of severe criticism by the public and other lawyers.¹⁰⁴

When percentages remained unreasonably high—in the 50 percent range—states and courts, through statutes and rules, drove the rates down to a 25 to 50 percent level.¹⁰⁵ These statutes and rules were

¹⁰² See Brickman, *Contingent Fees*, *supra* note 19, at 30 n.1.

¹⁰³ See *Wylie v. Coxe*, 56 U.S. 415 (1853) (the first Supreme Court opinion to approve a contingent fee; though there was considerable risk, the contingent percentage was 5 percent). In *Wright v. Tebbitts*, 91 U.S. 252 (1875), in which there was also considerable risk, the contingent percentage was 10 percent. In *Stanton v. Embrey*, 93 U.S. 548 (1876), the Court noted that the usual contingent fee was 20-25 percent, *see id.* at 549, though in the matter before it, the fee was 5 percent. *See id.* at 556. In a will contest fraught with uncertainty, the contingent fee was 5 percent. *See Schomp v. Schenck*, 40 N.J.L. 195 (1878) (plaintiff lawyer testified that the usual contingent fee for collection suits was 5 percent). In a personal injury action against a railroad, the contingent fee was 20 percent. *See Benedict v. Stuart*, 23 Barb. 420 (N.Y. App. Div. 1856). Higher percentages were also charged. *See, e.g., Bayard v. McLane*, 3 Del. (3 Harr.) 139 (1840) (66 percent).

¹⁰⁴ *Report of Committee on Contingent Fee*, in 1907 NEW YORK STATE BAR ASSOCIATION 121; ANN. REP. OF SPECIAL COMMITTEE ON DESIRABILITY OF JUDICIAL REGULATION OF CONTINGENT FEES FOR 1937-38 TO THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK 294 (1938):

[T]he amount of the contingent fee . . . has become in the large majority of cases . . . 50 percent of the recovery . . . For the first two or three decades after the legalization of the contingent fee, percentages were moderate, [sic] fifteen per cent. or twenty per cent. of the recovery was considered reasonable. This has grown until forty per cent is common, fifty per cent is not unusual, and sixty per cent has been known to have been charged.

Id.

¹⁰⁵ Typically, these rules and statutes established sliding scales applying the largest percentages to the initial amounts of recovery and smaller percentages to additional increments; some simply set a maximum percentage. New York's rule essentially limiting contingent fees in personal injury cases to one-third was first promulgated by the Appellate Division after attempts to enact legislation were blocked by lawyer legislators. *See* 22 N.Y.C.R.R. § 603.7 (e) (McKinney 2002); *Gair v. Peck*, 6 N.Y.2d 97, *cert denied*, 361 U.S. 374 (1960) (upholding the appellate division's fee-limiting rule as within the power of the court). In opposing a legislative effort by lawyers to overrule judicially imposed restrictions on contingent fee percentages, the *New York Herald Tribune* editorialized in 1960: "[T]he First Department. . . found that most of the lawyers in 150,000 contingency fees cases each year were hauling down 50 percent of amounts recovered for themselves. This, incidentally, seems to be pretty much the national picture." N.Y. HERALD TRIB., Mar. 23, 1960, quoted in Note, *A Study of Contingent Fees in the Prosecution of Personal Injury Claims*, 33 INS. COUNSEL J. 197, 203 (1966).

For other states' rules and statutes limiting contingent fees, *see, for example.,* CAL. BUS. & PROF. CODE § 6146(a) (2002) ("MICRA") (limiting contingent fees in medical malpractice actions to 40 percent of the first \$50,000, recovered, 33 percent of the next \$50,000, 25 percent of the next \$500,000, and 15 percent of any amount of recovery over \$600,000); CONN. GEN. STAT. § 52-251c (b)(2001) (limiting contingent fees in personal injury, wrongful death or damage to property claims to 33 percent of the first \$300,000, 25 percent of the next \$300,000, 20 percent of the next \$300,000, 15 percent of the next \$300,000 and 10 percent of any amount exceeding \$1,200,000); FLA. STAT. ch. 73.092 (2002) (capping contingent fees in eminent domain proceedings to 33 percent of any benefit up to \$250,000 25 percent of the benefit between \$250,000 and \$1,000,000, and 20 percent of any benefit exceeding \$1,000,000); OKLA. STAT. tit.

themselves predicated on the conclusion that fee percentages were too high and were unresponsive to competitive forces.¹⁰⁶ Had regulatory regimes not intervened to cap contingency fees at 50 percent or lower, the standard contingent fee would, in my judgment, likely have risen to the 60 to 75 percent range. The available historical evidence is to the effect that the regulatorily induced one-third (and higher) standard rate is essentially a political rather than a market-driven determination and represents a balance of power between the various relevant actors. To argue that it is also an equilibrium price which is the result of competitively derived forces not only ignores its historical derivation but also accepts that by the sheerest of coincidences, the one-third fee also represents a competitively derived rate of return.

III. FACTORS WHICH INHIBIT EMERGENCE OF A PRICE COMPETITIVE MARKET: MARKET FAILURES

A. *Asymmetrical Information*

In order for a competitive market to exist, consumers must be informed of the prices being charged by service providers.¹⁰⁷ This information must be easily available in terms which are meaningful to consumers; that is, the units in which the prices are stated must convey sufficient information to enable consumers to make price comparisons. In addition, consumers must be able to determine the relative quality levels of the service providers vying for their business so that they can make informed price/quality tradeoffs in selecting a provider.¹⁰⁸ In fact, however, consumers of contingency fee tort claiming services lack such essential knowledge and experience in dealing with lawyer-providers and are therefore disadvantaged in bargaining with such lawyer-providers for services.¹⁰⁹

5 § 7 (2003) (limiting contingent fees to 50 percent of the net recovery); TENN. CODE ANN. § 29-26-120 (2002) (limiting contingent fees in medical malpractice cases to 33 percent of all damages awarded); TEX. LAB. CODE ANN. § 408.221 (Vernon 2002) (limiting contingent fees in workers compensation cases to 25 percent of the plaintiffs' recovery); WIS. STAT. § 655.013 (1986) (limiting contingent fees in medical malpractice cases to 33 percent or 25 percent of the first \$1 million depending on whether the liability is stipulated within a statutory deadline, and 20 percent of any amount over \$1 million); WIS. STAT. § 102.26(2) (1993) (limiting contingent fees in workers compensation cases to 20 percent of disputed benefits). In social security cases, fees are typically limited to no more than 25 percent of back benefits up to a maximum of \$4,000. See 42 U.S.C. § 406(a)(2) (2003).

¹⁰⁶ See *supra* note 45.

¹⁰⁷ See *supra* text accompanying note 46.

¹⁰⁸ See generally James D. Dana, Jr. & Kathryn E. Spier, *Expertise and Contingent Fees: The Role of Asymmetric Information In Attorney Compensation*, 9 J. L. ECON. & ORG. 349 (1993).

¹⁰⁹ See *In re* Joint E. & S. Dists. Asbestos Lit., 129 B.R. 710, 864 (E.D.N.Y. 1991)

1. Consumers Lack Knowledge Of The Value Of Tort Claims

In the market for tort claiming services, awareness of price requires knowledge of the value of claims. This is so because while consumers are purchasing a service from the lawyer, they are paying for the service by exchanging a share of their claims. The reasonableness of the price of the service is therefore a function of the value of the claim being exchanged which is itself a function of the risk being undertaken by the lawyer. However, many tort claimants do not know whether they have a compensable claim and most have little knowledge of the value of their claims, or of the risk the lawyer is assuming in purchasing a share of their claims.¹¹⁰ That risk is itself a function of litigation risk and what the lawyer projects placing at risk: the amount of time the lawyer anticipates will be required to produce an adequate recovery and the litigation costs that he will have to advance. Tort lawyers, on the other hand, are experts in the valuation of claims and the risk involved, the estimated time to be required and the amount of funds that they will need to advance. This advantage redounds to the lawyer's benefit and disadvantages the consumer with regard to bargaining over the price of the service.¹¹¹ If risk and anticipated effort is so low that charging a standard contingency fee will likely lead to a windfall for the lawyer, he does not, as a matter of practice, share that information with the client as for example, when the lawyer reasonably anticipates that, because of the severity of the injury and the clear culpability of the alleged tortfeasor, he will be able to obtain a substantial settlement offer approaching policy limits after only 10-20 hours of work, generating a

("Contingent fee clients are often unsophisticated and infrequent consumers who may not be in a financial position to pursue an alternative [fee] arrangement."). The extent of the information asymmetry is suggested by the American Bar Foundation's finding that 80 percent of persons polled "cannot identify which particular lawyer is competent to handle their particular problem." Peter H. Schuck, *Consumer Ignorance in the Area of Legal Services*, 43 *INS. COUNSEL J.* 568, 568 (1976). See also Stephen Gillers, *Caveat Client: How the Proposed Final Draft of the Restatement of the Law Governing Lawyers Fails to Protect Unsophisticated Consumers in Fee Agreements With Lawyers*, 10 *GEO. J. LEGAL ETHICS* 581, 584 (1997) (asserting that "the number of unsophisticated clients who retain lawyers is probably greater than the number of sophisticated clients who do so" and that "in any one year, more lawyers probably have more unsophisticated clients than they have sophisticated ones"). "Surely, at a minimum, hundreds of thousands of unsophisticated clients hire tens of thousands of lawyers yearly." *Id.* Moreover, the recently adopted *RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS* ch. 3 (2000) fails to protect unsophisticated clients from being easy pickings for lawyers.

¹¹⁰ See Kritzer, *Seven Myths supra* note 1, at 778.

¹¹¹ See Brickman, *Contingent Fees, supra* note 19, at 56, 66, 68-71; see also Dana & Spier *supra* note 108 (examining the use of contingent fees when the lawyer has better information than the client about the quality of the client's case); Winand Emons, *Expertise, Contingent Fees, and Insufficient Attorney Effort*, 20 *INT'L REV. L. & ECON* 21, 21-23 (acknowledging the difference in knowledge and understanding between attorneys and clients and recognizing that clients must rely on attorneys as experts).

windfall fee amounting to thousands of dollars an hour.¹¹² If the client questions whether the fee is justified in light of the size or clarity of the claim, the lawyer can use his superior knowledge to fend off the attempt to bargain over the fee, for example, by exaggerating risk in order to justify the high price implicit in the standard contingent fee.¹¹³

2. Consumers Lack Other Meaningful Price Information

At first blush, it seems incongruous to argue that claimants lack knowledge of the price of lawyers' services when contingent fees are standard. However, knowing that the lawyer is charging one third or 40 percent of the value of a claim as realized, does not yield the kind of meaningful information that is needed for the operation of a competitive market. In order to make price comparisons, many consumers who purchase services effectively translate the cost of those services into a rough hourly rate equivalent. The sign above the auto mechanic's workshop that he charges \$90 an hour for his time conveys meaningful (but incomplete) information. The doctor who charges \$100 for an office visit is charging somewhere in the range of \$400-\$600 an hour plus additional fixed fees for specific services such as x-rays, lab work, etc. Similar calculations can be made for the plumber or the school teacher. Consumers of tort claiming services, however, have no basis upon which to estimate the effective hourly rate that the lawyer anticipates receiving since this requires estimates of the value of the claim and the amount of time to be required to produce an acceptable settlement or to take the case to trial. Here too, it is in lawyers' self-

¹¹² See DEREK BOK, *THE COST OF TALENT: HOW EXECUTIVES AND PROFESSIONALS ARE PAID AND HOW IT AFFECTS AMERICA* 140 (1993). There is little bargaining over the terms of the contingent fee. Most plaintiffs do not know whether they have a strong case, and rare is the lawyer who will inform them (and agree to a lower percentage of the take) when they happen to have an extremely high probability of winning. In most instances, therefore, the contingent fee is a standard rate that seldom varies with the size of a likely settlement or the odds of prevailing in court.

¹¹³ See, e.g., *In re Rappaport*, 558 F.2d 87, 88 n.3 (2d Cir. 1977); *Rohan v. Rosenblatt*, CV 930116887S, 1999 LEXIS 2231 (Conn. Super. Ct. Aug. 13, 1999) (attorney's representation that suit would be necessary to collect the proceeds of a \$100,000 life insurance policy on client's deceased wife "had no factual basis;" therefore, former client prevailed in suit to recover \$33,333.33 fee paid); *Robinson v. Sharp*, 201 Ill. 86, 92 (1903) (finding that lawyer aroused "serious [mis]apprehensions"); *In re St. John*, 43 A.D.2d 218, (1974); *Haight v. Moore*, 37 N.Y. Super. (5 Jones & Spencer) 161, 165-66 (N.Y. Super. Ct. 1874); *Ransom v. Ransom*, 70 Misc. 30, 41-42 (N.Y. Sup. Ct. 1910), *rev'd*, 147 A.D. 835 (1911); *Kickland v. Egan*, 36 S.D. 428 (1915); *Nugent v. Moody*, 271 S.W. 266 (Tex. 1925); *Committee on Legal Ethics v. Tatterson*, 352 S.E. 2d 107, 114 (W. Va. 1986) (lawyers "misrepresented the difficulty in obtaining the . . . proceeds"); *cf. United States v. Blitstein*, 626 F.2d 774 (10th Cir. 1980), *cert. denied*, 449 U.S. 1102 (1981); *Wunschel Law Firm, P.C. Va. Clabaugh*, 291 N.W.2d 331, 336 (Iowa 1980); *Renegar v. Staples*, 388 P.2d 867 (Okla. 1963). See also Brickman, *Contingent Fees*, *supra* note 19, at 65; Brickman, *Effective Hourly Rates*, *supra* note 1, at n.13; *infra* note 123.

interest not to make such disclosures since that might induce clients to seek to bargain for lower fees.¹¹⁴ A lawyer quoting a fee of one third may be stating that he intends to charge a substantially different effective hourly rate than another lawyer who is also quoting a one third fee.

Moreover, even after a settlement has been reached, tort claimants attempting to learn how many hours the attorney devoted to their matter are almost always rebuffed.¹¹⁵ Thus, a typical tort claimant agreeing to pay a lawyer a standard one third fee has no idea, *ex ante*, of the amount of the fee he is agreeing to pay, let alone of the effective hourly rate that the lawyer is charging, and does not know the effective hourly rate he actually paid, *ex post*.¹¹⁶

The contingent-fee-paying consumer's substantial lack of knowledge of the effective hourly rate that he is agreeing to pay to the lawyer further inhibits the operation of a competitive market.

3. Consumers Lack Knowledge Of The Quality Of Lawyering Services

In addition to lacking knowledge of the value of their claims and the anticipated effective hourly rates that the client is agreeing to pay, clients lack knowledge that would enable them to assess the quality of the lawyering services that they are contracting to hire.¹¹⁷ When

¹¹⁴ See *supra* note 112. It is also not in contingent fee lawyers' self-interest to disclose information about fees that would enable the public to determine their effective hourly rates of return or actual incomes. For consideration of the "stealth" function of contingent fees, see Brickman, *Effective Hourly Rates*, *supra* note 1, app. C.

¹¹⁵ I am basing this conclusion in part on anecdotal data I have acquired of the type referred to in Brickman, *Effective Hourly Rates*, *supra* note 1, at n.13. Tort claimants who have called me for advice in cases where they believe that the lawyer devoted very few hours to generate a very substantial settlement, almost always indicate that they are rebuffed when they ask their lawyers how much time the lawyer devoted to the matter. One standard answer they get from their lawyers is: I don't keep time records. Persistence may generate a more detailed answer, such as: I devoted substantial time to the matter. *Id.* Further persistence sometimes results in threats by the lawyer to sue the client if he does not agree to endorse the settlement check so the lawyer can deposit the funds into his trust account and then withdraw his fee.

¹¹⁶ For discussion of the stealthiness of contingent fees, see Brickman, *Effective Hourly Rates*, *supra* note 1, app. C.

¹¹⁷ The bar implicitly recognized the importance of such knowledge in creating a price competitive environment by using its power to regulate the practice of law to disable consumers from assembling a directory that would have constituted a step in that direction. See Supreme Court of Virginia v. Consumers Union of the United States, Inc., 446 U.S. 719 (1980) (holding that Virginia Disciplinary Rules (D.R.) 2-102 (A)(6) of the Virginia Code of Professional Responsibility unconstitutionally inhibited the gathering of information incident to the publication of a legal services directory designed to assist consumers in making informed decisions concerning selection of a lawyer). It is interesting to note that after prevailing in this matter, Consumer Union did not thereafter proceed with its plans to gather information and publish the directory.

consumers lack information needed to compare lawyers qualitatively, they are unable to exercise the kinds of choices that consumers regularly make in price competitive markets.¹¹⁸ In addition, consumers' inability to distinguish among lawyers qualitatively inhibits lawyers from offering lower prices and consumers from choosing lower priced tort claiming services—a subject which will be further explored later in this article.

B. Prohibitive Search Costs

The effect of these great imbalances between claimants' knowledge levels and that of tort lawyers is to tilt the fee bargain playing field decidedly in the direction of the lawyer. A claimant seeking to overcome the asymmetrical information burden faces a daunting task. As noted, tort lawyers do not engage in price advertising, let alone competitive price advertising.¹¹⁹ Claimants entering the market quickly learn, if they did not already know, that virtually all lawyers charge the same contingent fee percentage. The signal is clear: attempts to obtain lower prices are simply rebuffed. Magnifying the search cost is the fact that most tort claimants are unsophisticated one time users of legal services and lack experience in negotiating fees with lawyers.¹²⁰ Even if some claimants devote the requisite resources to

¹¹⁸ See Yeazell, *supra* note 3, at 202 ("Most clients with personal injury suits cannot make good comparative evaluations of lawyers, and as one-shot purchasers of legal services have little motivation to develop expertise.")

¹¹⁹ See *supra* note 95.

¹²⁰ The Federal Trade Commission has recently issued guidelines for consumers needing to hire a lawyer. See *Need a Lawyer? Judge For Yourself*, Federal Trade Commission, Bureau of Consumer Protection, Office of Consumer and Business Education, (June 2002), available at <http://www.ftc.gov> (last visited Nov. 19, 2002). In discussing payment arrangements, the FTC indicates that "before agreeing to a contingent fee," *id.*, the consumer should consider:

The size of a contingency fee, usually a percentage of any money you receive to resolve the case, is always negotiable. Sometimes you can negotiate a sliding scale fee (for example, 30 percent of any recovery up to \$10,000; 20 percent of any recovery up to \$50,000, etc.) Remember that there's no particular percentage of a consumer's recovery that constitutes a "standard" or "official" fee.

The size of the contingency fee should reflect the amount of work that will be required by the attorney. Some cases are straightforward; others can be novel or uncertain. You may want to ask whether the case is likely to settle quickly and whether government agencies will gather significant amounts of evidence. A fee arrangement sometimes can be negotiated with a lower percentage for a quick settlement and a higher percentage if it goes to trial. Be sure you know exactly what is covered in your agreement. Your state also may have rules about maximum contingency fees; check with your state's bar association.

Id. This attempt by the FTC to insinuate bargaining into the fee transaction between client and contingent fee lawyers is laudable but hardly likely to have any impact on "take it or leave it" uniform contingent fee pricing. See *Kenseth v. Comm'r*, 114 T.C. 399, 444 (2000) (Beghe, J. dissenting) ("a contingent fee agreement in all significant respects amounts to a 'contract of

amass information about the value of their claims, the amount of time a lawyer would reasonably anticipate being required and the quality of the lawyers being considered, the substantial cost of doing so would have to be justified by the savings to be realized. Any rational assessment, therefore, has to take into account that even when armed with this information, claimants may still not be able to induce lawyers to bargain over fees. Thus, for the one-time purchaser of tort claiming services who cannot amortize costs over a series of cases, standard pricing may raise search costs from daunting to prohibitive.

Search costs are further magnified by the unique efficacy of standard contingency fees in conveying deceptive information with regard to risk. To be sure, many tort claims involve considerable risk and insufficient reward. Attorneys, however, carefully screen these claims and reject a large portion, included most denominated as high risk.¹²¹ However, many claims involve little risk and relatively high reward, generating windfall fees that can amount to thousands of dollars an hour.¹²² To justify their substantial fees in these cases, contingency fee lawyers may, in the low visibility confines of their offices, deliberately exaggerate the risk they are undertaking in these cases.¹²³

As an alternative to such expressly deceptive behavior, tort lawyers, by collectively maintaining a standard rate, can announce to all

adhesion"); see also *Gisbrecht v. Barnhart*, 533 U.S. 789, 812 (2002) (Scalia, J. dissenting) ("[I]t is uncontested that the specialized Social Security bar charges uniform contingent fees . . . which are presumably presented to the typically unsophisticated client on a take-it-or-leave-it basis."); *Kenseth*, 114 T.C. at 422 ("[A] standardized form contract prepared by . . . [the attorney who] would have declined to represent . . . [the client] if he had not entered into the contingent fee agreement . . ."); Silver, *Civil Justice*, *supra* note 38, at 2088 ("[U]nsophisticated lay-persons cannot shop for legal services intelligently."); *supra* note 109.

¹²¹ See *supra* note 65.

¹²² See *supra* notes 22-23.

¹²³ See *supra* note 111. Exaggeration of risk to justify charging a substantial contingent fee may be endemic to contingent fee financing of tort claims. In England, a modest version of the contingent fee, called a conditional fee, has been instituted. See Colleen P. Gaffry, *Conditional Fees: Key to The Courthouse or the Casino*, 1 LEGAL ETHICS 70, 70-72, 79-83 (1998) (summarizing the history of the adoption of conditional fees). Under the conditional fee system, a lawyer can contract with a personal injury claimant to "uplift" the fee by up to 100% in exchange for undertaking the risk of decreasing the fee by a like percentage in the event the litigation fails. The uplift is supposed to reflect the degree of risk being assumed. This creates an opportunity for English solicitors to exaggerate the litigation risk, thereby mulcting clients by offering substantial uplifts in cases in which there is little or modest risk. According to an official report, that is precisely what is occurring:

The proportion of conditional fee cases with low estimated chances of success is surprising and raises questions about the way in which solicitors are assessing risk. This could cast a doubt over the fairness of the entire scheme. . . [T]he inconsistency in the uplift applied to cases with similar chances of success is worrying. The uplift appears to be either too low or (more often) too high, in almost half the cases. . . [A] cynical interpretation is that some solicitors might be deliberately over estimating risk to justify charging clients a higher uplift.

Report to the Lord Chancellor by Sir Peter Middleton, GCB, Review of Civil Justice and Legal Aid, Sept. 1997, at xii-xiii, xvii-xviii, as quoted in Gaffry, *supra*, at 85.

claimants that they are simply charging the standard fee that prevails in the community. In addition by maintaining a substantial standard contingent fee percentage ranging from one third to 50 percent, they also signal to potential tort claimants that *all* contingency fee financed litigation is high risk. If the case involves high risk and insufficient reward, the lawyer simply declines to take the case. If it will generate a substantial effective hourly rate, the lawyer presents the claimant with his standard contingent fee agreement form. If the client believes, however correctly, that his claim presents a low or nonexistent risk and therefore seeks a lower percentage fee, the lawyer insists on the standard rate because *it is the standard rate*.¹²⁴ Because all lawyers charge the same rate, it is necessarily "fair" and comparison shopping is therefore unnecessary.

C. *The Signaling Function of Standard Pricing*

The evidence so far considered most supports the conclusion that contingency fee lawyers maintain uniform pricing because at the levels charged, one third to 50 percent, substantial rents are levied. It is reasonable to conclude that lawyers maintain a uniform pricing structure because they perceive that it is in their self-interest to do so and not deviate, even infrequently, from the standard fee. A law firm considering whether to undercut the standard price would recognize that if it successfully did so, other firms would also lower their prices and that, as a consequence, both aggregate and individual income would fall.¹²⁵ This recognition provides a strong incentive for acting collusively to maintain a uniform price.

By "collusive," I do not mean that lawyers meet together, clandestinely or otherwise, to agree on a uniform price. Rather, I mean that lawyers act in the same manner as do gas stations owners on adjacent corners who recognize that if any of them lower the price, the others will respond by lowering their prices. The ensuing "gas war" will lead to lower profits for all of the adjacent owners. To avoid such mutually destructive behavior, adjacent gas station owners consciously collude with each other by maintaining at least near price uniformity. Lawyers maintain a uniform price for the same reason; that is, it maximizes revenue and also because it yields considerable rents.

¹²⁴ See Vonde M. Smith Hitch, *Ethics and the Reasonableness of Contingency Fees: A Survey of State and Federal Law Addressing the Reasonableness of Costs as They Relate to Contingency Fee Arrangements*, 29 LAND & WATER L. REV. 215, 245 (1994) ("Often clients accept whatever rate an attorney suggests merely because it seems to be the 'going rate,' and thus they do not realize that they are being overcharged.").

¹²⁵ Cf. Phillips & Butler, *supra* note 60.

Moreover, price collusion is aided by control over the practice of law which courts have reposed in themselves¹²⁶ and by use of that control to prohibit competitive behavior.¹²⁷

The argument that lawyers are acting collusively to fix the price of tort claiming is open to a number of objections. A collusive pricing system maintained by a few gas station owners is easily policed. Prices are posted and deviations are instantly identified. Thousands of lawyers operating in the low visibility confines of their offices cannot be nearly so sanguine that other players are maintaining the standard price. Indeed, economists would predict that some lawyers would deviate from cooperating with other contingent fee lawyers to maximize joint profits by charging less than the standard price, expecting to increase the volume of sales sufficiently to generate higher profits.¹²⁸ In addition, lawyers who operate more efficiently or who are more competent and therefore are able to obtain higher settlements, would also bid prices down, driving out less efficient and less competent lawyers. That contingent fee lawyers do not deviate from standard contingent fee pricing is therefore, under standard economic theory, an indication that the standard price is some form of competitive market-derived equilibrium price.¹²⁹ In that market, lawyers who charged less would not be able to compensate for lower prices with sufficient increased volume to generate higher profits. However, as already noted, there is considerable evidence that the market for contingent fee financed tort claiming services is not competitive. Standard economic theory, however, which seeks to explain the operation of markets under

¹²⁶ See CHARLES W. WOLFRAM, MODERN LEGAL ETHICS § 2.2.3 (1986); Charles W. Wolfram, *Lawyer Turf and Lawyer Regulation—The Role of the Inherent-Powers Doctrine*, 12 U. ARK. LITTLE ROCK L. REV. 1 (1989).

¹²⁷ See *infra* section VI. In addition to the structural impediments and ethical restrictions discussed *infra* which inhibit price competitive behavior, tort lawyers may also be reluctant to deviate from standard pricing out of concern that they will be ostracized by fellow tort lawyers. In addition to per group approval concerns, lawyers may also fear that courts and disciplinary bodies would not look kindly on such fee "cheating" and would use their discretionary authority to punish them in more tangible ways.

¹²⁸ According to economic theory, in the standard supply-demand curve, the demand curve slopes from left to right, that is, the lower the price, the higher the quantity demanded. See BEGG ET AL., ECONOMICS, *supra* note 18, at 35. Contingent fee lawyers, like oligopolists are "torn between the desire to collude, thus maximizing joint profits, and the desire to compete, in the hope of increasing market share and profits at the expense of rivals." *Id.* at 162. If one member-firm increases output by undercutting the standard price, consumers will substitute its services for those of the firms maintaining the (higher) standard price. This increase in demand will yield a rise in the price-cutting firm's profits at the expense of those maintaining the standard price, thus creating a strong incentive to stray from the tacit agreement. See *id.*

¹²⁹ Equilibrium price is the price at which the quantity supplied equals the quantity demanded. When price lies above this equilibrium, sellers must decrease the price in order to increase demand, thereby enabling sale of a quantity for which profits cover output costs. Likewise, when price lies below the equilibrium, demand exceeds supply and sellers are able to increase price until the equilibrium price is reached. See BEGG ET AL., ECONOMICS, *supra* note 18, at 32-34.

ideal conditions, may not therefore adequately account for the maintenance of uniform contingent fee pricing. Because deviations from expected competitive behavior appear to be the norm and not the exception, we need to look beyond standard economic theory to explain an apparent market failure.

1. Price Cutting Signals A Shirking Or Inferior Quality Lawyer

The lack of knowledge of most consumers of tort claiming services of the value of their claims places claimants at a distinct disadvantage in negotiating price with contingent fee lawyers. Claimants are also disadvantaged because they cannot effectively monitor their lawyer's services, that is, they have no realistic way of determining whether their lawyer is shirking or otherwise acting self-interestedly in negotiating a settlement.

These attributes of contingency fee claiming create a significant bias in favor of maintaining standard pricing. A price cutter may indeed be offering the same quality of service as other providers charging standard contingent fees. But a price cutter may also be signaling that she intends to devote fewer resources to prosecution of the claim than price maintainers. As a consequence, a lower settlement may be secured which yields a lower net payment to the client. When the client is neither able to determine the competence level of the lawyer he selects nor to verify the level of his lawyer's efforts, a rational response is to shun price cutters and to instead pay the standard contingent fee.¹³⁰

A related reason why lawyers who may wish to undercut the standard rate are deterred from doing so is because clients would likely perceive a cut rate price offer as signaling that the lawyer is inferior in quality to price maintainers. Since the client cannot monitor the lawyer's efforts to assure at least a reasonable quality of effort, the decision whether to hire that lawyer may entail substantial risk. As with a shirking lawyer, an inferior lawyer may gain a lower settlement, generating a lower net payment to the client than a lawyer charging the

¹³⁰ See Rudy Santore & Alan D. Viard, *Legal Fee Restrictions, Moral Hazard and Attorney Rents*, 44 J. L. & ECON. 549, 550 (2001) [hereinafter Santore & Viard]:

When attorney effort is not verifiable, contingent fees serve a dual role: in addition to compensating the attorney, contingent fees also provide the incentive for the attorney to put forth effort. Since attorneys put forth less effort at lower contingent fees, clients may prefer a higher contingent fee to the one that yields zero profits. Clients are unwilling to hire an attorney who offers a lower contingent fee, because doing so would reduce their net recovery—the lower level of attorney effort induced by the contingent fee would reduce the recovery by enough to outweigh the client's larger share of the recovery. As a result, attorneys cannot undercut this equilibrium by offering a lower contingent fee.

Id.

more expensive standard rate.

D. *A Comparative Analysis of Factors Affecting Pricing Of Real Estate Brokerage and Tort Claiming Services*

In summary, the market failures that account for the persistence of standard pricing for tort claiming services include: asymmetric information with regard to the value of tort claims, litigation risk, and the amounts of time required for prosecution of a claim; lack of meaningful price information; prohibitive search costs encountered by claimants seeking to make price and quality comparisons including the discouraging effect of those costs on consumers considering whether to expend resources to comparison shop; the unique efficacy of uniform pricing in misleadingly informing claimants that all cases are high risk; and the signaling effect of uniform pricing in deterring lawyers from competing on a price basis by deviating from standard pricing and further deterring claimants from searching for price-cutting lawyers.¹³¹ The effects of these market failures may usefully be examined by a comparison of the markets for real estate brokerage and tort claiming services.

At the outset, we can note that home owners seeking to hire real estate brokers and tort claimants seeking to hire a lawyer face vastly different search costs to acquire information about the price of the

¹³¹ Additional explanations exist for the persistence of uniform contingent fee rates. According to one such explanation, contingency fee lawyers may be aided in acting in a coordinated fashion to maintain standard contingency fee pricing by inertial social forces. "Path dependence," an economic theory, postulates that some remedially inefficient social systems persist because of information and public choice costs. See Stephen E. Margolis and S.J. Liebowitz, *Path Dependence*, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 17, 19 (Peter Newman ed., 1998). However, the empirical evidence advanced in support of this theory is weak. *Id.* at 21-22. See also Oona A. Hathaway, *Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System*, 86 IOWA L. REV. 601 (2001). Another explanation is based on a theory that law has an "expressive" function, that is, "that law influences behavior independent of the sanctions it threatens to impose[.]" by providing "a focal point around which individuals can coordinate their behavior." Richard H. McAdams, *A Focal Point Theory of Expressive Law*, 86 VA. L. REV. 1649, 1650-51 (2000). This theory may help to explain the persistence of standard contingency fee pricing. In a number of states, maximum contingency fees, usually one third, are set by statute or court rule. See ROBERT L. ROSSI, ATTORNEY'S FEES § 2:10, 114-20 (2d ed. 1995). Since there is standard pricing, that maximum fee is also, in reality, the minimum fee. Thus, the legal expression of a maximum fee "provide[s] a focal point for coordinating individual action," by contingency fee lawyers; that is, it signals to lawyers that by acting in a coordinated fashion, they can maintain the maximum fee as the standard fee. McAdams, *supra* 1666. "[T]he state can focus attention on one of several equilibrium solutions to a coordination game by commanding or merely recommending that individuals coordinate around that solution." *Id.* at 1663. "Each [lawyer] selects the salient strategy [of uniform contingent fee pricing] because they expect the other[s] to do the same and each has an interest in doing what the other[s] do." *Id.* at 1668.

services to be purchased. Most home owners have an at least approximate idea of the value of their homes; moreover, they can relatively easily acquire knowledge about value by consulting other real estate brokers, neighbors, listings of properties sold and recent appraisals done as part of refinancing mortgages. In addition, home owners can roughly approximate the amount of time that a broker will likely have to devote to the task of selling their home.¹³² Thus, home owners have a reasonable basis for estimating in advance the actual price in dollars that they are effectively agreeing to pay to brokers and can roughly approximate the hourly rates they are agreeing to pay, as well. An agreement to pay a commission of 6 percent of the sale price may therefore be seen as the substantial equivalent of an agreement to pay a fixed price for a reasonably quantifiable service contingent upon a sale. Home owners are therefore not being misled by the use of uniform pricing in brokerage services. They know the approximate price they are paying in advance of contracting for the service and are therefore able to make an informed determination whether to use the services of a full priced broker, a discount broker or, in the alternative, rely on their own efforts to sell their home. For these and other reasons, the market for real estate brokerage services is becoming increasingly competitive.¹³³

The situation is dramatically different for tort claimants. As noted, most tort claimants do not know whether they have a compensable claim, let alone the value of their inquiry. They must rely almost exclusively on the expert claim evaluator: the tort lawyer. In addition, they lack information about the amount of work that the lawyer reasonably anticipates that she will have to do to secure an acceptable settlement offer or to take the case to trial. Moreover, the lawyer has a clear incentive to exaggerate risk and overstate the amount of time to be required. A typical tort claimant agreeing to pay a standard one third fee neither knows the amount of the fee or the effective hourly rate he is agreeing to pay *ex ante* nor the effective hourly rate that he has paid, *ex post*.

The pricing in the respective markets that the two service purchasers are entering also differs because of critical differences in the nature of the services being purchased; in particular, qualitative differences in skill levels and quantitative differences in the range of each of the respective services. Sale of a home may take only weeks or may require many months. Even so, the range of effort expended by real estate brokers in selling a home varies considerably less than does

¹³² The more expensive the home, the greater the likely effort the broker may be expected to make but this is presumably compensated for by the higher commission resulting from the higher sale price.

¹³³ See *supra* notes 83-87.

the range of effort that a contingency fee lawyer may expend. The latter may range from a quick settlement requiring ten hours to a protracted settlement requiring fifty hours or more to a simple or complex jury trial requiring 100-500 hours or more. Thus, a home owner, having some reasonable basis for estimating the level of effort to be expended by the broker, can make a reasonably informed decision with regard to the price he is agreeing to pay to the broker. The tort claimant, however, for reasons already listed, is unaware of how much he is agreeing to pay the lawyer, how much effort the lawyer expects to devote to the matter, the value of the claim that he is selling to the lawyer in exchange for the service, and whether he is being mulcted by the lawyer by agreeing to pay—as he must—a standard contingent fee of one third or more in a case where risk may be slight and reward per unit of time may be great.

Since the reasonably informed home owner knows more or less what degree of effort he is purchasing and the price he is paying whereas the typical tort claimant does not, there are considerable differences with regard to the respective opportunities for bargaining out from the standard charge. For example, a home owner can decide to hire a standard priced broker, or attempt to sell the property on her own or hire a broker willing to work for a discounted fee of 2 to 5 percent. If she does the latter, she exposes herself to at most only moderate damage. If the broker can only produce buyers willing to pay a price less than that sought by the home owner, the latter can fire the broker and hire a higher priced one. The loss is substantially limited to the value of the delay in selling the home. The limited downside as well as the greater knowledge about the value and actual price of the services that they are purchasing provides support for the decision of some home owners to seek out brokers willing to discount fees.

The contrast with the tort claiming market is palpable. In addition to knowledge level differences, the tort claimant faces a significantly increased risk in choosing lawyer. Because the service is more complex, it is harder to judge the quality of the lawyer and harder to monitor what the lawyer is doing. As previously discussed, a lawyer may decide to maximize her effective hourly rate by devoting less time to the representation than required to obtain a substantial percentage of the maximum settlement value of the claim, or seek a quick settlement offer well below the maximum settlement value and then induce the client to accept it by, for example, portraying it as the best obtainable offer given unfavorable developments in the case of which the lawyer was unaware when she accepted the case.¹³⁴ In the alternative, a lawyer may simply be inferior in quality because of inexperience or incompetence and therefore lose the case at trial or generate a settlement

¹³⁴ See Brickman, *Money Talks*, *supra* note 23, at 283-87 nn.128-48.

offer that is substantially less than the maximum settlement value of the claim. Since most claimants cannot monitor their lawyers' performance and cannot evaluate the quality of the lawyer, the choice of a tort lawyer is more potentially impactuous than the choice of a real estate broker. Moreover, there is a *res judicata* effect when the lawyer is hired. If the client loses, he cannot then go back and hire a better lawyer. In the case of the substandard settlement offer, some clients do then terminate their lawyers and obtain new counsel but the costs are substantial and few are willing to persevere to that extent.¹³⁵

Under these circumstances, the tort claimant, unlike the home owner, may be reluctant to seek out a lawyer willing to charge a lower contingent fee than the one standard in that community for fear that such a lawyer is signaling that he will shirk or that he is of inferior quality.

The differences in search costs for the home owner seeking to hire a real estate broker and the tort claimant seeking to hire a contingent fee lawyer are thus substantial. These differences account, in part, for the substantial differences in the pricing of the respective services. The real estate brokerage market is increasingly price competitive. Standard pricing persists, however, in the tort claiming market.

IV. ALTERNATIVE FEE-SETTING MECHANISMS THAT WOULD BE EXPECTED TO OVERCOME THE PERSISTENCE OF UNIFORM PRICING AND INDUCE PRICE COMPETITION

Even though the market failures previously addressed account in some measure for the lack of price competition, they are insufficient to explain the persistence and pervasiveness of uniform contingent fee pricing. Absent additional factors, we would expect some lawyers to compete on the basis of price in the tort claiming market and advertise that they charge below market rates. In addition, we would expect a variety of other market-based solutions to be devised that would lead to price competition. In this section, I list a variety of ways in which price competitive behavior may be anticipated to arise and in succeeding sections, I consider why those projected solutions have not come to pass.

Perhaps the most obvious, though least utilitarian, alternative pricing mechanism that would induce price competition would be for lawyers to offer to charge noncontingent hourly fees or fixed fees instead of contingent fees. Indeed, ethics rulings have mandated that

¹³⁵ For discussion of how the fee is set when the client terminates a contingent fee lawyer, see generally Brickman, *Setting the Fee*, *supra* note 66.

contingent fee lawyers offer claimants just such alternative fee structures.¹³⁶ It is highly likely that, in such circumstances, tort lawyers would charge differential hourly rates, thus competing on a price basis. This solution fails, however, for three reasons. First, even though so mandated, tort lawyers honor that ethical requirement only in its breach.¹³⁷ Indeed, the fact that tort lawyers violate an ethical obligation by refusing to offer to represent clients on bases other than contingent fees has been cited by the American Bar Association as a justification for jettisoning the requirement—which it has recently done.¹³⁸ Moreover, even if the requirement were to be reinstated and enforced, most tort claimants could not afford to pay hourly rates or fixed fees and would therefore choose the contingent fee alternative. In addition, claimants who could afford to pay hourly rates would nonetheless be reluctant to choose that alternative because of their risk averseness and agency costs. Most tort claimants would have even less ability to monitor tort lawyers' efforts and the appropriateness of the hours claimed by lawyers to have been devoted to the task where lawyers are charging hourly rates as when charging contingent fees.

Other market-based alternative structures for the delivery of tort-claiming services that may be expected to have arisen and that would be expected to result in lawyers competing, *inter alia*, by offering differential pricing, include:

- 1) lawyers openly bidding against each other on the basis of price for the right to represent the claimant;
- 2) lawyers purchasing tort claims in their entirety from claimants thereby eliminating all agency costs;
- 3) lawyers promising that they will advance part of the anticipated recovery to clients upon being selected to represent them;
- 4) lawyers agreeing to provide "financial assistance" to clients at the outset and during the pendency of claims; and
- 5) lawyers and other entrepreneurs, claiming expertise in lawyer selection, offering to broker tort lawyers' services to claimants, including bargaining with tort lawyers over fees and expenses.

With only one notable exception, these market-based alternative fee setting arrangements have not arisen. In the next section, I consider that notable exception—airline crash litigation—and in the succeeding section, why that notable exception has been limited to a tiny sliver of the tort-claiming market and why other market-based alternative fee setting arrangements which would be price competitive, have not come into use.

¹³⁶ See Brickman, *Assault on Fiduciary Protection*, *supra* note 25, at text accompanying nn.106-21.

¹³⁷ *Id.* at text accompanying n.121.

¹³⁸ *Id.* at nn.144-47.

V. BIDDING FOR TORT CLAIMANTS: AVIATION ACCIDENT LITIGATION

There is one notable exception to the empirically based conclusion that contingent fees are standard and range from one third to 50 percent, depending on the jurisdiction: aviation accident litigation. Here prevailing contingent fees are not standard but rather, in many cases, are unique to each crash depending upon risk factors and are substantially below the standard rate in all other tort litigation. An inquiry into this highly specialized aspect of tort claiming is therefore mandated.¹³⁹

Very few aviation accident cases are brought annually, on the order of approximately 200.¹⁴⁰ The cases are very lucrative¹⁴¹ and often involve little or no liability risk because airline companies or their insurers often concede liability and agree to settle the claims.¹⁴² Lawyers compete for these lucrative cases by openly soliciting claimants. For these reasons a handful of law firms have come to dominate aviation accident litigation.¹⁴³ Many aviation accident claims,

¹³⁹ In addition to the sources cited in the footnotes in this section, I also rely on knowledge I have acquired during the course of my research from conversations with lawyers. I am especially compelled to rely on this personal knowledge with respect to fee information based on events occurring in the last decade because there is virtually no published literature describing airline litigation price setting practices after 1995. While trial lawyers are generally secretive about their effective hourly rates, see Brickman, *Effective Hourly Rates*, *supra* note 1, app. H, the level of secrecy I have encountered in seeking fee information on this subject far exceeds the already high level that prevails in tort claiming. See, e.g., Julie Kay, *Sad Dilemma: A Year After Attacks, Most Victims and Their Families Remain Uncertain About Best Venue for Seeking Redress*, MIAMI DAILY BUS. REV., Sept. 11, 2002, at A1 (reporting that "a veteran plaintiff lawyer" refused to disclose the contingent fee that he was charging families of 9/11 victims).

¹⁴⁰ See JAMES S. KAKALIK, E. KING, M. TRAYNOR, P. EBENER & L. PICUS, COSTS AND COMPENSATION PAID IN AVIATION ACCIDENT LITIGATION 88 (Rand, 1988) [hereinafter KAKALIK ET AL., AVIATION ACCIDENT LITIGATION].

¹⁴¹ See Andrew Blum, *The Aviation Bar Splits Over Turf*, NAT'L L.J., March 20, 1989 at 1 ("settlement amounts are growing . . . [t]he average award in the 1987 Northwest Airlines crash in Detroit is projected to be \$1 million, a far cry from the \$362,943 found in a 1988 RAND Corp. study . . ."). In tort trial cases terminated by trial in U.S. district courts in 1996-97, of 41 such cases described as "personal injury - airplane," the median award was \$937,000, far higher than the median for "product liability" cases. See Bulletin, Federal Tort Trials and Verdicts, 1996-97, Bureau of Justice Statistics, Feb. 1999, at p. 5. Of the 16 plaintiff verdicts in "airplane" cases, 43.8 percent were \$1 million or more. *Id.*

¹⁴² See KAKALIK ET AL., AVIATION ACCIDENT LITIGATION, *supra* note 140, at 70-71 ("[T]here is virtually always someone who is liable for an aviation accident. . . . Typically, the defendants either agree among themselves about how to divide expenditures for compensation and litigation, or they agree to let the outcome of one trial decide the division of liability."). See also Blum, *supra* note 141, at 1 ("[M]ost [aviation crash] suits are settled after the airline admits liability.").

¹⁴³ See ELIZABETH KING & JAMES P. SMITH, DISPUTE RESOLUTION FOLLOWING AIRPLANE CRASHES 11 (Rand, 1988) ("small number of plaintiff attorneys have specialized in aviation accident cases"); KAKALIK ET AL., AVIATION ACCIDENT LITIGATION, *supra* note 140, at 41 (fourteen plaintiffs' firms handled most of the sampled cases). For a list of the top lawyers and firms specializing in aviation law, see *Who's Who In Aviation Law*, NAT'L L.J., March 20, 1989, at 30.

however, are solicited by lawyers who do not specialize in that field of litigation but who intend to sell the claims to one of the dominant firms in exchange for a referral fee.¹⁴⁴

Before competition for these cases became the norm, standard contingent fees prevailed. Over the past thirty-five years, for reasons to be set out, contingent fees have declined steadily, averaging approximately 20 percent in the mid-1980s¹⁴⁵ and declining somewhat further since then.¹⁴⁶

One leading law firm establishes a price for each crash based upon its unique circumstances, including the number of passengers, the nature of the crash, the potential defendants, whether liability will be contested, and if it is, then the particular liability risk perceived; for a crash involving a significant number of victims where liability has been conceded, this law firm has charged rates of 12 to 14 percent.¹⁴⁷ Other

¹⁴⁴ See, e.g., Charles Maher, *Crashes & Disasters*, 5 CALIF. LAW 39, 41 (1985) (quoting an aviation lawyer that "solicitation by unqualified lawyers has become commonplace"); Kakalik, et al., *Aviation Accident Litigation*, *supra* note 140, at 46:

Many of the claims handled by plaintiff aviation litigation specialists are referred to them by other attorneys. Frequently the referring attorney is the family lawyer or a friend of the decedent or the decedent's relatives or has some preexisting business or professional or personal relationship with them

Sometimes the referring attorney has no preexisting relationship with the decedent or the claimants, but through advertising, publicity, or some other means has obtained several cases and wishes to refer them to an aviation specialist or involve such a specialist at some point. In this instance, the referring attorney usually insists on a portion of the total fee and may negotiate with one or more specialists to obtain the most profitable arrangement. Aviation specialists reported demands by such attorneys for as much as one-half the total fee.

Id.

¹⁴⁵ See Maher, *supra* note 144, at 40 (1985) ([C]ontingency fees "have dropped in 10 years from 35 percent to about 15 to 20 percent, mainly because of the [Tenerife] letter and approaches taken to make prompt compensation."); Andrew Blum, *Air Crash Death Average: \$ 362,943*, NAT'L L.J., May 23, 1988 (noting that in a Rand Corporation study from 1970 to 1984, claimants' attorney fees in 950 cases in which they were available averaged 21.5 percent). See also Jerry Gleeson, *Father-Son Legal Team Turns Tragedies into Triumphs*, JOURNAL NEWS, Feb. 17, 2002 (noting that Kreindler & Kreindler, the leading aviation liability law firm typically gets contingency fees below 25 percent "because the number of victims in airline disasters tends to run higher").

¹⁴⁶ See Bruce L. Hay, *Contingent Fees And Agency Costs*, 25 J. LEGAL STUD. 503, 525-27 (1996) [hereinafter Hay, *Agency Costs*] (stating that average contingency fees in aviation accidents are 17 percent as "[a]viation cases involve high potential damages, liability (and the extent of the plaintiffs' injury) is generally clear and frequently uncontested, and few defendants are involved in the litigation"). See also Kay, *supra* note 139, at A1 (reporting that "according to published reports" most plaintiff lawyers representing victims of the September 11, 2001 attacks on New York City take contingency fees of 10 to 20 percent); Tim O'Brien, *Cracks in the Plaintiff Bar's Solidarity: Sept 11 Survivors Caught Between Competing Brands of Legal Advice*, THE LEGAL INTELLIGENCER, Feb. 1, 2002 ("The going rate [for lawyers representing September 11 claimants] is a contingency fee of 10 percent to 15 percent . . .").

¹⁴⁷ This information was provided by a leading airline crash litigator in a private conversation at a conference on contingent fees. These percentages generate effective hourly rates that I estimate to amount to \$5,000-\$10,000. See also Ed Bean, *Damage Control: After 137 People Died In Its Texas Jet Crash, Delta Helped Families; But When Some Then Sued, It Investigated*

firms charge rates ranging from 15 to 25 percent depending on particular circumstances of each crash and the number of clients they represent in that matter.¹⁴⁸

The competitive pricing structure that has evolved in aviation accidents is a consequence of two phenomena unique to these claims: competitive bidding by lawyers and a settlement letter sent to victims' families by the major airline insurer (the "Tenerife Letter.")

When there is a commercial aviation accident, the names of the victims of the crash are made available by the airlines shortly thereafter and are often published in the press.¹⁴⁹ Immediately after a crash some lawyers or their representatives show up at the location which the airline has made available as an assembly point for grieving family members, to offer their condolences and solicit clients.¹⁵⁰ Others simply telephone the victims' families several days later to do the same.¹⁵¹ This competition for extremely lucrative cases generates bidding wars in which lawyers undercut the prices quoted by competitors.¹⁵²

the Dead; A Life Reduced to Dollars; Scott Ageloff, Homosexual, WALL ST. J., Nov. 7, 1986, at 1A (quoting Robert Alpert that fees in aviation crash cases "can work out to \$10,000 per hour"). When the claims are solicited by lawyers who will be selling the claims to the dominant firms, the former tack on a percentage to the prices set by the dominant firms that will be their part of the fee.

¹⁴⁸ See *supra* note 145. While I have been able to determine that law firms credit efficiencies of scale by decreasing contingent fees when they obtain additional clients in the same crash, I have not been able to determine whether these same firms go back to clients they previously entered into retainer agreements with and offer them the lower contingency fee rates they charge subsequently. The intensely secretive nature of the fee setting process impedes obtaining such information. By contrast, tort lawyers in other areas of practice almost never share efficiencies of scale with claimants. See, e.g., *supra* note 50 (noting the account of the aftermath of the underground steam pipe explosion in the Gramercy Park area of New York City).

¹⁴⁹ See Kaklik, et al., *Aviation Accident Litigation*, *supra* note 140, at 56 (names of victims published in the newspaper).

¹⁵⁰ See, e.g., Brickman, *Effective Hourly Rates*, *supra* note 1, at 136. It is yet unclear what the impact of the 1996 Aviation Disaster Family Assistance Act will have on this phenomenon. The Act comprises numerous provisions designed to protect and assist victims and their families in the aftermath of aviation accidents inside the United States. Among the provisions is a prohibition of unsolicited communication by lawyers, their agents or potential parties to related litigation:

Unsolicited communications—In the event of an accident involving an air carrier providing interstate or foreign air transportation and in the event of an accident involving a foreign air carrier that occurs within the United States, no unsolicited communication concerning a potential action for personal injury or wrongful death may be made by an attorney (including any associate, agent, employee, or other representative of an attorney) or any potential party to the litigation to an individual injured in the accident, or to a relative of an individual involved in the accident, before the 45th day following the date of the accident.

49 U.S.C. § 1136(g)(2) (2003). Giving teeth to the above provision is an enforcement mechanism allowing civil actions for its violation by either the National Transportation Safety Board or the Attorney General. See 49 U.S.C. § 1151 (2003).

¹⁵¹ See, e.g., Eric S. Roth, *Confronting Solicitation of Mass Disaster Victims*, 2 GEO. J. LEGAL ETHICS, 967, 971-72 (1989) (citing complaints of victims' families of solicitation ranging from twenty to over fifty unknown attorney contacts per victim).

¹⁵² See Lee S. Kreindler, *Aviation Law: Solicitation*, N.Y.L.J., Aug 5, 1985, at 1

Price competition has also been engendered by the use of the "Tenerife Letter" which was first sent in 1977 to victims' families, expressing the airline's condolences, offering immediate tangible assistance to cope with the effects of the tragedy,¹⁵³ and stating:

You may find yourself under pressure to sign a contingent fee retainer with an attorney whereby his fee is a percentage of the final award. The rationale for such a percentage fee is that the lawyer risks getting no fee if there is no recovery. There is no such contingency in this case. There is nothing to be gained by a precipitous lawsuit. We do suggest that it would be in your best interest to evaluate the offers which will be made to you and obtain the help of your attorney based upon a fee for the work involved rather than a percentage fee of the award.

Immediate legal action is unnecessary to avoid permitting applicable time periods (i.e., statutes of limitations, etc.) to expire. Should discussions not ultimately result in an amicable resolution of any claims that might exist, we provide a reasonable extension of any applicable time limitation based upon the facts and circumstances of the individual case in order that you will have ample time to take any path you choose as to counsel you retain, the basis upon which he is paid or whether you wish to institute a lawsuit. Please do not be rushed into limiting your alternatives or committing yourselves needlessly to an inordinate legal expense.¹⁵⁴

While the ostensible purpose of the letter is to present an offer by the airline's insurer to settle the case directly with representatives of the victims and bypass lawyers, the *sub rosa* purpose is to lower settlements costs by inhibiting contingent fee attorneys from using their usual zero-based accounting system to mulct clients by assigning a value of zero to the claim and thus applying the standard contingent fee to the entire amount of the recovery.¹⁵⁵ Victims' representatives, having in hand, substantial offers of settlement, are likely to be extremely reluctant to pay contingent fees applicable to the entire recovery without reasonable

("[S]olicitation in the mass-disaster context has the effect of bringing the fees down. Solicitation means competition and information. Even the best and most skilled lawyers must respond to competitive pressures if they want any cases."). I have been informed by a lawyer representing defendants in aviation crash cases that in a recent crash, a claimant received sixteen calls from plaintiff lawyers seeking him as a client. In addition to touting their wares, these plaintiff attorneys competed by offering price reductions.

¹⁵³ The Tenerife Letter was first sent by Robert L. Alpert, Senior Vice President and Director of Claims of United States Aviation Underwriters, Inc., as a result of the runway collision between a KLM Boeing 747 and a Pan American Boeing 747 at Tenerife, in the Canary Islands on March 27, 1977. See Randal R. Craft, Jr., *Factors Influencing Settlement of Personal Injury and Death Claims In Aircraft Accident Litigation*, 46 J. AIR. L. & COMMERCE 845, 897-98 (1981).

¹⁵⁴ The part of the Tenerife Letter reproduced above was sent to victims' families in the July 9, 1982 Pan Am 727 jetliner crash at New Orleans Int'l Airport, and is excerpted in Randal R. Craft, Jr., *The Letter Should Be Sent*, THE BRIEF, Nov. 1982 at 4, 7.

¹⁵⁵ See *supra* text accompanying note 24.

assurance that the increments in the recoveries to be secured by the lawyer will be sufficient to assure no net reduction in the clients' shares of the recoveries. If the lawyer advises a client to turn down the settlement offer and retain the lawyer to secure a higher recovery, then it is reasonable to anticipate that many clients in those circumstances will likely insist on limiting the contingent fee to the amount of value which the lawyer adds to the claim.¹⁵⁶

The effects of the Tenerife Letter on contingent fee pricing were dramatic. From its first use in 1977 to about 1985, contingent fees in aviation accident cases dropped from about 35 percent to 15 to 20 percent.¹⁵⁷ The dean of aviation accident litigation, Lee S. Kreindler, while strongly opposing use of the letter, acknowledged some of its many benefits:

In one respect-plaintiff lawyers fees-the . . . [Tenerife Letter] Approach has benefited the public. They have dropped from the 33.33 percent that prevails generally in the handling of negligence cases to little more than half that. In the major airline cases, they currently average about 17.5 percent.

Moreover, in some cases the plaintiff attorney's fee is based on the excess over what the defendant offers. In a situation where the claimant has been offered \$800,000 he may be reluctant to retain a lawyer for litigation without something close to a guarantee that he will at least net \$800,000. This has led to a variety of fee arrangements.

The . . . [Tenerife Letter] Approach has also substantially reduced the fees of defense lawyers. The negotiation and settlement role is largely exercised by the central claims office of an insurer, which imposes tight control over the process.¹⁵⁸

Plaintiff attorneys have been extremely critical of the use of the Tenerife Letter.¹⁵⁹ Though it has not been found by a court or

¹⁵⁶ See KAKALIK ET AL., AVIATION ACCIDENT LITIGATION, *supra* note 140, at 45 (some attorneys in aviation accident cases charge a contingent fee only on the portion of the recovery that exceeds the settlement offer that preceded representation). Victim's representatives are also inclined to exclude the in-hand settlement offer from the recovery to which a contingent fee is to apply because they tend to be more sophisticated than the average tort claimant. This reflects air traveler's higher socio-economic class than that of the general public. The reader who is familiar with the "early offer" proposal that I co-authored, see generally LESTER BRICKMAN ET AL., RETHINKING CONTINGENCY FEES, Manhattan Institute (1994) [hereinafter BRICKMAN ET AL., RETHINKING FEES], will recognize that the Alpert Letter is a form of the "early offer" proposal. Indeed, the Tenerife Letter was instrumental in the formulation of the "early offer" proposal.

¹⁵⁷ See *supra* notes 145-46.

¹⁵⁸ See Lee S. Kreindler, *supra* note 154, at 4, 38.

¹⁵⁹ See Andrew Blum, *The Aviation Bar Splits Over Turf*, NAT'L L.J., March 1989, at 1, 29 ("Plaintiffs' attorneys often criticize the . . . [use of the] Alpert Letter."); Bean, *supra* note 147 (quoting Robert Alpert on the aftermath of the New Orleans crash: "A lot of lawyers became critical of us for contacting people [in New Orleans]. They said we were trying to take advantage of people. They were concerned we were settling too many and they weren't getting their fees.");

disciplinary agency to violate ethical rules, the depth of opposition has led to its discontinuance by the aviation insurance industry.

Despite its discontinuance, the effects it has had on fees has persisted. Lawyers continue to actively compete for aviation crash clients and by so doing, engender price competition which has driven the average contingent fee to well below the level that prevails in all other tort litigation. The obvious question, of course, is why this phenomenon is limited to a tiny sliver, in terms of number of clients, of the tort claiming market. In the next section, I attempt to answer this question as well as consider why other mechanisms that would lead to price competition have failed to gain purchase in the tort claiming market.

VI. IMPEDIMENTS IMPOSED BY THE BAR TO THE ADOPTION OF ALTERNATIVE PRICE COMPETITIVE MECHANISMS

The simple answer to why competitive pricing that has developed in aviation accident litigation has not also developed in other tort-claiming services is that competing for clients by such direct communication constitutes solicitation and is unethical.¹⁶⁰ To be sure, it is unethical for lawyers to contact the families of aviation accident victims to solicit employment by offering to cut fees. It is nonetheless commonly done.¹⁶¹ Attempts to curb such solicitation are periodically undertaken by bar associations which resent out-of-state lawyers coming to the scene of aviation accidents and competing against in-state lawyers.¹⁶² Moreover, as noted, federal legislation has been enacted to curb the activity.¹⁶³ Still the lure of effective hourly rates running into the thousands and tens of thousands of dollars an hour often in instances where liability is not contested is a powerful inducement.

Anti-solicitation rules, though ineffective to preclude price competition in the ultra-small aviation accident market which averages 200 or so claims annually, are apparently more efficacious in curbing price competition in the tort-claiming market where claiming levels average 1,000,000 annually.¹⁶⁴ Such rules are one of a number of anti-

Craft, *supra* note 153, at 899 (1981) ("A number of aviation plaintiffs' attorneys feel strongly that [the Alpert] . . . letter is improper No court or bar association has censured the letter or directed that it not be sent.").

¹⁶⁰ MODEL RULES OF PROF'L CONDUCT R.7.3 (1983) [hereinafter MODEL RULES].

¹⁶¹ See *supra* note 149-51.

¹⁶² See generally Burnele V. Powell, *The Problem of the Parachuting Practitioner*, 1992 U. ILL. L. REV. 105.

¹⁶³ See *supra* note 150.

¹⁶⁴ See Brickman, *Disciplinary System*, *supra* note 26, at n.45. To be sure, direct solicitation of claimants is widespread in tort litigation. Nowhere has such solicitation been more widely

competitive policies instituted by the bar to preclude price competition. These policies are intended to prevent the rise of market mechanisms that would otherwise arise to challenge uniform pricing.

To be sure, all occupational groups seek to institute policies designed to limit price competition. For example, all seek to limit the supply of their services to drive up prices and seek to justify this and other anti-competitive strategies by invocation of the "public interest."¹⁶⁵ So too with lawyers. Over 150 years ago, lawyers fought

practiced than in asbestos litigation. Here, upwards of 1,000,000 or more present and former industrial and construction workers have been directly solicited by screening enterprises sponsored and paid for by lawyers. See Brickman, *Theories of Asbestos Litigation*, *supra* note 7, at V.A. Though this is one of the most massive recruitment efforts of any kind undertaken in this country and though the agents hired by the lawyers to solicit claimants receive substantial payments from the lawyers, anti-solicitation rules have not been applied to lawyers engaged in these activities. See *id.* at n.107. However, though lawyers engaged in these client recruitment efforts are obviously competing for business, they are not competing with each other on the basis of price. If someone recruited to attend an asbestos screening sponsored by Attorney X indicates at the screening that he has already signed up with Attorney Y, he is informed that he is not eligible for the free screening. *Id.* at text accompanying n.121. Indeed, I am unaware of any instance where one lawyer offered to represent an asbestos claimant for less than what another lawyer had agreed to charge the claimant. Indeed, even though tens of thousands of asbestos claims have been paid and are being paid through administrative processes, and have required as little as 10-15 minutes of paralegal time to process, many lawyers charge fees of 40 percent. See *id.* at n.89.

¹⁶⁵ For many years, the American Medical Association ("AMA") maintained that "it was unethical for physicians to join partnerships or other professional relationships with non-physicians unless ownership remained solely in the hands of the licensed physicians." American Antitrust Institute, *Converging Professional Services: Lawyers Against the Multidisciplinary Tide* (Feb. 9, 2000), available at <http://www.antitrustinstitute.org/books/multidisc.cfm>. The justification for these restrictions, according to the AMA, was to preserve the independent decision making power of doctors and maintain high standards of medical care. *Id.* When this rule came under attack in 1975, a federal court of appeals rejected the AMA's justification and found that the restrictions "had the purpose and effect of restraining competition by [non-physicians], and restricted physicians from developing business structures of their own choice." *American Med. Ass'n v. FTC*, 638 F.2d 443, 449 (2d Cir. 1980), *aff'd by an equally divided court*, 455 U.S. 676 (1982). The FTC has also successfully challenged the optometry profession's ethics regulations barring its members from establishing offices in commercial locations (shopping centers) and from "engaging in the 'corporate practice' of optometry." *Michigan Optometric Ass'n*, 106 F.T.C. 342 (1985); *American Academy of Optometry, Inc.*, 108 F.T.C. 25 (1986).

Anticompetitive regulations under the guise of justified professional structuring are not limited to the health care industry. Before the Supreme Court upheld a challenge to the restriction, the National Society of Professional Engineers maintained an ethics rule "barring members from engaging in competitive bidding." *National Society of Prof. Engineers v. U.S.*, 435 U.S. 679, 694-96 (1978). The association claimed that allowing competitive bidding would promote cost cutting measures and thus potentially endanger public safety. *Id.*

The legal profession has also been formed to be subject to antitrust laws. See, e.g., *F.T.C. v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411 (1990) (holding that the support and publicity provided by a lawyers' association for a group of attorneys who planned to boycott future representation of indigent criminal defendants if the government would not pass legislation providing for an increase in their fees as sufficient to "warrant condemnation under the antitrust laws"). The lawyers justified their actions by claiming that the quality of the representation would likely improve if the rates were increased. *Id.* at 423. The court felt, however, that this rationale was not a justification for unlawful restraint of trade. *Id.*

to free themselves from legislative regulation of the prices they charged to which they were then subjected,¹⁶⁶ and to opt instead for market based pricing. Once they achieved the right to freely negotiate prices with their clients,¹⁶⁷ they then sought to insulate themselves from market forces by: restricting entry to the profession; banning competition from outside the profession; prohibiting the outright purchase of tort claims; and adopting ethical rules to preclude price competition, including rules prohibiting lawyers' providing financial assistance to tort clients and the brokerage of lawyers' services.

A. *Barriers to Entry*

The beginning point of any analysis of why the lack of price competition due to the rigidity of standard contingent fee pricing has not been counteracted by market solutions is lawyers' control over the market for tort claims.¹⁶⁸ Tort claimants who wish to finance their pursuit by selling a percentage of their claim have a limited market. Nonlawyers are impermissible purchasers;¹⁶⁹ the contingent fee system

¹⁶⁶ See Lester Brickman & Jonathan Klein, *The Use of Advance Fee Attorney Retainer Agreements In Bankruptcy: Another Special Law for Lawyers?*, 43 S.C. L. REV. 1037, 1046-50 (1992) (describing lawyers' successful attempts to evade and then repeal, legislative "fee bills" which closely regulated their fees).

¹⁶⁷ See Lester Brickman & Lawrence A. Cunningham, *Nonrefundable Retainers: Impermissible Under Fiduciary, Statutory And Contract Law*, 57 FORDHAM L. REV. 149, 170-76 (1988) (discussing the adoption of 1848 N.Y. Laws § 258 and subsequent legislative history as § 474 of the New York Judicial Code, providing for the repeal of all "fee bills" regulating lawyers' fees and providing instead that "the measure of . . . [a lawyer's] compensation shall be left to the agreement, express or implied, of the parties").

¹⁶⁸ Lawyers' control over the market for tort claims is part of the broader monopolistic control exercised over the practice of law. See, e.g., Benjamin Hoorn Barton, *Why Do We Regulate Lawyers?: An Economic Analysis of the Justifications for Entry and Conduct Regulation*, 33 ARIZ. ST. L.J. 429, 483 (2001); Derek A. Denckla, *Nonlawyers and the Unauthorized Practice of Law: An Overview of the Legal and Ethical Parameters*, 67 FORDHAM L. REV. 2581 (1999). Technically, it is not lawyers qua lawyers who regulate the market for tort claims; rather, it is state supreme courts which have abrogated to themselves exclusive control over the practice of law. See *supra* note 126. This control is often exercised by the courts to further the interests of lawyers at societal expense. For a discussion of some of the "special rules" for lawyers that have emanated from this control, see Brickman, *Assault on Fiduciary Protection*, *supra* note 25, at sections VI-VIII. For purposes of this article, I use the term "lawyers' control" and "bar control" interchangeably to refer, *inter alia*, to control over the practice of law exercised by courts, bar associations, disciplinary boards and lawyers through collusive actions to maintain uniform pricing.

¹⁶⁹ See Scales, *Market For Tort Claims*, *supra* note 1, at 897 (stating personal injury litigation constitutes "a very odd market—one with only a single buyer . . . [and] usually only one seller"). Many states, by rule or statute, prohibit the sale (assignment) of tort claims, or categorize such sales as champertous and therefore illegal. See MODEL RULES, *supra* note 160, at R.1.8, cmt. 6 (explaining that the provisions of the Model Rules that prohibit lawyers from acquiring a proprietary interest in a subject of a pending litigation "has its basis in common law champerty and maintenance"); see also Michael Reese, *The Use of Legal Malpractice Claims as Security*

Under the UCC Revised Article 9, 20 REV. LITIG. 529, 534-35 (2001) (indicating that the UCC's prohibition of assigning security interests in a personal injury claim is a remnant of common law rules against maintenance and champerty). Since lawyers are able to, in effect, purchase a one third (or more) share of tort claims via a contingent fee arrangement, only lawyers are permissible purchasers of tort claims. *See, e.g.*, Title 17-A, § 516 of Maine's Criminal Code, which reads in relevant part:

1. A person is guilty of champerty if, with the intent to collect by a civil action a claim, account, note or other demand due, or to become due to another person, he gives or promises anything of value to such person.

2. This section does not apply to agreements between attorney and client to bring, prosecute or defend a civil action on a contingent fee basis . . .

ME. REV. STAT. ANN. tit. 17-A, § 516 (West 2002); N.Y. GEN. OBLIG. Law § 13-101(1) (McKinney 2002) (prohibiting transfers of personal injury claims or certain real property); OKLA. STAT. tit.12 § 2017(D) (2002) (prohibiting "the assignment of claims not arising out of contract"); *Cf.* 31 U.S.C. § 3727(b) (2002) (authorizing certain assignments of claims against the United States government to be made only "after a claim is allowed, the amount of the claim is decided, and a warrant for payment of the claim has been issued," and further requiring a series of hurdles to make such assignment, including certification by an official). Contrast the prohibition on the sale of tort claims to nonlawyers with the free wheeling sale of claims by lawyers as illustrated in *Cazares v. Saenz*, 208 Cal. App. 3d 279, 282 n.2 (4th Dist. 1989).

Rules prohibiting the sale of tort claims are a subset of common law rules against alienation of choses in action. *See, e.g.*, *Karp v. Seizer*, 132 Ariz. 599 (1982); J. B. AMES, *THE INALIENABILITY OF CHOSSES IN ACTION*, in *LECTURES ON LEGAL HISTORY* 210 (1913); Walter W. Cook, *The Alienability of Choses in Action*, 29 HARV. L. REV. 816 (1916); Jeffrey O'Connell & Janet Beck, *Overcoming Legal Barriers to the Transfer of Third-Party Tort Claims as a Means of Financing First-Party No-Fault Insurance*, 58 WASH. U. L.Q. 55 (1980). The persistence today of vestigial remnants of these prohibitions in the form of restrictions on the assignability of tort claims owes more to its utility as a means of precluding price competition in the tort claiming market than fidelity to tradition or policy. *See* Max Radin, *Maintenance by Champerty*, 24 CAL. L. REV. 48, 66, 72, 78 (1935).

In recent years, entrepreneurial ventures have begun providing financing to tort claimants in exchange for a share of the recovery. One such venture states:

Injury Funds provides non-recourse financing and settlement advancement to Plaintiffs in pending personal injury lawsuits. In simpler terms, we purchase a small percentage of your lawsuits [sic] anticipated recovery. We do not lend money, we do not make loans, and we do not earn interest on our investment. Instead, if the case is won, we get a percentage of the total recovery. If the case is lost, the funds are yours to keep and you owe us nothing.

Available at <http://www.injuryfunds.com/about.shtml> (last visited Jan. 29, 2003). Another similar enterprise may be accessed at <http://www.captron.com> (last visited Jan. 29, 2003). Both enterprises and several others invest in tort claims by advancing nonrecourse loans (called "investments") to tort claimants who have hired lawyers to represent them in personal injury claims. *See, e.g.*, Richard B. Schmidt, *Staking Claims*, WALL ST. J., Sep. 15, 2000, at A1 (describing the Resolution Settlement Corporation which make non-recourse loans directly to plaintiffs and occasionally to their lawyers, based on the firm's assessment of the strength of the case); Margaret Cronin Fisk, *Large Verdicts For Sale*, NAT'L L.J., Jan. 11, 1999, at 1 (Fisk explores the range of the now burgeoning business of investing in others' lawsuits and pointing out that it has now become common practice to invest in individuals' lawsuits. Investors have fully covered the market, beginning with wholly speculative claims that have yet to reach the settlement table, and continuing throughout the appeals process. A large portion of the business involves purchasing shares in previously awarded judgments that are on appeal.). Several state bar associations have issued ethics opinions allowing lawyers to provide clients with information about the availability of such nonrecourse loans providing that it is in the client's interest and the lawyer has no involvement in the process except for providing the firm with access to the client's file with the client's concurrence. *See, e.g.*, Professional Ethics of the Florida Bar, Op. 00-3 (March 15, 2002); Arizona Ethics, Op. 91-22 (Sept., 30 1991); New York, Op. 666 (June 1994).

channels all tort claims sellers to one class of purchaser—the lawyer-oligoponent. By insulating themselves from competition from nonlawyers for the purchase of tort claims,¹⁷⁰ lawyers fully capture, as one form of rent, the substantial finders' fees that lawyers pay to other lawyers, known as referral fees,¹⁷¹ that would otherwise be shared with nonlawyers or with clients who disintermediate and directly deal with the lawyer-litigator. By precluding competition in the purchase of tort claims, lawyers also facilitate minimization of price competition in the provision of legal services to tort claimants.

B. *The Prohibition Against The Outright Purchase of Tort Claims*

Most commentators agree that the most efficient fee structure—

However, bar association ethics opinions restrict their purview to ethical issues and do not opine on matters of law. Ventures such as InjuryFunds and CapTran, by investing in causes of action and by providing living expenses to claimants so that litigation can be carried on are engaging both in champerty and maintenance. See GEOFFREY HAZARD & WILLIAM HODES, *THE LAW OF LAWYERING* 273 (2d ed. 1990). Many if not most states, however, have largely abandoned these common law proscriptions and whether or not these enterprises will be found by courts to violate statutory law or public policy remains to be seen.

Another legal issue raised by these ventures is whether their fee structures violate laws against usury. The enterprises contend that though their nonrecourse loans are issued for effective interest rates that approach the “vigorish” rates charged by loan sharks, they are not usurious because of the non-recourse element, i.e., the risk of nonpayment in the event that there is no recovery. That is, they are investments, not loans. The Ohio Supreme Court rejected this argument and held that such an advance was a loan and therefore usurious. See *Rancman v. Interim Settlement Funding Corp.*, 99 Ohio St. 3d 121 (2003) (The plaintiff, Rancman, was advanced \$7000 by the defendant, Interim Settlement, with repayment contingent upon successful resolution of her underlying auto accident claim. The terms of the loan called for an eventual return of \$12,600 profit to the defendant. When Rancman settled her suit for \$100,000, she refused to pay the amount due, instead returning the principal with 8 percent interest. The Ohio court held for Rancman, and denounced the practice of third party investment in speculative litigation. While the court did not disclose the reason for rejecting the argument that the advance was an investment, not a loan, it hinted that the reason was that there was little or no real risk being borne by the defendant).

While these enterprises are experiencing substantial growth, other than the Ohio court ruling, there has been no major movement by the bar to ban them. This may be because these ventures constitute no threat to the bar's interests. Since the loans are only offered to claimants after they are represented by lawyers and, on occasion, to lawyers, they therefore do not induce any competitive behavior that threatens the bar's interest in precluding price competition; moreover, they do not adversely affect lawyers' shares of tort recoveries. For these reasons, these ventures are being at least tolerated by the bar. For a more detailed discussion of financial assistance to clients by entrepreneurs, see *infra* note 179.

¹⁷⁰ See Patrick T. Morgan, Note, *Unbundling Our Tort Rights: Assignability for Personal Injury and Wrongful Death Claims*, 60 MO. L. REV. 683, 705 (2001) (restricting the partial sale of tort claims via contingent fee arrangements creates an uncompetitive marketplace for tort claims sellers).

¹⁷¹ For further discussion of the effect of referral fee practices on the issue of the competitive nature of the contingent fee financed tort claiming market, see *supra* text accompanying notes 92-93.

one that competition among contingency fee lawyers would give rise to—is where attorneys vie with each other to buy the right to a client's legal claim and prosecute it on their own behalf.¹⁷² Such a structure, as well as other efficient fee structures that would promote competition,¹⁷³ are prohibited; states do not allow lawyers to purchase tort claims outright or bid for clients.¹⁷⁴ By “restricting the [contingent] fee arrangement to a simple percentage of the award [, the bar] prevents the

¹⁷² See, e.g., Hay, *Agency Costs*, *supra* note 146, at 513 n.20 (1996); Santore & Viard, *supra* note 130, at 549; Levmore, *Commissions and Conflicts*, *supra* note 58, at 522-23; Marc J. Shukaitis, *A Market in Personal Injury Tort Claims*, 16 J. LEGAL STUD. 329, 331 (1987) [hereinafter Shukaitis, *Market in Tort Claims*]; Kevin M. Clermont & John D. Currihan, *Improving on the Contingent Fee*, 63 CORNELL L. REV. 529, 596-97 (1978).

¹⁷³ Another efficient fee structure to both reduce agency costs and counter the ethically challenged zero-based contingent fee accounting system now in use, see *supra* notes 24 & 155, is for contingency fee lawyers to bid for clients by (1) identifying an amount of recovery (x) against which the lawyer will take a zero fee, and (2) the percentage of recovery that the lawyer will apply to an recovery in excess of x —which could be well in excess of 50 percent. The conceptual underpinning of this fee mechanism is set forth in Brickman, *Contingent Fees*, *supra* note 19, at 94-99. It also underlies the “early offer” proposal that is referred to *supra* note 156. See also Levmore, *Commissions and Conflicts*, *supra* note 58, at 522 (“[T]he optimal arrangement between lawyer and client from the perspective of reducing agency costs would be for contingency fee lawyers to “bid for clients, with the winning lawyer naming the highest x and receiving a standard percentage (such as 80 percent, for example) above x .”).

A variant of this fee structure was used in *In re Auction Houses Antitrust Litigation*, 197 F.R.D. 71 (S.D.N.Y. 2000), a class action suit brought against Sotheby's Holding, Inc. and Christie's International PLC and their respective subsidiaries. U.S. District Court Judge Lewis Kaplan initially ordered that all law firms bidding to be selected as class counsel were to offer two figures: X and a higher figure Y. Under this proposal the class would receive 100% of the gross recovery up to and including X. The lead counsel would receive 100% of the gross recovery in excess of X up to and including Y. The lead counsel would also receive 1/4 of any recovery above Y with the remainder going to the class. Counsel would be selected “on the basis of both the economic terms of the bids and the qualifications of the bidder.” *Id.* at 73. However, after “considering the comments of the *amici* and bidder,” the court revised the fee structure, requiring bidders to offer only one figure, X, where the lead counsel would receive 25 percent of any recovery in excess of X. As in the first scenario, the court would weigh the economic terms of the bid and the bidders' qualifications. *Id.* at 74. The winning bid of \$405 million as X was sufficient to secure the selection of David Boies and Richard B. Drubel of Boies, Schiller & Flexner, LLP as lead counsel. See *In re Auction Houses Antitrust Litigation*, No. 00 Civ. 0648(LAK) 2001 WL 170792 at *1 (S.D.N.Y. Feb. 22, 2001). A settlement award of \$512 million thus yielded lead counsel a fee of \$26.75 million, 1/4 of the recovery greater than \$405 million, or 5.2 percent of the recovery. See 2002 WL 170792 at *19-20. It is interesting to note that if this process were applied to selecting counsel in other class actions and it yielded similar percentages of the recovery, then class action lawyers would lose hundreds of millions of dollars and even billions of dollars in fee income that they are now receiving. This may explain why the class action bar (which also includes the lawyers who defend against class actions) has attempted to scuttle the auction approach with a broadside attack. See Third Circuit Task Force Report on The Selection of Class Counsel, Jan. 2002.

¹⁷⁴ See MODEL RULES, *supra* note 160, at R.1.8(j); Santore & Viard, *supra* note 130 at 551-56; Shukaitis, *Market in Tort Claims*, *supra* note 172 at 329-30. Prohibitions against bidding for clients are typically in the form of ethical rules prohibiting providing financial assistance to clients, see *infra* notes 179-82, paying anything of value to anyone for recommending a lawyer, see MODEL RULES, *supra* note 160, at R. 7.2(c) or operating for-profit lawyer referral services, see *infra* note 185.

type of price competition that would . . . eliminate [lawyers' rents]."¹⁷⁵ Whatever the historical bases for these restrictions, they are maintained today to inhibit the competitive behavior that would otherwise be unleashed.¹⁷⁶

C. *The Use of Ethical Rules To Preclude Price Competition*

From the time the first code of ethics was adopted¹⁷⁷ to the adoption of the Model Code of Professional Responsibility in 1967 and the Model Rules of Professional Responsibility in 1983, a central feature of the ethical regimes adopted by the bar has been restraint of price competition by lawyers. But for the intercessions of the United States Supreme Court, such essential elements of price competition as the absence of mandated minimum fees, advertising, and group legal services, would have remained ethically constrained.¹⁷⁸ Despite

¹⁷⁵ Hay, *Agency Costs*, *supra* note 146, at 513; *see also* Santore & Viard, *supra* note 130, at 550.

¹⁷⁶ *See* WOLFRAM, *supra* note 126, at 507; Samuel R. Gross, *We Could Pass a Law . . . What Might Happen If Contingent Fees Were Banned*, 47 DEPAUL L. REV. 321, 325-28 (1998); Radin, *supra* note 169, at 66.

¹⁷⁷ The first lawyer's code of ethics was adopted in 1887 at Albany, New York. H. DRINKER, *LEGAL ETHICS* 23 (1953). In the same year, the Alabama bar also adopted a code. ALA. STATE BAR ASS'N CODE OF ETHICS (1887). The anticompetitive tone of these codes was set by David Hoffman, a leading American lecturer on law in the mid-nineteenth century. His Resolution XXVIII provided: "I shall regard as eminently dishonorable all underbidding of my professional brethren." 2 DAVID HOFFMAN, *A COURSE OF LEGAL STUDY* 752-75 (2d ed. 1836), *reprinted in* DRINKER, *supra*, at 344.

¹⁷⁸ Provisions requiring adherence to minimum fee schedules or restricting advertising by lawyers—struck down by court—exemplify attempts by the bar to preclude price competition. *See* *Bates v. State Bar*, 433 U.S. 350, 384 (1977) (holding that a rule prohibiting lawyers from advertising violates the First Amendment); *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 793 (1975) (ruling that minimum fee schedules violate antitrust laws); Kenneth L. Penegar, *The Professional Project: A Response to Terrell and Wildman*, 41 EMORY L.J. 473, 477 (1992) (stating that the bar's traditional anti-competitive practices included minimum fee schedules and prohibitions on advertising); Deborah L. Rhode, *Why The ABA Bothers: A Functional Perspective on Professional Codes*, 59 TEX. L. REV. 689, 702 (1981) ("A principal force animating any occupation's efforts at self-regulation is a desire to minimize competition from both internal and outside sources."). *See generally* Gregory H. Bowers & Otis H. Stephens, Jr., *Attorney Advertising and the First Amendment: The Development and Impact of Constitutional Standard*, 17 MEM. ST. U. L. REV. 221 (1987) (discussing the constitutional protection afforded to attorney advertising before and after *Bates*). While the striking down of ethical rules prohibiting advertising has led to price competition among a segment of the bar charging hourly rates or fixed fees for certain routine services, it has not impacted contingent fee pricing.

Other examples of the bar's anti-competitive practices include entry restrictions and market-division strategies designed to limit competition within the profession. *See* Roger Cramton, *Delivery of Legal Services to Ordinary Americans*, 44 CASE W. RES. L. REV. 531, 551-52 (1994). In addition, ethical provisions regulating group legal services, prohibiting the aiding of the unauthorized practice of law and fee splitting, also seek to preserve lawyers' monopolistic control over the dispensation of certain services and, as well, to maintain lawyers' primacy over other professional groups. *See* Brickman, *Contingent Fees*, *supra* note 19, at 104; Brickman, *Money*

repeated instances of the Supreme Court's striking down anti-competitive rules adopted by the bar, many restraints on competition, expressed in the form of ethical rules endure, in particular, restraints on financing tort claimants and on business practices and organizational structures that would facilitate price competition.

1. Prohibitions Against Providing Financial Assistance to Clients

One ethical rule that applies virtually exclusively to contingent fee financed tort claiming prohibits lawyers from providing financial assistance to clients, typically in the form of payments to clients to defray living costs while the litigation proceeds—even if repayment is not contingent on the outcome.¹⁷⁹ The ostensible purpose of these

Talks, supra note 23, at 253. For an analysis of ethical rules ostensibly protecting client confidentiality but which maximize lawyers' fees and promote fraud, see *id.* at 253-54.

While the focus of this article is on the offensive use of ethical rules to preclude price competition in the contingency fee bar, defense lawyers also invoke such rules for anti-competitive purposes. For example, insurance companies have been forcing defense lawyers' fees down by limiting legal defense costs through billing and litigation management guidelines. Defense lawyers have struck back at these fee-depressing actions by invoking various sections of the *Model Rules of Professional Conduct* in an attempt to declare such guidelines as unethical. In at least one instance, a state supreme court has concurred. See *In re Rules of Prof'l Conduct and Insurer Imposed Billing Rules and Procedures*, 2 P.3d 806 (Mont. 2000). A number of bar associations have also opined in favor of defense lawyers' attempts to limit the ability of insurance companies to limit their fees. See Amy S. Moats, Note, *A Bermuda Triangle in the Tripartite Relationship: Ethical Dilemmas Raised by Insurers' Billing and Litigation Management Guidelines*, 105 W. VA. L. REV. 525 (2003).

There are less obvious features of ethical codes that may be seen to advance self-interest. For example, rules of ethics stress the obligation of the practitioner to zealously protect and advocate clients' interests irrespective of the social costs imposed by these rules. See Robert A. Kagan, *Do Lawyers Cause Adversarial Legalism? A Preliminary Inquiry*, 19 J. L. & SOC. INQUIRY 1, 37, 38 (1994) (suggesting that the ethical rules stressing zealous advocacy coupled with rules of evidence advanced by lawyers "that provide a broader and more absolute lawyer-client privilege than" exists in most countries, "are imposed without "concern for legitimate interests of third parties and society at large").

¹⁷⁹ Payments to clients to subsidize living expenses and payment of clients' litigation expenses are treated differently by the ethical codes; the former is referred to as "financial assistance" to clients and the latter as "advancing litigation costs." Ethical codes allowed lawyers to advance litigation costs such as filing fees, transcript costs and expert witness fees, provided the client remained liable for repayment of the advancement irrespective of the outcome of the claim. See MODEL CODE OF PROF'L RESPONSIBILITY, EC 5-8, DR 5-103(B) (1980) [hereinafter MODEL CODE]. This was changed when the Model Rules were adopted in 1983 to allow the repayment to be contingent on success of the claim. See MODEL RULES, *supra* note 160, at R.1.8 (e) (1983). This change simply mirrored what was already happening in practice despite the previous ethical provision. That is, when contingency fee lawyers advanced litigation costs and the litigation failed, in most cases, the lawyer did not seek to obtain reimbursement of these advancements as the ethics rules would appear to have mandated.

Both ethical codes prohibit providing financial assistance to clients, that is, subsidizing clients' living costs prior to or during the course of litigation. See MODEL CODE DR 5-103 (B); MODEL RULES, R.1.8 (e). For a detailed analysis of the origins of the rules prohibiting financial assistance to clients and of the policies cited in support of the rule, see James E. Moliterno, *Broad*

prohibitions is to protect clients from being seduced by offers of subsidized living costs into selecting lawyers on the basis of such offers rather than for other more "appropriate" criteria.¹⁸⁰ The real reason is

Prohibition, Thin Rational: The "Acquisition of an Interest and Financial Assistance in Litigation" Rules, 16 GEO. J. LEGAL ETHICS 223 (2003). For a sympathetic treatment of advancement of living expenses, see Jack P. Sahl, *The Cost of Humanitarian Assistance: Ethical Rules and the First Amendment*, 34 ST. MARY'S L.J. 795 (2003). Nine jurisdictions depart from the general rule and allow lawyers to provide financial assistance to clients. Most, however, carefully circumscribe their rules to prevent advances for living costs from becoming a basis for lawyers' bidding against each other to acquire clients by upping the amounts of the loans being offered. This is done by limiting advancements to only those who have already become clients and by other provisions designed to preclude price competition. The most liberal provision is the one in Texas which allows a lawyer to advance "reasonably necessary medical and living expenses, the repayment of which may be contingent on the outcome of the matter. . . ." TEX. GOV'T CODE ANN. tit 2, subtit. G. app. A, art. 10, § 9, rule 1.8 (d) (Vernon 1998). The Texas rule does not, on its face, preclude using promises to advance living expenses as a way of competing for clients. However, no Texas court or administrative tribunal has ever interpreted the rule to so authorize. Seven additional jurisdictions expressly authorize financial assistance, but, in efforts to avoid bidding wars, have carefully circumscribed the rules to ensure that "no promise or assurance of financial assistance [be] made to the client. . . prior to the employment of the lawyer." See ALA. RULE OF PROF'L CONDUCT 1.8(e)(3) (2002); RULE OF PROF'L CONDUCT OF THE STATE BAR OF CAL. 4-210(A)(2) (2000); see also D.C. RULE OF PROF'L CONDUCT 1.8 cmt. (2002) (where, in official comment, the Court of Appeals cautioned that the "provision does not permit lawyers to 'bid' for clients by offering financial payments beyond those minimum payments necessary to sustain the client," and that loans be made only "after employment"); MINNESOTA RULE OF PROF'L CONDUCT 1.8 (e)(3) (1999); MISS. RULE OF PROF'L CONDUCT 1.8(e)(2) (2002); MONT. RULE OF PROF'L CONDUCT 1.8(e)(3) (1999); N.D. RULE OF PROF'L CONDUCT 1.8(e)(3) (2000); WOLFRAM, *supra* note 126, at 509 n.89 (stating that California courts have interpreted the rule as forbidding attorneys to discuss the availability of loans before representation begins).

One state, Louisiana, authorizes financial assistance to clients in a limited capacity, despite its code language prohibiting the practice. See LA. RULE OF PROF'L CONDUCT 1.8(e) (2002). The Louisiana Supreme Court allows attorneys to loan reasonably necessary living expenses to clients only if "the advances were not promised as an inducement to obtain professional employment, nor made until after the employment relationship was commenced . . . and the attorney did not encourage public knowledge of this practice as an inducement to secure representation of others." Louisiana State Bar Ass'n v. Edwins, 329 So.2d 437, 446 (La. 1976); See also Chittenden v. State Farm Mutual Automobile Company, 788 So.2d 1140 (La. 2001). The Court noted that "[n]otwithstanding the wording of Rule 1.8(e), the current practice of law in our State follows the Edwins policy of allowing an attorney to advance funds under the constraints enunciated in Edwins," yet cautioning the bar "on the need for scrupulous adherence to the RPC so as to avoid ethical problems which may appear almost unnoticed in their practice." *Id.* at 1146 (emphasis added), 1152. Finally, the Missouri Supreme Court, in allowing an attorney to make a small loan to a destitute client, warned, "[O]f course, the loan should not be the consideration for the employment." See *In re Sizer*, 267 S.W. 922, 928 (Mo. 1924); see also *In re Berlant*, 328 A.2d 471, 479 (Pa. 1974) (Manderino, J., concurring and dissenting) (discipline of an attorney who advanced living expenses was appropriate because the advance was designed to influence the client to retain the attorney).

¹⁸⁰ See *Attorney Grievance Committee v. Kandel*, 563 A.2d 387, 390 (Md. 1989) ("An important public policy interest is to avoid unfair competition among lawyers on the basis of their expenditures to clients. Clients should not be influenced to seek representation based on the ease with which monies can be obtained. . . ."); *In re Carroll*, 602 P.2d 461, 467 (Ariz. 1979) ("[T]he practice of making advances to clients, if publicized, would constitute an improper inducement for clients to employ an attorney. . . . [B]etween a lawyer who offers such an agreement and a lawyer who does not, the client will choose the lawyer who offers the lesser financial

otherwise. In the absence of such a prohibition, lawyers would be expected to bid against each other through offers of financial assistance, based upon the anticipated value of the claim.¹⁸¹ This would drive contingent fee rates down, effectively forcing lawyers to divide rents with their clients. Indeed, for many high value claims in which there is no meaningful risk, lawyers could be expected to offer to pay substantial sums, in some cases of low risk and high reward, as much as hundreds of thousands of dollars to claimants as signing bonuses.¹⁸²

2. Prohibitions Against Brokerage of Lawyers' Services

One business structure that we would expect to emerge if the contingent fee market were competitive is the legal practice equivalent of mortgage brokerage, a business structure which arose after the home mortgage market was deregulated. Mortgage brokers intermediate between borrowers and banks, offering to evaluate the borrower's financial circumstances, recommend and obtain the lowest bank mortgage loan rates available to the lender and further facilitate the lending process.¹⁸³ Because of economies of scale, they are able to

obligation . . .").

¹⁸¹ See, e.g., *Attorney AAA v. The Mississippi Bar*, 735 So.2d 294, 299 (Miss. Sup. Ct. 1999) (restrictions against providing financial assistance to clients "are rationally related to the legitimate interest of the state in avoiding bidding wars"); *Mississippi Bar v. Attorney HH*, 671 So. 2d 1293, 1298 (Miss. 1996) ("[U]nregulated lending to clients [to provide financial assistance while a tort claim is being pursued] would generate unseemly bidding wars for cases. . ."); *Kentucky Bar Association, Op. E-375* (1995) (reaffirming the state's ban on advances for living and medical expenses after noting that "dropping the time-honored rule will invite bidding by lawyers for clients"); see also Brickman, *Contingent Fees*, *supra* note 19, at 107 n.317.

¹⁸² See, e.g., Brickman, *Effective Hourly Rates*, *supra* note 1, at text accompanying nn. 131-37 (discussing the client recruitment efforts that took place after the 1989 Alton, Texas school bus tragedy and its legal aftermath. Anticipating effective hourly rates of \$25,000 and more in a case where there was virtually no liability risk and little effort to be required, lawyers converged on Alton to sign up clients). Though it was both unethical and illegal to do so, lawyers "bid" for clients by offering various signing bonuses. See Paul Marcotte, *Barratry Indictments: DA Claims Four Texas Lawyers Solicited Bus-Crash Clients*, A.B.A. J., July 1990, at 21 (stating that a client was offered \$5000 cash and a new house by one attorney and a new GMC suburban van by another); Lisa Belkin, *Where 21 Youths Died, Lawyers Wage a War*, N.Y. TIMES, Jan. 18, 1990, at A1 (reporting the investigation of more than 15 lawyers for the possibility that they "gained cases by misleading or bribing families"). Lawyers did not, however, bid for clients on the basis of price. In this riskless, "sure thing" reward scenario, they charged contingency fees ranging from thirty to forty-five percent. See *id.* (reporting contingency fee rates as high as forty-five percent); James Pinkerton and Glen Golightly, *The Spoils of Tragedy; Profiting on Disaster*, HOUSTON CHRON., Aug. 2, 1992, at A1 (reporting rates of thirty to forty percent).

¹⁸³ See Robert Buss, *Use Caution in Picking a Mortgage Broker*, CHI. TRIB., Nov. 13, 1998, at 2G (stating that mortgage brokers act as middlemen during the real estate loan process, taking borrowers' applications, shopping them around to various lenders seeking the best loan terms, and finally collecting a commission for a successful matchmaking). For how mortgage brokers operate, see Edwin McDowell, *A Booming Business in Selling Money*, N.Y. TIMES, Dec. 2, 2001,

obtain discounted mortgage rates from banks and other lenders which they pass on to borrowers, thereby underselling the very same banks and lenders.¹⁸⁴ They derive income from fees paid directly by the borrowers but primarily from commissions paid by the lending banks. In a competitive contingency fee/personal injury market we would expect a similar structure to be replicated: the contingent fee-lawyer broker.

The hypothetical "The Personal Injury People, Inc." ("PIP") is an example of such a structure. Seizing upon the public's recognition of the high degree of specialization in all forms of law practice, including contingent fee practice, and the public's paucity of knowledge about the quality of individual contingency fee lawyers, PIP would advertise that it evaluates personal injury tort claims and if it concludes that a claim has value, it refers the injured person to a competent lawyer who specializes in that type of claim, e.g., supermarket slip-and-fall, landlord liability, defective automobiles, toxic exposures, medical malpractice, etc. PIP would claim that it has specialized knowledge not otherwise available to a claimant that enables PIP to refer the claimant to more highly competent attorneys than the claimant would likely be able to obtain through his own efforts. In this hypothetical model, PIP does not charge the claimant a fee for this triage service; instead, PIP collects a fee from the law firm to which the matter is referred in the form of a percentage of the fee that the referred law firm charged against any recovery. Since PIP's fee would likely be about one third of the referred lawyer's one third fee, i.e., one ninth of the recovery, PIP may further advertise that it will rebate a portion, e.g., one half of its one ninth referral fee, to the claimant if there is a successful outcome, thus undercutting the prices charged virtually all contingent fee clients. More ominously, if PIP's business model proved successful and it began to refer large numbers of claimants to lawyers, and its success led other contingent-fee-lawyer brokerages to be formed, PIP would likely seek to maintain its market share by bargaining with some of the law firms to give a volume discount in the form of a lowering of their standard contingency fee rates for PIP customers. If it succeeded in doing so, then PIP might further advertise that not only was it able to secure higher quality specialized personal injury representation than individuals could on their own but that PIP customers would be charged lower than standard contingency fee rates. PIP's business model would

at § 11, 1; Jane Bryant Quinn, *Mortgage Shopping Still Wise for Home Buyers*, CHI. TRIB., Dec. 17, 1990, at Bus. 9. The business of brokering home mortgages arose in the aftermath of the deregulation of the home mortgage industry. See *Brokers Look for the Best Deal*, EVENING POST (Wellington, Australia) (predicting a rise in the number of mortgage brokers in Australia, as has occurred in the U.S., due, in large part, to the deregulation of the banking industry).

¹⁸⁴ See BARRON'S, June 27, 1988, at 81.

thus likely lead to price competition and at least a fair amount of discounting by contingent fee lawyers from standard rates.

To ward off such price competition that would be engendered by PIP, the bar has promulgated ethics rules essentially prohibiting for-profit "lawyer referral services"—the term it uses to refer to the brokering of lawyers' services—and restricting not-for-profit lawyer referral services to those which pose no threat of price competition.¹⁸⁵

¹⁸⁵ The Model Code promulgated in 1963, the Model Rules promulgated in 1983, and the Model Rules as amended in August 2002 [hereinafter NEW RULES] have provisions regulating lawyer referral services and will be considered seriatim.

DR 2-103(B) (1980) of the Model Code provides:

A lawyer shall not compensate or give anything of value to a person or organization to recommend or secure his employment by a client, or as a reward for having made a recommendation resulting in his employment by a client, except that he may pay the usual and reasonable fees or dues charged by any of the organizations listed in DR 2-103(D).

Id. DR 2-103(D) (1980) provides in pertinent part:

A lawyer or his partner or associate or any other lawyer affiliated with him or his firm may be recommended, employed or paid by, or may cooperate with, one of the following offices or organizations that promote the use of his services or those of his partner or associate or any other lawyer affiliated with him or his firm . . . : (3) A lawyer referral service operated, sponsored, or approved by a bar association

Id.

Numerous advisory opinions of state and city bar associations purport to interpret these Model Code provisions which essentially prohibit for-profit lawyer referral services and restrict not-for-profit entities to those that do not pose a threat of facilitating price competition. *See, e.g.*, ABA Comm. on Ethics and Prof'l Responsibility, Informal Op. 85-1510 (1985) (participation in a for-profit lawyer referral service, even were there was no payment by participating lawyers, would be a violation of a literal application of the Model Code); Ala. Ethics, Op. RO-86-81 (1986) (giving discounts from usual rates in exchange for participation in a lawyer referral service would be valuable consideration, and thus unethical); Idaho, Formal Op. No. 114 (1985) (prohibiting a lawyer from paying a fee to join a private attorney referral service not sanctioned nor sponsored by the state bar association); Iowa Ethics, Op. 89-42 (1990) (considering the propriety of a law firm joining a referral program where, in exchange for being placed on the referral list, the firm "would agree to provide a free one-half hour consultation and legal services thereafter at a 25 percent reduction of [its] regular fees." Although the firm would not be charged any enrollment or processing fees to participate, the ethics committee opined that discounting its fee in exchange for participation would be a violation of D.R. 2-103(B)); Me. Prof'l Ethics Comm'n, Op. 87 (8/31/88) (opining that a lawyer referral service for personal injury claimants privately operated by lawyers which would either charge participating attorneys or split fees on referred matters, would violate Maine Bar Rule 3.9(f)(2) which essentially replicates DR 2-103(D)(3) prohibiting a lawyer from compensating another for recommending his services). *But see* Neb., Op. No. 87-2 (1987) (reduced fees in exchange for participation in a for-profit service does not constitute valuable consideration, and thus participation is not inherently unethical); Ohio Grievance, Disciplinary Op. 2002-1 (2002) (improper for a law firm to pay an annual fee to a real estate agency and offer discounted rates to clients referred to the firm by the agency in exchange for the agency's promoting the law firm as a service provider).

In 1983, the Model Rules replaced the Model Code and the operative language dealing with lawyer referral services was changed. Rule 7.2(c) provides "[a] lawyer shall not give anything of value to a person for recommending the lawyer's services except that a lawyer may . . . (2) pay the usual charges of a not-for-profit lawyer referral service or legal service organization . . ." *Id.*

While the operative language broadens the arena of permitted not-for-profit lawyer referral services from those "operated, sponsored or approved by a bar association" to those "not-for-

profit lawyer referral service[s] or legal service organization[s],” the net effect of the change is modest. Advisory opinions interpreting this language indicate a somewhat broader range of permissible not-for-profit lawyer referral services but none that would pose a threat of price competition. *See, e.g.*, Pa. Bar Ass’n Committee on Legal Ethics and Prof’l Responsibility, Informal Op. No. 90-42 (1990) (\$500 fee paid by referred lawyer to referral service excessive and a violation of Rule 7.2 (c) even though the service was not-for-profit); Wis., E-87-7 (1987) (lawyer may accept referrals from legal services organization so long as he pays no consideration for potential or actual receipt of clients through the service). For-profit lawyer referral services remain essentially prohibited unless the business model poses no threat of price competition. *See, e.g.*, ABA Comm. on Ethics and Prof’l Responsibility, Formal Op. 85-1510 (as long as lawyers did not pay a fee, they could ethically participate in a for-profit corporate lawyer referral service where the corporation provided “a variety of ‘professional-type services’ to its subscribers for the price of a \$75.00 membership card”); Pa. Bar Ass’n Committee on Legal Ethics and Prof’l Responsibility, Informal Op. No. 90-49 (1990) (membership in a for-profit lawyer referral service is unethical under the plain language of Rule 7.2).

Utah’s formulation of Rule 7.2(c)(2) (2002) differs from the Model Rule by omitting the words “not-for-profit.” Nevertheless, for-profit referral was still essentially prohibited in Utah State Bar Ethics, Advisory Op. No. 01-02 (2002), where the following question was presented:

A Utah lawyer referral service charges a referral fee to participating lawyers. It also charges a referral fee to its customers who are referred to lawyers. In order to make its business more appealing to the general public and businesses, the referral service also asks each participating lawyer to discount by 10 percent the lawyer’s usual fees to a referred client until the client is credited with an amount equal to the referral fee that the client paid to the referral service. Because not all participating lawyers agree to discount their legal fees, the referral service cannot guarantee to its customers that their referral fees will be reimbursed to them through the proposed payment arrangement.

Id. The Committee assumed that the referral service in question was provided by non-lawyers, and allowed that lawyers may pay a fee to a lawyer referral service “so long as that fee is not calculated on a per-referral basis.” *Id.* However, the Committee found that a 10 percent discount to the client is a direct payment, which “seems to serve as a pretext for avoidance of the prescriptions of Rule 7.2(c)” and is therefore unethical. *Id.*

For-profit lawyer referral services have gained some approbation from ethics committees where the for-profit entity is a law firm which, as part of its practice of law, refers clients to other attorneys in exchange for a “referral fee,” that is, a rebate of part of the fee collected by the referred attorney. The operative language in NEW RULES 1.5 provides in relevant part:

- (e) A division of a fee between lawyers who are not in the same firm may be made only if:
- (1) the division is in proportion to the services performed by each lawyer or, each lawyer assumes joint responsibility for the representation;
 - (2) the client agrees to the arrangement, including the share each lawyer will receive, and the agreement is confirmed in writing; and
 - (3) the total fee is reasonable.

Id. Under rule 1.5, law firms can divide fees in referred cases provided the requirements of the Rule are met. For purposes of determining the ethical validity of the PIP business model, the relevant ethics opinions are those focusing on whether law firms can create special purpose entities devoted entirely to referrals and whether law firms can be created which limit their activity solely to referrals. In this regard, see Conn., Ethical Op. 01-03 (1/22/01) (approving paying part of a fee by a referred attorney to a for-profit lawyer referral business established and operated by a law firm but as a separate entity). Only one advisory opinion condones the creation of a lawyer referral service whereby the law firm’s sole business is to provide referrals. *See* Philadelphia Bar Ass’n, Op. 93-13 (1993), which addresses the question:

Inquirer represents an attorney who is contemplating starting a for profit attorney referral business to assist members of the public in finding an attorney. A prospective client would not pay a fee to the referral service. The law firm which was retained would pay a referral fee to the referral service for any matters referred by the service to it.

Under the banner of ethics rules, the bar has declared the PIP model, R.I.P.¹⁸⁶

Id. The Committee found that so long as the business started was not something other than a professional corporation, Rule 1.5(e) would allow this fee splitting arrangement amongst lawyers.

The American Bar Association has recently amended the Model Rules, including the rules regulating lawyer referral services. Rule 7.2, as amended, provides:

(b) A lawyer shall not give anything of value to a person for recommending the lawyer's services except that a lawyer may:

... (2) pay the usual charges of a legal service plan or a not-for-profit or qualified lawyer referral service. A qualified lawyer referral service is a lawyer referral service that has been approved by an appropriate regulatory authority. . . .

Id. Comment 6 to amended Rule 7.2 provides:

A lawyer referral service . . . is any organization that holds itself out to the public as a lawyer referral service. Such referral services are understood by laypersons to be consumer-oriented organizations that provide unbiased referrals to lawyers with appropriate experience in the subject matter of the representation and afford other client protections, such as complaint procedures or malpractice insurance requirements. Consequently, this Rule only permits a lawyer to pay the usual charges of a not-for-profit or qualified lawyer referral service. A qualified lawyer referral service is one that is approved by an appropriate regulatory authority as affording adequate protections for prospective clients.

Id. Thus, the amended language is more explicit than the previous version of the Rule in prohibiting for-profit lawyer referral service and would appear to be inconsistent with *Philadelphia Bar Ass'n*, Op. 93-13 (1993), which approved a for-profit lawyer referral service provided that it was operated solely by lawyers. A member of the "Ethics 2000" Commission, which drafted most of the amendments to the Model Rules but not Rule 7.2—the latter changes were drafted by the Standing Committee on Ethics and Professional Responsibility—explains that the amendment allowing referred lawyers to make payments to a service "approved by an appropriate regulatory authority" was meant to "conform the rule more closely to ABA policy favoring expanded consumer access to legal services, while at the same time protecting prospective clients" in the hope that, *inter alia*, "states will establish a regulatory mechanism that ensures unbiased referrals to lawyers with appropriate experience. . . ." See Margaret Colgate Love, *The Revised ABA Model Rules of Professional Conduct: Summary of the Work of Ethics 2000*, 15 GEO. J. LEGAL ETHICS 441, 472 (2002). But it will be easier for a for-profit lawyer referral services to pass through the head of a pin than for them to gain the approbation of the "appropriate regulatory authority" which presumably would be state supreme courts or their delegates. *ABA Standing Committee on Ethics and Professional Responsibility: Report to the House of Delegates*, available at http://www.abanet.org/cpr/ethics-72_75.doc (last visited Nov. 7, 2002) (noting that actual payment by a referred lawyer to a nonlawyer professional is prohibited). Indeed, were state legislatures to set up regulatory authorities to "ensure unbiased referrals to lawyers", Love, *supra*, most state supreme courts would strike down such actions as infringing upon the exclusive authority of state supreme courts to regulate the practice of law. See Charles W. Wolfram, *Toward a History of the Legalization of American Legal Ethics-II: The Modern Era*, 15 GEO. J. LEGAL ETHICS 205, 212-13 (2002).

While ethical codes do not directly apply to non-lawyer entities such as for-profit lawyer referral services operated by lay persons or combinations of lay persons and lawyers, referring lawyers are prohibited from paying the entity a share of the fee obtained since that would violate Rule 7.2(c) and its replacement, Rule 7.2(b)(2), as well as the prohibition of fee-splitting with a nonlawyer as set forth in Rule 5.4.

Finally, the act of determining whether a potential claim should be referred to lawyer A versus B would almost certainly be found to be the practice of law. Accordingly, a for-profit lawyer referral service that was not a law firm would almost certainly be found to be in violation of state laws prohibiting the unauthorized practice of law. For a discussion of the anticompetitive effect of such laws, see Deborah L. Rhode, *Institutionalizing Ethics*, 44 CASE W. RES. L. REV. 665, 726-29; Charles W. Wolfram, MODERN LEGAL ETHICS § 2.41 (1986).

¹⁸⁶ *Requiescat In Pace* (rest in peace) is a prayer for the repose of a dead person.

D. *The Effects of These Impediments And Restriction*

Absent these structural impediments and ethical restrictions, which are means of "maintaining rents for members of the legal profession,"¹⁸⁷ it is likely that price competition in the market for tort claiming services would arise, thereby improving client welfare.¹⁸⁸

CONCLUSION

The evidence and analysis presented in this article supports the thesis that the market for tort claiming services is not price competitive. A variety of indicia of an uncompetitive market have been considered including uniform pricing unjustified by considerations of efficiency or reduction in agency costs, price inelasticity in the face of highly variable production costs and rewards, the level of increase over the past 40 years in the inflation adjusted effective hourly rate realized by tort lawyers and the historical derivation of the standard contingent fee.

Factors which inhibit the emergence of a competitive market have been identified including asymmetrical information with regard to the value of tort claims and quality of lawyering services, daunting if not prohibitive search costs, and price cutting as signaling an inferior or shirking lawyer. In addition, impediments to price competition imposed by the bar have been considered, including barriers to entry, the prohibition of the outright purchase of tort claims, and the use of ethical

¹⁸⁷ Santore & Viard, *supra* note 130, at 570.

¹⁸⁸ See *id.* ("absent . . . [such] ethical restrictions, competition removes the rents [t]hat constraints on competition create and client welfare is improved") One commentator has dismissed the relevance of this analysis to tort reform efforts which seek to counteract the outcomes of lawyers' self-interested strategies, noting that while "the obvious implication of their work is that the rules prohibiting purchase of claims and financing of clients' living expenses should be repealed . . . [b]ecause critics of plaintiffs' attorneys want more regulation, not deregulation, Santore and Viard's article gives them little comfort." Silver, *supra* note 38, at 2093. This critique is overstated. The "rules" that Santore and Viard implicitly criticize are those prohibiting both the full purchase of tort claims and of providing plaintiffs with financial assistance for living expenses. As one of the "critics of plaintiffs' attorneys" referred to by Silver, I do indeed favor the repeal of these anti-competitive rules, contrary to Silver's broad sweeping proposition. However, it does not therefore follow that I am necessarily in favor of "more regulation" to cure contingency fee abuses. I am quite content to enforce current regulations, for example, by adopting the "early offer" proposal referred to *supra* notes 36 and 156, and also in Brickman, *Effective Hourly Rates*, *supra* note 1 at nn. 265-68, which "increase[s] rather than diminish[es] consumer rights, . . . require[s] lawyers to comply with ethics rules[s]. . . [and] alter[s]. . . perverse incentives that encourages lawsuits rather than settlements." See Michael J. Horowitz, *The Road To Reform*, NAT'L REV., Aug. 20, 2001, at 31. Indeed, the "early offer" proposal may be seen to emulate the structure that would occur if there were a competitive market for contingent fee financed tort claiming services.

rules to prevent price competition including prohibitions against providing financial assistance to clients and brokerage of lawyers' services.

Perhaps the most controversial argument I advance to explain the lack of price competition is that lawyers act collusively to maintain a uniform price,¹⁸⁹ aided in that endeavor by a variety of other mechanisms listed above. This assertion is inferred from the fact of uniform pricing coupled with the lack of alternative viable explanations. A more solid basis for the assertion, such as empirical data, would be desirable but I have none to offer.

The explanations I offer for why the market for tort claiming services is not price competitive have a more solid basis. Even here, however, my analysis does not suffice to explain why no competitive models have evolved. Most especially, why tort lawyers do not compete against each other on the basis of price by advertising that they will offer, in select (lucrative) cases, to charge a contingency fee of zero on any amount of recovery up to \$X and a standard contingent fee on any amount of recovery above \$X, where X is a variable representing each lawyer's view about the amount of recovery that is virtually certain.¹⁹⁰ None of the structural impediments or ethical restrictions I consider would appear to preclude advertising such a fee structure. Here, too, I have to fall back to the less-than-satisfying explanation of collusive behavior to account for the failure of such a fee-setting device from having been introduced into the market for tort claiming services.

Whatever the explanation for the absence of competitive pricing in the tort claiming market, there is little reason to expect price competitive behavior to emerge in the immediately foreseeable future. The only way that the barriers that have been erected or which arise as part of the operation of the market may be overcome is by regulation of tort lawyers' behavior.

In theory, the market for tort claiming services is already regulated. Contingent fees are subject to both ethical rules and fiducial principles which limit such fees to "reasonable" amounts.¹⁹¹ In practice, however, the regulatory regimes have proven to be largely devoid of content¹⁹² and serve mostly to displace more effective regulation from outside the bar.

The regulatory change that should be first considered is one that would emulate the market bargain that would result if lawyers competed with each other on the basis of price—as they do in airline crash

¹⁸⁹ See *supra* text accompanying nn.123-24.

¹⁹⁰ This is the method described *supra* note 173.

¹⁹¹ See *supra* notes 19-21.

¹⁹² See *supra* note 26.

litigation.¹⁹³ That is, a fee agreement in which lawyers would not apply the standard contingency fee to the value of a claim that existed prior to the lawyer adding value to the claim; instead, the lawyer would apply a standard (or a variable) contingent fee only to the amount of any recovery added to the value of the claim as it existed before the lawyer's efforts augmented the claim value.

For such a regulatory approach to be implemented, it would have to be self-effectuating, require no additional bureaucracy for its enforcement and impose no significant transactional costs. These attributes are achieved in the "early offer" proposal that others and I have advanced.¹⁹⁴ The proposal would prohibit plaintiff lawyers in personal injury cases from charging standard contingency fees where alleged responsible parties made early settlement offers before the lawyer added any significant value to the claim. Instead, the lawyer would be restricted to charging an hourly rate fee for the effort required to notify the allegedly responsible party of the relevant details of the claim. If an early settlement offer were rejected and a subsequent settlement or judgment was obtained, the lawyer would apply a contingent percentage to the amount in excess of the early offer.

While this proposal, intended for adoption by state legislatures as an anti-price gouging consumer protection statute and by state supreme courts as part of the ethical code regulating lawyers' behavior,¹⁹⁵ would only address a small configuration of the problem identified, it would nonetheless constitute a significant step towards wresting control of the tort claiming market from those who impose limits on price competition and benefit from its absence.

¹⁹³ See *supra* section V.

¹⁹⁴ See BRICKMAN ET AL., RETHINKING FEES, *supra* note 156; see also *supra* notes 36 & 156; see generally Michael Horowitz, *Making Ethics Real, Making Ethics Work: A Proposal For Contingency Fee Reform*, 44 EMORY L.J. 173 (1995).

¹⁹⁵ See Adam Liptak, *In 13 States, A United Push to Limit Fees of Lawyers*, N.Y. TIMES, May 26, 2003, at A10.