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An Alternative to the Contingent Fee©

*Harold See**

I. Introduction

The most frequent attack on the contingent fee is that it is "unprofessional."[1] Support for the contingent fee has been based on the argument that it encourages the lawyer to work harder because the lawyer's own compensation depends on the outcome of the case[2] and on the argument that it enables a poor person with a valid claim to secure representation.[3]

The attorney-client relationship is built on a foundation that assumes certain incentives operate on the parties. The Code of

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1. *See* F. B. MacKinnon, Contingent Fees for Legal Services 4 (1964).

2. *Id.* at 3; *cf.* Kriendler, *The Contingent Fee: Whose Interests Are Actually Being Served?*, 14 Forum 406 (1979) (advocating use of contingent fees on basis that it encourages attorneys to work efficiently, economically and quickly). Others have noted, however, that "[i]t is assumed that a lawyer will be as scrupulous and honorable in the performance of his duties, and that he will labor as devotedly and diligently in the interest of the client, whether he is paid an absolute fee or whether his compensation hinges on the successful outcome of the lawsuit." Marine Midland Trust Co. v. Forty Wall St. Corp., 13 A.D.2d 118, 125, 213 N.Y.S.2d 689, 695, *aff'd without opinion*, 13 A.D.2d 630, 215 N.Y.S.2d 720 (1961). *See* Model Code of Professional Responsibility, Canons 6 & 7 and accompanying Ethical Considerations and Disciplinary Rules (1981).

3. F. B. MacKinnon, *supra* note 1, at 5; 1 S. Speiser, Attorney's Fees § 2:3, at 84 (1973); Aronson, *Attorney-Client Fee Arrangements: Regulation and Review*, 68 A.B.A. J. 284, 286 (1982); Clermont & Currivan, *Improving on the Contingent Fee*, 63 Cornell L. Rev. 529, 567 (1978). That principle is expressly recognized in the Model Code of Professional Responsibility EC 5-7 (1981), which states:

> The possibility of an adverse effect upon the exercise of free judgment by a lawyer on behalf of his client during litigation generally makes it undesirable for the lawyer to acquire a proprietary interest in the cause of his client or otherwise to become financially interested in the outcome of the litigation. However, it is not improper for a lawyer to protect his right to collect a fee for his services by the assertion of legally permissible liens, even though by doing so he may acquire an interest in the outcome of litigation. Although a contingent fee arrangement gives a lawyer a financial interest in the outcome of litigation, a reasonable contingent fee is permissible in civil cases because it may be the only means by which a layman can obtain the services of a lawyer of his choice. But a lawyer, because he is in a better position to evaluate a cause of action, should enter into a contingent fee arrangement only in those instances where the arrangement will be beneficial to the client.

Professional Responsibility attempts to assure that the incentives for attorneys are consistent with the interests of the client and that undesirable incentives operating on the attorney are counteracted.[4] The success of the adversary system is premised on the attorney's wholehearted representation of his client. Inherent in a typical contingent fee arrangement, however, are tensions that frequently result in a conflict of interest between attorney and client. This article examines that conflict from an economic and fairness perspective and suggests the "risk adjusted hourly fee" as a means of more equitably aligning client and attorney interests.

II. A Consideration of Contingent Fees

The typical contingent fee arrangement provides that the attorney will receive a percentage of the recovery. For example, the attorney may arrange to receive 33% of the recovery if the case is settled before trial, a higher percentage if the case goes to trial and, perhaps, a still higher percentage if the case is appealed. If the case is particularly attractive, that is, if little work is required or there is a high probability of a large return, lower percentage fees may be established. If there is a high probability of a low return, but also a possibility of a high return, the attorney may arrange to take a different percentage depending on the recovery. For example, the attorney may receive 75% of the first $10,000, 50% of the next $25,000, and 25% of any recovery above $35,000.[5] The fundamental feature of the contingent fee, however, remains the same—compensation to the attorney is contingent only on outcome, not on the amount of work performed.

Because the attorney's compensation is based on the outcome alone, the contingent fee gives rise to a conflict between the attorney and the client. Far from giving the attorney an incentive to work harder, the contingent fee may act to discourage the investment of attorney time. Because the attorney, not the client, is doing most of the work, the profit configurations of attorney and client differ.[6] For example, an attorney on a one-third contingent fee

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4. *See infra* note 16.

5. In principle, it is possible to combine charging higher contingent fees for taking the case to trial and appeal with fees that are skewed depending on recovery. In practice, however, that is rarely done, probably due to the complexity of such a schedule.

6. We are assuming simply that the client wishes to maximize his recovery net of his investment of effort and that the attorney similarly wishes to maximize his income net of the cost of his labor and overhead. Expenses for which the client is responsible, but which are seldom collected in the event of no recovery, are ignored.

who, with one hour's work, can settle an $18,000 claim for $9000 realizes a fee of $3000 per hour (one-third of the $9000 settlement for one hour's work). Another twenty hours of discovery and negotiation to push the settlement up to $10,000 results in an overall return of "only" about $159 per hour (one-third of $10,000 = $3333 for 21 hours work, or $158.73 per hour). That is still a high hourly return, but the net return on each of those twenty additional (marginal) hours is less than $17.[7] Thus, the attorney who can reach a moderate settlement with little work rather quickly reaches the point where additional work to improve the settlement is no longer sufficiently remunerative because alternative uses of time will yield higher returns. In the example above, the twenty hours additional work needed to generate a $1000 increase in the settlement results in a marginal hourly return to the attorney of $17. If alternative legal work is available at a higher hourly rate, however, the attorney is likely to settle the case for $9000 or, if the client will not settle, to avoid spending time on the case.[8]

For the client, the profit configuration is quite different. Because the attorney is doing the work, the additional twenty hours of discovery and negotiation will result in a return of $667 at virtually no additional cost—a phenomenal rate of return.[9] In practice,

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7. Twenty hours work produced an extra $1000, or $50 per hour, one-third ($17) of which goes to the attorney. The $17 figure is an "average marginal" figure. That assumes a discrete functional relationship between hours worked and result. In other words, it assumes that fewer than twenty hours work will produce no increase in the settlement. If each hour devoted to the case is expected to increase the settlement (or to increase the expected value of the judgment) by some amount, then each additional hour will have its own marginal value and the functional relation between hours worked and value of outcome will be more nearly continuous. In such a case there will come a point, depending on these marginal values, at which it will no longer be in the lawyer's interest to invest additional time. For such an analysis, *see* Schwartz & Mitchell, *An Economic Analysis of the Contingent Fee in Personal Injury Litigation*, 22 STAN. L. REV. 1125 (1970).

8. That is, the lawyer's effort could be devoted to alternative uses that are valued more highly than the value (increased settlement) that is created from devoting the effort to this case. For example, the lawyer might be able to increase the recovery by $100 if another 50 hours were devoted to the case. This would be worth $67 to the client and might cost the client little or nothing. Yet 50 hours of the lawyer's time for compensation of $33 is substantially below the minimum wage. One can imagine that there are other matters that the lawyer might have pursued, and that those matters would have been valued much more highly by their beneficiaries than $100.

9. *See* Schwartz & Mitchell, *supra* note 7, at 1139. The authors compare the optimal number of hours devoted by the attorney in a contingent fee case with the number of hours for which a client with perfect knowledge would contract and conclude that, at least in the absence of risk, "[t]he contingent fee, therefore, does not put the lawyer on the client's side but creates a gap between the lawyer's and client's best interests." *Id.*

The profit configurations of the attorney and the client can be demonstrated more formally. Let the subscript p denote the party and c denote the counsel.

of course, there may be some costs to the client in the form of time and expenses incurred and lost wages. Every day the client goes without the settlement also is another day without the money that has been offered. The cost of the anxiety over the lawsuit and its possible outcome may be particularly heavy if bills are piling up and creditors are demanding payment. If the attorney takes no action on the lawsuit, those costs increase, encouraging the client to accept the settlement offer.

The client also may suffer costs imposed by the defendant. For example, defendant's counsel may schedule depositions of plaintiff and plaintiff's family to increase the costs to both the party and his attorney, thereby encouraging settlement.[10] Wages lost because of work missed by the client and the anxiety of the deposition will likely serve as significant indirect costs to the client.

In the manner illustrated, costs may be imposed on the client

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(1) $R_p \equiv$ Expected revenue to the party. This is a function which yields a probability distribution of returns, but we may think of it as an expected value.

Assume that

$R_p = R_p(n, a, w_p, w_c)$, where

$n \equiv$ nature of the evidence

$a \equiv$ characteristics and preferences of the party,

$w \equiv$ work performed by the party ($_p$) and the counsel ($_c$).

Assume further that

$R_c = R_c(R_p)$, e.g., $R_c = 1/3\ R_p$.

(2) $C_p \equiv$ Cost to the party.

Assume that

$C_p = C_p(R_c, E_p, A, F_p, w_p)$, where

$E_p \equiv$ expenses payable by the party,

$A \equiv$ anxiety and other emotional costs,

$F \equiv$ income foregone.

Assume further that

$C_c = C_c\ (E_c, F_c, w_c)$.

The party maximizes profit by maximizing $R_p - C_p$. Assuming that he has no control over n or a, and assuming a positive relation between w and R_p, he can increase R_p by increasing w_p and w_c. He can minimize C_p by controlling E_p and w_p. Since w_c is not an argument in his cost function, the party has an interest in increasing w_c indefinitely.

The attorney maximizes profit by maximizing $R_c - C_c$. The w_c is a major component of the attorney's cost function; thus, he can be expected to maximize profit at a significantly lower level of w_c. Assuming that the attorney has another means of generating revenue from his labor, R_c', which may be other contingent fee cases or flat hourly work, when the marginal return on the first (contingent fee) case, $\partial(R_c - C_c)$, falls to the level of the marginal return on alternative uses of w_c (or leisure), $\partial(R_c - C_c) = \partial(R_c' - C_c')$, it is in the attorney's interest to stop devoting time to that case.

10. Of course, the attorney can minimize his investment in the case by shifting as much of that burden as possible onto others—the client, secretaries, paraprofessionals or lower paid associates.

as well as on the attorney, although there is no necessary relationship between the two.[11] In summary, in a contingent fee arrangement the attorney is forced into a conflict of interest with the client because the client is not accountable for any of the cost of additional legal work. If the attorney is required to comply with the wishes of the client, the client in effect treats the expenditure of attorney time as if it has zero cost. On the other hand, if the client is required to comply with the wishes of the attorney, the client is compelled to accept a settlement based on the attorney's own marginal values rather than those of the client himself.

From an economic perspective, neither option results in a socially optimal distribution of resources. The client "wastes" (uses too much of) the lawyer's time by requiring the expenditure of work that has a marginal value (opportunity cost) greater than its marginal productivity.[12] The lawyer, on the other hand, frequently chooses to devote too few hours to the case, as he stops devoting effort to the case before the marginal productivity of the effort (to the attorney and the client taken together) has fallen to the marginal value (opportunity cost) of that labor.

It is critical to the success and legitimacy of the adversarial process that the incentives operating on the attorney and the client be consistent. For example, the attorney is relied on to construct an adequate foundation of evidence to properly handle the case, yet the contingent fee, because it is "fixed" regardless of effort, creates an incentive on the attorney to limit his expenditure of effort. From an economic perspective, penalties are essentially interchangeable with subsidies. If the client does not wish to settle but the attorney wishes to settle, in order to align their economic interests the attorney could pay the client to agree to settle, as the consent of the client is required, or the client could pay the attorney to agree to do more work. Neither option, however, is viable in our society under a contingent fee arrangement. Thus, the economically equivalent alternative is for the client to harass, cajole, threaten or otherwise penalize the attorney for inaction in order to

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11. For example, compare: $C_p = C_p(R_c, E_p, A, F_p, w_p)$, while $C_c = C_c(E_c, F_c, w_c)$. The arguments of the functions are completely different. Of course, there may be some correlation between w_c and w_p because, e.g., the party's effort may be required to allow or compel the attorney to do more work, and between E_c and E_p, and between E and w generally. Also, there will be a correlation between F_p and F_c, since they undoubtedly depend on the decision of the adverse party to pay. In contrast, if the attorney is engaged on an hourly basis, the monetary cost to the client will vary directly with the work done by the attorney.

12. *See supra* note 8 and accompanying text.

get the attorney to do more work or for the attorney to impose costs or allow costs to be imposed on the client in order to compel a settlement. It should be remembered that this misalignment of economic interests is virtually inevitable because it is in the client's interest for the lawyer to expand his efforts on the case indefinitely.[13]

The traditional contingent fee, which allows the attorney a percentage of the recovery, is seriously flawed. To abandon it in favor of the traditional hourly fee, however, is not the answer. The contingent fee approach provides a means of securing representation otherwise not available for many.[14] Also, the hourly fee arrangement itself is not free from criticism.[15]

Nor does the solution to the conflict of interest between attorney and client lie in a disciplinary rule admonishing the lawyer to pursue the objectives of the client. That is already done both in

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13. It should also be noted that even if the attorney were to expand his efforts indefinitely—or to the point where no additional work remained to be done on the client's claim—there remains a conflict among the interests of different clients. It is inevitable that if the attorney has more than one client at one time, either the total amount of time available or the specific time available will be insufficient to meet the needs of all clients. How should such limited time (a scarce resource) be allocated among claims? The incentive on the attorney is to allocate the time based on his own perceived marginal profit configuration. For such an analysis, *see* Nagel, *Attorney Time Per Case: Finding an Optimum Level*, 32 FLA. L. REV. 424 (1980).

14. The contingent fee allows the poor client to obtain counsel of his choice. For this purpose there are two important distinctions between hourly and contingent fees. First, from a legal perspective, a contingent fee is an advance to the client. If such advances and guarantees to clients are prohibited, then as a practical matter the poor client is deprived of the opportunity to be represented. Banks and other financial institutions are unlikely to make loans against claims that they can neither evaluate nor control. Only an attorney who is willing to assume the case is in a position to evaluate the claims and decide how much of an advance it is worth. Second, from an economic perspective, the contingent fee provides compensation for the assumption of risk. A person with a claim who cannot secure a lawyer on an hourly basis does not become able to secure a lawyer because he or she offers to pay a fee contingent on the outcome. Rather, such a person becomes able to secure a lawyer because he or she offers a sufficiently large fee to compensate for risk. The contingent fee, by creating an asset in which the poor plaintiff can transfer a large interest, thereby enables the plaintiff to secure representation.

15. *See* Clermont & Currivan, *supra* note 3, at 540-43. The hourly fee generates a fixed amount of revenue to the attorney regardless of its value to the client. If one assumes that the party can determine the value of the attorney's work, then there is no problem, because the party would not authorize attorney work unless the value of that work exceeded its cost. Unfortunately, the party may lack sufficient information to make that decision. However, an attorney generally charges a uniform hourly rate to all clients. Thus, there is no incentive to overwork on any particular claim. In fact, the only time there is an incentive to overwork any case is when the attorney has a shortage of work. *See infra* note 51 and accompanying text. And in that case, the attorney must consider the effect of overbilling on future business, unless one assumes complete ignorance on the part of potential clients.

the Code of Professional Responsibility and in the Model Rules of Professional Conduct.[16] Moreover, if the attorney is compelled to yield to the client's wishes, the client's interest in requiring work from the attorney is likely to discourage the attorney from accepting a contingent fee arrangement, thereby damaging the legal system by denying representation to some potential clients. Nor would it be satisfactory to require the client to defer to the wishes of the attorney, as such a rule would discourage adequate preparation of the case.

Another means of rectifying the inconsistent economic interests of attorney and client in contingent fee arrangements would be for the client to offer additional compensation to the attorney to induce additional work. The Coase Theorem states that if there are no costs or barriers to negotiation between the attorney and the client, the client and the attorney should be able to arrive at a split of the recovery that would be economically appealing to both.[17] Assume an attorney can obtain a $9000 settlement with one hour's work but another twenty hours of work will increase the settlement to $10,000. In addition, assume the attorney values his

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16. The Code of Professional Responsibility requires the attorney to pursue competently the objectives of the client. MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 6 & DR 7-101(A) (1981). The Model Rules of Professional Conduct provide the same mandate. MODEL RULES OF PROFESSIONAL CONDUCT 1.1-1.2 (1983). Moreover, the client is given the final authority to discharge the attorney, MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-110(B)(4) (1981) and MODEL RULES OF PROFESSIONAL CONDUCT 1.16(a)(3) (1983), or to settle the claim, Raabe v. Universe Tankships, 263 F. Supp. 786, 787 (S.D.N.Y. 1966) (client has absolute right to settle case without consent of attorney) (citing *In re* Snyder, 190 N.Y. 66, 82 N.E. 742, 744-45 (1907)); ABA Comm. on Professional Ethics, Informal Op. C-455 (1961) (attorney may not withdraw from case merely because client refuses to accept the settlement obtained). *See, e.g.*, Harrop v. Western Airlines, Inc., 550 F.2d 1143, 1145 (9th Cir. 1977) (under California law, attorney must have express authority from the client to enter a settlement agreement that is binding on the client); Singleton v. Foreman, 435 F.2d 962, 970 (5th Cir. 1970) (under Florida law, attorney never has the right to prohibit client from settling an action in good faith). Although the attorney may not force the client to accept or prohibit him from accepting a settlement, in some cases where a contingent fee was involved, the attorney was able to recover his percentage of the settlement when the client refused to abide by the settlement agreement after accepting it. Lytle v. Commercial Ins. Co. of Newark, 285 So. 2d 289, 293 (La. Ct. App. 1973); Doucet v. Standard Supply & Hardware Co., 250 So. 2d 549, 551 (La. Ct. App. 1971). *But cf.* Harrison v. Gooden, 439 F.2d 1070, 1072 (1st Cir. 1971) (where settlement found not binding on client, attorney not entitled to fee).

17. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1961); *see also* C. GOETZ, LAW AND ECONOMICS: CASES AND MATERIALS 52 (1984) ("*where there are no obstacles to transacting*, legal rights will tend ultimately to be allocated . . . to the party that values them most highly") (emphasis in original); R. POSNER, ECONOMIC ANALYSIS OF LAW 35 (1977) (if there are no transaction costs, "value-maximizing accommodation . . . will be adopted whichever party is granted the legal right to exclude . . . the other").

time at $45 per hour. If the work is performed on an hourly contract, clearly the client will have the attorney put in one hour of work, as one hour will cost the client $45 and will produce $9000 in income. Will the client have the attorney put in the next twenty-hour block of time? That would cost $900 (20 hours x $45 per hour = $900) and would generate an extra $1000 in income. Again, the client would decide to have the extra twenty hours of work performed in order to generate a net income to the client of $100.[18]

Suppose, on the other hand, that the attorney is on a one-third contingent fee. He still values his time at $45 per hour. Thus, he works the first hour, which costs the attorney $45 (the value to him of his time). The result is a recovery of $9000. As his fee is one-third of the recovery, the attorney's income is $3000. The hour of work has cost $45 but has resulted in income of $3000. To generate another $1000 recovery will cost the attorney twenty hours of work, valued at $45 per hour, or $900. But the attorney will receive only $333 of the recovery. Therefore, he will choose not to perform the additional work. However, we have neglected the client. The extra work by the attorney would generate $667 in income to the client and cost the client nothing. The client, therefore, would decide to have the attorney do the extra work. That is the conflict of interest previously mentioned. But if the client is free to negotiate with the attorney, it is in the client's interest to offer to part with a share of the $667 to which he would be entitled in order that he might receive something. The cost of twenty hours of work to the attorney is $900, while the return is $333. Thus, the cost is $567 greater than the return ($900 - $333 = $567). To induce the attorney to do the additional work would require a payment of at least an additional $567. Because the client would profit by $667 if the work were done, theoretically the client would be willing to pay the attorney that $567. After the payment, the attorney would perform the additional twenty hours work, receive his $333 plus the $567 bonus, and the client would still be $100 better off than had the work not been performed.

Based on that theoretical model, the number of hours spent by the attorney will be the same regardless of whether the fee is hourly or contingent. Moreover, the specific percentage of the fee also is irrelevant. For example, in a fifty percent contingency arrangement the attorney would receive $500 at a cost of $900. The client would receive $500 and be willing to pay the attorney his

18. For the sake of simplicity, risk and delay are ignored in this example.

$400 deficit leaving a $100 profit for the client. The reason that works out—and it works out in all cases, given the assumption of no barriers to negotiation—is that the costs and the return are the same regardless of ownership of the claim. No matter what the fee arrangement, the cost of the labor is twenty hours at $45 per hour, or $900, and the return is $1000. Because, in this example, the return is greater than the cost of labor necessary to get that return, it always will be profitable to incur the additional cost. Therefore, if there are no barriers to the division of that profit between the attorney and client, they will agree on some division and the twenty hours work will be performed.

Although the logic of the Coase Theorem is appealing, there are strong social and informational barriers to lawyer surcharges for additional work in contingent fee cases. At the very least, it would be difficult and costly to determine whether the attorney has worked the number of hours which will maximize his net return. Moreover, information on the need for and the likely productivity of additional hours of attorney work is in the possession of the attorney and not in the possession of the client. The cost to the client of obtaining that information (e.g., hiring another attorney to examine the file and give an expert opinion on the probable value of hours devoted to the case, and of additional hours which may be devoted to the case) is in all likelihood prohibitive. Even if such information were easily and cheaply available, attorneys who propose surcharges for work beyond that which maximizes their expected returns would have to contend with the ill will such a practice may generate with clients and potential clients, the hostility that courts might feel toward such a contract, and the professional attitude that the quality of an attorney's work should be independent of the fee charged. The situation we are contemplating speaks for itself: the attorney has agreed to handle the case for a percentage of recovery, let us say one-half. The attorney now approaches the client and says, "I believe I can get another $1000, but it's not worth it to me to do it unless you agree to give me $900 of that $1000." What is the likely reaction of the client, the bench and the bar? Even a contract term designed to handle that situation likely would face severe scrutiny.

In addition to the social and informational barriers that inhibit the operation of the Coase Theorem, there are significant wealth distribution effects with which we may be concerned. That is, if the attorney is permitted to demand a surcharge, we have given the attorney a greater property right in the claim. Although

fees on average may be expected to take into account whether the attorney has the right to demand a surcharge for additional work (i.e., to refuse to do additional work), it can make quite a difference in a particular case. Consider the case we have been discussing in which twenty additional hours (valued at $900) will generate $1000 of recovery of which the attorney is entitled to $500. If the attorney may demand a surcharge, the (rational) client will pay $400 to induce the attorney to devote the extra twenty hours to the case. This will net the client $100. If, on the other hand, the attorney is obliged to do the extra work without a surcharge, the client will receive $500 (rather than $100). This extra $400 to the client comes from the attorney who invested $900 worth of time for an additional $400 fee. Which one—attorney or client—is "entitled" to the $400, or for that matter to the rest of the recovery, is a question of fairness of the distribution that is discussed below.[19]

Others have struggled with the distorted economic incentives of the contingency fee and have proposed alternatives. Kevin M. Clermont and John D. Currivan ("C&C"), in their article *Improving on the Contingent Fee*, propose the "contingent hourly-percentage fee"[20] ("ch-p" fee). There are two elements of the ch-p fee: (1) it is paid only in the event of recovery and (2) it is composed of a regular hourly fee component and a percentage of the difference between the total recovery and the total hourly fee component.[21]

After presenting the strengths and weaknesses of the hourly fee and of the traditional contingent fee,[22] C&C propose combining the two so that the ch-p fee is the normal hourly fee plus a percentage (C&C assume 5-10%) of the difference between the total recovery and the hourly fee.[23] Such a combination, according to C&C, results in certain advantages: the elimination of exorbitant profits; the rewarding of attorneys for effective representation; and the alignment of economic interests between attorney and client.[24] Each of those advantages will be examined briefly in turn.

First, C&C argue that the ch-p fee proposal eliminates exorbi-

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19. *See infra* notes 34-37 and accompanying text.

20. Clermont & Currivan, *supra* note 3, at 530, 546-47.

21. *Id.* at 546-47. If the total hourly fee component is larger than the total recovery, then the percentage component is zero. *Id.*

22. Clermont & Currivan note, for example, that the lawyer may overreach in setting the fee. *Id.* at 577. Other disadvantages of the contingent fee have been noted above. *See supra* notes 6-13 and accompanying text.

23. Clermont & Currivan, *supra* note 3, at 546-47.

24. *Id.* at 547, 578-79.

tant profits that a contingent fee may yield in certain cases.[25] That occurs because the ch-p fee is based on hourly fees combined with a low percentage of the net recovery. As a result, the recovery by the attorney more accurately reflects the cost of his services.[26] However, even though C&C propose a 5 to 10% component of the fee, they also state that an alignment of interests could occur with any combination of hourly rate and percentage fee.[27] Although that should be apparent, consider the effect of a higher percentage component. Assume the attorney's charge is an hourly rate of $50 plus 33% of the difference between the hourly charge and the total recovery. If it takes one hour to secure a $10,000 settlement, the attorney will receive $50 plus 33% of $9950, or $3366.67 for one hour's work. The assertion that the ch-p fee proposal eliminates exorbitant attorney profit is accurate only if the percentage component is *required* to be low. Even at C&C's 10% figure the attorney fee would be $50 plus 10% of $9950, or $1045 for one hour's work. It is certainly true that in reducing exorbitant fees, a low percentage ch-p fee is preferable to a high percentage traditional contingent percentage fee, but the key difference is not the nature of the fee but whether the percentage is high or low.

Second, C&C argue that the ch-p fee rewards the attorney for effective representation in the same manner that a straight percentage fee does, "thus giving him a direct economic incentive to work as diligently and efficiently as possible."[28] The attorney is rewarded financially only when there is a favorable result. Because the fee is determined, at least in part, by the amount of the recovery, the larger the recovery, the more the attorney receives. That statement is true, but what C&C do not make explicit is that the attorney's share of the reward depends directly on the particular percentage chosen. Therefore, the particular percentage selected determines the strength and effectiveness of the incentive on the attorney. Just as a traditional contingent percentage fee of 50% rewards the attorney twice as much as a 25% fee and thereby gives the attorney twice the incentive to increase the award, so a 10% contingency element in a ch-p fee gives the attorney much less an incentive than would a larger percentage component. Quite simply, the incentive for the attorney to increase the award depends on the share of that award that will go to the attorney.

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25. *Id.* at 579.
26. *Id.*
27. *Id.* at 547.
28. *Id.* at 578.

Third, C&C contend that the ch-p fee aligns the economic interests of the attorney and the party.[29] They demonstrate that by using the ch-p fee, the attorney maximizes his profit by working precisely the same number of hours worked, which will maximize the recovery to the client.[30] C&C argue, therefore, that the ch-p fee efficiently harmonizes the interests of the attorney and the client.

The extent to which that occurs, however, depends on the strength of the incentives that motivate the parties to harmonize their interests. Two elements act as incentives in the ch-p fee: the percentage rate chosen and the base hourly fee. As those components rise or fall, the strength of the incentives promoting harmonization of the interests of the attorney and the client vary. Thus, as the number of hours devoted to a case increases, two things happen: (1) the fee component based on hours devoted to the case increases; and (2) the fee component based on percentage of recovery decreases in absolute terms and also in terms of recovery per hour devoted to the case. For example, assume that the award for either one hour or two hours of work is $10,000. The results are as follows:

Award Amount	Hours Spent	Hourly Charge	Percentage Charge (@ 10%)	Percentage Fee Per Hour	Total Fee
$10,000	1	$ 50	(10,000 - 50) (10%) = $995	$995	$1045
$10,000	2	$100	(10,000 - 100) (10%) = $990	$495	$1090

Although the total fee has increased, note that it has increased by only $45.[31] We assumed an hourly fee of $50. The $45 increase in the total fee is 10% less than the attorney could earn in alternative hourly employment. That decrease occurs because the extra $50 hourly charge has reduced the difference between the total recovery and the total hourly charge. The 10% decrease is not coincidental. It is less by 10% because by subtracting the extra $50 from the recovery, the attorney did not receive 10% of the value of that $50.

There are two important facts to note. First, the level of the hourly and percentage components will define the cost to the attorney of working extra hours. The incentive not to work extra hours depends, therefore, on the level of the hourly fee and the percentage selected. Second, the lower the percentage component, the

29. *Id.*

30. *Id.* at 546-50.

31. Note also that had the extra hour of work increased the award to $11,000, the fee would have increased to $1190 (that is, $50/hour x 2 hours = $100; 10% of ($11,000 - $100) = $1090; $100 + $1090 = $1190). That would be a fee increase of $95 for an hour's work.

more closely the hourly rate must approach the value of alternative hourly employment if the attorney is to be induced to work an optimal number of hours.[32]

In fact, the attorney would be expected to shift to hourly work before his ch-p fee reaches the C&C optimal level of employment. That will occur because the ch-p fee is contingent but the hourly fee on alternative work is not. Therefore, the number of hours at which the attorney is indifferent between hourly and contingent work is *not* the point at which the marginal return on contingent work is $50. Given the choice between earning an essentially guaranteed $50 or an uncertain $50, one would expect the ordinary risk averse attorney to select the hourly work. Therefore, the point at which the incentive is to shift to fixed fee work will depend on the degree of risk aversion of the particular attorney, but in all cases involving risk averse attorneys, that point will occur before the point in a fixed fee case at which the fully informed client would choose to have the attorney stop work on the case.

In summary, the ch-p fee provides a compromise between the standard hourly fee and the traditional contingent fee. It provides an incentive to the attorney to work diligently and efficiently but that incentive varies *directly* with the size of the percentage component. It also provides the attorney with an incentive to work a number of hours that approaches (depending on the degree of risk aversion of the particular attorney) the number of hours the client would choose for the attorney to work but that incentive varies *inversely* with the size of the percentage component. The ch-p fee, therefore, cannot be expected to fully achieve those two objectives simultaneously. Of course, one may prefer the ch-p compromise at some particular percentage component (say 10%) to the alternatives of a fixed hourly rate or a traditional contingent fee. An overall preference for the ch-p fee, however, should not be based on the belief that such a fee will effectively produce efficiency both in terms of the work product of the attorney and the preferences of the client.

We have demonstrated that the ch-p fee does not eliminate exorbitant fees. It does, however, have the tendency to do so to the

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32. If the attorney has idle time, then either the hourly rate must be equal to the attorney's implicit price for leisure or the percentage must be large enough to force the overall compensation to that level. Similarly, if the attorney has regular hourly work that will generate $40 per hour, but on contingent cases charges a $50/10% ch-p fee, the incentive will be to work extra hours at $45 rather than to switch to hourly work.

extent that the percentage component selected is small.[33] That is the same manner in which the traditional contingent fee may be said to eliminate exorbitant fees: if the percentage is small enough the fee will not appear disproportionate to the work done. However, that is not the nature of the objection to large contingent fee recoveries. The issue is not one of efficiency but one of the fairness of the distribution of ownership of a claim between the client and the attorney.[34] The fundamental weakness of both the ch-p fee and the contingent fee is that neither approach is designed to produce a fair split of a legal claim. F.B. MacKinnon, in his classic work on the contingent fee,[35] devotes his penultimate and longest chapter to *The Fairness of Contingent Fees*. His conclusion is as follows:

> Taken as a whole, the problem is essentially one of assessing the "fairness" of a fee which is out of proportion to the work done on a particular case. However, when this fee is put with many smaller, compensatory fees, with noncompensatory fees on fully tried, difficult cases, and with instances of no recovery, it contributes to a picture of legal services which are not as a whole unreasonably priced performed by a bar with a modest average income.
>
> From the point of view of the individual lawyer, it appears that to earn a reasonably high income he must not only charge a contingent fee which takes account of the risk of no recovery at trial but must also handle a good proportion of moderate-sized claims which are settled at an early stage of the proceedings, when the risk of loss is small.
>
> Part of the difficulty of the problem of judging the fairness of the contingent fee system in personal injury litigation arises from the existence of two different principles of "fair" pricing. On one hand, if the fee in the individual case is examined according to the usual methods of measuring the value of legal services, any recovery by the lawyer over that value is "unfair." This aspect of the matter is strengthened by the tradition of the legal profession to deal with each client's case as a unique transaction. And, because the client usually will not have more than one personal injury case, it is not

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33. *See supra* notes 25-28 and accompanying text.

34. *See* F.B. MacKinnon, *supra* note 1, at 196 ("It would seem, in spite of the general protestations of courts to the contrary, that there is a joint ownership of the claim, with the lawyer acting as managing partner"). In a speech delivered on August 5, 1984, at the dedication of the new headquarters of the American Bar Association, Chief Justice Warren E. Burger questioned the fairness of contingency fees in cases where there is little or no dispute about liability. Ranni, *Burger, Trial Bar Clash Over Contingent Fees*, Nat'l L.J. Aug. 20, 1984, at 7, Col. 1; Margolick, *Burger Assails Lawyers' Ads and Contingent Fees*, N.Y. Times, Aug. 6, 1984, at 20, col. 2.

35. F.B. MacKinnon, *supra* note 1.

> possible to argue that, as to him, the fees will average out at a fair figure.
>
> On the other hand, when the mass of cases is taken as a whole, the idea of using overcharges to some clients to offset undercharges to others does not seem an unfair way to support a system of providing competent legal services to clients who need them, assuming there is no feasible alternative system.[36]

Such an argument for overcharging may be applied to all sorts of situations in which the opportunity to exploit the ignorance or misfortune of another presents itself. Most lawyers are familiar with the story of the old successful trial attorney who tells the graduating law student that when he was young and inexperienced, trying cases against older more experienced adversaries, "I lost many cases I should have won," but as he grew older and more experienced, and by comparison his adversaries grew younger and less experienced, "I won many cases I should have lost, so on the average, justice was done." Neither fairness nor justice is averageable. Such a defense would not be available to a merchant or a physician and should not be available to an attorney. An excessive fee to one client cannot be made fair by undercharging another client.[37]

III. The Risk Enhanced Fee

The primary problem with the traditional percentage contingent fee is rooted in the "fixed" nature of the fee.[38] That is, unfairness results from the fact that the fee does not increase with added work. Whether a $45,000 settlement is obtained after an hour's work, one hundred hours' work, or one thousand hours' work, the attorney on a percentage fee receives a fixed return. On a one-third percentage fee, for example, the attorney would receive (ignoring expenses) $15,000; or, on a per-hour basis, $15,000, $150, or $15, respectively. However, the risk that is actually assumed by the lawyer in a contingency fee case varies with the time invested in the case. In the example used above the lawyer devoted one hour, one hundred hours, or one thousand hours to obtain a $45,000 settlement. The amount at risk for the attorney (assuming a $50-per-

36. *Id.* at 182.

37. MacKinnon treats the system as an "insurance" system. *Id.* at 182-83. But one must question whether an "insurance" principle is proper in a situation in which the "insurer" is selling his skill to control the probabilities of success in the particular case.

38. *See supra* notes 6-13 and accompanying text.

hour fee as a measure of the value of the work) is $50 in the first case, $5000 in the second case, and $50,000 in the third case. Thus, an attorney's decision to devote an additional hour to a case simultaneously involves a decision to place the value of an additional hour's work at risk. Yet under the traditional percentage fee, a greater investment put at risk by the attorney frequently results in less compensation for that risk (i.e., there is a smaller difference between the usual attorney fee and the investment).[39]

The same principle applies to the ch-p fee. The percentage component, which is the risk compensation component of the fee, is fixed at 10%. In the above example, the reward for risk is, respectively, $4495 for one hour invested (10% of the difference between $45,000 recovery and $50 hourly charge), $4000 for one hundred hours invested (10% of the difference between $45,000 recovery and $5000 hourly charge), and $0 for one thousand hours invested. (In the latter instance there would be no compensation for risk because the total hourly charge exceeded the amount recovered. In fact, one would not expect 1000 hours to be devoted to the case under either a traditional contingent or a ch-p fee system.) Under both the traditional contingent fee and the ch-p fee, compensation for risk varies inversely with actual risk assumed.

In order to maintain the advantages of the contingent fee and to remove the primary cause of maldistribution of the recovery, the compensation for risk must vary directly with the attorney's hours. The attorney should assign the risk—the likelihood of non-recovery or of inadequate recovery—to the hourly charge. Therefore, the charge would be the basic hourly charge (let us say $50 per hour) plus a per-hour charge for risk.[40] The fee charged might be $65, reflecting a basic fee of $50 plus a 30% risk charge. Calculating reasonable attorney's fees by calculating a weighted risk factor along with the number of hours worked has been done previously

39. For example, if an attorney's services are valued at $100 per hour, and four hours are devoted to achieving a $2000 recovery, the attorney nets, above his investment of $400 (4 hours at $100 per hour), $267 (one-third of $2000 is $667, less the $400 investment). If the attorney had decided to invest an extra two hours' work to assure that result, his net compensation would have been only $67 above his investment ($667 attorney fee less $600 investment—6 hours at $100 per hour). With a one-third contingent fee, the attorney's net recovery increases only if the attorney's work increases the recovery by at least three times the value of the work invested.

40. The risk charge could be set to vary with hours devoted as large investments of time could reduce the probability of adequate recovery to cover the fee. *See infra* note 42 and accompanying text.

by some courts.[41]

Moreover, attorneys are familiar with assessing risk of recovery. Such estimates are necessary not only for advising clients how to proceed during litigation, but also for advising clients on the chances of recovery prior to pursuing a certain course of action. An attorney who uses the risk adjusted fee needs to convert this risk assessment into an adjusted fee. For example, assume that an attorney has made a preliminary examination of a case and is prepared to accept it. He values his time at $50 per hour (opportunity cost) and determines that there is an 80% chance the claim will result in a judgment for the client. For simplicity's sake, assume that the only possible outcomes are a $50,000 judgment for the client or no judgment for the client. An 80% chance of recovery, therefore, means that the value of the fee is only 80% of the fee charged, as only eight times out of ten (if the case were handled a large number of times) would the attorney receive the fee. Thus, if the attorney were to charge $50 per hour as a contingent fee in this case, the actual value of that fee would be $40 per hour (80% of $50). The attorney would not receive compensation for the risk he has undertaken.

To adjust for risk the attorney must charge a fee which, after risk is taken into account, is equal to his opportunity cost (usual hourly noncontingent fee). In our example, 80% of the risk adjusted fee (F) should equal the usual hourly fee: $0.8F = \$50$, or $F = \$50/0.8 = \$62.50$. Expressed more generally, the risk adjusted fee (F) should equal the opportunity cost (H) divided by the probability of success (P):[42]

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41. *See, e.g.*, Jorstad v. IDS Realty Trust, 643 F.2d 1305, 1314 (8th Cir. 1981); Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary Corp., 540 F.2d 102, 117 (3d Cir. 1976). *See generally* Leubsdorf, *The Contingency Factor in Attorney Fee Awards*, 90 YALE L.J. 473 (1981) (examining the justifications and problems presented by the contingent fee and suggesting appropriate alternatives); cases cited in *id.* at 473 n.1.

42. Few cases are all or nothing. Suppose there are three possible outcomes: $50,000, $5000 or $0. In that case, it is possible that while the $50,000 recovery would cover the full attorney's fee, the $5000 recovery would be insufficient. In that case, the attorney is assuming a risk of no recovery, but also a risk of partial recovery of his investment. In practice, such scenarios can be made quite complex, and attorneys seldom will quantify all the possible outcomes. What is required, however, is an appreciation of the array of probable outcomes and their associated probabilities. In this example, let us assume a 70% chance of $50,000, a 20% chance of $5000 and a 10% chance of $0. Because there is a 90% chance of recovery, the fee charged (given a $50 normal fee) would be approximately $55.50 ($50/0.9). Because ninety hours of work would exhaust the $5000 recovery ($5000/$55.50 = 90), that fee would apply only to the first ninety hours worked. Thereafter, the probability that the attorney will recover his investment is 70%. Thus, the fee will rise to approximately $71.50 ($50/0.7). Of course, such an agreement must be reached in advance. Alternatively, a single

$$F = \frac{H}{P}$$

Note, however, that adjusting for risk by dividing the fee by the probability of recovery makes the expected return on a contingent fee case equal to the return on the case were it noncontingent. Most people are "risk averse." That is, they would prefer a certain return of $50 to a risk that yields an expected return of $50. Suppose, for example, someone has his house on the market and is willing to sell it for $75,000. One prospective buyer offers to pay $75,000. A second prospective buyer offers in return for the house to pay $150,000 if an impartial flip of a fair (50/50) coin comes up heads, or nothing if the coin comes up tails. The expected value of the second offer is $75,000: (0.5 x $150,000) + (0.5 x $0) = $75,000. The expected yields of the two offers are the same, yet few people would accept the second offer over the first.[43] Most people are "risk averse" most of the time. That is, it requires something extra to get them to take the risk. In our example, a $50 noncontingent fee has the same expected value as a $62.50 contingent fee. That is, it compensates exactly for the risk of loss of the principal amount. But most people will not assume a risk unless they receive a premium to overcome their risk aversion. For example, the fee may be $65 per hour rather than $62.50. We cannot identify a specific value for risk aversion because it is idiosyncratic; however, one would expect its value to be small. Because there appears to be a high degree of variation among individuals as to the extent of their risk aversion, those attorneys with the least risk aversion would be expected to be more willing to offer contingent fees and, by charging a lower risk aversion component, to attract more contingent fee cases. Moreover, risk aversion in an individual attorney will not vary substantially from case to case.[44]

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fee could be established that would reflect the expected number of hours to be worked and the likelihood that the probable recovery would be sufficient.

43. Those who would prefer the second option are said to have "a positive risk preference." Clearly, different people may have different risk preferences. Anyone may have a positive risk preference under the right circumstances. Suppose one's business, which is all one has to show for a lifetime of work and sacrifice, will go under without an infusion of $150,000 and all other sources have been exhausted. In that case, $75,000 is of no more value than $0, but $150,000 is of enormous value. *See* C. GRAYSON, JR., DECISIONS UNDER UNCERTAINTY 279-319 (1960) (discussing the effect that individual utility configurations may have on individual risk preferences).

44. We would expect somewhat more risk aversion where large investments are expected than where small ones are involved, but this is a systematic variation that can be identified. Also, external factors can affect it. When debts are coming due, one may be more risk averse than when they all have been paid.

Attorneys do not merely assume risks like an insurer. They also control risks. The likelihood of success on the merits depends not only on the case itself, but also on how the case is handled. To one attorney a case may offer a probability of success of 80%. Another attorney may be able to structure the case such that the probability of success is 90% (for example, by filing in a different court). If both attorneys charge $50 per hour for noncontingent work, the fee for the first would be $62.50 ($50/0.8) plus a risk aversion inducement, while for the second it would be $55.50 ($50/0.9) plus a risk aversion inducement. Therefore, even though the second attorney may be more averse to risk than the first and value his time the same, he may still charge a lower fee due to his ability to manage as well as assume risks.

In summary, the attorney should divide his hourly noncontingent fee by the probability of success to determine an appropriate risk adjusted fee. To that he should add a small (and, for him, standard) risk aversion supplement sufficient to compensate for taking an expected value rather than an assured value. The result is the risk enhanced fee.[45]

A brief examination of the risk enhanced fee demonstrates its superiority to the traditional percentage fee and to C&C's approach.[46] There are three major advantages to the risk enhanced hourly fee. First, while the traditional contingency fee creates a conflict of interest between the attorney and the client, the risk adjusted hourly fee does not. The cost of each hour worked is the same to the client as to the attorney. Thus, there is no incentive for the attorney to encourage premature settlement, or to impose or allow the imposition of costs on the client. Although the ch-p fee, with a sufficiently large percentage component can approximate an efficient result (the closeness of the approximation depends on the attorney's aversion to risk), it does so at the cost of

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45. By its nature, a contingent fee cannot be collected until there is a recovery. Even noncontingent fees may not be payable until after final disposition of the case. In such cases, the attorney frequently builds in a pure interest charge, *i.e.*, a charge for the time value of money. Such interest charges, which do not reflect a risk component, but only the value of having the money today rather than in the future, should probably be stated expressly. There is a substantial body of literature on proper measures of the "real" interest rate, but one might use the rate of interest paid on passbook savings accounts or on government debt such as Treasury bills.

46. The Clermont & Currivan approach, *supra* notes 20-34 and accompanying text, as has been demonstrated, is only a deviation by degree from the traditional contingent fee and ameliorates, depending on the evil in question, only to the extent that it reduces or increases the return to the attorney.

giving the attorney a claim to a larger share of the recovery, regardless of the risk assumed by the attorney. Second, the risk adjusted hourly fee is efficient in that it encourages devotion of the optimal number of attorney hours to a case.[47] That is true even in the presence of the barriers to transactions that prevent clients from giving up part of their potential award under percentage fee arrangements.[48] As was noted above, the ch-p fee is also efficient in this regard but only if there is a sufficiently high percentage component to be an effective incentive. Third, and most importantly, the risk adjusted hourly fee results in a more desirable distribution of ownership of the claim. A fair distribution of the recovery should recognize the contribution of the attorney in terms of work contributed to the case and in terms of risk assumed. The remainder of the recovery should go to the client. MacKinnon demonstrates that averaged over all claims that is true of contingent fee personal injury cases.[49] There is no reason to believe that would not also be true if the ch-p fee were adopted. However, fairness is not averageable among individuals. Although such fees may be fair to attorneys who handle a large number of cases, and therefore, on the average, can expect to be compensated for their work and their assumption of risk, they are not fair to clients (such as personal injury plaintiffs) who do not have a large number of cases over which to average their net recoveries. If the specific ch-p fee used has a percentage component sufficiently smaller than the alternative specific traditional contingent fee percentage (e.g., if the 10% ch-p fee replaces the 33% traditional contingent fee), the dollar value of the unfairness in any particular case is less. Nonetheless, in the ch-p fee, as in the traditional contingent fee, the compensation for risk paid by the client and received by the attorney varies inversely with the risk assumed by the attorney. That is not fair to the client who does not have a large number of cases over which to average his return.[50]

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47. An hourly charge is also preferable from an economic, resource allocation perspective. The hourly charge represents the opportunity cost of the work to the lawyer. Because the marginal product of the effort flows to the client, the client's decision whether to employ additional marginal hours of lawyer time will be socially efficient.

48. *See supra* text accompanying note 19.

49. *See supra* text accompanying notes 35-36.

50. It is unassailable that if the client were able to sell his claim outright to the attorney, the attorney would have a direct incentive to work the optimal number of hours. All costs and benefits of such work would affect the attorney directly. It is that principle that underlies the Clermont & Currivan proposal. The higher the attorney's percentage ownership of the recovery above the normal hourly fee, the more assurance there is that the

There are inherent weaknesses in any hourly fee approach whether contingent or not. The attorney may work unproductively or may "pad" his hours. That problem is not peculiar to the hourly fee.[51] If the problem exists, it must be founded in ignorance on the part of the client. Only if the client is ignorant of what is to be received in return for the fee can the attorney successfully charge for unproductive time. But if the client is completely ignorant, then he must be similarly unable to choose the best hourly rate, or the best contingent fee rate. One could argue the ignorance is selective: the client can choose a rate, but cannot judge the productivity of the lawyer. Such a suggestion is foolish on its face. Legal services are not one homogeneous product. If they were, every client should go to that attorney who charges the least. Choice of attorney would be simplified to choice of the lowest hourly or percentage fee. Neither attorneys nor clients, however, believe that services are homogeneous. The value of the product worked by the client depends on both the number of hours received and the quality of that work. If the client is to judge the reasonableness of a charge, then knowledge is required both of the rate and of the value of services per hour. That is as true of a percentage fee as it is of an hourly fee. Is a 33% fee charged by F. Lee Bailey a better or worse fee than a 40% fee charged by Melvin Belli? The answer depends on more than the fee. It depends also on the productivity of the services rendered.

C&C address the risk enhanced fee and conclude that it results in an "economic conflict of interest" between lawyer and client.[52] The specific conflict to which they refer is that the incentive for the attorney to work the "efficient" number of hours (based on the client's preferences) is not present. The conclusion is based on the premise that the attorney cannot be a perfect forecaster of actual risk in all cases. Therefore, as the case progresses, the attorney

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attorney will efficiently allocate resources. Unfortunately, if attorneys purchased claims, the problem under discussion would not be eliminated but only shifted. As the client usually has access to vital information or is a key witness, the attorney would be in the position of having to assure that the *client* put in an appropriate (efficient) number of hours on the case.

51. Halpern & Turnbull, *Legal Fees Contracts and Alternative Cost Rules: An Economic Analysis*, 3 INT'L REV. OF LAW & ECON. 3 (1983). The authors construct an economic model with which they analyze fixed and contingent fee arrangements. The contingent fee arrangements considered are percentage (like those common in personal injury cases) and hourly (like those common in antitrust cases). They conclude, inter alia, that certain questionable practices may occur in the absence of alternative work available for the lawyer, regardless of the fee contract form. *Id.* at 22.

52. Clermont & Currivan, *supra* note 3, at 595-96.

may realize that he has either overestimated or underestimated the risk. That will act as an incentive for the attorney to overwork or underwork the case. There is some merit to their concern but the conclusion that "to avoid severe misalignment, a precise calculation of the risk [must be made],"[53] overstates that case.

First, the fundamental conflict in the traditional contingent fee is not a mere problem of alignment but one of actual conflict. The attorney has no standard by which to measure the amount of work that should go into a case. It is in the client's best interest for the attorney to expand his efforts indefinitely. What C&C are discussing in the case of the risk enhanced fee is not the absence of a standard but the misalignment of incentives.

Second, the choice with which we are presented is not one between a system that will perfectly align interests and one that will not. We have noted that the ch-p fee (if a relatively small percentage component is used) will provide a relatively small incentive for the attorney to work a number of hours that will approximate, but be less than, the number of hours the client would choose to have him work.[54] If the attorney misjudged the risks in a risk enhanced fee case, there would be an incentive commensurate with the degree of misjudgment. C&C assume, however, that at the initial determination the attorney will misjudge, but later the attorney will know the true risk. In fact, attorneys can judge only within ranges. An attorney will not assign a likelihood of success of 62% in one case and 58% in another. Both will be treated as 60% cases. That is so because there is always uncertainty. Thus, "precise" assessment is not required.

Third, there are counter-incentives to overworking or underworking the case. Those include the attorney's ethical obligation to best serve the client's interests rather than his own, the client's own control over the case, the effect on future business of any serious breach, and (in the event of overworking the case) pressure from other clients.

Fourth, in choosing a desirable fee structure, it is clear that there are serious problems with the traditional contingent fee. It is not clear whether the ch-p fee or the risk enhanced fee, in practice, would come closer to aligning attorney and client interests. The answer to that question depends in the case of the risk enhanced fee on the effectiveness of client and bar supervision of attorneys

53. *Id.* at 596.

54. *See supra* notes 30-33 and accompanying text.

and of attorneys' feelings of ethical obligation to their clients, and in the case of the ch-p fee on the size of the risk component selected, the risk aversion of attorneys, and the availability of other work. It is clear, however, that the ch-p fee shares with the traditional contingent fee the fundamental unfairness of an award for risk that varies inversely with the risk actually assumed. That is not true of the risk enhanced fee, as its most important advantage is the direct relationship between the award for risk and the risk assumed.

The problem of overreaching by attorneys exists regardless of the fee structure[55] to the extent consumers of legal services are and remain ignorant. On the other hand, in some circumstances courts have the power to adjust legal fees that they believe are improper,[56] and clients have the same remedies for fraud, malpractice and breach of contract against attorneys as they do against plumbers, auto mechanics, or any other provider of services. The proposal made in this article does not answer the problem of the lawyer who commits fraud on his client. Increased knowledge on the part of clients[57] (including informative advertising), competition in the provision of legal services and increased self-policing by the profession[58] hold the best hope to minimize such practices.

Regardless of the difficulties that will always be found with unethical attorneys, ethical attorneys should not be placed in a fee arrangement where they cannot act in a way that is in the client's best interest. Efficiency should not be purchased at the price of unfairness to the client by giving the attorney more of the client's claim than is justly his.[59] The risk enhanced hourly fee promotes

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55. *Id.* at 580.

56. F.B. MacKinnon, *supra* note 1, at 23-24. *See, e.g.*, Jorstad v. IDS Realty Trust, 643 F.2d 1305, 1314 (8th Cir. 1981); Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary Corp., 540 F.2d 102, 118 (3d Cir. 1976).

57. One study indicates that a participatory model in which the client is actively involved in the preparation and handling of the case improves the results in personal injury cases. D. Rosenthal, Lawyers and Clients: Who's in Charge? 46-47, 61 (1974).

58. *See* Halpern & Turnbull, *supra* note 51, at 20.

59. *Id.* at 16. The authors note in their analysis that under certain conditions a percentage-type fee that gives the client a fixed sum and the attorney the residual can be substituted for a contract that depends in part on attorney effort. That is, a theoretically superior system would be one in which the attorney could buy claims. There are, however, obvious practical problems to such a system. First, it is clearly contrary to Model Code of Professional Responsibility DR5-103(A) (1981), which prohibits acquisition of a proprietary interest in the cause of action, except for a reasonable contingent fee, and is arguably contrary to *id.* DR5-103(B), which prohibits general advances to the client. Second, the attorney would be faced with a "client" who has no interest in working to increase the recovery beyond the level of the client's own fixed sum. This latter problem, while perhaps not

efficiency, but compensates the attorney for (1) hours worked (at a rate reflecting the productivity of those hours) plus (2) risk actually assumed.[60] In the case of an attorney whose usual fee is $50 per hour, and who accepts a case with an 80% probability of success, the fee charged will be $62.50 plus a risk aversion component. Let us suppose the total fee is $65 per hour. If the case is settled for $9000 after twenty hours work, the attorney receives $1300. That payment represents compensation at $50 per hour for the work done, for a total payment of $1000. As there was only an 80% probability of success, the attorney receives an additional $250 payment to exactly offset the probability that he would have lost his $1000 investment. Over a large number of cases, that payment should result in the attorney earning an average of $50 per hour for all hours worked, with each client paying an amount specifically related to the riskiness of his own case. Finally, the attorney receives a $50 inducement to encourage him to put his $1000 at risk. That may be viewed as a payment for the contingency option.

Had the case been settled after only one hour, the attorney would have received $65. Fifty dollars would compensate for the work done; $12.50 would have offset the risk of loss of the $50 investment; $2.50 would have been the inducement to put the $50 at risk. Risk assumed varies directly with the hours devoted to the case, and under the risk enhanced hourly fee approach, so does the compensation for that risk.[61]

While the percentage fee may compensate for risk on an aggregate basis, the share of that charge borne by a given client does not bear any necessary relationship to the riskiness of that case.[62] With a risk enhanced hourly fee, risk is compensated for on a case-by-case basis. Each case compensates for risk assumed based on

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insurmountable, would loom large in cases such as personal injury cases where a great deal of client involvement is required. Halpern and Turnbull also note that a contingent hourly fee is not "optimal" since it does not provide an incentive to the lawyer to obtain as large a payoff as possible. Halpern & Turnbull, *supra* note 51, at 17. As is noted above, such an incentive is effective only to the extent that it transfers ownership of the claim to the lawyer, which raises problems of fairness.

60. *See supra* notes 40-43 and accompanying text.

61. Had this case been a percentage contingent fee case at 20%, the fee would have been $1800 (ignoring expenses). If twenty hours had been worked, the fee would have amounted to compensation at the rate of $90 per hour. That far exceeds our assumed risk compensation costs. But assume that it is reasonable. Now consider the hourly value to the attorney if that case is settled in one hour: $1800 per hour. Yet much less attorney investment was at stake in the latter case. The compensation in a percentage fee case varies (improperly) *inversely* with risk.

62. *See supra* notes 39-40 and accompanying text.

the riskiness of that case. The individual attorney is compensated for risk based on the ability of that attorney to judge risks and to control them. That is the same basis on which an insurance company or bank would be rewarded if it, rather than an attorney, were in the business of enabling poor clients to be represented by extending them credit based on their claims.[63] A necessary result of that approach is elimination of astronomical fees except in those cases that involve astronomical hours or astronomical risks.

IV. Conclusion

With adoption of a risk enhanced hourly fee, as additional hours are devoted to settlement or to trial preparation, the attorney makes the marginal calculations based on opportunity costs (adjusted for risk and expected marginal productivity of those efforts). The costs incurred by the attorney pass through to the client, and the attorney's incentive to avoid devoting time to the case, based on a set of incentives different from those operating on the client, is removed. Such an arrangement is efficient and avoids a conflict of interest between the attorney and the client. More importantly, it is fair both to the attorney and to the client because it fully compensates the attorney both for work and for risk, but does not overcompensate the attorney at the expense of the client.

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63. *See supra* note 14.