

# NOTIONS OF FAIRNESS AND CONTINGENT FEES

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## I

### INTRODUCTION

Notions of fairness occupy a prominent position in the law generally, and in assessing the validity of transactions and the need for their regulation, in particular. Fairness judgments can refer to various aspects of a transaction, yet their primary object is the adequacy of remuneration: does each party receive fair value in return for what she gives? One type of transaction whose fairness has been extensively and hotly debated is the hiring of attorneys on a contingent fee (CF) basis by plaintiffs in tort and other actions. This article reports and analyzes findings of several experiments designed to ascertain what factors determine people's judgments of the fairness of CF arrangements, how these judgments affect the market for attorneys' services, and what broader implications can be drawn from these judgments. Assessing the fairness of transactions obviously entails normative judgments, and we shall indeed discuss normative issues involved in these judgments. However, our primary focus is not normative. Rather, the article strives to elucidate the way people form fairness judgments regarding CF arrangements and possible mechanisms through which these judgments affect the market.

CF arrangements are the standard method of financing civil litigation in various types of suits, including personal injuries. Under such arrangements, an attorney's fee is contingent upon the success of the claim, calculated as a certain

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percentage of the amount recovered, and paid upon recovery.<sup>1</sup> In the United States, the conventional flat CF rate is 33% of the recovery. When the rate depends on the stage at which the case ends, it is usually 25% if the case does not go to trial, rising to as high as 50% if the case reaches an appellate court.<sup>2</sup> Many statutes in the United States and elsewhere regulate CF arrangements by setting caps on CF rates for specific types of suits, such as medical malpractice and road accidents.<sup>3</sup> In addition, courts, and sometimes the bar, are authorized to judicially or quasi-judicially review the reasonableness of fees on a case-by-case basis.<sup>4</sup>

Advocates of CF point out that CF arrangements enable plaintiffs of limited financial means to secure otherwise unaffordable legal services. These CF arrangements increase access to the courts, thereby empowering the underprivileged and forcing injurers to internalize the costs of their activities.<sup>5</sup> Essentially, CF arrangements provide clients with credit (since the fee is only paid upon recovery) and with a sort of insurance (since the fee is not paid if the claim fails).<sup>6</sup> CF arrangements induce attorneys not to take cases whose expected value is too small, thus saving their clients, and the court system, the costs involved in pursuing such claims. A CF arrangement also incentivizes the

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1. See Eyal Zamir & Ilana Ritov, *Revisiting the Debate over Attorneys' Contingent Fees: A Behavioral Analysis*, 39 J. LEGAL STUD. 245, 245–46 (2010).

2. Herbert M. Kritzer, *Seven Dogged Myths Concerning Contingency Fees*, 80 WASH. U. L.Q. 739, 757–61 (2002). According to Kritzer, about two-thirds of the cases, excluding those governed by special regulation, involve a fixed percentage (flat fee), and about one-third involve a variable percentage. In 88% of flat fee cases, the CF is 33% of the recovery. The common pattern in the cases employing a variable percentage is to charge 25% of the recovery if the case does not go to trial or does not involve substantial trial preparations; 33% if the case goes beyond that point, and 40% to 50% if the case results in an appeal. See Zamir & Ritov, *supra* note 1, at 245–46.

3. See GABRIEL KLING, *ETHICS FOR LAWYERS* 243–58 (2001); Casey L. Dwyer, *An Empirical Examination of the Equal Protection Challenge to Contingency Fee Restrictions in Medical Malpractice Reform Statutes*, 56 DUKE L.J. 611, 614–17 (2006) (discussing caps on contingency fees in several states as well as congressional attempts to place limits on contingency fees in medical malpractice suits); Steven Garber et al., *Do Noneconomic Damages Caps and Attorney Fee Limits Reduce Access to Justice for Victims of Medical Negligence?*, 6 J. EMPIRICAL LEGAL STUD. 637, 649–50 (2009) (providing information on contingency fee limits in various states).

4. ROBERT H. ARONSON, *ATTORNEY-CLIENT FEE ARRANGEMENTS: REGULATION AND REVIEW* 90–93 (1980) (discussing judicial review of CF rates); 1 ROBERT L. ROSSI, *ATTORNEY'S FEES* 110–13 (2d ed. 1995) (same); Lester Brickman, *Contingency Fee Abuses, Ethical Mandates, and the Disciplinary System: The Case Against Case-by-Case Enforcement*, 53 WASH. & LEE L. REV. 1339 (1996) (describing and criticizing the enforcement of the pertinent ethical norms); Ted Schneyer, *Legal-Process Constraints on the Regulation of Lawyers' Contingent Fee Contracts*, 47 DEPAUL L. REV. 371, 396–97 (1998).

5. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 615 (7th ed. 2007) (arguing that, although a CF arrangement makes it easier for illiquid or risk-averse people to bring suits, it does not necessarily produce more litigation, because “the likelier a suit is to be brought if there is violation of law that causes injury, the greater is the deterrent effect . . . and hence the less likely are potential defendants to engage in the forbidden conduct”); Neil Rickman, *The Economics of Contingency Fees in Personal Injury Litigation*, 10 OXFORD REV. ECON. POL'Y 34, 39, 47 (1994) (pointing to the distributional and deterrence advantages of enhancing access to justice through CF).

6. Richard W. Painter, *Litigating on a Contingency: A Monopoly of Champions or a Market for Champerty?*, 71 CHI.-KENT L. REV. 625, 653–55 (1995). See also Zamir & Ritov, *supra* note 1, at 246.

attorney to win the case or attain a favorable settlement, and at the same time to avoid investing too much time in handling it.<sup>7</sup> Given these additional benefits to the client, it is argued that the effective hourly rate (EHR) resulting from the prevailing CF rates—the expected fee divided by the number of hours the lawyer works on the case—is very reasonable compared to prevailing hourly rates.<sup>8</sup>

Critics of current CF practices portray a very different picture. They argue that the insurance element of CF is illusory, for there is typically no real risk involved in the cases attorneys take on a CF basis.<sup>9</sup> Similarly, the credit element should not add much to the fee because the attorney enjoys an excellent collection method: she deducts her fee from the award before forwarding it to her client.<sup>10</sup> Current CF rates, so it is charged, reflect various market failures, including plaintiffs' inability to assess the value and prospects of their case and the scope of work involved in handling it, lawyers' uniform pricing practices, the absence of price advertisements, clients' prohibitive search costs, and the prohibitions against the purchase of tort claims and against brokerage of lawyers' services.<sup>11</sup> Consequently, CF arrangements often result in effective rates that are several times higher than ordinary hourly rates.<sup>12</sup>

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7. Standard CF arrangements do not perfectly align an attorney's interests with those of her client, as it induces the attorney to accept settlement offers that are not necessarily in the client's best interest; yet, the higher the lawyer's share of the recovery (through the CF rate), the more their interests converge. The client's expected gain from strengthening the lawyer's motivation may outweigh the expected loss from the larger share paid to the lawyer. On the various incentive effects of CF arrangements, see, e.g., Murray L. Schwartz & Daniel J.B. Mitchell, *An Economic Analysis of the Contingent Fee in Personal-Injury Litigation*, 22 STAN. L. REV. 1125 (1970). See also Zamir & Ritov, *supra* note 1, at 246, 252; Kevin M. Clermont & John D. Currivan, *Improving the Contingent Fee*, 63 CORNELL L. REV. 529, 534–46 (1978); Eric Helland & Alexander Tabarrok, *Contingency Fees, Settlement Delay, and Low-Quality Litigation: Empirical Evidence from Two Datasets*, 19 J.L. ECON. & ORG. 517 (2003); Michael McKee, Rudy Santore & Joel Shelton, *Contingent Fees, Moral Hazard, and Attorney Rents: A Laboratory Experiment*, 36 J. LEGAL STUD. 253 (2007); Geoffrey P. Miller, *Some Agency Problems in Settlement*, 16 J. LEGAL STUD. 189 (1987); A. Mitchell Polinsky & Daniel L. Rubinfeld, *Aligning the Interests of Lawyers and Clients*, 5 AM. L. & ECON. REV. 165 (2003); Terry Thomason, *Are Attorneys Paid What They're Worth? Contingent Fees and the Settlement Process*, 20 J. LEGAL STUD. 187 (1991).

8. See HERBERT M. KRITZER, *THE JUSTICE BROKER* 137–43 (1990) [hereinafter *THE JUSTICE BROKER*] (arguing, on the basis of a large-scale empirical research study conducted in 1979–1980, that “in an overall sense, contingent fee lawyers do not do better than they would do charging on an hourly fee basis, at least in ordinary litigation”); HERBERT M. KRITZER, *RISKS, REPUTATIONS, AND REWARDS: CONTINGENCY FEE LEGAL PRACTICE IN THE UNITED STATES*, 180–218 (2004) [hereinafter *RISKS, REPUTATIONS, AND REWARDS*] (comparing the median hourly earnings of hourly fee lawyers and effective hourly earnings of contingent fee lawyers); Zamir & Ritov, *supra* note 1, at 246.

9. Lester Brickman, *Contingency Fees Without Contingencies: Hamlet Without the Prince of Denmark?*, 37 UCLA L. REV. 29 (1989). See Zamir & Ritov, *supra* note 1, at 246.

10. Brickman, *supra* note 9, at 118–19 (arguing that the credit component of CF arrangements contains no element of risk, and thus, a reasonable rate would be the statutory rate for prejudgment interest). See also Zamir & Ritov, *supra* note 1, at 246.

11. Lester Brickman, *The Market for Contingent Fee-Financed Tort Litigation: Is It Price Competitive?*, 25 CARDOZO L. REV. 65 (2003); Painter, *supra* note 6, at 653–68 (discussing additional

In a previous article, we presented a series of experiments designed to reveal people's preferences regarding attorneys' fees.<sup>13</sup> Contrary to common economic wisdom, these experiments demonstrated that loss aversion (rather than risk aversion or incentivizing the lawyer to win the case) plays a major role in clients' preferences for CF arrangements. Plaintiffs prefer a contingent fee over a fixed fee (FF) even if it yields an expected fee that is two or three times higher than a non-contingent one. These findings fall in line with the prevalent perception that the EHR under CF is significantly higher than under non-contingent fee arrangements, and that this difference cannot be entirely attributed to the insurance and credit elements of CF arrangements.<sup>14</sup>

The current article seeks to advance understanding of the market for attorneys' services and its regulation from a different angle, namely the perceived fairness of CF arrangements. It reports a series of experiments designed to identify the factors bearing on the perceived (un)fairness of CF arrangements and discusses their practical implications. Four primary factors determine the EHR resulting from a CF arrangement: the claimed sum, the probability of recovery, the CF rate, and the number of hours the attorney works on the case. Specifically, the EHR is the product of the first three factors—the claimed sum, the probability of recovery, and the CF rate—divided

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market imperfections allegedly characterizing the CF market, including the tie-in of different products—legal services, credit, and insurance—and price discrimination).

12. Lester Brickman, *Effective Hourly Rates of Contingency-Fee Lawyers: Competing Data and Non-Competitive Fees*, 81 WASH. U. L.Q. 653 (2003) (arguing that the yields from CF practice have become inordinately high and that they are "often amounting today to thousands of dollars an hour"); Susan P. Koniak, *Principled Opinions: Response to Brickman*, 65 FORDHAM L. REV. 337, 352 (1996) (suggesting that attorneys should be obliged to adjust standard CF rates downward whenever it turns out that securing the recovery required only minimal time and effort).

13. Zamir & Ritov, *supra* note 1.

14. Brickman, *supra* note 11, at 69–74; Leonard E. Gross, *Are Differences Among the Attorney Conflict of Interest Rules Consistent with Principles of Behavioral Economics?*, 19 GEO. J. LEGAL ETHICS 111, 138 (2006) ("Personal injury lawyers realize that they can make much more money per hour by handling cases on a contingent fee basis."); Koniak, *supra* note 12, at 352. See also Thomas B. Metzloff, *Resolving Malpractice Disputes: Imagining the Jury's Shadow*, 54 LAW & CONTEMP. PROBS. 43, 100–01 (Winter 1991) (arguing that in damages-only cases, that is cases in which liability is not seriously disputed, "a contingency fee agreement awarding 33 percent or more of the total recovery would, in most instances, be grossly out of proportion to the effort required and the costs incurred"); Stephen D. Annand & Roberta F. Green, *Legislative and Judicial Controls of Contingency Fees in Tort Cases*, 99 W. VA. L. REV. 81, 87–88 (1996). Even Kritzer's empirical study, while estimating that the median effective hourly fee resulting from CF arrangements in Wisconsin in the early 1990s (\$132) was only marginally higher than ordinary hourly fees (\$124), found that the mean effective hourly fee (\$242) was almost twice as large as the ordinary hourly fee. Kritzer, *supra* note 2, at 761–68. Based on this data and on data regarding federal cases, Kritzer points out that the large gap between the mean and median effective rates comes from the top ten percent of cases that produce the largest profits for CF lawyers. Excluding those ten percent, an attorney may expect a fee premium of twenty-five percent to thirty percent compared to what hourly rates generate. The premium is much higher once all cases are taken into account, including the most profitable ones. RISKS, REPUTATIONS, AND REWARDS, *supra* note 8, at 218. See Zamir & Ritov, *supra* note 1, at 251.

by the number of hours worked.<sup>15</sup> Mathematically, each of these factors equally affects the EHR. Therefore, a change in any of these factors should have a similar proportional effect on the perceived fairness of the CF arrangement.

This is not, however, what our experiments show. According to our findings, high CF rates are considered unfair, even when they result in a rather low EHR, whereas low CF rates are deemed fair even if they result in a relatively high EHR. The effect of the CF rate on the perceived fairness is considerably and significantly higher than the effect of any of the other variables examined. This means that CF arrangements invoke notions of division fairness (the fairness of dividing a certain pie) much more than fairness of exchange (the equivalence between the attorney's fee and the value of her services). At the same time, there was no direct correlation between people's perceived fairness of different CF arrangements and their preferences when asked to choose between a contingent and a non-contingent fee. It is thus conjectured that the primary mechanisms through which the prevailing perceptions about the fairness of contingent fees affect the market are the behavior of attorneys who care about their reputation, and regulators who set caps for CF rates, rather than clients' preferences. The resulting "fairness constraint" drives very high CF rates out of the market, even in cases in which the parties would have found them mutually beneficial.

If very high CF rates are deemed unfair even when they result in a rather low EHR, then the rarity of such rates does not necessarily point to a market failure such as asymmetric information or imperfect competition. It may rather reflect a fairness constraint on pricing legal services. These findings also indicate that the tendency of legislators and courts to regulate CF arrangements by setting caps on high CF rates—while largely disregarding the probability of recovery, the amount of work the case is likely to require, and often the expected reward—does not necessarily or exclusively rest on the practical difficulty of assessing the latter three variables. It probably rests also, and to a considerable extent, on intuitive judgments of fairness.

15.  $EHR = \frac{rpS}{h}$  where  $EHR$  is the Effective Hourly Rate,  $r$  is the CF rate,  $p$  is the probability

of recovery,  $S$  is the claimed sum, and  $h$  is the expected hours the attorney will work on the case. In fact, the fee's expected value is determined by the distribution of the possible sums of recovery. In a discrete setting, the effective hourly rate is an aggregation of the products of each sum and the

likelihood of its recovery, namely  $\sum_{i=1}^n p_i S_i$ , where  $\sum_{i=1}^n p_i = 1$ . In a continuance setting, the expected

value of the sum of recovery is the integral over the probability density function. Similarly, the amount of work is typically uncertain ex ante, and thus the relevant factor is the expected value of hours. Assuming a discrete distribution, in which the likelihood that the amount of hours  $h_i$  required to

complete the work is  $q_i$ , the expected number of hours is  $\sum_{i=1}^m q_i h_i$ , where  $\sum_{i=1}^m q_i = 1$ . In addition to

the four primary factors, the attorney's effective fee also depends on such secondary factors as the delay between doing her work and being paid for it.

The present article sheds light on the complex phenomenon of lawyers' CF arrangements from one angle only. It does not purport to refute or undermine other explanations—economic, psychological, or sociological—for the prevailing rates. Although the experimental findings illuminate an important aspect of the CF practice, they do not yield direct normative or policy implications. Drawing such implications would require the consideration of numerous factors and arguments, including the importance of access to justice, market competitiveness, plaintiffs' loss aversion, the parties' incentives, and institutional competence of regulators. Those issues lie beyond the scope of the present article.

Although CF arrangements and their perceived fairness have some unique features, the experimental findings have broader implications regarding the ways people form judgments of fairness and the mechanisms through which these judgments may affect market behavior and legal rulemaking. Any social context or transaction in which people make different contributions to a common undertaking and the output or revenues are then divided between them, shares characteristics of CF arrangements. These contexts range from relationships between spouses to commercial joint ventures.<sup>16</sup> Some forms of contingent fees are also common in real estate brokerage, contracts between issuers of securities and underwriters, and the hiring of architects and engineers.<sup>17</sup> Drawing broader conclusions from our experiments obviously requires paying close attention to the differences between the various contexts.

The article proceeds as follows: part II first proposes a taxonomy of various notions of fairness that may be deemed relevant in evaluating CF arrangements. It then points out the ways in which such judgments may affect actual CF rates in the market. Part III describes a series of experiments. The first five experiments aim at determining which factors affect people's judgments of the fairness of CF arrangements and to what extent. We examine directly how these judgments are affected by the size of the expected recovery, the probability of recovery, the CF rate, and the expected scope of work, and indirectly how they are affected by the lawyer's EHR. The sixth experiment studies the correlation between the perceived fairness of CF arrangements and clients' choices between contingent and fixed fees. Part IV discusses our findings and examines their implications for judicial and statutory supervision on CF rates, as well as for fairness judgments more generally.

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16. On the former, see, e.g., Gerold Mikula, *Division of Household Labor and Perceived Justice: A Growing Field of Research*, 11 SOC. JUST. RES. 215 (1998) (discussing perceptions of fairness in the gender imbalance of household labor).

17. See generally Saul Levmore, *Commissions and Conflicts in Agency Arrangements: Lawyers, Real Estate Brokers, Underwriters, and Other Agents' Reward*, 36 J.L. & ECON. 503 (1993) (discussing the similarities between fee arrangements of real estate brokers, lawyers, underwriters, and other services providers). See also Hsuan-Chi Chen & Jay R. Ritter, *The Seven Percent Solution*, 55 J. FIN. 1105 (2000) (analyzing underwriters' uniform commissions).

## II

## NOTIONS OF FAIRNESS AND CONTINGENT FEES

## A. Notions of Fairness: A Taxonomy

Judgments of fairness are often multidimensional.<sup>18</sup> Judging the fairness of CF arrangements is particularly complex. At least six different factors may be deemed relevant in forming such judgments: procedural, redistributive, output, pricing, and division fairness; as well as fairness of exchange. Although this article does not deal with all of these factors, it seems useful to mention them here so as to put the present article in perspective and to set the ground for future studies of fairness in comparable transactional settings.

*Procedural fairness* refers to the fairness of the process by which a fee arrangement is determined. Is the fee arrangement negotiated between the parties or rather dictated by one of them? Is the arrangement clearly explained to the uninformed party prior to the agreement? Is she offered a choice between different fee arrangements? Procedural fairness (often called procedural justice) has long been studied by social psychologists in various contexts, including wages and other aspects of employment relationships.<sup>19</sup> Several studies have discussed the process of contracting for CF arrangements.<sup>20</sup>

Another factor, *redistributive fairness*, has to do with the relative and absolute overall positions of the parties. Studies of the perceived fairness of wages, for instance, indicate that workers' neediness may affect the perceived fairness of their wages.<sup>21</sup> Similarly, one may conjecture that the relative and absolute wealth of an attorney and her client may bear on the assessed fairness of the fee. In fact, some discussions of the regulation of lawyers' fees implicitly or explicitly refer to the socioeconomic characteristics of plaintiffs.<sup>22</sup>

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18. Colin F. Camerer & Kenneth R. MacCrimmon, *Underground and Overpaid: Equity Theory in Practice*, in EQUITY THEORY: PSYCHOLOGICAL AND SOCIOLOGICAL PERSPECTIVES 295 (David M. Messick & Karen S. Cook eds., 1983) (enriching the social psychology analysis of fairness judgments by incorporating a host of economic and decision theory factors).

19. See generally DISTRIBUTIVE AND PROCEDURAL JUSTICE (Kjell Törnblom & Riël Vermunt eds., 2007); THE SENSE OF INJUSTICE: SOCIAL PSYCHOLOGICAL PERSPECTIVES (Roger Folger ed., 1984) (discussing procedural justice in the political and legal spheres); Robert Folger, *Distributive and Procedural Justice: Combined Impact of "Voice" and Improvement on Experienced Inequity*, 35 J. PERSONALITY & SOC. PSYCHOL. 108 (1977) (discussing procedural fairness in the context of a wage experiment); Foard F. Jones, Vida Scarpello & Thomas Bergmann, *Pay Procedures—What Makes Them Fair?*, 72 OCCUPATIONAL & ORGANIZATIONAL PSYCHOL. 129 (1999) (discussing methods of assessing procedural fairness in the context of pay systems).

20. See JOHN W. TOOTHMAN & WILLIAM G. ROSS, LEGAL FEES: LAW AND MANAGEMENT 168–76 (2003) (discussing formal and informational aspects of CF agreements); Brickman, *supra* note 9, at 49–54 (discussing clients' information problems and lawyers' disclosure duties); Gross, *supra* note 14 (analyzing conflicts of interests between lawyers and clients in the contracting process); THE JUSTICE BROKER, *supra* note 8, at 57–59 (describing the contracting process between lawyers and litigants).

21. Miriam Dornstein, *The Fairness Judgment of Received Pay and Their Determinants*, 62 J. OCCUPATIONAL PSYCHOL. 287, 289, 294 (1989).

22. Cf. Stephen Gillers, *Caveat Client: How the Proposed Final Draft of the Restatement of Law Governing Lawyers Fails to Protect Unsophisticated Consumers in Fee Agreements with Lawyers*, 10

Without denying their importance in transactional contexts and their relevance to the CF debate, the present article will not directly discuss procedural and redistributive notions of fairness. Rather, it will focus on the substantive fairness of the fee arrangement and sidestep redistributive issues.

A third factor affecting the fairness of the fee arrangement is the outcome of the attorney's work, or *output fairness*. The central characteristic of CF arrangements is that the fee is not calculated on the basis of the attorney's input—time, effort, expertise, and reputation—but rather, on the output of her work—the amount recovered.<sup>23</sup> Like contingent remunerations in other spheres, such as typical brokerage fees, CFs directly depend on the benefit the client derives from the attorney's services. From this perspective, CF arrangements are ipso facto more responsive to the concern of output fairness than other arrangements.

The fourth factor, *pricing fairness*, has to do with the relation of the present fee to the fees charged by other attorneys for similar cases or by the same attorney for other cases. A vast body of literature focuses on the fairness of prices, including wages and rents. These studies forcefully establish the importance of reference points in making such judgments. The reference point may be the price paid by other customers or the wage paid to other employees.<sup>24</sup> It may also be the price a firm ordinarily charges for a certain good or the wage it ordinarily pays. These would be the pertinent reference points when a firm considers raising prices or cutting salaries in response to sudden changes in the demand for its products or unemployment rates at a certain locality.<sup>25</sup> There is no reason to assume that legal fees are in any way different from other prices in this respect. In fact, the manifest standardization and stability of CF rates are

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GEO. J. LEGAL ETHICS 581 (1997) (suggesting that the sophistication of the client will affect the reasonableness of the fee).

23. Rickman, *supra* note 5, at 36–37.

24. J. Stacy Adams, *Inequity in Social Exchange*, in 2 ADVANCES IN EXPERIMENTAL SOCIAL PSYCHOLOGY 267, 280 (Leonard Berkowitz ed., 1965) (positing that employees seek to maintain equity between the inputs that they bring to a job and the outcomes that they receive from it against the perceived inputs and outcomes of others); Jennifer C. Smith, *Wage Interactions: Comparisons or Fall-Back Options*, 106 ECON. J. 495 (1996) (providing empirical evidence that wages paid elsewhere matter in pay bargaining because comparisons are important to workers, even if workers do not have a real “fall back” option); Dornstein, *supra* note 21 (describing empirical findings indicating that pay fairness evaluations are based, inter alia, on comparisons with similar as well as dissimilar others). The central role of comparisons to others is also manifest in the context of plea bargains. Avishalom Tor, Oren Gazal-Ayal & Stephen M. Garcia, *Fairness and the Willingness to Accept Plea Bargain Offers*, 7 J. EMPIRICAL LEGAL STUD. 97, 107–09 (2010).

25. ARTHUR K. OKUN, PRICES AND QUANTITIES: A MACROECONOMIC ANALYSIS 169–70 (1981) (suggesting that increasing prices due to cost increases is generally accepted as fair while raising prices on the basis of increase in demand are not; and that these conventions often shape the behavior of sellers); George A. Akerlof, *The Case Against Conservative Macroeconomics*, 46 ECONOMICS 219, 230–33 (1979); Daniel Kahneman, Jack L. Knetsch & Richard Thaler, *Fairness as a Constraint on Profit Seeking: Entitlements in the Market*, 76 AM. ECON. REV. 728 (1986) [hereinafter *Fairness as a Constraint*]; Daniel Kahneman, Jack L. Knetsch & Richard Thaler, *Fairness and the Assumptions of Economics*, 59 J. BUS. S285 (1986).

plausibly reinforced by the prevailing perception of these rates as fair.<sup>26</sup> The existing body of literature takes prevailing rates as a reference point; hence, it does not answer the questions that interest us most, namely, what determines the perceived fairness of CF rates and how these perceptions affect the going rates.

Another body of literature on fairness judgments is rooted in game theory and deals with the division of a certain pie between two or more people, that is, with *division fairness*.<sup>27</sup> The Ultimatum and Dictator games are particularly pertinent to this notion of fairness. Ultimatum is a game in which one person, the proposer, is asked to divide a sum of money between herself and another person. The other person, the responder, may then either accept the proposed division, in which case the division is implemented, or reject it, in which case both players receive nothing. Dictator is a game in which one party unilaterally decides how to divide a sum of money between herself and another person. Rational choice theory predicts that, in an Ultimatum game, the proposer will offer the responder the smallest unit of money used in the game and the responder will accept this offer and that, in a Dictator game, the dictator will appropriate the entire sum. Numerous experiments have established, however, that in Ultimatum games, most proposers offer responders a generous share of the pie (40% on average) and that responders reject very low offers. Even in Dictator games, though the offers are much lower, in most cases they are still positive.<sup>28</sup> Thus, people do not necessarily behave as rational maximizers of their own utility. Instead, they seem to give considerable weight to notions of fairness. Responders' rejections of clearly disproportionate divisions in the Ultimatum game indicate that people are even willing to bear some costs to punish others for what they perceive as an unfair division of resources.<sup>29</sup> There is an obvious similarity between these studies and CF arrangements in the sense that CFs highlight the division of a pie—the expected recovery—between two people, the plaintiff and her attorney.<sup>30</sup>

There are, however, important differences between CF arrangements and such bargaining games. When a client hires an attorney, none of the parties necessarily makes a take-it-or-leave-it offer to the other as in the Ultimatum

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26. See Brickman, *supra* note 11, at 99 (arguing that clients are led to believe that “[b]ecause all lawyers charge the same rate, it is necessarily ‘fair’”).

27. See generally STEVEN J. BRAMS & ALAN D. TAYLOR, *FAIR DIVISION* (1996).

28. For a general survey and analysis of the experimental data, see COLIN F. CAMERER, *BEHAVIORAL GAME THEORY: EXPERIMENTS IN STRATEGIC INTERACTION* 43–117 (2003).

29. See *id.* at 43 (reporting that in Ultimatum games, responders typically reject offers of twenty percent or so half the time).

30. Instead of, or in addition to, comparing the plaintiff's share to the total recovery, the plaintiff's net recovery may be compared to her actual loss or injury. This notion may be dubbed *compensation fairness*. Whenever recovery equals the plaintiff's loss, *compensation* and *division* fairness should basically converge. However, the total recovery may differ from the actual loss due to such factors as statutory limitations on damages or the award of punitive damages. Presumably, the lower the plaintiffs' recovery compared to her actual loss, the more *any* fee arrangement may be deemed unfair, and vice versa.

game, and certainly none of them enjoys a dictatorship position. More fundamentally, a CF arrangement is not only, or even primarily, a way to divide a certain pie; it is chiefly a way to remunerate the attorney for her time and skill, and to provide her with an incentive to win the case. In that sense, the pertinent fairness judgment should presumably refer to the equivalence between the attorney's work and her remuneration, to the *fairness of exchange*.<sup>31</sup> Put differently, whereas pricing fairness would compare a particular CF rate with the prevailing rates in the market, and division fairness would compare the attorney's share of the recovery to the client's share, fairness of exchange compares the attorney's fee to the value of her work.

With reference to the notion of output fairness mentioned above, fairness of exchange could also be termed input fairness.<sup>32</sup> Input plays a major role in Equity Theory developed by psychologist Stacy Adams with regard to exchange relations in the workplace.<sup>33</sup> Fairness of exchange has also been widely discussed in contract law scholarship.<sup>34</sup> This notion assumes that an attorney deserves a higher fee the more time she and her team dedicate to a case, the more talented and experienced she is, the better her reputation, and possibly the higher her opportunity costs of taking on the client's case. An attorney does not deserve a windfall of a high fee for little work.<sup>35</sup>

In contrast to hourly fee arrangements, CF arrangements do not directly reflect the input factor. Yet, the attorney's input presumably affects both the case's outcome and the perceived fairness of the fee.<sup>36</sup> The present article only

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31. See Brickman, *supra* note 11, at 71–72 (arguing that CF arrangements yield windfall fees unearned by either risk or effort); Virginia G. Maurer, Robert E. Thomas & Paula A. DeBooth, *Attorney Fee Arrangements: The U.S. and Western European Perspectives*, 19 NW. J. INT'L L. & BUS. 272, 298–99 (1999) (arguing that an attorney charging on a CF basis may “benefit disproportionately to the efforts and risk he invests”).

32. Division fairness is not, however, identical to output fairness. Only the latter is pertinent to arrangements in which the entitlement to remuneration—but not the remuneration's size—depends on the success of the claim, such as the conditional fee arrangements used in the United Kingdom. For comparisons of contingent fee arrangements and conditional fee arrangements, see Winand Emons, *Conditional Versus Contingent Fees*, 59 OXFORD ECON. PAPERS 89 (2007); Winand Emons & Nuno Garoupa, *U.S.-Style Contingent Fees and U.K.-Style Conditional Fees: Agency Problems and the Supply of Legal Services*, 27 MANAGERIAL & DECISION ECON. 379 (2006). At the same time, only division fairness is directly relevant to scenarios in which nobody's input is involved in producing the divided pie and thus the very notion of “output” is arguably inapplicable.

33. J. Stacy Adams, *Toward an Understanding of Inequity*, 67 J. ABNORMAL & SOC. PSYCHOL. 422 (1963); Adams, *supra* note 24.

34. See generally P.S. ATIYAH, *Contract and Fair Exchange*, in *ESSAYS ON CONTRACT* 329 (1990); JAMES GORDLEY, *THE PHILOSOPHICAL ORIGINS OF MODERN CONTRACT DOCTRINE* (1991); James Gordley, *Equality in Exchange*, 69 CALIF. L. REV. 1587 (1981) [hereinafter *Equality in Exchange*]; Eyal Zamir, *The Inverted Hierarchy of Contract Interpretation and Supplementation*, 97 COLUM. L. REV. 1710, 1778–82 (1997).

35. Lester Brickman, *ABA Regulation of Contingency Fees: Money Talks, Ethics Walks*, 65 FORDHAM L. REV. 247 (1996); Brickman, *supra* note 12; Brickman, *supra* note 11, at 72; Maurer et al., *supra* note 31, at 298–99.

36. The outcome of the case is affected not only by the attorney's effort, expertise, and experience, but also by her reputation, as the latter may affect the defendant's willingness to settle a case.

considers the amount of time an attorney works on the case because other aspects of the attorney's input are not as easily observed or quantified.

Notions of fairness ordinarily involve comparisons. Some notions require a comparison to *external* reference points such as the standard CF rates within the market (for assessing pricing fairness), or the hourly fee that would have been charged for the same service (fairness of exchange). To circumvent the difficulty of assessing fairness of exchange in the abstract, one may compare the EHR resulting from the CF with the hourly fee the attorney would have charged for similar services. Alternatively, the expected CF may be compared to a fixed, global fee that the attorney would have charged for handling the same case. Division fairness, in contrast, does not rest on such external yardsticks. It may be assessed by comparing the shares each person gets of the entire pie, without resorting to any external reference.

It is possible that a certain CF rate would be judged fair under all conceivable notions, or unfair under all of them. Often, however, the fairness of a CF rate in a particular case may be deemed fair according to one conception of fairness and unfair according to another.

As indicated above, pricing fairness is unhelpful when assessing the fairness of the standard CF rate rather than deviations from it. As between fairness of exchange and division fairness, only the first should presumably be considered relevant in the context of CFs. Compare, for instance, a case in which the expected recovery is \$50,000 and the prospect of recovery is 75%, with a case in which the expected recovery is \$500,000 and the prospect of recovery is 90%. Let us further assume that the standard hourly fee for legal services in the relevant locality is \$250, that handling each of the cases is expected to require 125 hours of work, and that the standard CF is 33% of the recovery. If both cases are taken on the basis of a CF of 33%, the attorney is expected to get an effective hourly rate of \$100 in case A, and \$1,200 in case B.<sup>37</sup> Put differently, for the same amount of work, the lawyer is expected to earn \$12,500 in case A, and \$150,000 in case B. This is compared with \$31,250 had she charged a fixed fee based on the standard hourly fee (\$250) multiplied by the amount of expected hours (125). Presumably, in case A, a CF rate of 80%, resulting in an expected fee of \$30,000 and EHR of \$240, should be deemed perfectly fair, and possibly even too low, given the insurance and credit elements embodied in CFs. At the same time, in case B, a CF rate of 20%, which resulted in an expected CF of \$90,000 and EHR of \$720, should be considered unreasonably high.

The article will presently describe the experiments designed to discover what factors actually determine the perceived fairness of CF arrangements. Before doing so, however, some further explanation of the practical significance of fairness judgments, that is, the possible ways in which they may affect the market for legal services, is in order.

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37.  $\$50,000 \times .75 \times .33 \div 125 = \$100$ ;  $\$500,000 \times .90 \times .33 \div 125 = \$1,200$ .

## B. Fairness Judgments and the Market for Legal Services

In addition to their theoretical interest, people's perceptions of the fairness of CF arrangements are potentially important for three practical reasons. First, these perceptions might affect clients' choices among different fee arrangements, as well as their decision to hire an attorney in the first place. If people dislike being treated unfairly, as the findings of experimental game theory described above possibly indicate,<sup>38</sup> then they might avoid entering into what they perceive as an unfair contract.

Second, it stands to reason that profit-seeking firms, including attorneys, take judgments of fairness into account when setting their prices. Various studies have indicated that people do not view agreed-upon prices, or prices determined by supply and demand in a certain market at a given point in time, as ipso facto fair.<sup>39</sup> Firms that wish to enhance their reputation (and decision-makers in the firm who prefer to act fairly) may thus be expected to take the prevailing notions of fairness into account.<sup>40</sup> If attorneys know or assume that certain fee arrangements are likely to be perceived as unfair, they might refuse to handle cases using such arrangements. Note that, under this explanation, attorneys may care about the perceived fairness of their conduct even if they do not expect it to directly affect the contracting choices of future clients.

Third, prevailing judgments of fairness may affect the market for legal services by affecting the regulation of CFs, both ex ante, when legislators and other policy makers consider whether and how to regulate CFs, and ex post, when judges are called upon to review such arrangements. Judges and legislators often lack the macroeconomic data and expertise necessary to evaluate the competitiveness of a market or the efficiency of a regulatory scheme. In fact, even experts often disagree about these issues, as the CF debate demonstrates. Judges and regulators may thus base their decisions on notions of fairness. Furthermore, even if uncontested economic data was available, policy makers might view fairness as a more appropriate criterion for regulation, or unconsciously base their decisions on judgments of fairness. To the extent that policy makers are affected by public opinion and that public opinion reflects prevailing standards of fairness, policy makers will be affected by those standards.<sup>41</sup> In actuality, both judges and legislators sometimes resort to notions of fairness as criteria for determining the validity of CF arrangements.<sup>42</sup>

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38. See *supra* text accompanying note 29.

39. *Fairness as a Constraint*, *supra* note 25; Bruno S. Frey & Werner W. Pommerehne, *On the Fairness of Pricing—An Empirical Survey Among the General Population*, 20 J. ECON. BEHAV. & ORG. 295 (1993); ATIYAH, *supra* note 34, at 331–32 (noting the deeply-embedded notion in Western societies that transactions should be substantively fair, and not only the product of a fair contracting process).

40. *Fairness as a Constraint*, *supra* note 25, at 736–37; Akerlof, *supra* note 25, at 230–33.

41. See generally EDWARD E. ZAJAC, *POLITICAL ECONOMY OF FAIRNESS* (1995) (discussing prevailing notions of fairness, their effect on policy makers, including the courts, and strategic uses of fairness arguments by interest groups in various contexts).

42. See, e.g., 735 ILL. COMP. STAT. 5/2-1114(c) (2010) (“The court may review contingent fee agreements for fairness.”); *McKenzie Constr., Inc. v. Maynard*, 758 F.2d 97, 101 (3d Cir. 1985) (holding

Conjecturing that judgments of fairness can directly (through the market) and indirectly (through the interplay between market actors and regulators) affect CF rates, we set out to identify what factors impact these judgments. Since the structure of the CF arrangement brings to mind notions of division fairness, we hypothesized that the CF rate would have greater effect on people's perceptions of fairness than the claim sum, the probability of success, the expected number of hours worked, and the resulting effective hourly rate. An additional experiment was designed to examine the correlation between people's fairness judgments and their choice of fee arrangement, thus testing the hypothesis that those judgments affect the market through clients' choices.

### III

#### EXPERIMENTS

##### A. Experiment 1: Judgments of Fairness

The first experiment explored how the perceived fairness of CF arrangements is affected by the magnitude of the sum claimed, the probability of success, and the CF rate. In a previous experiment, we found no significant correlation between the perceived fairness of CF arrangements and any of the following variables: (1) the timing of evaluation (prior to contracting with the lawyer versus following the successful handling of the case but before paying the fee), (2) the type of harm (personal injury versus property damage), and (3) the evaluator's position (the client versus a disinterested third person).<sup>43</sup> This lack of correlation may either accurately reflect people's judgments of fairness in the real world or stem from the abstract nature of the laboratory experiment. In light of the results of that experiment, in the present and following experiments, all questions referred to personal injuries and all participants were asked to make their judgments from the perspective of a third person, prior to contracting.

##### 1. Participants

One hundred and thirteen university students and applicants (46 men and 67 women) participated in the experiment in exchange for five new Israeli shekels (NIS).<sup>44</sup> Their ages ranged from 19 to 67, with a mean of 26 years.

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that the validity of a CF agreement should be determined according to an "equity and fairness standard"); *King v. Fox*, 418 F.3d 121, 135 (2d Cir. 2005) (holding that, to be valid, a CF arrangement should be "fair" both when it is made and at the time of its enforcement).

43. Since nobody has argued that the CF arrangements are unfair to the lawyer (who is much more familiar with this arrangement and often wealthier than the client), we did not ask respondents to assess the fairness of CF arrangements from the lawyer's perspective.

44. One new Israeli shekel roughly equals \$0.25.

## 2. Experimental Design

This experiment employed eight cases. Each one included details of the claim and the CF arrangement. All cases involved personal injury, and were evaluated *ex ante* from the perspective of an uninvolved observer. In all cases, the lawyer was expected to spend 100 hours working on the case. Three factors were varied orthogonally within subject: the amount claimed (100,000 NIS versus 500,000 NIS), the probability of success (65% versus 90%), and the proportion of CF (20% versus 55%).<sup>45</sup> Thus, each participant was asked to assess the fairness of eight cases. The complete list of cases presented, with the numerical details for each, is presented in Appendix Table A1. In addition, the order of the cases was counterbalanced between subjects using four different presentation orders. For each case, participants were asked to indicate their evaluation of the fairness of the agreement on a scale ranging from 1 (“definitely fair”) to 9 (“unfair and excessive”). Although a fee agreement may be deemed unfair either because it yields an unduly high remuneration or an unduly low one, the present and following experiments focused on excessive fees because this is the type of unfairness relevant to the current CF debate. A typical question read as follows:

Imagine that a person was harmed during medical treatment in a hospital and that he is considering suing the hospital for damages. The estimation is that, if the court would find the hospital liable, the person would receive damages of 100,000 NIS, that the claim’s chance of success is 65%, and that a lawyer who would handle the case would have to spend 100 working hours. The lawyer whom this person approached is willing to take the case for a fee of 20% of the awarded damages (that is, the lawyer will receive 20,000 NIS if the claim is successful and 0 NIS if the claim is dismissed).

How would you describe this fee along a scale of 1 to 9, where 1 indicates a definitely fair fee and 9 indicates an unfair and excessive fee (mark one number):

Definitely fair 1 2 3 4 5 6 7 8 9 Unfair and excessive

## 3. Results

Although order of presentation had a significant effect across cases,<sup>46</sup> it did not significantly interact with any of the three factors. Our main concern is the effect of the three factors: claim sum, probability of success, and CF rate. Hence, for the following analyses, the data was collapsed across presentation orders. Table 1 presents the mean *unfairness* rating for all combinations of the three factors.

45. To keep the questions simple, the cases did not mention the possibility of obtaining different amounts of damages in different probabilities. Even if this gap leaves some ambiguity in the description, it should not affect the results since this ambiguity is common to all cases.

46.  $F(3, 106)=6.173, p=0.001$ , in a repeated measure analysis of variance (ANOVA) of fairness ratings by factors and order. The mean unfairness rating across cases was higher in the two questionnaires that began with cases that were considered less unfair than in the two questionnaires that began with cases that were considered more unfair. Thus, the case encountered first seems to affect subsequent judgments perhaps due to a contrast effect.

Table 1: Mean Unfairness Ratings in Experiment 1

Claim Sum	100,000			500,000		
	65%	90%	Overall	65%	90%	Overall
Probability of Success	3.36	3.56	3.44	3.82	4.25	4.01
CF = 20%	6.14	6.56	6.32	6.24	6.95	6.54
Overall	4.75	5.04	4.89	4.97	5.56	5.27

Each of the three factors contributed significantly to the perceived unfairness of the lawyer's fee. Specifically, the lawyer's fee is perceived as more unfair the larger the total claim, the higher the probability of success, and the higher the CF rate.<sup>47</sup> The EHR is a product of these three factors. Hence, to the extent that the EHR plays a role, this should be reflected in significant interaction effects. However, the three factors seem to have an additive effect on the evaluation as none of the interactions reached a significant level. Although all three factors affect unfairness judgments, the impact of the CF rate clearly overshadows the other two factors. For each subject, the difference in mean judgment between cases with a high value and cases with a low value was computed for each of the factors. A repeated analysis of variance (ANOVA) of the resulting differences showed a significant difference between the three: increasing the CF rate from 20% to 55% increased average unfairness by 2.70 on a scale of 1 to 9, whereas increasing the claim from 100,000 to 500,000 NIS increased average unfairness by only 0.38, and increasing the probability of success from 65% to 90% increased average unfairness by only 0.44. Thus, the impact of the CF rate was several times greater than the impact of the other two factors. This conclusion should, however, be taken with care as the differences between the high and low values of each of the three factors—claim sum, success probability, and CF rate—and the scales on which they are indicated are dissimilar and do not lend themselves to straightforward comparison.

## B. Experiment 2: Separate Evaluations

In this experiment, the same cases were presented as in Experiment 1, with each participant evaluating a single case. Thus, it was a completely between-subject design. Since all relevant judgments of fairness are conventionally based on comparisons, it was interesting to examine whether respondents' answers would present the same pattern as in Experiment 1 when each respondent was presented with a single case.

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47.  $F(1, 109)=10.239$ ,  $F(1, 109)=42.768$ , and  $F(1, 109)=192.425$ , for claim value, probability of success, and CF rate, respectively, in a repeated measure ANOVA of the eight unfairness ratings by the three independent factors.  $p<0.01$  in all cases.

### 1. Participants

Two hundred and forty-nine students (130 men and 119 women) participated in the experiment voluntarily. Their ages ranged from 18 to 57, with a mean of 25 years.

### 2. Experimental Design

Experiment 2 used the same eight cases as Experiment 1. The complete list of the cases is presented in Appendix Table A1.

### 3. Results

The results essentially replicated those of the within-subject Experiment 1. All three factors—the CF rate, the amount claimed, and the probability of success—had a significant effect on the perceived fairness of the fee, but the CF rate seems to have a greater impact. Increasing the claim sum from 100,000 NIS to 500,000 NIS increased the mean unfairness rating by 0.73, from 5.02 to 5.75, increasing the probability of success from 65% to 90% increased mean unfairness by 0.53, from 5.13 to 5.66, and increasing CF rate from 20% to 55% increased mean unfairness by 1.59, from 4.59 to 6.18 (all on a scale of 1 to 9). Table 2 presents the mean unfairness rating for all combinations of the three factors.

Table 2: Mean Unfairness Ratings in Experiment 2

Claim Sum	100,000			500,000			
	Probability of Success	65%	90%	Overall	65%	90%	Overall
CF = 20%		3.74	4.24	3.98	5.56	4.75	5.16
CF = 55%		5.28	6.74	6.00	5.90	6.84	6.37
Overall		4.52	5.53	5.02	5.73	5.78	5.75

## C. Experiments 3 and 4: Changing CF Rates

In Experiment 1, the ratio between the two claim sums was 1:5, the ratio between the two probabilities of success was 1:1.38, and the ratio between the two CF rates was 1:2.75. Because it is difficult to draw general conclusions from a single set of variables, Experiments 3 and 4 were designed to examine the generality of the results of Experiment 1 using different values of CF rates.

### 1. Participants

Eighty students participated in the experiment in exchange for 5 NIS. Forty-one students (21 men and 20 women), whose ages ranged from 20 to 50, with a mean of 26, participated in Experiment 3. Thirty-nine students (19 men and 20 women), whose ages ranged from 18 to 60, with a mean of 25 years, participated in Experiment 4.

## 2. Experimental Design

The experimental design of Experiments 3 and 4 was identical to that of Experiment 1 except for changing the CF rates. Thus, in each experiment, three factors were varied orthogonally within subject: the amount claimed (100,000 NIS versus 500,000 NIS), the probability of success (65% percent versus 90%) and the CF rate (30% versus 40% in Experiment 3 and 45% versus 55% in Experiment 4). The complete list of cases, with their respective numerical details, is presented in Appendix Tables A2 and A3. In all cases, the lawyer was expected to spend 100 hours on the case. The order of the cases was counterbalanced between subjects, using four different presentation orders.

## 3. Results

The order of the cases did not have a significant main effect,<sup>48</sup> nor did it interact with the other factors. Since our main hypothesis concerns the effect of the three factors—claim sum, probability of success, and CF rate—in the following analyses, the data was collapsed across presentation orders. Table 3 presents the mean unfairness rating for all combinations of the three factors separately for each of the experiments.

Table 3: Mean Unfairness Ratings in Experiments 3 and 4

	Claim Sum	100,000			500,000		
		Probability of Success	65%	90%	Overall	65%	90%
Experiment 3	CF = 30%	3.83	4.49	4.16	4.59	5.22	4.90
	CF = 40%	5.29	5.66	5.48	5.59	6.63	6.11
	Overall	4.56	5.07	4.82	5.09	5.93	5.51
Experiment 4	CF = 45%	4.44	5.12	4.78	4.93	6.02	5.48
	CF = 55%	5.25	6.07	5.66	5.98	6.78	6.38
	Overall	4.84	5.60	5.22	5.45	6.40	5.93

In both experiments, each of the three factors contributed significantly to the perceived unfairness of the lawyer's fee. Specifically, the lawyer's fee was judged as more unfair the larger the total claim, the higher the probability of success, and the higher the lawyer's share.<sup>49</sup> Again, these factors seem to have an additive effect on the evaluation as none of the interactions reached a significant level.

48. A main effect is the effect of the variable averaging over all levels of other variables in the experiment.

49.  $F(1, 40)=8.477$ ,  $F(1, 40)=7.969$ , and  $F(1, 40)=40.988$ , for claim value, probability of success, and the lawyer's share in Set 1, respectively, in a repeated measure ANOVA of the eight unfairness ratings by the three independent factors.  $p<0.01$  for all main effects.  $F(1, 40)=8.085$ ,  $F(1, 40)=9.867$ , and  $F(1, 40)=43.316$ , for claim value, probability of success, and the lawyer's share in Set 2, respectively, in a repeated measure ANOVA of the eight unfairness ratings by the three independent factors.  $p<0.01$  for all main effects.

As in Experiment 1, the difference in mean fairness judgment between cases with a high value and cases with a low value for each of the factors was computed for each participant. For Experiment 3, a repeated ANOVA of the three resulting differences showed a significant difference between the three: increasing the CF rate from 30% to 40% increased average unfairness by 1.26 on a scale of 1 to 9, whereas increasing the claimed amount from 100,000 NIS to 500,000 NIS increased average unfairness by 0.69, and increasing the probability of success from 65% to 90% increased average unfairness by 0.68. Thus, the impact of the CF rate was considerably greater than the impact of the other two factors although the ratio between the two CF rates was 1:1.33 and the ratio between the claimed sums was 1:5, and the ratio between the two probabilities of success was 1:1.38.

In Experiment 4, in contrast, the differences between the effects of the three factors were not significant: increasing the CF rate from 45% to 55% increased average perceived unfairness by 0.89, whereas increasing the claimed sum from 100,000 NIS to 500,000 NIS increased average unfairness by 0.71, and increasing the probability of success from 65% to 90% increased average unfairness by 0.85.

#### D. Experiment 5: Varying Working Hours

In the first four experiments, the three variables were the claimed sum, the probability of recovery, and the CF rate while the hours the attorney was expected to spend on the case remained constant. To examine the effect of varying the hours worked, the probability of success was held constant in Experiment 5, and the expected hours required to handle the case were varied instead.

##### 1. Participants

One hundred and two students (43 men and 59 women) participated in the experiment in exchange for 5 NIS. Their ages ranged from 19 to 67, with a mean of 25 years.

##### 2. Experimental Design

The experimental design of Experiment 5 was based on the design of Experiments 1, 3, and 4. To avoid doubling the number of cases, the same probability of success, 80%, was indicated in all cases. Three factors were thus varied orthogonally within subject: the amount claimed (100,000 NIS versus 500,000 NIS), the hours the lawyer was expected to spend on the case (100 versus 40), and the CF rate (20% versus 40%). The complete list of cases, with their numerical details, is presented in Appendix Table A4. In addition, the order of the cases was counterbalanced between subjects, using four different presentation orders.

### 3. Results

Although the order of the cases had a significant overall effect,<sup>50</sup> it did not significantly interact with any of the three factors. Therefore, for the following analyses, the data was collapsed across orders. Table 4 presents the mean unfairness rating for all combinations of the three factors.

Table 4: Mean Unfairness Rating in Experiment 5

Claim Sum	100,000			500,000			
	Number of Hours	100	40	Overall	100	40	Overall
CF = 20%		4.12	4.64	4.37	4.58	5.50	5.04
CF = 40%		5.08	6.02	5.56	5.90	6.60	6.28
Overall		4.59	5.33	4.95	5.24	6.05	5.65

Each of the three factors contributed significantly to the unfairness judgment of the lawyer's fee. The lawyer's fee was judged as more unfair the larger the claimed sum, the lower the estimated hours worked, and the higher the CF rate.<sup>51</sup> As in the previous experiments, the interactions between the factors did not reach a significant level. To compare the relative impact of the differences along the three factors, once again, the difference in mean judgment between cases with a high value and cases with a low value for each of the factors was computed. A repeated-measure ANOVA of the three resulting differences as a within-subject factor yielded a significant effect.<sup>52</sup> Increasing the CF rate from 20% to 40% increased average unfairness by 1.22, whereas increasing the claim sum from 100,000 NIS to 500,000 NIS increased average unfairness by 0.70, and decreasing the working hours from 100 to 40 increased average unfairness by 0.77. Thus, while the CF rate was increased by a factor of 2, its effect on the judged unfairness was considerably greater than the effect of increasing the claim sum by a factor of 5, and decreasing the number of hours worked by a factor of 2.5.

#### E. Experiment 6: Judgments and Choices

As indicated above, perceptions of unfairness may affect market behavior through clients' choices, lawyers' choices, and regulation. To test the first possibility, Experiment 6 examined plaintiffs' choices between CF and fixed fee (FF) arrangements in eight scenarios corresponding to the scenarios described in Experiment 1. The details of the cases used in Experiment 6 closely follow the details of the cases used in Experiment 1 except for two complementary

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50.  $F(3, 97)=4.061, p<0.01$  in a repeated-measure ANOVA of fairness ratings by factors and order. The mean unfairness rating across problems was lowest in the two questionnaires that began with a case that was considered the most unfair. As in Experiment 1, here too the case encountered first seems to affect subsequent judgments, probably due to a contrast effect.

51.  $F(1, 97)=26.694, F(1, 97)=36.927$ , and  $F(1, 97)=71.723$ , for claimed sum, number of hours, and CF rate, respectively.  $p<0.01$  for each of the three factors.

52.  $F(2, 202)=5.661, p<0.01$ .

modifications. In both experiments, we used the same set of cases in terms of the probabilities of success and CF rates. However, in Experiment 6, both the claimed sum and the expected number of working hours were divided by two. For instance, while Case 8 in Experiment 1 referred to a claim of 500,000 NIS with a 90% probability of success, a CF rate of 55%, and 100 working hours, the corresponding case in Experiment 6 referred to a claim of 250,000 NIS with the same probability of success and CF rate, but only 50 working hours. Hence, the EHR in both experiments was identical, but the expected fee was half as large in the choice experiment. In all cases, respondents were asked to choose between hiring a lawyer on a CF basis, hiring a lawyer on an FF basis, and not handling the case at all. In all cases, the ratio between FF and the expected contingent fee (ECF), that is, the amount claimed multiplied by the probability of success and by the percentage of CF, was 1:2.5. Thus, by dividing both the claimed sum and the expected number of working hours by 2, we correspondingly decreased the FF in each case by 2. The FF sum thus ranged from 2,600 NIS to 49,500 NIS, which we assumed would be closer to what a student respondent could reasonably afford. The ratio of 1:2.5 between the FF and the ECF was chosen based on the results of other experiments revealing people's preferences regarding attorneys' fees. Those experiments indicated that while less than half of the respondents prefer CF when the FF:ECF ratio is 1:3.3, more than half prefer CF when the ratio is 1:2.<sup>53</sup>

### 1. Participants

Forty-three students (15 men and 27 women, one participant did not indicate gender) participated in the experiment in exchange for 5 NIS. Their ages ranged from 19 to 53, with a mean of 25.

### 2. Experimental Design

We employed eight decision problems. Each subject was presented with eight scenarios, varying as to the sum claimed (50,000 NIS versus 250,000 NIS), the probability of success (65% versus 90%), and the CF rate (20% versus 55%). These three factors were varied orthogonally within subject. In addition, two different presentation orders of the eight problems, as well as two orders of the CF and FF options, were counterbalanced across subjects. All cases involved physical injury caused during medical treatment in a hospital. In all scenarios, the attorney was expected to work 50 hours on the case. Subjects were asked to decide which fee arrangement, CF or FF, they would prefer as a plaintiff. The complete list of cases is presented in Appendix Table A5. A typical question read as follows:

Imagine that, during a treatment in a hospital, damage was caused to your left hand and that you are considering suing the hospital for damages. It is estimated that if the

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53. Zamir & Ritov, *supra* note 1, at 267–68. Note that the information regarding the expected working hours was actually immaterial in the choice problems, as the choice was between a contingent fee and a fixed fee, and not between the former and an hourly fee.

court would rule that the hospital is liable for the injury, you would receive damages of 50,000 NIS, that the suit's chance of success is 65%, and that the attorney who would handle the case will have to spend about 50 working hours.

You may choose one of the following three options:

A. Ask a lawyer to represent you in claiming damages for 20% of the sum received following his handling of the case (if the damages were obtained, the lawyer would get 10,000 NIS; if no damages were obtained, the lawyer would get nothing). Assume that the lawyer bears all of the costs involved in handling the case.

B. Ask a lawyer to represent you in claiming damages for a fixed sum of 2,600 NIS (to be paid even if you receive no damages at all). Assume that the lawyer bears all of the costs involved in handling the case.

C. Avoid handling the matter.

What option would you prefer? (Circle the appropriate answer) **A B C**

### 3. Results

Table 5 presents the percent of participants who preferred CF over FF in each case. A repeated-measure ANOVA predicting choice in each of the eight cases from claim value, probability of success, and CF rate yielded a significant effect for probability of success as well as a significant effect for the claim value.<sup>54</sup> The effect of the CF rate did not approach a significant level ( $p=0.3$ ), and neither did any of the interactions. Overall, respondents preferred CF in 4.49 out of 8 cases. Thus, in 58% of the choices (excluding avoidance), respondents preferred the CF option over FF even when the expected CF was 2.5 times higher than the FF.

Table 5: Percent of CF Choices, Out of All Non-Avoidance Choices<sup>55</sup>

Claim Sum	50,000		250,000	
	Probability of Success	CF = 20%	Probability of Success	CF = 20%
65%	90%	65%	90%	
64.3	23.8	92.7	52.4	
68.3	34.1	80.0	53.7	

## IV

### ANALYSIS AND IMPLICATIONS

#### A. Division Fairness Versus Fairness of Exchange

The experiments examining judgments of fairness revealed that all four factors—the sum claimed, the probability of success, the CF rate, and the expected working hours—affect the perceived fairness of a CF arrangement. These findings make perfect sense. The larger each of the first three factors, and the smaller the fourth factor, the higher the lawyer's fee, and, thus, the more it

54.  $F(1, 42)=42.743, p<0.001$  and  $F(1, 42)=17.99, p<0.001$ , respectively.

55. In each cell, no more than three respondents chose the avoidance option.

is likely to be considered “unfair and excessive.”<sup>56</sup> However, the disproportionate weight of the CF rate indicates that the fairness of CF arrangements is primarily seen as raising an issue of division fairness rather than fairness of exchange. Viewed from the perspective of fairness of exchange—which is presumably the appropriate one—the experiments’ results are counterintuitive and even strange. Compare, for example, Case 2 in Experiment 1—involving a 100,000 NIS claim with a 65% probability of success and a CF rate of 55%—to Case 7 in the same experiment—involving a 500,000 NIS claim with a 90% probability of success and a CF rate of 20%. Although in the latter case, the lawyer assumes a smaller risk, and her EHR is more than 2.5 times greater than in the former (900 NIS compared to 357.5 NIS), the fee arrangement in the latter case is considered much fairer (4.25 compared to 6.14). Similarly, although the EHR in Case 5 is considerably higher than the EHR in Cases 2 and 4 of the same experiment (650 NIS compared to 357.5 NIS and 495 NIS, respectively), the CF arrangement in Case 5 is considered much fairer than in Cases 2 and 4 (3.82 compared to 6.14 and 6.56, respectively).

Similar observations apply to Experiment 3. Compare, for instance, Case 7—claimed sum of 500,000 NIS, 90% probability of success, and a 30% CF rate—in which the effective hourly rate is 1,350 NIS, with Case 2—claimed sum of 100,000 NIS, 65% success probability, and 40% CF rate—in which the EHR is 260 NIS. Despite the fact that in Case 7, the attorney is expected to earn a sum that is more than 5 times greater than in Case 2, the perceived unfairness of the two cases is almost identical, and in fact, it is slightly higher for Case 2 (5.29 compared to 5.22). Similarly, although the EHR in Case 5 (975 NIS) is 3.75 and 2.7 times greater than the EHRs in Cases 2 and 4 (260 NIS and 360 NIS), respectively, the perceived unfairness of the CF in Case 5 (4.59) is considerably *smaller* than the perceived unfairness in Cases 2 (5.29) and 4 (5.66).

Although the mean effect of the CF rate on the perceived unfairness of CF in Experiment 4 was not much higher than the mean effect of the probability of success and the sum claimed (0.89, compared to 0.85 and 0.71), some of the results of this experiment are similarly counterintuitive. Thus, although the effective hourly rate in Case 5 (1,462.5 NIS) is approximately four times higher than in Case 2 (357.5 NIS) and three times higher than in Case 4 (495 NIS), the perceived unfairness in Case 5 (4.93) is *smaller* than in Case 2 (5.25) and Case 4 (6.07). These striking results are due to the fact that, in this experiment, the ratio between the two values of CF rates (45% and 55%), 1:1.22, was smaller than the ratio between the two amounts claimed (100,000 NIS and 500,000 NIS), 1:5, and between the two probabilities of success (65% and 90%), 1:1.38.

Finally, the results of Experiment 5 follow the pattern of Experiments 1 and 3 and present similar peculiarities. For instance, although the effective hourly

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56. Since the participants in this experiment were laypersons, who are unlikely to know what the prevailing rates in the market for legal services in Israel are, it is improbable that their judgments were in any way affected by a comparison between the details provided in the questions and the prevailing rates.

rate in Case 7 of this experiment (2,000 NIS) is 2.5 times higher than in Case 4 (800 NIS), the perceived unfairness in Case 7 (5.5), in which the CF rate is 20%, is *smaller* than in Case 4 (6.02), in which the CF rate is 40%. Similarly, while the EHR in Case 5 (800 NIS) is 2.5 times higher than in Case 2 (320 NIS), the perceived unfairness in Case 5, in which the CF rate was 20% (4.58) is *smaller* than in Case 2, in which the CF rate was 40% (5.08).

It thus seems that the impact of the attorney's share on the perceived fairness of CF arrangements is considerably stronger than the other three factors—the probability of success, the sum claimed, and the hours spent on the case. This is true not only when the ratio between the compared CF rates was 1:2.75, but also when it was much smaller. At the same time, although in our experiments, the sum claimed had the greatest effect on the attorney's remuneration because the ratio between the two values was 1:5, its effect on the perceived unfairness was relatively small. This result may have to do with the decreasing marginal utility of money. In any case, the most striking result of the first five experiments is that the very use of the CF obscures its role as a means of calculating remuneration for work done and highlights its role in dividing the pie—thus invoking judgments based on notions of division fairness rather than fairness of exchange. Arguably, the disproportionate impact of the CF rate on the perceived fairness of the fee arrangement stems from the fact that unlike the other factors—claimed sum, chance of success, and working hours—it is volitionally determined by the lawyer. However, none of these factors is truly exogenous, as they all depend on the lawyer's behavior. More importantly, this difference between the various factors is not a product of our experimental design, but rather a feature of CF arrangements in the real world. It thus remains true that CF arrangements primarily invoke notions of division fairness.

It should be noted that no support was found for the hypothesis that these judgments are due to framing effects.<sup>57</sup> In a separate between-subject experiment, we used three different depictions of the CF arrangement. One depiction indicated only the percentage of recovery (as is common in the real world), another specified only the contingent global sum, and the third denoted only a contingent hourly rate.<sup>58</sup> Although the perceived unfairness of the fee arrangement was highest in the contingent hourly rate framing and lowest in the percentage framing, these differences did not approach a significant level.<sup>59</sup>

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57. Framing effect refers to the dependence of a choice on the manner in which an option is presented, so that changing the presentation format alters people's choices.

58. For instance, we used a case in which the claimed sum was 300,000 NIS, the chance of success 80%, and the lawyer was expected to spend 100 hours on the case. The first version indicated that the lawyer will receive 25% of the recovery, the second version referred to a global fee of 75,000 NIS, and the third to an hourly fee of 750 NIS, if the claim succeeds (clarifying, in all three versions, that if the claim fails, the lawyer gets nothing). The attorney's expected fee is the same under all three framings.

59. Similarly, in another experiment, where the three factors of claimed sum, probability of success, and CF rate were varied orthogonally within subject, and the CF arrangement was described to some respondents as a percentage of recovery and to others as a contingent hourly fee (with the same

Our findings also shed light on a more general aspect of fairness judgments, namely, the role of comparisons. Specifically, the results of Experiments 1, 3, and 4 display a contrast effect.<sup>60</sup> Thus, a CF rate of 55% was considered more unfair in Experiment 1, in which it was juxtaposed to a CF rate of 20%, than in Experiment 4, in which it was juxtaposed to a CF rate of 45%.<sup>61</sup> In the same vein, the overall unfairness rating of a CF rate of 45% that was presented along with a CF rate of 55% in Experiment 4 was judged fairer than a CF rate of 40% that was presented along with a CF rate of 30% in Experiment 3.<sup>62</sup> It seems that people do not have a precise, cardinal scale of fairness. Rather, they base their judgments of fairness on comparisons to some baselines. This observation must not, however, be overstated. For one thing, the same pattern of fairness judgments was manifest in Experiments 1 and 2, despite the fact that in the latter, each respondent was presented with a single case. Presumably, therefore, people do have some general notions of fairness that do not hinge on the data specifically presented to them. The fact that the mean unfairness rating of the lower CF rate presented in Experiments 1, 3, and 4 (20%, 30%, and 45%, respectively) increased the higher the CF rate was, also supports this conjecture.<sup>63</sup>

## B. Judgments, Choices, and Regulation

Very high CF rates may be mutually beneficial, especially if the expected recovery is relatively small and the plaintiff does not have the means to finance legal services.<sup>64</sup> According to the available data, however, such rates are actually rare.<sup>65</sup> Can the perceived unfairness of very high CF rates explain its rarity?

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clarification in both versions regarding the resulting total amount), the between-subject framing factor did not significantly affect perceived unfairness, nor did it significantly interact with any of the three within-subject factors.

60. On anchoring (contrast and assimilation) effects in fairness judgments, see, e.g., Barry Markovsky, *Anchoring Justice*, 51 SOC. PSYCOL. Q. 213 (1988).

61. Overall unfairness ratings of 6.32 and 6.54 for the 100,000 NIS and 500,000 NIS claim sums, respectively, in Experiment 1 compared to 5.66 and 6.38 for the two claim sums in Experiment 4.

62. Overall unfairness ratings of 4.78 and 5.48 for the 100,000 NIS and 500,000 NIS claim sums, respectively, in Experiment 5 compared to 5.48 and 6.11 for the two claim sums in Experiment 3.

63. The mean unfairness rates for the lower CF rate in the three experiments were 3.44, 4.16, and 4.78 for the 100,000 NIS claim sum, and 4.01, 4.90, and 5.48 for the 500,000 NIS claim sum, respectively. It should be noted, however, that the three experiments differed not only with regard to the value of the lower CF rate, but also with regard to the ratio between the low and the high CF rate in each experiment. As the lower CF rate increased, the ratio between the two rates decreased, and it may be argued that this decrease affected the fairness assessments.

64. Excluding such claims may be socially desirable if the costs they impose on the court system are larger than their benefits to the parties involved. However, this consideration is unlikely to affect the behavior of the plaintiff and her attorney.

65. RISKS, REPUTATIONS, AND REWARDS, *supra* note 8, at 37–43 (finding that only about one percent of CF arrangements in Wisconsin based on a flat rate had fees exceeding one-third of recovery and citing other studies that found CF arrangements in excess of one-third to vary between ten and twelve percent of the total).

Although the probability of success and the sum claimed yielded a significant effect on the preference for the CF over the FF in Experiment 6, the effect of the CF rate did not approach a significant level. This result may seem surprising given the large difference between CF rates of 20% and 55%, and the robust difference in the perceived fairness of the two rates as found in Experiment 1. This result is less surprising once one recalls that, to maintain a constant ratio of 1:2.5 between the FF and ECF, the FF in the cases of the 55% CF rate was quite high—possibly prohibitively high for some respondents in some of the cases (as fixed and hourly fees are, in fact, for some plaintiffs in the real world).

The design of the experiments does not allow for general claims about the relationships between plaintiffs' fairness judgments and their choices. First, the choices examined in Experiment 6 called for a comparison of a CF to a FF. As the experiments did not study fairness perceptions of fixed fee arrangements, one cannot unequivocally rule out the possibility that the choices were affected by perceived relative fairness of the two options. Second, the evaluation mode was different in the judgment and the choice experiments. In the five fairness experiments, the participants assessed the fairness of each CF arrangement on its own, rather than the relative fairness of different arrangements; whereas in the choice experiment, the choice was made between two alternatives (three, if one includes the avoidance option).

Earlier research suggests that, for the same set of options, tasks that call for comparative judgment and tasks that rest on isolated judgments may yield different rankings. This has been shown for fairness versus preference,<sup>66</sup> satisfaction versus choice,<sup>67</sup> and other domains.<sup>68</sup> It is possible that the mode of evaluation played a role in this article's experiments as well. Although this plausible argument limits our ability to draw general conclusions regarding the relationship between fairness and preferences from the experiments, it does not

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66. See generally David M. Messick & Keith Sentis, *Fairness, Preference, and Fairness Bias*, in *EQUITY THEORY: PSYCHOLOGICAL AND SOCIOLOGICAL PERSPECTIVES* 61 (David M. Messick & Karen S. Cook eds., 1983); David M. Messick & Keith Sentis, *Fairness and Preference*, 15 *J. EXPERIMENTAL SOC. PSYCHOL.* 418 (1979); Max H. Bazerman, George F. Loewenstein & Sally Blount White, *Reversals of Preference in Allocation Decisions: Judging an Alternative Versus Choosing Among Alternatives*, 37 *ADMIN. SCI. Q.* 220 (1992); Max H. Bazerman et al., *The Inconsistent Role of Comparison Others and Procedural Justice in Reactions to Hypothetical Job Descriptions: Implication for Job Acceptance Decisions*, 60 *ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES* 326 (1994); Max H. Bazerman, Sally Blount White & George F. Loewenstein, *Perceptions of Fairness in Interpersonal and Individual Choice Situations*, 4 *CURRENT DIRECTIONS IN PSYCHOL. SCI.* 39 (1995); Wen-Qiang Bian & L. Robin Keller, *Patterns of Fairness Judgments in North America and the People's Republic of China*, 8 *J. CONSUMER PSYCHOL.* 301 (1999).

67. Amos Tversky & Dale Griffin, *Endowment and Contrast in Judgments of Well-Being*, in *SUBJECTIVE WELL-BEING: AN INTERDISCIPLINARY PERSPECTIVE*, 101, 113–15 (Fritz Strack et al. eds., 1991).

68. See Christopher K. Hsee, George F. Loewenstein, Sally Blount & Max H. Bazerman, *Preference Reversals Between Joint and Separate Evaluations of Options: A Review and Theoretical Analysis*, 125 *PSYCHOL. BULL.* 576 (1999) (reviewing the literature and proposing an explanation for the phenomenon of preference reversal between joint and separate evaluations).

detract from its relevance to the market for legal services. Experiment 6 suggests that, whenever a plaintiff would face a choice between CF and FF arrangements, she would not likely base her decision on abstract notions of fairness. In cases of small expected recovery (the claimed sum multiplied by the probability of success) in which plaintiffs face a choice between a very high CF rate, a relatively high non-contingent fee, and avoiding any action, plaintiffs will likely opt for the very high CF rate.<sup>69</sup>

To the extent that the rarity of very high CF rates has to do with its perceived unfairness, it thus seems that this is not primarily due to plaintiffs' preferences. The remaining possible mechanisms are (1) the preferences of attorneys who care about their reputation and do not wish to be viewed as charging excessively high fees, and (2) the interplay between the bar and the courts and the legislators who regulate CF rates. While we have not tested these interrelated hypotheses experimentally, they both seem plausible and the latter actually coheres with our findings.

Firms that care about their reputation are likely to avoid actions that are commonly perceived as unfair, even if such actions are profitable, legal, and not obviously dishonest.<sup>70</sup> This "fairness constraint" may be particularly effective where reputation and personal trust loom large as in the market for legal services. Assume that, due to a small expected recovery or a slim chance of success, representing a plaintiff on a CF basis in a certain case is deemed profitable only if the CF would be 70% of the recovery. If the attorney knows such a CF would be considered unfair by most people and, hence, adversely affect her reputation once made public, she would probably refuse to take the case on a CF basis.<sup>71</sup> She will either refuse to take the case or accept it on an hourly fee basis (explaining to the client, one should hope, the expected costs and benefits of pursuing the case). This would be the case even if the client were perfectly willing to hire the attorney on a CF basis. Lawyers who strive to enhance their reputation, who are attentive to the recurring public debates about legal fees, and who may fear further regulation, plausibly take prevailing notions of fairness into account when setting their fees.<sup>72</sup> The very fact that,

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69. This conclusion holds whether the attorney offers the client such a choice or (which is more often the case in some legal fields) only offers her the standard CF arrangement. Even if the latter may seem unfair in the abstract, the client would prefer it over a fixed fee. The client would therefore either refrain from raising the issue or, when offered such a choice in response to her inquiry, stick to the CF arrangement.

70. *Fairness as a Constraint*, *supra* note 25. The alternative explanation, according to which lawyers do not work for very high CF rates because the cases in which such rates might be mutually beneficial are very risky, is less persuasive. A lawyer who handles many cases is presumably risk-neutral.

71. *Cf.* RICHARD MOORHEAD & REBECCA CUMMING, *DAMAGE-BASED CONTINGENCY FEES IN EMPLOYMENT CASES* 43, 81–82 (2008, updated 2009) (finding that "a high risk case is more likely to be refused contingency funding in the first place than taken on but for a higher potential fee").

72. An indirect support for this conjecture may be found in the answers lawyers gave Herbert Kritzer when asked to explain why they sometimes collect fees that are less than what the retainer agreement entitles them to:

unlike other fee arrangements, a CF invokes notions of division fairness, which do not hinge on any external benchmark, makes it easier for people to form an opinion on the fairness of these arrangements. These opinions may then fuel the public debate, which, in turn, affects lawyers' conduct. The hypothesized fairness constraint possibly protects clients from exploitation by lawyers, yet, at the same time, it also hinders mutually beneficial bargains and obstructs poor people's access to justice.

Turning to the interplay between the bar, the courts, and the legislators, the experiments' findings are compatible with the rulings of American courts reviewing CF arrangements. Like the respondents in our experiments, courts at least rhetorically pay heed to all the circumstances of the case, including the scope of the attorney's work, the sum claimed, the risk involved in the case, and the CF rate.<sup>73</sup> However—once again, much like our respondents—the courts seem to give more weight to the CF rate than to other variables. On the one hand, courts do not generally interfere when the CF rate is low,<sup>74</sup> even though the EHR in such cases may be quite high when the claimed sum and chance of success are sufficiently large and the amount of work is sufficiently small. On the other hand, courts invalidate very high CF rates despite the fact that such rates may result in low EHRs whenever the sum claimed and the chance of success are relatively low, or the amount of work is sufficiently large. Thus, commentators have observed that “[j]udicial tolerance of fee percentages seems to end at 50 percent.”<sup>75</sup> Although our findings do not indicate a particular

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[S]ome lawyers expressed the view that the lawyer should not walk away with more than the client; in cases in which substantial payments had to be made to subrogated parties, lawyers often reduced their fee to a level that they split with the client what was left after paying the subrogated claims.

RISKS, REPUTATIONS, AND REWARDS, *supra* note 8, at 41.

73. *See, e.g.,* Garden Hill Land Corp. v. Succession of Cambre, 306 So. 2d 718, 723 (La. 1975) (holding that an attorney representing a minor in probate proceedings should be allowed to prove that a “50% contingency fee contract was reasonable . . . taking into account among other things, the risk of non-recovery, the amount of legal work, the size of the minor’s estate, and the anticipated delay in receipt of his fee . . .”). *See also* Clark v. Sage, 629 P.2d 657, 661 (Idaho 1981) (mentioning nine different factors that courts and administrative agencies must consider in determining a reasonable fee on a contingent fee basis); ARONSON, *supra* note 4, at 92 (“[R]easonableness depends on the circumstances of the case.”); ROSSI, *supra* note 4, at 111–12 (“Courts have generally stated that the reasonableness of a contingency fee contract should be looked at in light of the factors as they existed at the time the contract was entered into . . .”).

74. ARONSON, *supra* note 4, at 91 (observing that “a 25 percent contingent fee has been generally approved,” and that courts have also approved contingent fees in the range of one-third).

75. *Id.* at 92. *Accord* TOOTHMAN & ROSS, *supra* note 20, at 178; Brickman, *supra* note 9, at 32; Greg N. Anderson, *Survey of the Law of Professional Responsibility*, 41 IND. L. REV. 1213, 1223 (2008).

significance for 50%,<sup>76</sup> CF rates of 20% or 30% are regarded as relatively fair, and CF rates of 45% and 55% are considered quite unfair.<sup>77</sup>

When statutes set caps for CF rates, their disregard for other variables—the sum claimed, probability of success, and scope of work—is even more striking. Notions of division fairness are not the only explanation for this prevailing tendency. The considerable costs of more precise regulation, tailored to fit the specific characteristics of every case, are certainly pertinent as well.<sup>78</sup> Also, to the extent that high CF rates are characteristic of frivolous suits, capping CF rates may inhibit such suits.<sup>79</sup> We nevertheless believe the prevailing notions of fairness play a central role in this context.

Arguably, when statutes use sliding scales—that is, a set maximal CF rate for awards up to a certain amount of recovery, a lower maximal rate for any additional sum up to another point, and a lower maximal rate for sums recovered beyond this higher point—they indirectly take into account the attorney’s working hours. The marginal effort needed for recovering any additional sum beyond some minimal award is probably decreasing.<sup>80</sup> Thus, sliding scales of this type better approximate the fairness of exchange (or input fairness).

Interestingly, statutory sliding scales in the United States do not ordinarily use another proxy for the attorney’s input, namely, the stage at which the suit terminates—whether the case is settled without filing a suit, requires filing a lawsuit, goes to trial, or even reaches an appeal. In this respect, there is a striking difference between the statutory sliding scales and the variable-percentage CF used by lawyers. The former reduces the attorney’s share the larger the recovered sum while ignoring the stage at which it was recovered; the latter increases the attorney’s share the more stages are required to recover the award and disregards the amount recovered. While both formulas seem superior to a flat CF rate, the one used by lawyers plausibly better approximates the lawyer’s input and, thus, the fairness of exchange. So, why do regulators opt for the sliding scale formula?

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76. Thus, in Experiment 4, the difference between the unfairness ratings of 45% and 55% (0.89 on a scale of 1 to 9) was smaller than the difference between the unfairness ratings of 30% and 40% in Experiment 3 (1.26 on the same scale). Plausibly, the perceived unfairness depends also on the ratio between the values compared (1:1.33 in Experiment 3; 1:1.22 in Experiment 4) and it gradually increases as the CF rate increases.

77. The findings are also compatible with the empirical findings concerning the determination of fees by courts in class actions. While courts take into account such factors as reasonable hourly rates and scope of work, there is “an overwhelming correlation between class recovery and attorney fees . . . .” Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. EMPIRICAL LEGAL STUD. 27, 72 (2004).

78. Schneyer, *supra* note 4, at 395–402, 410–11 (arguing that ex post review of the reasonableness of CF arrangements faces great practical difficulties, while “fee caps are inherently overbroad and underbroad”).

79. Dwyer, *supra* note 3, at 622–29.

80. *Id.* at 625.

One explanation is that regulators concerned with the “litigation explosion” want to remove any incentive for attorneys to file suits (or appeal judgments). Rather, they wish to encourage out-of-court settlements that ease the burden on the courts.<sup>81</sup> Another explanation rests on defendants’ lobbying. Presumably, insurance companies and health providers are not particularly interested in ensuring fair remuneration for lawyers. Instead, they have a clear interest in diluting attorneys’ incentives to recover very high sums from defendants.<sup>82</sup> Finally, it stands to reason that legislators, similar to the respondents in our experiments, view the issue as one of division fairness, and so are less concerned about the fairness of exchange.

To sum up, our findings do not provide a conclusive answer to the question of how fairness judgments affect the prevalent CF rates. However, they support the proposition that these judgments primarily influence the market through attorneys’ choices and regulators’ decisions, rather than through the preferences of clients.

On the normative level, there are several justifications for ensuring the fairness of remuneration. Arguably, a legal regime guaranteeing such fairness is just because it is the type of regime that rational, risk-averse people would have chosen behind a Rawlsian veil of ignorance.<sup>83</sup> From an efficiency standpoint, invalidation of unfair contracts may assist parties in reaching an agreement by deterring them from taking extreme positions in negotiation. Such invalidation also saves parties the need to take inefficient precautions against the risk of unfair bargains.<sup>84</sup> Ensuring contractual fairness may also be justified on grounds of market failure,<sup>85</sup> as well as on distributive and paternalistic grounds.<sup>86</sup> While these justifications are all contestable, one thing seems quite clear. These are all possible justifications for ensuring contractual fairness of exchange, not division fairness. Inasmuch as judicial and statutory supervision of attorneys’ contingent

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81. See Brickman, *supra* note 4, at 1349; Dwyer, *supra* note 3, at 626 (explaining that contingency fee limitations will increase the take-home pay for clients—incentivizing them to accept settlements and decrease the attorney’s stake in litigation, making them more amenable to settlement as well).

82. Dwyer, *supra* note 3, at 625 (discussing the chilling effect of sliding scales on handling cases with high expected damages). See also Garber et al., *supra* note 3 (assessing the impact of damages that caps possess on lawyers’ willingness to handle cases).

83. Hugh Collins, *Distributive Justice Through Contracts*, 45(2) CURRENT LEGAL PROBS. 49, 54 (1992).

84. F.H. Buckley, *Three Theories of Substantive Fairness*, 19 HOFSTRA L. REV. 33, 37–59 (elaborating on these efficiency arguments).

85. Unfair contractual arrangements often result from flawed contracting processes or market failures, such as information problems and exploitation of monopoly power. See ATIYAH, *supra* note 34, at 333–34 (discussing the interrelations between substantive and procedural fairness).

86. Unfair allocation of the proceeds of a transaction may result from initial unequal distribution of power and wealth, and may perpetuate and even broaden such inequality. See, e.g., *Equality in Exchange*, *supra* note 34, at 1588–90. As for paternalism, once it is realized that people’s decisions do not always serve their best interest due to various cognitive biases, at least in some cases of misjudgment, it may be justified to protect people from extremely unfair contracts. Cf. Zamir, *supra* note 34, at 1780, 1785–88 (examining paternalistic justifications for mildly regulating contracts’ content).

fees rests on fairness considerations, the intuitive tendency to focus on division fairness is hardly defensible.

## V

### CONCLUSION

The findings of the experiments presented in this article shed new light on the perceptions of fairness informing the ongoing debate about attorneys' contingent fees, as well as on the ways people are likely to form such judgments in comparable contexts. CF arrangements strongly invoke notions of division fairness that tend to overshadow notions of fairness of exchange. Thus, high CF rates are deemed unfair even when they result in rather low effective hourly rates, and vice versa. These perceptions likely animate the public and legal debate on CF arrangements, which in turn may directly (by imposing a fairness constraint on pricing) and indirectly (by inducing actual or threatened regulation) drive high CF rates out of the market. Notions of fairness may thus explain why high CF rates are rare even in cases in which they would have clearly served the interests of both parties. Our findings also provide additional explanation—though hardly a justification—for the basic patterns of judicial review and legislative regulation of CF arrangements, which very often place great emphasis on the percentage of the contingent fee while ignoring other factors that equally affect the adequacy of the lawyer's remuneration.

## APPENDIX

Table A1: Cases Employed in Experiment 1<sup>87</sup>

Case	Award	Prob.	EV	%CF	ENV	ECF	Hours	EHR
1	100,000	.65	65,000	20	52,000	13,000	100	130
2	100,000	.65	65,000	55	29,250	35,750	100	357.5
3	100,000	.90	90,000	20	72,000	18,000	100	180
4	100,000	.90	90,000	55	40,500	49,500	100	495
5	500,000	.65	325,000	20	260,000	65,000	100	650
6	500,000	.65	325,000	55	146,250	178,750	100	1,787.5
7	500,000	.90	450,000	20	360,000	90,000	100	900
8	500,000	.90	450,000	55	202,500	247,500	100	2,475

Table A2: Cases Employed in Experiment 3

Case	Award	Prob.	EV	%CF	ENV	ECF	Hours	EHR
1	100,000	.65	65,000	30	45,500	19,500	100	195
2	100,000	.65	65,000	40	39,000	26,000	100	260
3	100,000	.90	90,000	30	63,000	27,000	100	270
4	100,000	.90	90,000	40	54,000	36,000	100	360
5	500,000	.65	325,000	30	227,500	97,500	100	975
6	500,000	.65	325,000	40	195,000	130,000	100	1,300
7	500,000	.90	450,000	30	315,000	135,000	100	1,350
8	500,000	.90	450,000	40	270,000	180,000	100	1,800

Table A3: Cases Employed in Experiment 4

Case	Award	Prob.	EV	%CF	ENV	ECF	Hours	EHR
1	100,000	.65	65,000	45	35,750	29,250	100	292.5
2	100,000	.65	65,000	55	29,250	35,750	100	357.5
3	100,000	.90	90,000	45	49,500	40,500	100	405
4	100,000	.90	90,000	55	40,500	49,500	100	495
5	500,000	.65	325,000	45	178,750	146,250	100	1,462.5
6	500,000	.65	325,000	55	146,250	178,750	100	1,787.5
7	500,000	.90	450,000	45	247,500	202,500	100	2,025
8	500,000	.90	450,000	55	202,500	247,500	100	2,475

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87. In this table and the following ones, EV denotes the expected value of the claim (the sum claimed multiplied by the probability of obtaining it); ENV is the expected net value of the claim (EV minus ECF, the expected contingent fee); and EHR is the expected effective hourly fee (ECF divided by the number of hours the attorney is expected to spend on the case).

Table A4: Cases Employed in Experiment 5

Case	Award	Prob.	EV	%CF	ENV	ECF	Hours	EHR
1	100,000	.80	80,000	20	64,000	16,000	100	160
2	100,000	.80	80,000	40	48,000	32,000	100	320
3	100,000	.80	80,000	20	64,000	16,000	40	400
4	100,000	.80	80,000	40	48,000	32,000	40	800
5	500,000	.80	400,000	20	320,000	80,000	100	800
6	500,000	.80	400,000	40	240,000	160,000	100	1,600
7	500,000	.80	400,000	20	320,000	80,000	40	2,000
8	500,000	.80	400,000	40	240,000	160,000	40	4,000

Table A5: Cases Employed in Experiment 6

Case	Award	Prob.	%CF	EV	ECF	FF
1	50,000	.65	20	32,500	6,500	2,600
2	50,000	.65	55	32,500	17,875	7,150
3	50,000	.90	20	45,000	9,000	3,600
4	50,000	.90	55	45,000	24,750	9,900
5	250,000	.65	20	162,500	32,500	13,000
6	250,000	.65	55	162,500	89,375	35,750
7	250,000	.90	20	225,000	45,000	18,000
8	250,000	.90	55	225,000	123,750	49,500