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International Review of Law and Economics 26 (2006) 180–194

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International  
Review of  
Law and  
Economics

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# Conditional versus contingent fees: Litigation expenditure incentives<sup>☆</sup>

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## Abstract

Many jurisdictions in the UK and Australia now allow conditional fees to be struck between a lawyer and their client. While both conditional and contingent fees are outcome-contingent, only under the former is the lawyer's remuneration a function of inputs. The public policy arguments put forward for each fee structure hinge importantly on litigation expenditure incentives. We show that conditional (contingent) fees are not better suited to the English (American) rule of fee-shifting. We also show that whether conditional fees result in higher or lower expenditure than contingent fees depends crucially on whether the inputs to litigation are determined by the lawyer or the client. If the latter, then conditional fees result in (weakly) lower expenditure than contingent fees. If the lawyer determines inputs then expenditure is higher under conditional fees.

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*JEL classification:* K40; K41

*Keywords:* Conditional fees; Contingent fees; Litigation expenditure

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## 1. Introduction

The passing of the Courts and Legal Services Act, Section 58, in England and Wales in 1990 has resulted in litigants being able to enter 'conditional fee' arrangements with their lawyer (Bowles, 1994).<sup>1</sup> The Conditional Fee Agreements Order 1995 brought this new system into effect and was substantially revised in 2000. Conditional fee agreements

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<sup>☆</sup> I thank Philip Williams for his many helpful discussions and both referees for their insightful suggestions.

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<sup>1</sup> Scotland had introduced this fee structure prior to 1990.

are now generally permissible in all but family and criminal matters (Jeffries, 2002). Similarly, conditional fees are now allowable in the states of New South Wales and Victoria in Australia.

Conditional fees are similar to the contingent fees widely used in the US in that both ensure that the lawyer is remunerated only if their client wins—they are outcome-contingent. They differ in that the lawyer obtains a fraction of the plaintiff's *award* under a contingent fee (often one third), while obtaining a percentage above the *market price* for their services under a conditional fee (to a maximum of 100% in the UK and 25% in Australia). Our objective is to compare the expenditure incentives associated with these two types of fee structures, with a view to understanding the environments to which each is best suited.

The pros and cons of contingent fees have been analyzed extensively (Danzon, 1983; Halpern & Turnbull, 1983; Hay, 1997; Miceli, 1994; Rickman, 1999; Rubinfeld & Scotchmer, 1993; Schwartz & Mitchell, 1970; Swanson, 1991). In contrast, conditional fees have received relatively little attention to date, a notable exception being the analysis by Gravelle and Waterson (1993). This lack of attention is presumably due to conditional fees being a recent innovation and not having been adopted in the US. Our aim here is to compare the litigation expenditure incentives under the two types of fee. Whether conditional fees, *ceteris paribus*, result in higher or lower expenditure than contingent fees is important as it directly impacts on whether the underlying public policy goals for introducing conditional fees are likely to be realized.

Two important public policy motivations for introducing conditional and contingent fees, rather than fixed fees, are to increase access to justice and to reduce the misalignment of incentives between the lawyer and client in relation to the quantum of legal inputs used. If, for example, conditional fees can be shown to result in higher expenditure than contingent fees, then it can be argued that contingent fees are more effective than conditional fees in addressing the misalignment of lawyer–client incentives.

The issue of access to justice has at least two dimensions—the affordability of litigation and the ability to access representation and the court system even when it is affordable. However, the argument that outcome-contingent fees enhance access to justice for litigants with meritorious suits but few resources focus only on the first of these two dimensions (Fenn & McGuire, 1994; Rubinfeld & Scotchmer, 1993).<sup>2</sup> We likewise focus only on this dimension here.<sup>3</sup> The rationale is that outcome-contingent fees promote affordability by ensuring that litigants with meritorious suits incur no costs in the (unlikely) event they lose at trial, while if they win, their costs are funded from their award for damages.

While the above argument holds straightforwardly for contingent fees, it is not so obvious that conditional fees enhance access to justice since the lawyer's fee is not tied directly to the plaintiff's award but rather is a mark-up on the value of services provided. Thus, the effectiveness of conditional fees in enhancing access to justice depends on how they

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<sup>2</sup> Other rationales that have been proposed are that contingent fees induce people to take greater care to prevent injury and that they support a more efficient allocation of risk between the lawyer and client (Lord Chancellor's Department, 1989b; Paterson, 1989).

<sup>3</sup> In order to comment on the effects of the two fee structures on the volume and quality of cases bought, our model would need to be broadened from a representative case to the entire market for cases.

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