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LEGAL ADVICE

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## Legal Advice

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*Abstract.* Legal advice is the information that lawyers provide to clients about the nature of legal rules, about the probability and magnitude of sanctions for their violation, and about litigation and legal procedure. The chief questions addressed here are how legal advice helps clients and how, or whether, it advances social welfare. The analysis distinguishes between two major types of legal advice: ex ante advice, obtained when a party is contemplating an action with possible legal consequences; and ex post advice, secured after a party has acted or someone has been harmed, which is to say, at the stage of possible or actual litigation.

## Legal Advice

Steven Shavell\*

### 1. Introduction

Legal advice is the information that lawyers (or other experts on law) provide to clients about the nature of legal rules, about the probability and magnitude of sanctions for their violation, and about litigation and legal procedure. Thus, for example, advice might concern the current understanding of the definition of negligence in the design of a product, the likelihood of tax audit, the desirability of bringing a suit for losses suffered in an automobile accident, or the best way of presenting evidence in litigation about such an accident. The provision of legal advice is not taken to be coextensive with the provision of legal services in general, however. Some legal services (such as, often, the making of argument in court) are better regarded as the performance of specialized tasks than as the provision of information.

A client may obtain legal advice *ex ante* -- when he is contemplating an action -- or he may secure it *ex post* -- after he has acted or someone has been harmed, which is to say, at the stage of possible or actual litigation. Advice of these two types will be considered separately because of their distinctive aspects. A notable difference between the types of advice is that *ex ante* advice can channel behavior directly in conformity with law, whereas *ex post* advice comes too late to accomplish that (although it has indirect effects on behavior). *Ex ante* legal advice was first studied from an economic theoretical perspective in Shavell (1988) and Kaplow and Shavell

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(1992); ex post legal advice was initially investigated from this standpoint in Kaplow and Shavell (1989, 1990); what is reviewed here is in many respects a synthesis of these articles. Legal advice was further studied in Bundy and Elhauge (1991, 1993).

Several assumptions will be maintained in most of the discussion in this entry: that advice is not purposely subversive of the law (for instance, that advice is not intended to enable a person to perpetrate a financial fraud); that lawyer-client communications and legal work product are confidential; and that lawyers are truthful to clients and endeavor to provide them with good advice. However, each of these assumptions will be examined in later sections.

## **2. Advice about Contemplated Acts**

Advice will have private value to a party who is considering taking some action with a possible legal consequence if the advice might lead him to alter his decision. Suppose, for example, that a firm is deciding whether to release a chemical waste from a holding tank into a river rather than to spend on transport of the chemical to a dump site -- but the firm does not know whether a discharge of the chemical would violate an antipollution statute. One possibility is that, without advice, the firm would elect to discharge the chemical into the river (suppose the firm thinks this probably does not violate the statute). In such situations, advice would have private value if it might lead the firm instead to transport the chemical to the dump site (the advice might be that a discharge would in fact violate the statute), because advice would then enable the firm to avoid sanctions for violating the antipollution statute. The converse possibility is that, in the absence of advice, the firm would decide to transport the chemical to the dump site (suppose the firm believes that a discharge would violate the statute). Here advice would have value to the firm if it might lead the firm instead to discharge the chemical into the river (the advice might be

that a discharge would not violate the statute), because advice would then save the firm transport costs.

In general, the private value of legal advice is the expected value of the private gain from possible changes in a party's decisions. This notion of the private value of legal advice is, it may be noted, just an application of the conventional definition of the expected value of information to a decisionmaker, as presented for instance in Raiffa (1968).

The social, as opposed to the private, value of ex ante legal advice inheres in the social desirability, or lack thereof, of advice-induced changes in parties' behavior. Suppose that it is socially desirable for the chemical not be discharged (because the harm from a discharge would exceed the cost of transport to the dump site). Then if advice would result in the firm deciding against discharging the chemical, the advice would be socially desirable. But if advice would lead the firm to discharge the chemical (say, because the firm would learn that the probability of sanctions is low), the advice would not be socially desirable. The social value of advice is the expected value of the potential social gains and losses produced by the advice.

Comparison of the social and the private values of ex ante legal advice is of interest for, among other reasons, it informs us whether the amount of such legal advice that is purchased does or does not tend toward the socially correct level. In particular, when the private value of advice exceeds the social, the amount of advice demanded will tend to be socially excessive, and in the reverse situation the demand for advice will tend to be socially inadequate.

The comparison between the social and the private values of legal advice depends on the form of liability: whether it is strict (under which a party pays for any harm caused) or based on the negligence rule (under which a party pays for harm only if he was negligent). In the

consideration of these rules, it will be assumed that law enforcement is perfect in the sense that a sanction equal to harm is imposed whenever parties are supposed to be liable for harm. Then the situations when there is underenforcement or misapplication of legal rules will be addressed.

When parties are strictly liable, the private value of legal advice is the same as its social value. This basic and important conclusion follows essentially because a party's liability burden will equal the harm he causes. If a party learns through advice that taking some precaution will reduce his liability from \$15,000 to \$5,000, this also means that the precaution will lower harm by \$10,000. Hence, it should not be surprising that the private and social values of advice are equivalent.

The conclusion is different when liability is based on negligence; under this rule, the private value of legal advice tends to exceed its social value. The explanation is suggested by two points. First, if a party avoids negligence because of advice, the party's liability saving will generally be larger than the reduction in expected harm he accomplishes. Suppose that, without advice, the party just mentioned would not take the precaution and would be found negligent and liable for the harm of \$15,000. And suppose that, with advice, the party would take the precaution and thereby avoid liability for negligence. Thus the advice would lead to a reduction in liability for the party of \$15,000 -- an amount exceeding the \$10,000 reduction in harm. The reason that the private liability saving from advice is larger than the reduction in harm is that, under the negligence rule, a party escapes having to pay for any harm caused when he acts nonnegligently (the party escapes having to pay for the \$5,000 of harm he still generates if he takes the precaution). The second point is similar. If a party would learn from advice that he can relax somewhat his level of precautions and will continue not be found negligent, his saving will

be the full amount of the reduction in precautionary costs. However, society will not save as much as the party, for when precautions fall, expected harm rises.

Consider now the situation when legal rules (whether based on strict liability or on negligence) are underenforced, that is, when the probability of having to pay for harm is less than 100 per cent or when the level of damages is less than harm. When this is so and expected sanctions thus fall short of expected harm, it might seem that the private incentive to obtain legal advice is less than socially appropriate. Nevertheless, that is not clear. The explanation involves the observation that when a party obtains legal advice, he will not necessarily be induced to act in a socially desirable way: advice may lead him to act undesirably precisely because he may learn that the law is underenforced. In consequence, it is ambiguous whether the private value of legal advice is socially excessive or inadequate when the law is poorly enforced.

Finally, consider the case where legal rules are sometimes incorrectly formulated or applied. For example, an environmental authority might mistakenly omit a truly harmful chemical from its list of substances for which discharge will result in a penalty, or it might mistakenly include on its list a chemical that is truly harmless. When rules are erroneously applied and legal advice gives a party foreknowledge of error, the only possible effects of the advice are undesirable (either to discharge the substance when it should not be, or not to discharge it when it should be). Thus, the social value of advice is negative -- it would be best for parties not to obtain advice -- even though its private value is positive.

### **3. Advice about Acts Already Committed**

The private value of ex post legal advice, advice provided after acts have been committed, is analogous to the private value of ex ante legal advice. It resides in the possibility that the

advice will lead a party to change his decisions, but now about whether to sue or how to conduct litigation (including settlement negotiation) rather than about the party's earlier, substantive behavior. Ex post legal advice can affect not only what legal arguments to pursue, but also how to develop evidence, what evidence to present and not to present, and how to challenge false arguments. It is virtually inevitable that ex post legal advice will have substantial private value because of the complicated nature of legal procedure and the unlikelihood that potential litigants will know the law in real detail.

In considering the social value of ex post advice and comparing it to the private value of ex post advice, let us begin with advice about whether a harmed party should bring suit. The social value of this advice derives principally from the effect of suit on the prior behavior of parties who might be sued, that is, on their precautions and participation in potentially harm-producing activity. This incentive effect of suit could be small or large, and either be exceeded by or surpass the expected private gain from suit; see Shavell (1982). To illustrate, if there is little that injurers can do to prevent harm, suit will not have much social benefit, but the private motive of injured parties to bring legal actions may be high (especially under strict liability) because they can collect damages for harm sustained. In such a situation, legal advice about whether to bring suit would be likely to have greater private value than social value (assuming that the advice would tend to promote suit). If, on the other hand, injurers can take inexpensive steps to prevent harm and would do so if sued, suit may have substantial social value, but relatively small private value if the magnitude of harm is not significant. In this situation, legal advice about whether to bring suit would be likely to have greater social value than private value (again assuming that the advice would foster suit).



Now consider legal advice that parties obtain during litigation. As noted in the introduction, because such advice is, by its nature, imparted to parties only after they have acted, it cannot have aided them in conforming with the law in choosing how to act if they were uncertain about the law. (The firm that does not know whether discharging a chemical waste into a river will violate an antipollution statute cannot be led to behave appropriately by learning what the law is after it decides about discharging the chemical.) This simple but fundamental observation means that ex post advice does not raise social welfare in the direct way that ex ante advice does. Nonetheless, ex post advice certainly may influence behavior and social welfare.

One way that ex post advice may affect social welfare is by lowering sanctions for those who knowingly violate the law, that is, ex post advice may dilute deterrence of undesirable conduct. Lawyers may lower expected sanctions by advantageous use of legal strategy, and importantly by counseling defendants on the selection of evidence to present and to suppress. Given that individuals anticipate that their expected sanctions for causing harm will be reduced due to the subsequent availability of legal advice, fewer individuals will be deterred from engaging in undesirable behavior. Thus, legal advice may have negative social value, a point that was early emphasized by Bentham (1827). (In principle, a partial remedy for this problem, though, would be for the state to raise sanctions overall to offset the dilution of deterrence due to advice.)

However, ex post advice may also enhance social welfare by raising otherwise inadequate sanctions that would be imposed on those who knowingly commit sanctionable acts. Advice may raise expected sanctions because lawyers may help *plaintiffs* to obtain higher judgments, better reflecting the harms they have sustained, than they would receive if they did not have legal advice.

Additionally, ex post advice may raise social welfare by lowering sanctions for defendants

who did not violate the law, or who face higher sanctions than they should. If parties anticipate that, if they ever incorrectly face a legal sanction, advice will help them to avoid that sanction, they will not be undesirably discouraged from engaging in many useful activities or be led to take expensive and inordinate precautions.

There is no way on the basis of logic alone to conclude whether or not ex post advice provided during litigation is on balance socially desirable -- whether or not its socially undesirable effect, due to dilution of deterrence, is less important than its desirable effect, due to increased accuracy of legal outcomes for the guilty and for the innocent. Either effect could outweigh the other, depending on context.

Let us next restrict attention to ex post legal advice that does increase the accuracy of legal outcomes and ask how the generally positive social value of this advice compares to its private value. The general answer to this question is that either the private value of the advice or its social value could be larger, so that the private incentive to spend on the advice could be socially excessive or it could be inadequate. The reason, as discussed in Shavell (1997), is essentially that explained above with respect to the bringing of suit: the social value of legal advice that increases accuracy inheres in its incentive effect on prior behavior of parties; and this has little connection to the private incentive to spend on advice, for that derives from the amount at stake in litigation.

In some contexts, however, the private value of accuracy enhancing advice will tend to exceed the social value, so that too much of the advice will be purchased. Notably, consider advice that will enable a party to establish accurately the degree of harm suffered in an adverse event. If the presently estimated harm deviates from the truth by \$100, a party will be willing to

spend up to \$100 on legal advice to prove the correct amount (if the estimate exceeds the correct level, the defendant will spend on legal help; and if the estimate is below the correct level, the plaintiff will spend on legal help). It can be shown that the social value of the more accurate estimate tends, however, generally to be lower than \$100, essentially because the social value of accuracy is based on its effects on incentives. Indeed, there would be little or no beneficial incentive benefit from accurate assessment of harm if all that potential injurers know when choosing their precautions (for instance, how carefully to drive on the road) is the probability distribution of possible harm (the range of possible damage that could occur in an automobile accident). For development of this point, see Kaplow and Shavell (1996).

In sum, the social value of ex post legal advice is complicated to determine, possibly negative and possibly positive, and not closely related to its private value. In certain domains, a plausible conjecture is that, in an appropriate average sense, the private value of ex post advice exceeds the social.

#### **4. Subversion of the Law**

It has been assumed for the most part above that legal advice is purely informational in character, conveying knowledge about the law and legal sanctions but not altering expected sanctions. Yet lawyers are sometimes able to subvert the law by effectively lowering sanctions or their probability. As mentioned above, lawyers may inappropriately reduce expected sanctions by selecting only favorable evidence to present. Also, lawyers may diminish the real magnitude of sanctions by helping clients to hide assets; and lawyers can also decrease the likelihood of sanctions if they have knowledge of enforcement strategies (such as how the tax authorities choose whom to audit). Such legal assistance is to be distinguished from advice that lowers

expected sanctions for bona fide reasons, for example, by demonstrating that an asserted harm was not a true harm. Of course, lawyers are not supposed to thwart law enforcement, but they have an economic incentive to do so and can fairly easily avoid punishment for it (lawyers give advice in private and can phrase their advice in hypothetical but readily understood terms). From the social perspective, legal advice that frustrates law enforcement is obviously undesirable.

## **5. Confidentiality of Advice**

The legal system protects the confidentiality of communications between lawyers and their clients under wide circumstances, and this protection has been implicitly assumed in the above discussion. Confidentiality of legal advice will benefit clients when there is positive probability that disclosure of advice would lower its value. This would usually be true of advice about the selection of evidence to present in litigation: such advice generally would be robbed of effectiveness if it were disclosed to the opposing side and the court. Confidentiality is also of obvious importance to those obtaining advice subversive of the law. By contrast, confidentiality often should not matter to parties obtaining advice about the legality of an act or about magnitude or likelihood of sanctions, because disclosure of such advice will usually not disadvantage them. For example, disclosure of the *ex ante* advice that a party obtains about what is considered negligent behavior ordinarily should not matter to the party.

Still, whatever is the character of legal advice, maintaining the confidentiality of much information *about clients* that is revealed to lawyers in the course of their dealings with clients will frequently be of importance to the clients. For instance, a firm would usually not want information pertaining to its business plans revealed to others, and an individual would ordinarily not want information of a personal nature disclosed to outsiders.

Because protection of confidentiality can benefit clients (and never is a disadvantage to them), it encourages clients to consult with and reveal information to their lawyers. This in itself is sometimes thought to imply that confidentiality is socially desirable. That reasoning, however, is mistaken: confidentiality is socially desirable only if the legal advice that confidentiality encourages is socially desirable, and has been explained above, that may not be the case.

## **6. Protection of Legal Work Product**

The legal system also protects the confidentiality of legal work product -- documents and other records of lawyers' effort -- that they generate on behalf of clients in expectation of litigation. The protection of work product is accomplished principally by denying opposing litigants the legal right to discover work product (that is, the right to order the party with work product to produce it). The effect of work product protection is similar to that of protection of confidentiality, so it can be very briefly considered. As Easterbrook (1981) stressed, protection of work product encourages lawyers to engage in research on and development of their clients' cases, for much of the value of such research and development would be lost if it became immediately known to the other side. (Thus, the protection functions analogously to copyright.) Because protection of work product raises the value and quality of legal advice, it inures to clients' benefit. But whether protection of work product is socially desirable is not evident *a priori*; for it depends on whether or not the advice that the work product supports is socially desirable. A further complication is that, even when the advice is socially desirable, the private value of advice, and thus the amount of work product, may be socially excessive.

## **7. Quality and Truthfulness of Advice**

The issue of lawyers' incentives to supply good advice and to be truthful to clients has not

been addressed above. To the degree that poor or dishonest advice would be discovered and that lawyers would suffer penalties for having provided such advice, they will have reason not to do so. There are two basic types of penalty lawyers face for furnishing unsound legal advice: loss of business because of damage to reputation; and legal sanction, in the form of a damage judgment arising from a malpractice action, a fine assessed by a court, or a punishment imposed by a professional association. For a general treatment of these ways of regulating lawyer conduct, see Wilkins (1992).

Several observations are worth making about penalties for unsound advice. First, the ability of clients to discover that they were given subpar advice varies according to context. Poor advice about well-defined legal questions is more likely to be detected than poor advice about areas of law that are unsettled or than poor advice about the probability of a legal outcome (probabilities are hard to verify objectively, and lawyers may be able to ascribe adverse legal results suffered by their clients to bad luck). In some domains, lawyers' motivations to provide good advice are particularly perverse. For example, lawyers have reason to exaggerate the probability of winning cases when they give advice about bringing suit, for this will generate business for themselves. To some extent, this problem of dishonest reporting of the chance of prevailing may be mitigated through contingency fee arrangements, whereby lawyers bear most legal expenses and receive a fraction of any settlement or court award.

Second, the existence of law firms serves to foster provision of advice of good quality. Firms have a greater reputational stake than individuals, and a continuing one. Additionally, firm members are often able to (and have reason to) check on the advice that one another are providing to clients.

## **8. Conclusion**

Perhaps the most important lessons of the foregoing review of the subject of legal advice are two. First, ex ante advice, given when parties are contemplating actions with possible legal consequences, is quite different from ex post advice, provided at the stage of possible or actual litigation. Second, for a variety of reasons, the private incentive to obtain legal advice may deviate from (and often exceed) the social reason to do so.

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