

# The Problem of Contingent Fees for Waiters

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In a series of influential papers, Lester Brickman (2003a, 2003b, 2004) has argued that the income and effective hourly rate of tort lawyers using contingent fees has increased by 1400% since 1960 and that the market for contingent fee lawyers is uncompetitive as evidenced by lack of price advertising and uniform pricing across practitioners, cases and time. He also argues that contingent fee lawyers use “contingent-fee math” to build up additional costs and fees. I critically examine Brickman’s calculations and compare contingent fees in the market for lawyers with contingent fees, usually called tips, in the market for waiters.

## ***How much has Lawyer Income Increased?***

Brickman (2003a, Appendix A) does not calculate lawyer income and its growth directly but reasons that “increases in average verdicts, adjusted for inflation, translate into proportionately higher annual incomes.” Using this method he calculates that the income of contingent fee lawyers and their effective hourly rate has increased by 1400 percent since 1960.

A growth rate of 1400 percent, however, appears to be inconsistent with what we know about lawyer income today. The Bureau of Labor Statistics estimates median lawyer income in 2002 of \$90,290.<sup>1</sup> If lawyer income had grown by 1400 percent since 1960 this would imply a real (\$2002) income in 1960 of just \$6019. But GDP per-capita in 1960 was \$15,075.<sup>2</sup> Thus Brickman’s growth estimate implies (implausibly) that lawyers in 1960 were earning substantially less than the average person.

In contrast, Wolff (1976) estimated that income for “Deans, Lawyers, and Judges” in 1960 was \$56,680 (in \$2002 dollars) nearly ten times the figure implied by Brickman’s calculation. Using Wolff’s more realistic estimate I calculate that real income for lawyers has increased by 59 percent since 1960. Substantial, but a far cry from 1400 percent.<sup>3</sup>

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<sup>1</sup> Bureau of Labor Statistics, U.S. Department of Labor, *Occupational Outlook Handbook, 2004-05 Edition*, Lawyers, on the Internet at <http://www.bls.gov/oco/ocos053.htm> (visited March 07, 2005). Similar figures are reported by PayScale.com.

<sup>2</sup> Statistical Abstract of the United States (2001), Table 647, with adjustment from 1996 dollars to 2002 dollars.

<sup>3</sup> Nor is this the largest increase of all occupations. Physician income has grown by more than lawyer income. In 1960 physicians earned about 10% more than lawyers but in many specialties today physician income is more than double that of lawyers (Bureau of Labor Statistics, U.S. Department of Labor,

Brickman focuses on contingent fee lawyers, who predominate in personal injury law, but if lawyer salaries in one field were substantially larger than in another (after taking into account differences in working conditions etc.), lawyers would switch fields. Lawyer salaries in different fields, therefore, cannot depart from one another too much.<sup>4</sup> The point may be moot in any case because although the BLS doesn't break down lawyer income by field, PayScale.com, a private collection of wage information for a variety of professions, lists median wages for Personal Injury and Wrongful Death lawyers at \$64,500, *less* not more than the average for all lawyers.

Certainly, one can find examples of very high payments to contingent fee lawyers.<sup>5</sup> On December 11, 1988 a group of lawyers was awarded over 8.2 *billion* dollars in fees for representing Florida, Mississippi, and Texas in their suits against tobacco companies to recover health-care expenses. All told, the state settlements generated somewhere between 18 billion and 38 billion in fees, equivalent to tens of thousands of dollars per hour in compensation for each lawyer involved.<sup>6</sup>

The fees in the tobacco deal have become a mainstay of critics of contingent fees but not too much should be read into this case. The tobacco case was less a settlement of a legal case than a political bargain between the tobacco companies, the state governments and the lawyers, all of whom gained at the expense of an unrepresented group, the smokers. The fees are shocking but the tobacco deal itself was shocking - 243 billion dollars over 25 years on the basis of weak law and false economics (Viscusi 2002). Lower fees would hardly have made the deal more reasonable.

In a winner-take-all field such as trial law it's not surprising that some contingent fee lawyers earn large sums but as in acting we should not take the earnings of the winners to represent the average. Nor is it the case that the method of payment is key to the high earnings. Julia Roberts often works on contingent fee (she gets a cut of the box office receipts) but she would still be rich even if she only took a wage income.

## ***Contingent Fees for Waiters***

Brickman's figures on lawyer income appear to be overstated but what of his other arguments that the market for contingent fee lawyers is uncompetitive?

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*Occupational Outlook Handbook, 2004-05 Edition*, Physicians and Surgeons, on the Internet at <http://www.bls.gov/oco/ocos074.htm> (visited March 07, 2005).

<sup>4</sup> The argument is consistent with Kritzer (1998, 2004) who finds roughly similar hourly rates across contingent and non-contingent compensation schemes.

<sup>5</sup> The next three paragraphs draw from Tabarrok and Helland (2005).

<sup>6</sup> Perhaps due to the uproar over the first announcement, the Attorneys General, the tobacco companies and the lawyers have kept the exact fees secret (see Viscusi 2002, 4). Levy (1999) calculates that the fee in the Florida, Mississippi, Texas case was equivalent to over \$14,000 dollars an hour, assuming 12 hours of work a day, 7 days a week for 42 months. See also Brickman (2003, note 13) who cites equivalent hourly fees in the hundreds of thousands of dollars an hour once hours are estimated realistically.

Brickman (2003b, 2004) argues extensively that the uniformity of contingent fees both across practitioners, types of cases and through time is a sure sign of collusion and non-competitive pricing. These pricing regularities raise puzzles but they do not demonstrate that the market for lawyers is uncompetitive because exactly the same regularities are found in other industries that also use contingent fees but that everyone regards as competitive.

For example, a significant fraction, 50 to 90 percent, of the income of waiters comes from a contingent fee, more often called a tip.<sup>7</sup> In many ways, tips are the consummate contingent fee, they are contingent on service and they are typically a percentage of the total food bill.

Brickman (2004) indicates that contingent fees in law vary only from 33 to 50 percent; but contingent fees in waiting vary even less, 15 to 20 percent is standard. Tip rates, moreover, are the same at single to triple-star restaurants, the same in small towns as in big cities, the same in California as in New York. But if it is difficult to believe that the field of law is uncompetitive it is impossible to believe that the markets for waiters is uncompetitive.

Consider in particular the uniformity of contingent fees across types of cases. Brickman (2003, 671 n. 50) writes:

“It is an anomaly of the contingent fee-financed tort system that a lawyer obtains a considerably higher effective hourly rate fee if the injury that is the basis of the suit is more severe (e.g. total disability as in quadriplegia) than if it is less severe (e.g., partial disability as in loss of a limb) even though in such cases there is likely no appreciable difference in the level of effort required...”

But we see exactly the same phenomena in waiting, that is tip percentages do not vary much with the expense of the meal so the absolute tip increases directly with bill size (Bodvarsson and Gibson 1997). The waiter who carries a filet mignon from kitchen to table earns a substantially higher effective hourly rate than the waiter who carries a hamburger and fries the same distance.

Indeed, to add insult to injury there is a modest although clear trend for the tip rate to be higher in more expensive restaurants! Waiters in expensive restaurants, therefore, “grossly overcharge” twice – once on account of the tip being calculated on a larger base and again on account of a higher percentage. Alternatively, perhaps waiters in better restaurants are better waiters.

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<sup>7</sup> The Bureau of Labor Statistic’s, Occupational Outlook Handbook, 2004-05 Edition suggests that more than half the wages of Food and Beverage Serving Workers come from tips. Waiters also indicate that at least half their income and as much as 90 percent comes from tips. See, for example, discussions at <http://www.tip20.com/div/foh/articles/bigslice.html>, and <http://www.contracostatimes.com/mlld/cctimes/living/food/9096393.htm?1c>.

Brickman (2003b, 91) also infers collusion from the fact that the contingent fee is stable over time writing “if the standard one third fee were an equilibrium price, we would expect to find historical evidence of price fluctuation, both up and down...” But tip percentages for waiters are also very stable – they do not vary over the business cycle and they have not fallen in over 100 years. In the early part of the twentieth century, a 10 percent tip was common but 15 percent was standard by the 1970s and today 15 to 20 percent is the standard.<sup>8</sup> Once again this may be a puzzle but the solution cannot be that waiters have colluded to make waiting tables an uncompetitive market.

According to Brickman (2003, 700) a “clear indicator of the inadequacy of reliance on market competition to exert downward pressure on contingent fees is the fact that contingency-fee lawyers do not engage in competitive fee advertising.” Yet, despite hundreds of millions of dollars being spent on restaurant advertising, no restaurant, to my knowledge, has ever published an advertisement encouraging smaller tips.

Brickman (2003, 673, n. 57) also excoriates contingent fee lawyers for “inflated and fraudulent incurrence of medical expenses, orchestrated by contingent fee lawyers to increase fees.” The charge is a strong one and it may contain some truth<sup>9</sup> but the problem should be kept in perspective. Brickman argues (2003) that by encouraging frivolous lawsuits contingent fees for lawyers contribute to our epidemic of lawsuits. In the same way, one might argue that by encouraging frivolous desserts contingent fees for waiters contribute to our epidemic of obesity. Too many torts are bad for you and so are too many tortes (Banzhaf 2002).

The Houston Chronicle recounted this illustrative exchange<sup>10</sup>:

The waitress with corkscrew curls understands the finer points of the waiting game.

"What do you recommend?" a diner asks.

"The filet mignon," the waitress replies. "It's the leanest cut of meat."

At \$26, it's also the most expensive entree.

What else?

"The Hawaiian rib-eye is very good," she suggests. "It's really tender." At \$23, it's the second most expensive option.

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<sup>8</sup> See Azar (2004) and Templeton (1996) on the increase in the tip percentage over the twentieth century.

<sup>9</sup> Brickman's evidence, however, is not compelling. He argues that medical expenses are larger for those who retain lawyers than those who don't. It wouldn't be surprising, however, if even after controlling for measurable injuries people with more serious injuries hired lawyers more often.

<sup>10</sup> Huynh, Dai. 2004. Waiters understand tips of the trade. Houston Chronicle (Wed, Jul. 07, 2004).

The waitress also recommends the smoked salmon and the spinach dip, the priciest starters at \$11 and \$10, respectively.... the waitress was doing what many waiters do: up-selling or suggestive selling.

"The bigger the bill size, the bigger the tip," explains Michael Lynn, a former waiter and bartender who has scrutinized tipping practices.

Up-selling may be a negative aspect of tips but tips also have benefits, they insure prompt service. More generally, if the costs of tipping exceeded the benefits we would expect restaurants to advertise a no-tipping policy in order to improve business (just as some department stores indicate that their sales staff do not work on commission). Contingent fees in law also benefit the client (Tabarrok and Helland 2005) and competition among lawyers gives us little reason to believe that the benefits are exceeded by the costs.<sup>11</sup>

## ***Conclusions***

The increase in the income of contingent fee lawyers appears to be nowhere near as large as Brickman claims. Some contingent fee lawyers earn a lot of money but this is true of many "winner take-all" industries. Uniformity of price cannot be a sure sign of collusion because tip percentages in the restaurant industry are stable at 15 to 20 percent across a wide variety of restaurant types, times, and places. Waiters and lawyers also both practice contingent-fee math – boosting up the bill so as to increase fees – in the process contributing to an expansion of torts and an expansion of waists, respectively. But all incentive systems have benefits and costs and there is little reason to think that the net effect of contingent fees for waiters is to harm restaurant customers. If tipping did harm restaurant customers, profit maximizing restaurant owners would have an incentive to end the practice. A similar argument suggests that on net contingent fees for lawyers do not harm clients.

Brickman (2004) estimates that tort fees amount to 22 billion dollars a year. Waiter tips have been estimated at 26 billion dollars a year (Azur 2003). Thus we can conclude that the problem of waiter tips is at least as serious as that of lawyer contingent fees, and vice-versa.

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<sup>11</sup> If we are concerned about incentive systems then the case against realtors is much stronger than that against lawyers. Realtors also work on contingent fees but unlike lawyers they have incentives opposite those of their buying clients – the more the buyer pays the more the realtor earns! Yet strangely, Brickman (2003b, 85) contrasts the market for realtors favorably against that of lawyers.

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