



FOR IMMEDIATE RELEASE: August 22, 2005

TWO CHEERS FOR CONTINGENT FEES

By Alexander Tabarrok and Eric Helland

Why Limits on Contingency Fees May Not Be Good for Tort Reform

If America is a “lawsuit hell,” contingent-fee lawyers have often been cast as the devils. Contingent fees (or contingency fees) have been called unwarranted, and the lawyers who accept them have been denounced as unethical and uncivilized. Furthermore, in the midst of increased filings and escalating awards, it is difficult not to notice that some plaintiffs’ lawyers have become very rich. As a result, tort reformers have called for limits on contingent fees and many states have obliged. But limits have been enacted without any empirical evidence that contingent fees were either responsible for the liability crisis or that limiting them would produce benefits.

In *Two Cheers for Contingent Fees* (AEI Press, September 2005)—one of the first empirical examinations of contingent fee limits—economists Alexander Tabarrok and Eric Helland find that contingent fees benefit plaintiffs and do not cause higher awards:

- It is difficult for a plaintiff to evaluate how hard a lawyer is working. Contingent fees motivate effort in the same way that tips motivate effort from waiters.
- Contingent fees improve access to the courts for low-income plaintiffs.
- Contingent fees help to spread risk since the plaintiff does not pay if he loses the case.

Most importantly, since a contingent-fee lawyer is paid only if he wins the case, these lawyers have an incentive to screen cases, rejecting those cases that are unlikely to be won. Restrictions on contingent fees increase the incentive of a lawyer to move toward hourly fees. Lawyers paid by the hour are willing to take more cases to court than contingent-fee lawyers, thus limits on contingent fees can increase the number of low-value “junk suits.” Consistent with this theory, the authors find that when contingent fees are restricted, plaintiffs begin many cases that they later find to be of little value and subsequently drop.

- In states that limit contingency fees in medical malpractice cases, 18.3 percent of these cases were eventually dropped, but in states without limits only 4.9 percent were abandoned. No differences in the drop rate of auto cases was discovered (auto cases are not limited in any of the compared states in this study).

- The drop rate for medical malpractice cases increased in Florida by 15 percent (3.5 percentage points) when Florida limited contingency fees in 1985.

Tabarrok and Helland also found that lawyers paid by the hour are likely to take longer to settle cases than lawyers paid by contingent fees:

- The time to settle a case is 22 percent longer in states that restrict contingent fees.
- In the thirteen months after contingent fees were restricted in Florida medical malpractice cases, the time to settlement increased by 13 percent.

Restrictions on contingent fees, therefore, are likely to harm plaintiffs. But what about society at large? There is no evidence that contingent fees increase awards. In fact, the average medical malpractice award is twice as high in states that restrict contingent fees than it is in states that do not restrict contingent fees (\$500,816 versus \$225,105). Although this does not mean that contingent fees *decrease* awards, it does call into question the idea that contingent fees increase awards. Tabarrok and Helland point out that contingent fees have been common in the United States for more than 100 years, far longer than the tort crisis.

The authors conclude that while tort reform is an important goal, limiting the contractual rights of plaintiffs and their lawyers is an unattractive and likely ineffective method of achieving that goal.

ALEXANDER TABARROK is an associate professor of economics at George Mason University. He is also research director for the Independent Institute and a research fellow with the Mercatus Center. His research interests include empirical law and economics, tort reform, bounty hunters, judicial electoral systems, voting theory and alternative political institutions, and health economics. **ERIC HELLAND** is an associate professor of economics at Claremont-McKenna College. His research interests include law and economics, environmental economics, regulation, industrial organization, applied econometrics, and microeconomics.

###