LEGAL ADVICE ABOUT CONTEMPLATED
ACTS: The Decision to Obtain
Advice, Its Social Desirability,
And Protection of Confidentiality

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Abstract

A model is examined in which parties contemplate committing
acts that may result in sanctions (not only acts in the
traditional area of crime, but also behavior that may violate
tax, securities, or other regulatory law). The decisions of
parties whether to seek legal advice and whether to commit the
acts are described and the influence of the privilege of
confidentiality is considered. In addition, the issue of the
social desirability of the provision of legal advice and of
protection of confidentiality is analyzed.

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The Decision to Obtain Advice, Its Social Desirability, and Protection of Confidentiality

Steven Shavell[*]

I. Introduction

When will a party decide to obtain legal advice about a contemplated act, and when will he decide to commit it? In this paper I will examine a model describing how parties will rationally make both types of decisions and how their decisions will be influenced by the presence or absence of rules protecting the confidentiality of their communications with legal advisors[1] about contemplated acts.[2] The acts of concern will be those that may result in sanctions, that is, in either criminal or civil penalties or in the payment of damage judgments. Included, therefore, are not only acts in the traditional area of crime, but also, for example, behavior that may violate tax or securities law, or environmental or safety regulation, and conduct that may give rise to private actions in tort or for breach of contract.[3]

In addition to studying parties' decisions whether to obtain legal advice and whether to commit contemplated acts, I will ask when provision of legal advice will result in

socially desirable changes in behavior, that is, either in parties not committing undesirable acts that they would have committed in the absence of legal advice; or in their committing desirable acts that they would not have committed in the absence of advice. Protection of confidentiality will lead to socially desirable changes in behavior when it both encourages parties to obtain legal advice (something that will be shown not always to be true) and when the legal advice they obtain will promote desirable changes in behavior.

Three types of legal advice will be distinguished in the model: advice concerning the legality or "sanctionability" of acts;[4] advice concerning the probability or magnitude of sanctions; and advice instructing parties how to lower the probability or magnitude of sanctions.

The next part of the paper will analyze the model informally (an appendix will analyze the model formally) and the concluding part will comment briefly on the interpretation of the analysis and the relevant law.[5]

II. Analysis of the Model

Parties will be assumed in the model to choose between alternative courses of action on the basis of the probability-discounted or "expected" values of the actions; that is, parties will be assumed to be "risk-neutral."[6] Their decisions whether to obtain legal advice and whether

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to commit acts will be described and evaluated for each of the three types of advice just noted.

A.   Parties are uncertain whether acts are sanctionable

Here it will be supposed that parties are initially uncertain whether a contemplated act is sanctionable but do know the probability and magnitude of the sanction that will apply if the act is sanctionable.[7] Thus legal advice will concern only the sanctionability of acts. Two cases will be examined.

1. Case where legal advice about sanctionability is definitive. It will be assumed in this case that legal advice about the sanctionability of acts is definitive -- the advice will either be that an act is surely sanctionable or that it is surely not (and the advice will be correct and realized to be so).

behavior in the absence of legal advice. In the absence of definitive legal advice about the sanctionability of an act, a party's decision whether to commit it will depend on how likely he believes the act is to be sanctionable, together with the probability and magnitude of sanctions if it is sanctionable, and the gain he would obtain from it. Consider the following illustration.

Example 1. The owner of a small plant is deciding whether to release a chemical waste product into a nearby river. He does not know if the waste product

would be considered toxic under an environmental safety ordinance and therefore whether discharging the waste product into the river would constitute a violation of the ordinance. The owner would save $3,000 by discharging the waste product into the river (rather than transporting the waste product to a dump), but the penalty for violating the ordinance would be $5,000. If in the owner's opinion the probability of a violation is, say, 40% and he discharges the waste product into the river, his expected net gain will be $3,000 - 40%x$5,000 = $3,000 - $2,000 = $1,000.[8] He will therefore proceed; in general, he will proceed as long as his subjective probability of a violation is less than 60%.[9]//

In this example, it was assumed that if a party committed a sanctionable act, a sanction would be applied with certainty (a discharge that violated the ordinance would definitely be noticed). In the next example, concerning the permissibility of a tax deduction, it is assumed that an impermissible act will be sanctioned only with a probability, that of a tax audit.

Example 2. A person considers claiming a deduction from his taxable income that would allow him a $20,000 saving in taxes. He estimates that the probability that the deduction is permissible is 50%. He also believes that, given the nature of the deduction, the

chance that his tax return will be audited is 75% and that, if his return is audited and the deduction is found impermissible, he will lose his deduction and have to pay a penalty of $10,000.[10] Thus, if he claims the deduction and it is in fact impermissible, his expected penalty will be 75%x$10,000 = $7,500 and his expected gain will be 25%x$20,000 = $5,000. Hence, if he claims the deduction, his expected net gain will be 50%x$20,000 + 50%x($5,000 - $7,500) = $8,750. Therefore, he will decide to claim the deduction (and would do so as long as he thinks the likelihood of its permissibility exceeds 11.11%.[11])//

Further reference to these two examples will be made below.

behavior if legal advice is obtained. To ascertain whether it will be worth his while to obtain legal advice about the sanctionability of an act, a party must ask himself what use he would make of the advice that he might be given. If he learns that an act he contemplates is in fact not subject to sanctions, he will commit the act (presuming he will obtain a positive gain from doing so). If he learns that an act is sanctionable, he will not commit it if the expected sanction exceeds his expected gain, but he will go ahead and commit it if the expected sanction is less than his expected gain. In Example 1, the plant owner clearly will not discharge the waste product into the river if he learns that that would violate the environmental

ordinance, since his gain of $3,000 would be exceeded by the $5,000 penalty. In Example 2, the person will not claim a tax deduction if he learns that it is not permissible, since his expected gain would be $5,000 -- recall he would escape audit 25% of the time -- and his expected penalty would be $7,500. However, if the probability of audit were lower, for instance 10%, the person would decide to claim the deduction even if he knew it was impermissible, since his expected gain would be $18,000 and his expected penalty only $1,000.

the decision whether to obtain legal advice. A party will obtain legal advice if its expected value exceeds its cost. The expected value of advice is determined by the probability that advice will lead a party to alter his behavior, multiplied by the benefit he will obtain from his altered behavior.[12] Consider a party who, in the absence of advice, will decide not to commit a contemplated act. For him, the expected value of advice will equal the probability that he will learn that the act is not sanctionable, multiplied by the gain he will enjoy from then committing the act. On the other hand, consider a party who will commit an act in the absence of advice but will not if he learns that the act is sanctionable. For him the expected value of advice will equal the probability that he will be told that the act is sanctionable, multiplied by the expected sanction he would have borne less the expected gain

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that he would have enjoyed had he committed the act. In Example 1, the owner who believes that the probability of a violation of the ordinance is 40%, and will thus discharge the waste product into the river in the absence of advice, will calculate advice to have an expected value of $800: with probability 40%, the owner believes he will learn that a discharge into the river would constitute a violation and will then take the waste product elsewhere, avoiding a penalty of $5,000 but forgoing savings of $3,000; thus, advice will benefit him by $5,000 - $3,000 = $2,000 with probability 40%, and 40%x$2,000 = $800. (Of course, the fact that with probability 60%, the owner believes he will learn that a discharge would not constitute a violation does not enter into this calculation since in that case his behavior will not be altered.[13]) In consequence, the owner will obtain advice if its cost is less than $800. Similar calculations show that the expected value of advice about the tax deduction in Example 2 is $1,250: with probability 50%, the person will learn the deduction is impermissible, not claim it, and thereby avoid expected penalties of 75%x$10,000 = $7,500 but forgo expected gains of 25%x$20,000 = $5,000; advice will therefore result in expected savings of $2,500 with probability 50%, and 50%x$2,500 = $1,250.

It should be noted that advice will be of no value to a party, and therefore will not be obtained, if advice would never lead him to alter his behavior. This will be the case

only if, in the absence of advice, a party will commit an act, and if, on learning that the act is sanctionable, he will still commit the act because the expected sanction will still be less than the expected gain. That will be true in Example 2 if the probability of an audit is only 10%; for, as mentioned above, the person will then claim the deduction even if he knows it is impermissible.[14]

social desirability of legal advice.[15] Before asking whether legal advice leads to socially desirable changes in behavior, we must say which acts are considered socially desirable and which undesirable. Let us suppose that it is socially undesirable for an act to be committed if the party's gain from it would be less than the harm done but desirable for the act to committed otherwise.[16] Let us also suppose that acts are sanctionable if and only if they are harmful; and that if an act is sanctionable, the expected sanction for committing it is less than or equal to the harm.[17]

Now consider the question whether definitive legal advice about the sanctionability of an act results in socially desirable changes in behavior. Observe first that the advice cannot lead a party to commit a sanctionable act that he would not otherwise have committed; if a party would not commit an act in the absence of advice and the act is sanctionable, he will learn this when he obtains advice and that will only reinforce his decision not to commit the

act.[18] Hence, advice can lead to only two types of change in behavior: to a party's committing an act that is not sanctionable and that he would not otherwise have committed (because he erroneously thought it likely to be sanctionable); or to a party's not committing a sanctionable act that he would otherwise have committed (because he erroneously thought it unlikely to be sanctionable). Both these types of change in behavior are socially desirable. Given the assumptions of the last paragraph, it is socially desirable for an act that is not sanctionable to be committed, and it is socially undesirable for an act that is sanctionable to be committed if the expected sanction exceeds the gain.

effect of protection of confidentiality. It has been implicitly assumed so far that obtaining legal advice will not raise the likelihood or magnitude of sanctions if a party commits a sanctionable act. It was taken for granted in Example 2, for instance, that the probability of audit and the size of the possible penalty will not rise if a person obtains advice about the permissibility of a tax deduction. Such an assumption will be interpreted as reflecting legal protection of confidentiality of communications with legal advisors.[19] In the absence of protection, it will be supposed that the probability or magnitude of sanctions will rise if a party obtains legal advice.[20]

It will now be shown that protection of confidentiality will have no effect on a party's decision to obtain

definitive legal advice about the sanctionability of an act. Remember from above that a party will decide to obtain such legal advice only if he would _not_ commit an act that he learns is sanctionable. Therefore, it will be irrelevant to a party who decides to obtain advice that the probability or magnitude of sanctions might be raised as a consequence; this would only strengthen his decision not to commit an act that he learns is sanctionable. Hence, the expected value of legal advice will not be changed if confidentiality is unprotected, and a party will therefore decide to obtain advice exactly when he would were confidentiality protected.

To illustrate, in Example 2 we reasoned that if the probability of a tax audit is 75% and the penalty for an impermissible deduction is $10,000, the person will not claim a deduction if he learns that the deduction is impermissible. Accordingly, if he decides to obtain advice, it will not matter to him that the size of the penalty for an impermissible deduction or the probability of audit might be raised.[21] The expected value of advice will thus still be $1,250 and he will still obtain legal advice if and only if its cost is less than this amount.

Because protection of confidentiality will have no effect on a party's decision to obtain definitive advice about the sanctionability of an act or on his behavior if he obtains advice, protection of confidentiality will have no effect on whether he commits a contemplated act.

<u>social desirability of protection of confidentiality</u>.
This issue is moot in the present case, since protection of
confidentiality has no effect on behavior.[22]

2. <u>Case where legal advice about sanctionability is not</u>
<u>definitive</u>. It will now be assumed that legal advice is in
the form of an opinion expressed by a probability that an
act is or is not sanctionable. In this case, the
conclusions about the effects and desirability of legal
advice about the sanctionability of acts and of protection
of confidentiality will differ from in the case just
examined.

    <u>behavior in the absence and in the presence of legal</u>
<u>advice; the decision to obtain advice</u>. How a party will
behave in the absence of advice here is, of course,
identical to how he behaved in the absence of advice before.
Here, however, if a party obtains advice, he will employ the
legal advisor's probability of the sanctionability of an act
in deciding whether to commit the act. That is, a party
will compare the expected gain from the act to the advisor's
probability that the act is sanctionable multiplied by the
expected sanction for a sanctionable act. For instance, if
the plant owner in Example 1 is told by his legal advisor
that the likelihood of a violation of the ordinance is 80%,
he will not discharge the waste product into the river,
since he will compare the gain of $3,000 to 80%x$5,000 =

$4,000. The expected value of advice will be found, as before, by multiplying the probability that a party would be led to change his decision whether to commit an act by the expected benefit that he would obtain as a consequence;[23] and a party will obtain advice if its expected value exceeds its cost.

social desirability of legal advice. In considering this matter, it will be assumed that the legal advisor's probabilistic opinion constitutes the best information available to the party ex ante about the sanctionability of an act, or, equivalently, about whether the act would be socially harmful.[24] Further, it will be assumed that it will be socially desirable ex ante for a party to commit an act if and only if the gain he would obtain exceeds the expected harmfulness of the act, computed by multiplying the legal advisor's probability that the act is sanctionable by the harm the act would do. Suppose in Example 1 that if discharging the waste product is a violation, the magnitude of the harm (in terms, say, of the death of fish) would be $5,000, so that this figure multiplied by the advisor's probability of a violation equals the expected harm that would be done by the discharge.[25] Then, since the gain from the discharge would be $3,000, the assumption is that it will be socially desirable ex ante that the waste product be discharged if the legal advice is that the likelihood of a violation is less than 60% (recall that 60%x$5,000 is $3,000).

Note from this illustration that when parties act desirably in the ex ante sense, it may well be that they commit acts that turn out to be sanctionable.[26] That that should be the case ought not disturb the reader. If, according to the best information available at the time a decision is made, an act is thought to be harmful and sanctionable only with a probability, it makes sense that the act should be committed when the benefits from doing so are sufficiently high. A contrary conclusion would lead to the reductio ad absurdum that when there is any chance that an act is sanctionable, it should not be committed, however large the gains would be.

With this in mind, the question whether legal advice about the probability that acts are sanctionable will lead to socially desirable behavior is easily answered. The advice will lead to such behavior if the expected sanctions for sanctionable acts equal the expected harm the acts would do. For then parties will, desirably, be led to compare their expected gains from contemplated acts to the expected harmfulness of the acts. Thus, in Example 1, since the sanction for a violation of the ordinance was assumed to equal $5,000, legal advice will lead to socially desirable decisions.

If, however, expected sanctions for sanctionable acts are less than the harm they would do, then legal advice might not lead to socially desirable behavior. In the

absence of advice a party might decide against committing an ex ante undesirable act if his estimate of the likelihood of its sanctionability is high enough. Yet with advice that the act is less likely to be sanctionable, the party may decide to commit the undesirable act, since he will face an expected sanction that is less than the expected harm. This might be true in Example 1 if the penalty for a violation was $4,000 (rather than the harm of $5,000), the owner's initial belief of a violation was 80%, and the legal advisor's probability was 70%.[27] A similar case might arise in Example 2 if the audit probability or penalty were inadequate, and the person would not take a deduction in the absence of advice but might do so with advice.[28]

The preceding paragraph is not meant to imply that legal advice will necessarily be undesirable in the ex ante sense when expected sanctions understate the harmfulness of acts. Advice might well still be desirable if, although expected sanctions are low, parties will be induced to behave appropriately with advice and will not otherwise.

effect of protection of confidentiality. Protection of confidentiality in the present case will tend to encourage parties to obtain legal advice. The reason is that parties will know that _after_ obtaining advice, they may decide to commit an act that could turn out to be sanctionable. This in turn means that anything -- and in particular protection of confidentiality -- that reduces, or prevents from

increasing, the probability or size of sanctions for committing sanctionable acts will be desired by parties who obtain legal advice. Protection of confidentiality will therefore raise the expected value of advice to them and may be what leads them to obtain advice. For instance, the person in Example 2 contemplating the tax deduction might say to himself, "I will claim the deduction if my legal advisor informs me that the likelihood of its impermissibility is low. But since the deduction may still turn out to be impermissible, I am glad that my advisor will not go to the tax authorities and suggest they audit my tax return. Indeed, if my advisor might do that, I might not consult him."

As this should make clear, the expected value to a person of protection of confidentiality inheres entirely in the possibility that he will decide, on the basis of advice, to commit an act that turns out to be sanctionable. Hence, the extent to which protection of confidentiality encourages parties to obtain legal advice will depend on how likely they believe they are to decide to commit sanctionable acts after obtaining advice.

<u>social desirability of protection of confidentiality</u>. Since protection of confidentiality encourages parties to obtain legal advice, protection of confidentiality will result in socially desirable changes in behavior if expected sanctions equal the harm due to sanctionable acts.

However, where expected sanctions are less than the harm done by acts, legal advice and thus protection of confidentiality may or may not lead to socially desirable behavior. Specifically, one must consider the effect of protection of confidentiality on two groups of parties. The first group is those who would obtain legal advice even without protection of confidentiality. Protection of confidentiality can have only a socially undesirable effect on the behavior of this group; for since confidentiality will prevent the expected sanction from rising to a more appropriate level, confidentiality can lead only to parties committing undesirable acts that they would not have committed in the absence of confidentiality. The second group is those who will obtain legal advice only if there is protection of confidentiality. Protection of confidentiality for this group may or may not have a socially undesirable effect since, as stated, the provision of legal advice may or may not have that effect.[29]

B. <u>Parties are uncertain about the magnitude or probability of sanctions</u>.

In this section it will be assumed that parties know which acts are sanctionable and will therefore commit acts that are not sanctionable. Parties' only uncertainty will be over the magnitude or probability of sanctions applying where acts are sanctionable, and attention will thus be

restricted to sanctionable acts. Suppose, for instance, that in Example 1 the plant owner knows that discharging the waste product will violate the ordinance but is unsure of the penalty for a violation; or suppose in Example 2 that the person realizes that the tax deduction is impermissible but is not clear about the audit probability or the size of the possible penalty. Because such uncertainty is in many respects similar to uncertainty about whether acts are sanctionable, it can be briefly treated.

behavior in the absence and in the presence of legal advice; the decision to obtain advice. In the absence of legal advice about the probability or magnitude of sanctions, a party will decide whether to commit a contemplated sanctionable act by comparing his estimate of the expected sanction to the expected gain from the act. If the person in Example 2 is unsure of the audit probability, he will estimate the likelihood of different possible audit probabilities, calculate the expected gain and the expected penalty, and make his decision whether to claim the deduction accordingly.[30] The expected value of advice is determined analogously to before. A party will multiply the probability that advice will lead him to alter his behavior by the expected benefit he will obtain from his altered behavior. He will obtain advice if its cost is less than its expected value.

social desirability of legal advice. The conclusions here parallel those in Section II.A.2, where advice con-

cerned the likelihood that acts are sanctionable. That is, the provision of legal advice about the probability and magnitude of sanctions will lead to socially desirable changes in behavior if the probability and magnitude of sanctions are set so that expected sanctions equal the harm due to acts. For then informed parties will be induced to behave in a socially desirable way; whereas if parties do not obtain legal advice and incorrectly estimate expected sanctions and thus the expected harmfulness of acts, they may decide to commit undesirable acts or not to commit desirable acts.

On the other hand, the provision of legal advice may or may not promote socially desirable behavior where the probability and magnitude of sanctions is less than the harm caused by acts. The possibility that the provision of legal advice will be undesirable arises because it may lead parties to commit undesirable acts that they would not otherwise have committed because they overestimated expected sanctions.

effect of protection of confidentiality. Protection of confidentiality will raise the willingness of parties to obtain legal advice for essentially the same reason it did in Section II.A.2. Parties will reason that they may, on the basis of advice, decide to commit sanctionable acts. Hence, they will be better off, and will value advice more, if the probability or magnitude of sanctions is not increased as a consequence of their obtaining advice.

<u>social desirability of protection of confidentiality</u>.
As in Section II.A.2, protection of confidentiality will
lead to socially desirable changes in behavior where
expected sanctions equal the harmfulness of acts, but may or
may not encourage desirable behavior where expected
sanctions are lower.[31]

C.   <u>Parties wish to lower the probability or magnitude of</u>
<u>sanctions</u>.

It will be assumed here that parties know which acts
are sanctionable and what the usual probability and
magnitude of sanctions are, but that they can lower the
probability or magnitude of sanctions if they obtain certain
advice. For instance, suppose in Example 2 that the person
can obtain advice from his legal advisor enabling him to
reduce the probability of a tax audit.[32]

<u>behavior in the absence and in the presence of legal</u>
<u>advice; the decision to obtain advice</u>. A party will as
before decide whether to commit a contemplated sanctionable
act on the basis of the expected gain and the expected
sanction. The difference that the type of advice now under
consideration will make is that it will lower the expected
sanction, and thus make it more likely that the party will
commit the act. Advice will be valuable to the party
whenever, given advice, he will commit the act. The party
will obtain advice when its cost is less than its expected
value.

social desirability of legal advice. The provision of
legal advice that lowers the probability or magnitude of
sanctions is socially undesirable because it can lead only
to an increased number of socially undesirable acts.

effect and social desirability of protection of
confidentiality. The effect of protection of confiden-
tiality is plainly to encourage individuals to obtain the
type of legal advice under consideration. And since, as
just observed, provision of this advice is socially
undesirable, protection of confidentiality is socially
undesirable.[33]

III. Concluding Discussion

This section will summarize the conclusions from the
model and will then offer comments on a significant omission
from the analysis, on the law governing the confidentiality
of attorney-client communications about planned acts, and on
the sense, or lack thereof, that that law makes.

(a) summary of conclusions from the model: prediction
of behavior. With regard to prediction of parties'
behavior, several points were developed in the model.
First, a party will choose to engage in a contemplated act
if the benefit would outweigh the expected sanction that
might be associated with the act. Second, a party will
decide to obtain legal advice about an act on the basis of a
comparison of the cost of advice with the benefits, namely,

any advantages flowing from an advice-induced change in his decision whether to commit the act, discounted by the likelihood of his receiving advice that leads to such a change. Parties' decisions whether to obtain legal advice and whether to commit acts were illustrated in several numerical examples, indicating, it is hoped, the potential for making realistic predictions.[34]

Third, the value to a party of protection of confidentiality inheres in the possibility that _after_ he obtains advice he will decide to commit an act for which he might be sanctioned; it is only in this circumstance that his legal advisor's not communicating with enforcement authorities will do the party good. Hence, protection of confidentiality will be most valuable to parties, and will most encourage them to obtain legal advice, when legal advice is unclear or when the level of sanctions is inadequate; for if either is so, then after obtaining advice parties will often decide to engage in acts that may turn out to be sanctioned. On the other hand, protection of confidentiality will be least valuable when the opposite is true. The extreme case is where legal advice about whether acts are sanctionable is definitive. In this case parties who choose to obtain advice will not commit acts that they learn are sanctionable, and protection of confidentiality will therefore have no effect on the decision to obtain legal advice.

(b) summary of conclusions from the model: social desirability of legal advice and protection of confidential-

ity. The answer to the question when provision of advice, and equally, when protection of confidentiality, will result in socially desirable changes in parties' behavior, depends on the type of advice parties seek. First, where advice concerns whether acts are sanctionable and the advice is definitive, then advice can lead only to desirable changes in behavior. Legal advice is sometimes exactly of this character; where the law is settled, that will generally be so.

Second, where the law is not clear or where advice concerns the magnitude or probability of sanctions, whether advice will lead to desirable changes in behavior depends on the level of expected sanctions. If the level of expected sanctions equals the expected harmfulness of acts, advice will be socially desirable: parties with advice will be led to take into correct account the harmfulness, if any, of their acts because they will know the expected sanctions associated with their acts. Hence, one would usually expect provision of legal advice about tort, contract, and much regulatory law to be socially desirable; for, in principle, damages and, often, penalties for violations are supposed to equal harm done, and violations will frequently be noticed and sanctioned or settlements will be paid.

On the other hand, if the level of expected sanctions is less than the expected harmfulness of acts, advice may or may not lead to desirable changes in behavior. Advice will

not lead to desirable behavior if, without advice, parties would overestimate the level of expected sanctions and that would lead them to act more appropriately than they would with advice; advice will lead to desirable behavior, however if parties intially underestimate the level of expected sanctions. When will the level of expected sanctions be too low to induce informed parties to behave desirably? One supposes that this could sometimes be true in the area of tort, contract, or regulatory enforcement,[35] and that it will very often be true in the area of crime. Thus, in these areas, to answer the question whether advice about contemplated acts will lead to undesirable or desirable changes in behavior requires us to know how parties' initial beliefs concerning the level of expected sanctions diverge from their actual level.

Third, where advice helps to lower (rather than only to inform about) the probability or magnitude or sanctions, advice can only lead to the commission of undesirable acts and is therefore undesirable.

(c) behavior of legal advisors. The behavior of legal advisors was not analyzed in the model, and two important questions about it arise. Namely, what are the incentives of legal advisors to keep confidential or to disclose information about their clients? And how effectively can legal advisors' behavior in these respects be controlled?

As a general matter, one suspects that legal advisors will not wish to disclose information that their clients

want held confidential, since the advisors will wish to please their clients. Therefore, it seems that legal advisors would have to be legally required to reveal information for that usually to be accomplished, and enforcement would have to rely on discovery of communications establishing that advisors knew their clients' plans. Establishing this might be difficult since what would be at issue is a kind of behavior (frequently, mere verbal communications) about which there would often be no evidence and that the involved parties would ordinarily want to conceal. Consequently, the ability to enforce requirements that legal advisors disclose information seems circumscribed.[36]

There may, however, be occasions where it will be in a legal advisor's self interest to disclose information. For example, by reporting that a client is about to perpetrate a securities fraud, it is conceivable (although admittedly unlikely) that a legal advisor would better his reputation in the community of potential victims and profit sufficiently from greater future business from them to justify disclosure. In addition, a legal advisor's reputation among the public might be enhanced by revealing certain information and, of course, his notions of morally proper behavior might lead him to do the same.

Where, for such reasons as these, a legal advisor wishes to disclose information, it may be that a rule against disclosure applies. Enforcement of such a rule

appears straightforward if an advisor would reveal his own identity when making a disclosure, for the advisor could then be sanctioned, and his disclosure could also be ignored by courts and even by police or other authorities (although it would not be by victims). If, however, a legal advisor would make an anonymous disclosure, it might be difficult to sanction him. Still, in some cases an inference that he was the source of information could be made. Also, an anonymous disclosure might not be believed; and even if believed, it might deny the legal advisor a benefit (an enhanced reputation) he seeks from disclosure. Thus, the situation is complex, but the ability to enforce a rule against disclosure appears to be substantially greater than the ability to enforce a rule requiring disclosure.

A remark about the collective incentive of legal advisors, that is, of their professional associations, should be added. Other things being equal, one would expect a professional association of legal advisors to favor policies that increase the demand for advisors' services. Thus, one would expect a professional association to favor rules preserving confidentiality.[37] This bias may be important because professional associations may strongly influence the rules regarding confidentiality, and, as just argued, because there are real possibilities for enforcing rules against disclosure.

(d) the law regarding attorney-client communications about planned acts. In the United States, the law is

roughly this.[38]   (i) Attorneys are generally <u>not obligated to disclose</u> planned acts of clients communicated to them in confidence.[39]   (ii) Attorneys in all states have the <u>discretion to disclose</u> clients' planned acts if the acts are crimes threatening serious bodily injury; and in most states attorneys have the discretion to disclose any type of crime or fraud.[40]   (iii) Attorneys generally <u>cannot disclose</u> information about other planned acts, such as an intention to commit a breach of contract or much behavior that could give rise to a tort.   Furthermore, in some states, attorneys cannot disclose information about any planned act unless it is a crime threatening serious bodily injury.[41]   (iv) However, an attorney's obligation not to disclose a planned act might not apply if he gains his information inadvertently (for example, if he overhears his client talking to another person), if a third party who would not be expected to maintain confidentiality is present when the client speaks to the attorney, if the attorney has been drawn into assisting an illegal act, or if the client waives the privilege of confidentiality.   In such cases, attorneys may have the discretion to disclose planned acts.[42]

(e) <u>the law in light of the analysis</u>.   What do the conclusions from the model suggest about the social desirability of the above-described law?   The conclusion that protection of confidentiality is undesirable where a client's object is to obtain advice enabling him to evade

the law by lowering expected sanctions implies that it may be advantageous for attorneys to have a duty to disclose certain planned acts. Thus, a duty to disclose might be desirable where an individual obtains advice from his attorney helping him to conceal capital gains from the tax authorities, or where a client corporation obtains advice about the timing of inspections at its factory that will allow it to avoid being caught for violations.[43] That the law does not impose an obligation on attorneys to disclose clients' plans in such situations, or may forbid disclosure, raises questions.[44]

Another conclusion was that it is unclear whether protection of confidentiality is undesirable or desirable where advice, while not enabling clients to evade the law, provides information about expected sanctions and the sanctions are not high enough to ensure that parties will act desirably. The model does not suggest, therefore, whether attorneys ought to disclose or keep secret clients' plans to commit crimes or other acts for which expected sanctions might be thought inadequate. To make a recommendation, data is needed on the effects of confidentiality vs. disclosure on the incidence of these acts, yet essentially no data exist.[45] Moreover, intuition about the effects does not furnish me, at least, with real guidance. I can easily adduce reasons why more bad acts would be prevented if attorneys were obligated to disclose clients' plans,[46] and

also quite plausible reasons why more bad acts would be prevented were attorneys forbidden from disclosing clients' plans.[47]

I should add that I see no obvious justification for distinguishing the treatment of attorneys' information about clients' plans to commit many "lesser" bad acts from attorneys' knowledge of plans to commit such serious crimes as murder. To be sure, murder is more important to prevent than robbery, fraud, and the like. But how does this bear on the question whether a policy of disclosure or of confidentiality will result in prevention of more bad acts? Not in an apparent way. With regard to bad acts, the main advantage of disclosure, we know, is that individuals who see and are not dissuaded from acting by attorneys in the absence of disclosure may be led to change their minds or may be prevented from acting by disclosure. The main advantage of confidentiality is that more individuals discuss their plans with attorneys, and then may decide against acting. I do not see why the comparison of these advantages should be influenced in a general way by the gravity of the bad act.

Nevertheless, the law and many commentators seem agreed that disclosure is more appropriate for serious crimes than for lesser ones. The explanation probably lies in a disposition to think first of the direct effect of disclosure -- that in the case at hand, disclosure may prevent an identi-

fied harm from being done (a known individual from murdering another individual) -- and in an accompanying reluctance to count properly the unseen, indirect effects of disclosure on incentives to reveal information to attorneys.

An additional conclusion from the model was that protection of confidentiality is desirable where expected sanctions are sufficient to induce informed parties to behave desirably. From the perspective of this conclusion, it makes some sense that attorneys must not disclose information about planned breaches of contract, and also about certain tortious behavior and behavior that would, or might with some probability, violate certain regulations. For as noted earlier, the expected sanctions for such acts should often approximate the harm in which they result. At the same time, and as was also suggested before, there will be some such acts for which expected sanctions are too low (the small fine for leaving unrepaired a crack in a dam). That attorneys may well be obligated to maintain confidentiality about clients' plans of this type (instead, say, of having discretion to report them) gives one pause.

A final point about the law that was not addressed directly in the model should be added. There is an obvious reason why attorneys should not be obligated to keep confidential information that they obtain inadvertently, in the presence of third parties not expected to maintain confidentiality, or from clients who waive the privilege of

confidentiality. Namely, the possibility that attorneys will disclose such information should have little or no effect on parties' incentives to seek legal advice. A person will likely not expect to be overheard any more by his attorney than by others, so this factor will not weigh much in his calculations whether to obtain legal advice. Likewise, a person's decision whether to obtain legal advice will be unlikely to be affected by the chance of his attorney's disclosure if he is willing to allow the presence of third parties who would not be expected necessarily to maintain confidentiality. And plainly, if a person is willing to allow disclosure, then he will hardly be discouraged from seeking advice if there is disclosure.

Appendix: formal analysis of the model

The assumptions are essentially those discussed informally in Section II. Risk neutral parties contemplate engaging in acts that will yield them a gain, that may do harm, and that may be sanctionable.[48] Parties may obtain legal advice before deciding whether to commit acts. Specifically, let

g = gain to a party from committing an act; g > 0;

h = harm due to committing an act; h ≥ 0;

s = magnitude of the sanction applying if a sanctionable act is sanctioned; s ≥ 0;

p = probability of imposition of a sanction for a sanctionable act; and

c = cost of legal advice; c ≥ 0.

A party's initial knowledge and the nature of the legal advice he may obtain will be described below.

Assumptions about the social desirability of acts and the relation between sanctions and the social desirability of acts are as follows: An act will be considered socially desirable if it results in a gain exceeding the harm. Acts that cause no harm will not be sanctionable. Thus, it will be socially desirable for parties to commit such acts. Acts that cause positive harm will be sanctionable, and the expected sanction for such acts, ps, will be less than or equal to the harm h. It follows that if ps = h, it will be socially desirable for sanctionable acts to be committed if

and only if g > ps. If ps < h, it may be socially undesirable for an act to be committed even if g > ps; for only if g > h will it be socially desirable for an act to be committed.

The analysis will be in three parts, as in Section II.

A.   <u>Parties are uncertain whether acts are sanctionable</u>

It will be assumed here that parties do not know whether contemplated acts are sanctionable in the absence of legal advice and that parties know the probability p and sanction s applying if an act is sanctionable.

<u>Case where legal advice is definitive</u>. Here it will be supposed that legal advisors will tell parties for sure whether acts are sanctionable. Define

> q = party's subjective probability that an act is sanctionable.

If a party does not obtain advice, he will commit an act if[49]

> (1) g > qps,

in which case his expected net gain will be g - qps; otherwise he will not commit an act and his gain will be 0.

If a party obtains advice and is told that an act is not sanctionable, he will commit it and obtain g. If he is told that an act is sanctionable, he will not commit it if

> (2) g ≤ ps.

Hence, if (2) holds and a party obtains advice, his expected net gain will be

(3) $(1 - q)g$;

and if (2) does not hold and he obtains advice, his expected net gain will be

(4) $g - qps$.

Given the foregoing, the expected value of advice -- the expected net gain if advice is obtained less the expected net gain if it is not -- can be calculated. If (2) does not hold, then clearly (1) must hold; therefore, the expected value of advice will be $(g - qps) - (g - qps) = 0$. (As discussed in Section II.A.1, the explanation is that if (2) does not hold, the party will commit the act whether or not he learns it is sanctionable; advice will thus be valueless since it will not lead to a change in behavior.) If (2) and (1) hold, the expected value of advice will be

(5) $(1 - q)g - (g - qps) = q(ps - g)$,

that is, the expected savings in sanctions avoided net of gains if the party learns that the act is sanctionable and does not commit it. If (2) holds and (1) does not hold, the expected value of advice will be

(6) $(1 - q)g$,

the expected gain if the party learns the act is not sanctionable and thus does commit it.

Hence, a party will not obtain advice if (2) does not hold; otherwise, he will obtain advice if its value, as given by (5) or (6), exceeds c.

The provision of advice can lead only to socially desirable changes in behavior. From what has been said, it

is evident that advice can lead to only two types of changes in behavior. On the one hand, a party may decide to commit an act that is not sanctionable that he would not have committed in the absence of advice. That is socially desirable given the assumption that acts that are not sanctionable cause no harm. On the other hand, a party may decide not to commit an act that is sanctionable that he would have committed in the absence of advice. That will be socially desirable, since if a party decides on the basis of advice not to commit a sanctionable act, then $g \leq ps \leq h$.

To this point, it has been assumed that the probability or magnitude of sanctions will not rise as a consequence of obtaining advice, in other words, that confidentiality of communications with legal advisors is protected. Assume now that there is no protection of confidentiality, so that if a party obtains legal advice, the probability or magnitude of sanctions will rise. Let

> p', s' = probability and magnitude of sanctions, respectively, if there is no protection of confidentiality and a party obtains legal advice; $p's' > ps$.

Lack of protection of confidentiality will not affect parties' behavior under any circumstances. To see why, let us show that in each possible situation there will be no change in behavior.

Suppose first that (2) does not hold. In that situation, the value of advice was 0 before, so that a party would not obtain advice, and he would commit the act. In

the absence of confidentiality, if (2) does not hold, there
are two possibilities: either $g > p's'$, or $g \leq p's'$. If
$g > p's'$, then since a party will commit his act even if he
learns that it is sanctionable, the expected value of advice
will be $(g - qp's') - (g - qps) = q(ps - p's') < 0$; advice
would have negative expected value and would not be
obtained. (The apparent peculiarity that advice has
negative expected value is due to the fact that if the act
is sanctionable, the expected sanction rises owing to
advice.) If $g \leq p's'$, then since a party will not commit
his act if he learns it is sanctionable, the expected value
of advice will be (5), which will be negative. Thus, in
this case as well, a party will not obtain advice, and will
commit his act.

Now assume that (2) and (1) hold. Then, before, a
party would obtain advice if (5) exceeded c and would commit
the act only if he learned it was not sanctionable. If (5)
did not exceed c, he would commit the act. In the absence
of protection of confidentiality, since (2) holds, $g < p's'$.
Hence, if a party obtains advice and learns his act is
sanctionable, he will not commit it. Therefore, if he
obtains advice, he will behave as before, and if he does not
obtain advice, he will obviously behave as before. In
consequence, (5) will, as before, be the expected value of
advice. Hence, a party will obtain advice if and only if
(5) exceeds c, and behave identically as before.

Finally, assume that (2) holds and (1) does not hold. Then, before, a party would obtain advice if (6) exceeded c and would commit the act only if he learned it was not sanctionable. If he did not obtain advice, he would not commit the act. In the absence of protection of confidentiality, for reasons analogous to those given in the last paragraph, if a party obtains advice, he will commit the act only if he learns it is not sanctionable. Therefore, as before, a party will obtain advice if and only if (6) exceeds c, and will behave identically.

Summarizing, we have

<u>Proposition 1</u>. In the case where legal advice concerns whether an act is sanctionable and the advice will be definitive, (a) a party's decision whether to obtain advice is as described in the paragraph containing Exps. (5) and (6); (b) protection of confidentiality will have no effect on parties' behavior, and (c) the provision of legal advice can lead only to socially desirable changes in behavior.

2. <u>Case where legal advice is not definitive</u>. Now assume that legal advice is in the form of a probability that an act is sanctionable. Let

> t = probability that an act is sanctionable as reported by a legal advisor to a party who obtains advice; and

f(t) = party's probability density over advice t.

Thus, note, we have the identity $q = \int_0^1 tf(t)dt$.

As in the last case, if a party does not obtain advice, he will commit an act if $g > qps$, and his net expected gain will be $g - qps$.

If a party obtains advice and confidentiality is protected, he will commit an act if $g > tps$; hence, his net expected gain will be

$$(7) \quad \int_0^{g/ps} (g - tps)f(t)dt;$$

expression (7) less $g - qps$ (if $g > qps$) or 0 (if not) is then the expected value of advice.

With regard to the social desirability of legal advice, suppose, as is natural, that t is the best information available to the party and that it is socially desirable for an act to be committed if and only if $g > th$. Then if $ps = h$, legal advice will be desirable because with advice parties will act desirably but might not otherwise. On the other hand, if $ps < h$, legal advice may or may not be socially desirable. Advice may be desirable, since it may sometimes lead parties not to commit undesirable acts that they would otherwise commit; and advice may be undesirable, since it may also lead parties to commit undesirable acts that they would not otherwise have committed.[50]

If a party obtains advice and there is no protection of confidentiality, he will commit an act only if $g > tp's'$ -- less often than if confidentiality is protected -- and his net expected gain will be

$$(8) \quad \int_0^{g/p's'} (g - tp's')f(t)\,dt.$$

This is smaller than expression (7) since p's' > ps. Thus, the expected value of advice will be lower, and parties will obtain advice less often when there is no protection of confidentiality.

Since protection of confidentiality results in parties obtaining legal advice more often, protection of confidentiality will be socially desirable if ps = h, and protection of confidentiality may or may not be desirable if ps < h.[51]

Thus, we have

Proposition 2. In the case where legal advice concerns whether an act is sanctionable and the advice will be in the form of a probability, (a) a party's decision whether to obtain advice is as described in the paragraph containing Exp. (7); (b) protection of confidentiality will lead parties to obtain legal advice more often than they other- wise would; and (c) provision of legal advice and protection of confidentiality will lead to socially desirable changes in behavior if expected sanctions are adequate (ps = h), but may or may not lead to desirable changes if expected sanctions are inadequate (ps < h).

B. Parties are uncertain about the magnitude or probability of sanctions.

In this part it will be assumed that parties are

uncertain about the magnitude or probability of sanctions but do know which acts are sanctionable. Thus parties will seek legal advice only about sanctionable acts, and attention will be confined to these acts. If a party obtains legal advice about a sanctionable act, it will be supposed that he will learn the true probability and magnitude of sanctions. Let

$h(p,s)$ = party's probability density over p and s.

If a party does not obtain legal advice about an act, he will commit the act if $g > E(ps)$ (where E is the expectation operator), and $g - E(ps)$ will be his expected net gain; otherwise, his gain will be 0.

If a party obtains legal advice about an act, he will commit the act if $g > ps$, and his expected net gain will be

$$(9) \quad \int_0^{g/p} \int_0^1 (g - ps)h(p,s)\,dp\,ds.$$

The expected value of advice equals (9) less $g - E(ps)$ or 0, as the case may be; and the party will obtain advice if its expected value exceeds c.

The provision of legal advice will be socially desirable if $ps = h$, for in that situation parties with advice will commit acts if and only if $g > h$. However, if $ps < h$, the provision of legal advice may or may not be socially desirable.[52]

If there is no protection of confidentiality, the probability density of p's' will clearly be to the right of

the density of ps. Hence, if parties obtain legal advice, parties will commit acts less often, and the expected value of legal advice will decline. Therefore, parties will obtain legal advice less often.

Because protection of confidentiality will induce parties to obtain legal advice more often, and because the advice will necessarily be desirable only if ps = h, protection of confidentiality will necessarily be desirable only if ps = h; if ps < h, confidentiality may or may not be desirable.[53]

<u>Proposition 3</u>. In the case where legal advice concerns the probability or magnitude of sanctions (a) a party's decision whether to obtain advice is as described in the paragraph containing Exp. (9); (b) protection of confidentiality will lead parties to obtain advice more often than they otherwise would; and (c) provision of legal advice and protection of confidentiality will lead to socially desirable changes in behavior if expected sanctions are adequate (ps = h), but may or may not lead to desirable changes if expected sanctions are inadequate (ps < h).

C.   <u>Parties wish to lower the probability or magnitude of sanctions</u>

It will be assumed here that parties can obtain legal advice that will reduce the probability or magnitude of sanctions from their usual levels. It will also be assumed that parties know which acts are sanctionable so that,

again, attention will be restricted to sanctionable acts.
Let

$\bar{p}, \bar{s}$ = the probability and magnitude of sanctions given advice on how to lower them; $\bar{p}\bar{s} <$ ps.

If a party does not obtain legal advice about a sanctionable act, he will commit the act if $g > ps$, and if he does obtain advice, he will commit the act if $g > \bar{p}\bar{s}$, and thus more often. If $g > \bar{p}\bar{s}$, the expected value of advice will be $ps - \bar{p}\bar{s}$ in the case where $g > ps$ (the act would have been committed in the absence of advice), and $g - \bar{p}\bar{s}$ in the case where $g \leq ps$; advice will be obtained if its expected value exceeds c. If $g \leq \bar{p}\bar{s}$, advice will have no value.

The provision of legal advice of the type under consideration can only be socially undesirable, since it may lead a party to commit a sanctionable act when he would not otherwise have done so, that is, when $g < ps \leq h$, and thus when commission of the act is socially undesirable.

The protection of confidentiality is socially undesirable. In its absence, if legal advice is obtained, the expected sanction will be $p's' > \bar{p}\bar{s}$. Therefore, in the absence of protection of confidentiality, legal advice will be obtained less often, which, as explained in the last paragraph, is socially preferable.

Proposition 4. In the case where legal advice will enable a party to lower the probability or magnitude of sanctions, (a) a party's decision whether to obtain advice as described in the second paragraph; (b) protection of confidentiality

will lead parties to obtain advice more often than they otherwise would; and (c) provision of advice and protection of confidentiality are socially undesirable.

Footnotes

1. While in the model legal advisors can be interpreted to be any persons who supply legal advice, the reader will no doubt wish to think of legal advisors as attorneys or, perhaps, as accountants.

2. I will not discuss communications with legal advisors about acts <u>already</u> committed. This will be the subject of a successor paper.

3. Not of interest are plans, such as the drafting of a will, that do not ordinarily expose parties to sanctions.

4. I use the term "sanctionability" rather than "legality" or "illegality" because I want the reader to be thinking of the broadest category of acts that may result in sanctions (for instance, acts that do not violate any statutes and are not illegal but for which parties might be liable in tort).

5. The main contribution of the present paper is that it identifies how the effects and the social desirability of

legal advice and protection of confidentiality depend on the type of advice about contemplated acts that is sought; in addition, the fact that the analysis employs a model of rational choice will, I hope, prove clarifying. I am not aware of other work studying explicitly the decision to obtain legal advice about contemplated acts or the social desirability of the advice. However, much has been written about the protection of confidentiality of legal advice about contemplated acts (or, in the parlance of legal ethics, "future acts"). See Jeremy Bentham, The Rationale of Judicial Evidence, Book V 308-12 (1827), and John H. Wigmore, 8 Evidence in Trials at Common Law 572-80 (John T. McNaughton rev. 1961). See also, for example, Student note The Future Crime or Tort Exception to Communications Privileges, 77 Harv.L.Rev. 730 (1964); Geoffrey Hazard, An Historical Perspective on the Attorney - Client Privilege, 66 Cal.L.Rev. 1062-69 (1978); John McCormick, McCormick on Evidence 229-31 (Edward Cleary et al. rev., 3rd ed. 1984); Student note, Developments in the Law - Privileged Communications, 98 Harv.L.Rev. 1501-14 (1985); Charles Wright & Kenneth Graham, 24 Federal Practice and Procedure, Federal Rules of Evidence, Rejected Rules 502 to 503, 493-528 (1986); Charles W. Wolfram, Modern Legal Ethics 279-82, 692-706; Frank Easterbrook, Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information, 11 S.Ct. Rev. 353-64 (1982); and B. Peter Pashigian,

Regulation, Preventive Law, and the Duties of Attorneys, in
the Changing Role of the Corporate Attorney 28-41 (William
J. Carney ed. 1982).

Bentham is well known for his criticism of protection
of confidentiality. His criticism amounts in essence to the
claims that (a) protection of confidentiality will benefit
those who intend to break the law and thus will dilute
deterrence, while (b) the protection will not benefit law
abiders, so that absence of the protection will not hurt
them. The general form of response to Bentham has been (a)
that the law is not always clear, so that not all acts can
be seen as clearly violative of the law or as clearly
conforming to it; and (b) that protection of confidentiality
encourages parties to obtain legal advice, which is a good
thing. I will comment on Bentham's argument and this
response in notes 22, 29, 31, and 33 below.

6. Readers who are unfamiliar with the concepts of
expected value and risk neutrality will be unlikely to have
difficulty understanding the present analysis if they are
careful to follow the numerical examples; however, they may
wish to consult Howard Raiffa, Decision Analysis (1968), for
an introduction to decision theory. It will be clear to
readers who are familiar with decision theory that the
qualitative nature of the results to be obtained do not
depend on the assumption of risk neutrality.

7. In reality, of course, parties will often be uncer-
tain about a combination of factors. I assume uncertainty

over only one factor at a time in the present analysis in order to isolate each factor's importance.

8. Note that the expected net gain may be interpreted as the average net gain if the owner made many similar decisions.

9. At a probability of a violation of 60%, his net expected gain would be zero: $3,000 - 60%x$5,000 = 0.

10. The nature of the deduction and prior experience with the taxpayer can strongly influence the probability of an audit. Thus, even though only a small proportion of all returns are now audited by the IRS, it is not necessarily unrealistic to assume that the probability is 75% in a particular case. With regard to the penalty, the reader should note that under the new tax law, the "no-fault" penalty for understatement of taxes is 25% of the amount of the tax savings resulting from the understatement (IRC-§6661); the penalty for negligence is 5% plus 50% of interest owed (IRC-§6653(a)); the civil penalty for fraud (which may be established merely by a preponderance of the evidence) is 75% plus 50% of interest owed (IRC-§6653(b)); interest is compounded on taxes not paid (IRC-§6622); and neither penalties nor interest is tax deductible (IRC-§§162(f) and 163(h)). Taking these factors into account, a penalty of $10,000 on a $20,000 savings due to tax understatement may not be unrealistic in certain cases. In any event, the present example is not intended to portray a

typical situation facing a taxpayer; its chief purpose is to illustrate the character of a taxpayer's decisionmaking.

11. For 11.11%x$20,000 - 88.89%x$2,500 = 0.

12. While it should seem plausible that this is the expected value of advice, the point can be demonstrated directly by computing the net expected gain if a party obtains advice (taking into account how he will wish to act given advice), and then by subtracting the net expected gain if a party does not obtain advice. See Raiffa, supra note 6, at 27-32, for an introductory discussion of the expected value of information.

13. However, suppose that the owner would not discharge the waste product in the absence of advice, because he initially thinks the probability of a violation is higher, say 80%. In this situation, the expected value of advice would derive from the possibility that he would learn that a discharge would not constitute a violation; the expected value of advice would equal 20%x$3,000 = $600, the probability that he will learn that a discharge will not constitute a violation, multiplied by the gain from then discharging the waste product into the river.

14. Actually, a qualification going outside the model is worth mentioning. It may be that a person who would claim a deduction (or commit some other act) whether or not he is told that it is definitely impermissible will still place a positive value on knowledge of its impermissibility.

One reason is that this knowledge may be useful in deciding whether he should later take steps to conceal his act (such as not claiming a similar deduction the following year); if he learns his act is impermissible, he may well want to take such steps.

15. When I speak of the social desirability of legal advice (and later of protection of confidentiality), I will limit consideration to whether it induces parties to make socially desirable decisions; I will not ask whether any change for the better in parties' decisions is justified by the cost of legal advice.

16. The reader should not be detained by this particular assumption, and by the thought that there may be some acts that are socially undesirable whatever the gain to the parties who commit them. The main importance of the assumption is that it allows the category of desirable acts to be described very simply.

17. This assumption seems the one of greatest relevance to me because both casual empiricism and theoretical considerations (having to do with the costliness of imposing sanctions) suggest that expected sanctions are more often less than or equal to the level necessary to achieve optimal deterrence than greater than necessary. However, the interested reader will have no difficulty in tracing out the consequences of the assumption that the expected sanction exceeds the harm. For the most part the qualitative nature

of the conclusions under that assumption are the same as those where the expected sanction is less than the harm.

18. Of course, advice about facts other than the sanctionability of an act might lead a party to commit a sanctionable act that he would not have committed in the absence of advice. As will be discussed below, advice that the expected sanction for an act is lower than a party initially thought may well lead him to commit it.

19. Legal advisors' motives, and the ability to enforce legal rules regarding confidentiality and disclosure, will be discussed briefly in the concluding section.

20. If a legal advisor discloses a client's intentions, the likelihood that the client will be caught and sanctioned will generally increase, and the magnitude of the sanction may rise as well since it may depend on the client's state of mind.

21. The fact that being audited may be time consuming and unpleasant is ignored.

22. In the present case, why is Bentham's argument (see note 5) against protection of confidentiality wrong? The answer is that the disadvantage of protection that he mentioned -- that law breakers would be helped -- is irrelevant because those who would break the law do not obtain legal advice. At the same time, what I called the general response to Bentham is also irrelevant, since protection of confidentiality does not encourage parties to obtain legal advice.

23. For example, suppose that the owner in Example 1 initially believes that the probability of a violation is 50%; that with probability 50%, a legal advisor will tell him that the probability of a violation is 20%; and with probability 50%, the advisor will tell him the probability of a violation is 80%. (Note that the person's initial probability equals the probability-weighted average of the probabilities he might learn: 50% = 50%x20% + 50%x80%. This must be true by the definition of conditional probabilities.) Then in the absence of advice, we know that the owner will discharge the waste product; and we know that if the advice is that the probability of a violation is 80%, he will not discharge the waste product. Hence, the expected value of advice is 50%x(80%x$5,000 - $3,000) = 50%x$1,000 = $500.

24. Recall from above that the assumption is that an act will be sanctionable if and only if it is harmful.

25. In fact, reflection about this computation of expected harm reveals an artificiality in the assumption that an act is harmful if and only if it turns out to be sanctionable. Where there is uncertainty whether discharging a waste product into a river will violate an ordinance intended to protect the health of the river, the uncertainty presumably often arises because the waste product in question <u>verges</u> on the toxic. Hence, (a) even if the waste product does not turn out to be considered toxic

under the ordinance, discharging it may well still cause some detrimental change in the river. On the other hand, (b) if the waste product does turn out to be considered toxic under the ordinance, discharging it will probably usually cause less harm to the river than would the discharge of an unambiguously toxic waste product. Since these factors work in opposite directions and may be offsetting, taking them into account would not materially affect the analysis here, and for expositional reasons I ignore them.

26. Also, it may be that when parties act desirably in the ex ante sense, they do not commit acts that would turn out not to be sanctionable.

27. To complete this example, suppose that the owner believes he will be told with probability 50% that the probability of a violation is 90%, and with probability 50% that the probability of a violation is 70%. Then, since in the absence of advice his probability of a violation is 80% (for 50%x90% + 50%x70% = 80%), he will not discharge the waste product, for the expected penalty will be 80%x$4,000 = $3,200, which will exceed his gain of $3,000. However, he will decide to discharge the waste product if he obtains advice and is told that the probability of a violation is only 70%, since then the expected penalty will be only 70%x$4,000 = $2,800, which is less than $3,000. But discharging the waste product will be socially undesirable

even if the probability of a violation is 70%, since the expected harm will be 70%x$5,000 = $3,500, which exceeds $3,000.

28. Note the contrast with the situation where advice was definitive, where, recall, advice was desirable independent of the magnitude of expected sanctions. There, the only reason that a party who would not commit an act in the absence of advice would be led by advice to commit it was that the advice was that the act was <u>definitely</u> not sanctionable. Here, as just explained, however, a party could be led to commit an act merely because the advice is that the act is <u>more</u> <u>likely</u> than he had thought not to be sanctionable -- which leaves open the possibility that it <u>is</u> sanctionable. For this latter reason, it is important here, but was not before, that the party with advice face an appropriately high expected sanction if the act is sanctionable. That is why here, but not before, it matters whether the expected sanction is fully equal to the harm.

29. In the present case, Bentham's argument against protection confidentiality is not really applicable since it does not address the situation where, after obtaining legal advice, parties do not know whether or not their acts will be sanctionable. This, recall, was part (a) of the general response to Bentham. However, part (b) of the response, that protection of confidentiality is good because it encourages parties to obtain legal advice, is not

necessarily a correct response. It is not necessarily correct because, as we have seen, the provision of legal advice is not always good. The response is also incomplete because it overlooks the effect of protection of confidentiality on those who would have obtained advice even in the absence of protection.

30. Suppose, for instance, that the person believes that the audit probability is either 30% or 90%, and feels the two possibilities are equally likely. Then, if he claims the deduction, the expected penalty will be (50%x30% + 50%x90%)x$10,000 = 60%x$10,000 = $6,000, and the expected gain will be 40%x$20,000 = $8,000, so he will claim the deduction.

31. In the case just considered, Bentham's argument against protection of confidentiality overlooks its possible advantage for the simple reason that his argument does not take into account two things: that committing a sanctionable act may sometimes be desirable; and that a party who is encouraged to obtain legal advice may decide not to commit an undesirable sanctionable act because he learns the expected sanction is higher than he had thought. The general response to Bentham overlooks the factors that were mentioned in note 29, that the provision of legal advice can be disadvantageous, etc.

32. He might be told that by changing the place on the tax return where he claims the deduction (for instance, in

the place for miscellaneous deductions rather than in the place for deductions for business expenses), the audit probability will be significantly lowered, or that if he appends a statement to his return, the probability will be similarly reduced.

Advice may also enable a person to lower the sanction for a given act, for example, by allowing him to better conceal evidence that would have helped to establish intent.

33. In the present case, Bentham's argument is correct. The general response to him is incorrect because, although protection of confidentiality encourages parties to obtain legal advice, the provision of advice is socially undesirable.

34. Given data on the cost of legal services and on the character of information individuals have without advice (obtained, perhaps, through survey sampling), it should be possible to estimate the demand for legal advice.

35. Consider difficulties in establishing causation (allowing a tortfeasor or violator to go free), the judgment proof problem (weakening deterrence in any setting), and patently incorrect sanctions for regulatory infractions (a small fine for failure to repair a crack in a dam.)

36. I do not want to overstate this point, however. There will occasionally be evidence of communications, like recordings of conversations or documents. In addition there may be an opportunity to enforce rules mandating disclosure

through use of undercover agents. The agents would pose as clients and make statements that advisors would be required to disclose. Finally, the threat of barring a legal advisor from engaging in his profession is a very severe one, and might therefore aid enforcement even if the likelihood of an advisor being sanctioned is small.

37. While association committees responsible for drafting rules may be comprised of the most civic minded individuals, what the committees propose can be voted down by an association's membership (see note 39 below), and in any event, the committees may, anticipating the response from the membership, propose only that which they think will be acceptable to the membership.

38. The law is not easy to summarize because some states have adopted the American Bar Association (A.B.A.) Model Code of Professional Responsibility (hereafter the "Code") and others (a minority), the A.B.A.'s 1983 revision of the Code, the Model Rules of Professional Conduct (hereafter the "Rules"). Moreover, states have often modified the Rules or the Code. In addition, the meaning and interpretation of the rules within a given state may be uncertain. A further complication is that the rules applying with respect to disclosure of information by an attorney outside of court (for example, to police, or to a potential victim) may differ from the rules concerning an attorney's disclosures in court. For example, an attorney

might be forbidden from revealing information outside of court, but have the obligation to do so in court.

39. There is, however, an exception concerning proceedings at court. An attorney may be obligated to disclose to the court a client's plan to deceive the court; see Rule 3.3(a)(2) of the Rules and DR 7-102(A)(3) of the Code. Also, some states have introduced their own provisions requiring attorneys to make certain disclosures, as noted in Andrew Kaufman, Problems in Professional Responsibility 190 (2nd ed. 1984).

It should also be mentioned that according to a rejected version of the Rules, attorneys were required to disclose clients' plans to commit acts that would result in death or serious bodily harm. See the discussion in Kaufman at 189-91.

40. See Rule 1.6(b) of the Rules and DR 4-101(C) of the Code.

41. See Rule 1.6(a) of the Rules and DR 4-101(B) of the Code.

42. This is based in part directly, and in part inferentially, on Rules 1.2(d) and 1.6 of the Rules and DR 4-101(A-C) of the Code. See also Secs. 89, 91, and 93 of McCormick, supra note 5, and Secs. 6.3 - 6.4 of Wolfram, supra note 5.

43. An attorney is not supposed knowingly to aid a client in evading the law in such ways as these. But

attorneys may not discover until after they have supplied information or performed a service how their clients will thereby be aided.

44. It is true that enforcement of a requirement to disclose would require courts to differentiate between such situations and situations where attorneys were merely supplying information about the probability or magnitude of sanctions. While this would often be a difficult task, it would not always be so. Suppose, to elaborate on the example mentioned above, that a court determined that an attorney learned that the information he supplied about the timing of inspections (that they occurred only during the day) would allow a corporation to adopt a definite strategy to avoid detection (dumping toxic wastes at night) and that the corporation would probably do this. Then the attorney could be found liable for failure to disclose. If the court knew only that the attorney had given the general odds of inspection, but not that the corporation could or would adopt a particular strategy to lower the odds, the attorney would not be found liable for failure to disclose.

45. The only study of which I am aware is described in Student note, Functional Overlap Between the Lawyer and Other Professionals: Its Implications for the Privileged Communications Doctrine, 71 Yale L.J. 1261-73 (1962). The study reported on a survey of the opinions of laymen, attorneys, judges (and accountants, psychiatrists, and other

professionals) as to the effects of rules of confidentiality. This, it need hardly be said, is not the sort of information normally relied upon in social scientific empirical research. Such research is usually based upon observation of actual changes in behavior, not somebody's predictions of changes in behavior.

46. The argument might run along the following lines: Most individuals who disclose plans to commit bad acts are either crazy or stupid. In either case, attorneys are unlikely to convince the individuals against committing murder. Therefore, disclosure of the individuals' plans to police or the potential victims may prevent bad acts. Further, since attorneys are themselves unlikely to be able to convince individuals not to commit bad acts, the fact that a policy mandating disclosure may discourage some individuals from revealing their plans to attorneys cannot be counted as the loss of a valuable opportunity. Finally, if most individuals who disclose plans to commit bad acts are crazy or stupid, perhaps they will be unaware of an obligation attorneys might have regarding disclosure.

47. The argument, of course, is this: Most individuals will not disclose plans to commit bad acts if they think that attorneys will, or are even allowed to, disclose this information. If individuals do disclose plans to commit bad acts, however, they can often be convinced not to commit the acts. Indeed, the type of person who would ever admit his

plans to an attorney might be the type of individual who wants, consciously or subconsciously, to be dissuaded, for why else would he discuss his plans? Hence, making it impermissible for attorneys to disclose plans to commit bad acts could significantly increase the number of people who both disclose such plans and who are convinced by their attorneys not to commit bad acts.

48. Gains, harm, and sanctions are assumed to be monetary or to have monetary equivalents; it will be obvious that the qualitative nature of the results do not depend on this assumption. Also, gains will be assumed to be obtained with certainty if an act is committed, rather than only if a sanction is not imposed. This assumption, however, amounts merely to one of convenient formulation. For, a situation where a gain of g is enjoyed only if a sanction s is not imposed is equivalent to a situation where g is enjoyed with certainty and the sanction is $s + g$. (Conversely, a situation where g is enjoyed with certainty and the sanction is s is equivalent to a situation where g is enjoyed only if a sanction is not imposed and the sanction is $s - g$.) Thus, the second example of the text, where it was assumed that a party would benefit from claiming a tax deduction only if he was not sanctioned, is described by the model studied here.

49. It will be assumed for concreteness that if $g = qps$, a party will not commit an act, and similar assumptions will be made below without comment.

50. To see that advice can be undesirable when ps < h, consider a simple discrete example: g = 10; t = .6 with probability 50% and t = 1 with probability 50%; p = .5; s = 30; and h = 20. Here it is socially undesirable for the act to be committed, as it is undesirable for it to be committed if t = .6 (since 10 = g < th = .6x20 = 12) or if t = 1 (since 10 < 20). The act will not be committed in the absence of advice, since the expected sanction will be .8x.5x30 = 12 > 10. Yet, if advice is obtained, then if t = .6, the act will be committed, since .6x.5x30 = 9 < 10. Hence, advice is socially undesirable.

To see that advice can be desirable when ps < h, consider a modification of the previous example; the modification will be such that, in the absence of advice, a party will commit the act, yet given advice, he will not commit the act in the case where he learns t = 1. Assume that the probability that t = .6 is 90%. Then, in the absence of advice, the party will commit the act, since the expected sanction will be (.9x.6 + .1x1)x.5x30 = .64x.5x30 = 9.6 < 10. However, given advice, the party will decide not to commit the act if he learns that t = 1 since 1x.5x30 = 15 > 10.

51. To see that protection of confidentiality might be undesirable when ps < h, observe that in note 50, it was assumed that there was confidentiality -- since p was assumed to be .5 regardless of whether advice was obtained.

In the example of the first paragraph of the note, we saw that if advice was obtained, that was socially undesirable. It is also clear from that example that advice has positive value to the party. Thus, if the cost of advice is low enough, the party will obtain advice. But in the absence of protection of confidentiality, the party might not obtain advice (for example, suppose that p would rise to 100% if the party obtained advice). Hence, protection of confidentiality might be undesirable.

To see that protection of confidentiality might be desirable, a similar scenario can be described with the example of the second paragraph of the previous note.

52. To see that advice could be undesirable, assume as in the first paragraph of note 50, except that s = 32 with probability 50% and s = 16 with probability 50%. Then the party will not commit the act in the absence of advice, since the expected sanction will be .5x.5x32 + .5x.5x16 = 12 > 10. However, if he obtains advice, the party will commit the act if s = 16. Hence, advice will be undesirable.

An example in which advice is desirable is the following. Assume as in the paragraph above, except that the likelihood of s = 32 is 10% and the likelihood of s = 16 is 90%. Then, in the absence of advice, the party will commit the act, since the expected sanction will be .1x.5x32 + .9x.5x16 = 8.8 < 10. On the other hand, if he obtains advice, the party will not commit the act if s = 32.

53. In the examples of the previous note, it was assumed that there was protection of confidentiality. If there is not, the party may be discouraged from seeking advice, and will therefore act in the way a person without advice will act. Hence, examples can be constructed in which protection is desirable and in which it is not.

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