

# Private versus Socially Optimal Provision of Ex Ante Legal Advice

Louis Kaplow and Steven Shavell  
Harvard University and the National Bureau of Economic Research

## 1. Introduction

In this article, we are concerned with the provision of legal advice,<sup>1</sup> given before individuals act, about their potential liability for causing harm.<sup>2</sup> We ask whether the demand for such ex ante legal advice is socially appropriate or tends to diverge from what is optimal.<sup>3</sup> The substantial amounts spent on legal advice and the frequently expressed opinion that the use of legal services is excessive suggest the importance of this question.<sup>4</sup>

Ex ante legal advice is of value to individuals who are uncertain about the

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1. Our model of legal advice is applicable to information relevant to potential liability even if the information is not strictly "legal" in content (for example, advice about the injuries a machine might cause).

2. We do not investigate certain forms of ex ante legal advice, notably about drafting contracts. Also, we do not discuss ex post advice, about the conduct of litigation. See Section 4.3.

3. Prior analysis of ex ante legal advice includes Shavell (1988), who studies the social desirability of the effects of advice on behavior but not whether individuals' incentives to purchase advice are socially desirable given its cost, and Kaplow (1990, 1991), who considers aspects of optimal law enforcement when individuals may obtain advice. In these articles, attention is confined to strict liability. Calabresi and Klevorick, and Shavell (1992) examine variations of the negligence rule and strict liability in a related context; see note 15.

4. Annual expenditures on legal services were \$47.5 billion in 1990, according to the Department of Commerce (1991).

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applicability of legal rules to their contemplated behavior. Individuals in this situation may decide upon their course of action using their own estimates of how legal rules apply, or they may first purchase advice about legal rules and then act in light of what they learn. They will purchase advice if its private value—the expected reduction in the sum of liability payments and other expenses—exceeds its cost. The social value of advice, however, consists of the expected reduction in the sum of harm caused and other expenses. When expected harm does not equal expected liability payments, the possibility arises of a divergence between the private and the social values of legal advice.

We consider the relationship between the private and social values of advice employing the standard model of liability for acts that cause harm, in which we examine individuals' choice of the level of care under the rules of strict liability and negligence. Two types of advice are studied: advice about properly determined liability, and advice about mistakes that are likely to be made in determining liability (as might occur because of incomplete evidence, jury sympathies, and so forth).

In Section 2, we investigate advice about properly determined liability. When liability is strict, liability payments, by definition, equal harm caused. Thus, private costs (liability payments and the cost of care) equal social costs (harm caused and the cost of care), both when individuals are uninformed and when they are informed. This implies that the private incentive to acquire information is socially correct.

Under the negligence rule, by contrast, the private incentive to acquire information is socially excessive (even though the social value of information is positive, because informed individuals are induced to take due care). This is for two reasons, each having to do with the fact that individuals who take due care are relieved of liability for any harm that they cause. Consider first individuals who obtain advice and learn that due care is higher than the level of care they would have taken if uninformed. They will be induced to take due care, but, as a consequence, they will escape liability for harm that still occurs. Thus, their private benefit from learning that they should increase their level of care exceeds the social benefit.<sup>5</sup> Second, consider individuals who obtain advice and learn that due care is lower than the level of care they would have taken if uninformed. They will take less care, only due care. Because these individuals will not bear liability for harm, however, they will ignore the fact that their reduction in care increases the harm they cause. Hence, individuals who become informed generate a social cost that they do not incur.<sup>6</sup> In sum, on two accounts the private value of advice exceeds the social value.

5. To illustrate, assume that without advice individuals spend 10 on care. With advice, they learn that due care is 15, which reduces expected harm from 50 to 30. The social benefit of this reduction in expected harm is 20, but the private benefit is 50, because uninformed individuals would not have taken due care and thus would have borne expected liability of 50.

6. Assume as in the previous note that uninformed individuals spend 10 on care. Upon becoming informed, they learn that due care is 6, which raises expected harm by 3. The private

In Section 3, we consider advice about mistakes in determining liability (assuming now that individuals know what properly determined liability would be).<sup>7</sup> In this case, under strict liability, it is no longer true that the private and social benefits of advice coincide. Although individuals benefit from advance knowledge of mistakes that the tribunal will make, social welfare declines, because such information leads individuals to adjust their behavior to conform to mistakenly applied rules. For example, an individual who learns that the tribunal is likely to underestimate the harmfulness of his act will be led to take too little care. Under the negligence rule, the private incentive to acquire information also is socially excessive, but for reasons like those identified in Section 2.

In Section 4, we comment on the interpretation of our analysis.

## 2. Legal Advice about Properly Determined Liability

Risk-neutral individuals engage in an activity that causes harm  $h$  with probability  $p$ . Initially, an individual does not know the particular level of harm that his activity might cause; he knows only that harm is distributed according to the positive density  $f(\cdot)$  on  $[0, \infty)$  in the population of individuals who engage in the activity.<sup>8</sup> Before they act, individuals may purchase information and thereby learn the level of harm, which is what a tribunal would observe if an accident occurs.<sup>9</sup> Expenditures on care  $x$  reduce the probability of harm at a diminishing rate:  $p'(x) < 0$ ,  $p''(x) > 0$ .

Individuals decide whether to acquire information and choose a level of care to minimize the sum of their cost of care, their expected liability costs, and the cost of information. The social objective is minimization of the sum of the cost of care, expected harm, and the cost of information. Note that the difference between the private and social objectives is that the former involves expected liability costs and the latter expected harm.

### 2.1 Strict Liability

Under strict liability, an individual must pay damages equal to the harm he causes. To decide whether to acquire information about the level of harm he might cause, an individual will compare his situation if he is uninformed to

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benefit is the entire savings in expenditures on care of 4, whereas the social benefit is only 1 because the increase in expected harm of 3 must be subtracted from the savings in the cost of care of 4.

7. In particular, we assume that legal advice allows an individual to predict the type of error—an over- or underestimate of the level of harm—that will be made in his type of case. Also, we suppose that the tribunal is correct on average (the mean of the error is zero).

8. Individuals might not know how the legal system values the injuries (for example, pain and suffering, disruption of securities markets) that their conduct may cause. (Similarly, they might not know the extent of the injuries they may cause, although information concerning this may not typically be obtained from lawyers.) Of course, individuals might also be uncertain about the cost of care or the effect of care on the likelihood of accidents. It is for simplicity that we assume uncertainty only about harm. See Section 4.1.

9. The analysis would be similar if information merely improved individuals' estimates rather than made them perfect.

that if he is informed. If he is uninformed, he will choose the level of care  $x_u$  that minimizes the sum of the cost of care and the expected harm, and his expected cost will be<sup>10</sup>

$$C_u = x_u + p(x_u) \int_0^{\infty} hf(h)dh. \quad (1)$$

If an individual acquires information, he will learn  $h$  and choose the level of care  $x_i(h)$  that minimizes the sum of the cost of care and the expected harm, and his expected cost will be

$$C_i = \int_0^{\infty} [x_i(h) + p(x_i(h))h]f(h)dh. \quad (2)$$

The private value of information is

$$I = C_u - C_i. \quad (3)$$

$I$  is positive, as information allows individuals to tailor their level of care to the harmfulness of their acts.<sup>11</sup>

Because liability equals harm under strict liability, expected private costs equal expected social costs whether individuals are uninformed or informed. Thus, the social value of information equals the private value,

$$I^* = I. \quad (4)$$

(The use of an “\*” denotes social rather than private values or costs.) Hence, we can state the following proposition.

*Proposition 1.* Under strict liability, the private and social values of legal advice about properly determined liability are positive and equal.

## 2.2 The Negligence Rule

Under the negligence rule, an individual pays no damages for harm he causes if his level of care  $x$  is at least equal to due care, but if his level of care is lower than due care, he is liable for harm caused. Due care is assumed to equal  $x^*(h)$ , the optimal level of care given  $h$ —that which minimizes  $x + p(x)h$ . [Note that  $x^*(h)$  increases with  $h$ .<sup>12</sup>]

10. The first-order condition determining  $x_u$  is  $p'(x_u) = -1/\bar{h}$ , where  $\bar{h}$  denotes the expected harm.

11. When an individual learns that  $h$  is lower than  $\bar{h}$ , he will take less care, and when he learns the  $h$  is higher than  $\bar{h}$ , he will take more care, for the first-order condition determining  $x_i$  is  $p'(x_i(h)) = -1/h$  and  $p''(x) > 0$ .

12. This follows from the first-order condition determining optimal care,  $p'(x) = -1/h$ , and the assumption that  $p''(x) > 0$ .

An uninformed individual will choose the level of care  $x_u$  that minimizes the sum of the cost of care and expected liability payments, and his expected cost will be

$$C_u = x_u + p(x_u) \int_{\hat{h}}^{\infty} hf(h)dh, \quad (5)$$

where  $\hat{h}$  is the level of harm for which due care is  $x_u$ . When  $h$  exceeds  $\hat{h}$ , due care exceeds  $x_u$ , so the individual will be liable for damages equal to  $h$ . When  $h$  is less than  $\hat{h}$ , due care is less than  $x_u$ , so the individual will not be liable.

An informed individual knows  $h$  and will choose the level of care  $x_i(h)$  that minimizes the sum of the cost of care and expected liability payments. Thus, as is well known, the individual will take due care given  $h$ , so he will not be liable for the harm he causes. Consequently, his expected cost will be

$$C_i = \int_0^{\infty} x_i(h)f(h)dh. \quad (6)$$

The private value of information is

$$I = C_u - C_i, \quad (7)$$

which is positive because information allows individuals to choose their level of care as a function of  $h$ .

The expected social cost of an individual's activity is the sum of his cost of care and the expected harm he causes. If an individual is uninformed, the expected social cost differs from his private cost (5), because the latter includes harm only when  $h$  exceeds  $\hat{h}$ . Thus, the expected social cost can be expressed as

$$C_u^* = C_u + p(x_u) \int_0^{\hat{h}} hf(h)dh. \quad (8)$$

The second term measures the expected harm for cases in which the due care standard is met. If individuals are informed, the expected social cost is

$$C_i^* = C_i + \int_0^{\infty} p(x_i(h))hf(h)dh. \quad (9)$$

The second term here is the expected harm, which is not a private cost because informed individuals always take due care and thus avoid liability. The social value of information is  $C_u^* - C_i^*$ , or

$$I^* = C_u + \int_0^{\hat{h}} p(x_u)hf(h)dh - C_i - \int_0^{\infty} p(x_i(h))hf(h)dh. \quad (10)$$

$I^*$  must be positive, because informed individuals take optimal care for all  $h$ , while uninformed individuals take optimal care only when  $h = \hat{h}$ .<sup>13</sup>

Using expression (7), we find that the divergence between the private and social values of information is

$$I - I^* = \int_0^{\hat{h}} [p(x_i(h)) - p(x_u)]hf(h)dh + \int_{\hat{h}}^{\infty} p(x_i(h))hf(h)dh. \quad (11)$$

From (11), it follows that the private value of information exceeds the social value of information on account of two factors. (Note that the private incentive to acquire information under the negligence rule is socially excessive despite the desirability of individuals' changes in their level of care when they become informed—that is, despite the positive social value of information.) The first term on the right side of (11) is the increase in expected harm for cases in which  $h < \hat{h}$ . In such cases, informed individuals take less care, implying that  $p(x_i(h)) > p(x_u)$ . Because they take due care, however, they are not liable for the increase in expected harm, which is of course a social cost, so their incentive to acquire information tends to be excessive. The second term on the right side of (11) is the expected harm for cases in which  $h > \hat{h}$ . In these cases, informed individuals take more care to avoid liability, but harm may still occur. Uninformed individuals would have been found negligent and thus paid damages equal to any harm they caused. Therefore, part of an individual's benefit from obtaining information is escaping liability for harm caused when he takes due care. But this is not a social benefit, again leading to an excessive incentive to acquire information.

In summary, we have the following proposition.

*Proposition 2.* Under the negligence rule, the private and social values of legal advice about properly determined liability are positive, but the private incentive to obtain advice is socially excessive.

*Remarks.* (a) In our formulation of the negligence rule, we make the conventional assumption that individuals who take less than due care are responsible for all the harm that their acts cause. Kahan, however, emphasizes that the doctrine of legal causation is such that, in principle, negligent actors are liable for only the additional accidents caused by their failure to take due care. (For example, if the probability of accidents increased from 10 percent to 15 percent because of inadequate care, the negligent actor would be liable for

13. Substituting for  $C_u$  and  $C_i$  in (10), we obtain

$$I^* = \int_0^{\infty} \{[x_u + p(x_u)h] - [x_i(h) + p(x_i(h))h]\}f(h)dh.$$

The integrand is obviously positive whenever  $x_i(h)$  differs from  $x_u$  (i.e., whenever  $h \neq \hat{h}$ ).

only the additional 5 percent of accidents thereby caused.<sup>14</sup>) Under this alternative formulation, the expected cost for uninformed individuals in (5) becomes

$$\begin{aligned} C'_u &= x_u + \int_{\hat{h}}^{\infty} [p(x_u) - p(x^*(h))]hf(h)dh \\ &= C_u - \int_{\hat{h}}^{\infty} p(x^*(h))hf(h)dh. \end{aligned} \quad (5')$$

$C'_u$  is less than  $C_u$  by an amount that equals the second term of the expression for  $I - I^*$  in (11). [In (11), the level of care in this term is  $x_i(h)$ , but because informed individuals take due care,  $x_i(h) = x^*(h)$ .] Thus, the private value of information still exceeds the social value, but now due only to the first term in (11).

(b) Our formulation of the negligence rule also assumes that due care for uninformed individuals would be based on the actual harm caused by their acts, rather than on individuals' ex ante beliefs about possible harm. This is plausible because actual harm is typically observed ex post, while it may not be possible for courts to determine whether an individual was informed ex ante or what his expectations were. If we assumed instead that courts are able to determine whether individuals were uninformed and what their expectations were, other variations of the negligence rule could be considered and the results would be different.<sup>15</sup> But when individuals' lack of information concerns legal rules or legal consequences rather than, say, technology, it is not apparent that a court would consider the perspective of uninformed individuals in defining due care even if it could.

### 3. Legal Advice about Mistakes in Determining Liability

In this section, we examine the case in which individuals' uncertainty concerns errors in the amount a court would award if they cause harm. To focus on advice about legal error, we assume that individuals know the actual harm

14. We do not know to what degree the doctrine of causation affects actual case outcomes. If a tribunal could readily identify which 10 percent of the accidents would have occurred even if due care had been taken, it is plausible that there would be no liability in these cases. But if a tribunal could not determine which of the accidents would have been avoided if due care had been taken (or if all 15 percent would have been avoided and a different 10 percent would have been caused), it might find negligence in all 15 percent of the cases.

15. For example, it can be shown that if individuals are deemed negligent only if their care was less than optimal care for an uninformed individual, then the private value of information would be less than the social value. If, however, due care is determined using the information individuals actually possessed, the private value of information could be more or less than the social value. And if due care is taken to be optimal care given the optimal decision whether to acquire information, the private and social values of information would be equal. Such variations of the negligence rule are considered in the context of technological uncertainty in Calabresi and Klevorick and in Shavell (1992).

$h$  and that a tribunal's award equals  $h$  plus an error  $e$ , which is distributed according to the positive density  $g(e)$  on the interval  $[-h, \infty)$  and has a mean of zero. (That is, the tribunal makes errors in measuring  $h$ , but over the universe of cases its measurements are unbiased.) If an individual obtains information, he acquires knowledge of the error that will be made if he comes before a tribunal.<sup>16</sup>

### 3.1 Strict Liability

When subject to strict liability, individuals who are uninformed have an expected cost of

$$C_u = x_u + p(x_u) \int_{-h}^{\infty} (h + e)g(e)de, \quad (12)$$

because liability is  $h + e$ . Observe that the integral equals  $h$  because the mean of  $e$  is zero, so uninformed individuals choose  $x_u = x^*(h)$ . Individuals who acquire information choose their level of care after learning  $e$ . [They will choose  $x_i(e) = x^*(h + e)$ .] Their expected cost will be

$$C_i = \int_{-h}^{\infty} [x_i(e) + p(x_i(e))(h + e)]g(e)de. \quad (13)$$

Individuals who learn that  $e > 0$  will increase their level of care (because their damage payment will be  $h + e$  rather than an expected payment of  $h$ ); similarly, those who learn that  $e < 0$  will decrease their level of care. Because, with knowledge of  $e$ , an individual's costs will be lower (except when  $e = 0$ , in which case costs are unaffected), the private value of information is positive.

Social costs differ from private costs in that the terms multiplying  $p(x)$  by  $e$  in expressions (12) and (13) are not social costs. The reason is that social welfare depends on the actual harm,  $h$ , rather than the amount of the liability award,  $h + e$ . Thus, the difference between the private and social values of information is

$$I - I^* = \int_{-h}^{\infty} [p(x_u) - p(x_i(e))]eg(e)de. \quad (14)$$

The value of (14) is positive, because informed individuals take more care (reducing the probability of causing harm) when  $e > 0$  and less care when  $e < 0$ . The private incentive to obtain information is, therefore, socially excessive. This conclusion can be readily understood. When individuals learn of

16. The assumption that the error can be predicted with certainty, rather than merely predicted better, simplifies the exposition without greatly affecting our arguments. We presume that experienced legal experts often would have some idea in advance whether, for a particular type of case, a tribunal's award is likely to be higher or lower than in the average case.



any  $e \neq 0$ , they alter their level of care. Yet this must always be socially undesirable, because the optimal level of care  $x^*(h)$  is taken when individuals are uninformed. Since informed individuals do better for themselves but worse for society, the incentive to acquire information must be too great.

*Proposition 3.* Under strict liability, the private value of legal advice about mistakes in determining liability is positive and the social value of advice is negative; the private incentive to obtain advice is socially excessive.

*Remark.* The result in Proposition 3 differs from that in Proposition 1 (the private value of advice about properly determined liability equals its social value) because advice concerns error, not simply because error is introduced into the model. If one introduces error into the model of Section 2 but advice concerns only harm, it is easy to verify that Proposition 1 still holds.

### 3.2 The Negligence Rule

In this version of the model, due care is taken to be  $x^*(h + e)$ , the level of care that would be optimal if harm were  $h + e$ . When subject to the negligence rule, individuals who are uninformed have an expected cost of

$$C_u = x_u + p(x_u) \int_{\hat{e}}^{\infty} (h + e)g(e)de, \quad (15)$$

where  $\hat{e}$  is the level of error for which due care is  $x_u$ . When  $e$  exceeds  $\hat{e}$ , due care exceeds  $x_u$ , so individuals will be liable for damages of  $h + e$ .<sup>17</sup> Informed individuals learn  $e$  and choose  $x_i(e) = x^*(h + e)$ , and their expected cost will be

$$C_i = \int_{-h}^{\infty} x_i(e)g(e)de. \quad (16)$$

The private value of information  $C_u - C_i$  is positive, again because information allows individuals to choose their level of care as a function of  $e$ .

Social costs under the negligence rule differ from private costs. If individuals are uninformed, the expected social cost can be expressed as

$$C_u^* = C_u + p(x_u) \int_{-h}^{\hat{e}} hg(e)de - p(x_u) \int_{\hat{e}}^{\infty} eg(e)de. \quad (17)$$

The second term measures the expected harm for cases in which the due care standard is met. The third term is subtracted because payments by negligent

17. Behavior under the negligence rule in the presence of error has been studied, notably, by Diamond and by Craswell and Calfee, but they do not study acquisition of information about error.

actors include the error [the component of the integrand in (15) that involves  $e$ ], which is not a social cost but is included in  $C_u$ . If individuals are informed, the expected social cost is

$$C_i^* = C_i + \int_{-h}^{\infty} p(x_i(e))hg(e)de. \quad (18)$$

The second term is the expected harm, which [as in Section 2, expression (9)] is not a private cost because informed individuals always take due care. [Since the actual harm they cause is  $h$ , rather than the amount the court awards,  $h + e$ , only  $h$  appears in (18).] The social value of information is  $C_u^* - C_i^*$ , or

$$\begin{aligned} I^* = C_u - C_i + \int_{-h}^{\hat{e}} p(x_u)hg(e)de \\ - \int_{-h}^{\infty} p(x_i(e))hg(e)de - p(x_u) \int_{\hat{e}}^{\infty} eg(e)de. \end{aligned} \quad (19)$$

The sign of  $I^*$  is ambiguous.<sup>18</sup>

The divergence between the private and social values of information is

$$\begin{aligned} I - I^* = \int_{-h}^{\hat{e}} [p(x_i(e)) - p(x_u)]hg(e)de \\ + \int_{\hat{e}}^{\infty} p(x_i(e))hg(e)de + p(x_u) \int_{\hat{e}}^{\infty} eg(e)de. \end{aligned} \quad (20)$$

Each term on the right side of (20) is positive, so the private value of information exceeds its social value. The first two terms are analogous to the two terms of Equation (11), which measure the excessive incentive to acquire information under the negligence rule in the model of Section 2. The third term involves the same group of individuals as the second—those who would have been negligent in the absence of information. In addition to being relieved of liability for the actual harm they cause when they take due care, they also are relieved of liability for the error component that they would have paid when taking care of  $x_u$  if uninformed.<sup>19</sup> This private benefit is not a social benefit.

18. If  $\hat{e}$  is near zero,  $I^* < 0$ . (If  $\hat{e} = 0$ ,  $I^*$  is the same as under strict liability, and thus is negative.) If  $\hat{e}$  is sufficiently different from zero,  $I^*$  may be positive. (For most  $e$ , behavior would improve when individuals become informed.)

19. This component is positive, as the mean of  $e$  is zero and the integral excludes the lowest values of  $e$ .

*Proposition 4.* Under the negligence rule, the private value of legal advice about mistakes in determining liability is positive, and the private incentive to obtain advice is socially excessive.

*Remarks.* (a) Note that there is little resemblance between the reasons that the incentive for acquiring information is excessive under strict liability and under negligence. The results under the negligence rule are similar for the two types of uncertainty studied in this article, while those under strict liability are different.

(b) Consider again the alternative formulation of the negligence rule in which negligent actors are responsible only for the additional accidents caused by their failure to take due care. For the same reason that applied to (11), the first term in the expression for  $I - I^*$  in (20) would be unaffected under the alternative formulation of negligence. Again, the second term would be zero because of the reduction in  $C_u$ . The third term would differ, but would still be positive: the excessive incentive on account of avoiding liability for the erroneous component would reflect only the portion of that component attributable to the failure to take due care.<sup>20</sup>

#### 4. Extensions and Discussion

In this section, we discuss the applicability of our analysis to different types of legal advice and note some additional factors that bear on our conclusions.

##### 4.1 Other Sources of Uncertainty about the Extent of Liability

For concreteness, we examined uncertainty about true harm and about mistakes in assessing harm. Our main arguments, however, apply to any factors that would be relevant to due care or damages. Thus, we might have assumed that uncertainty concerned the cost of care or the effect of care on the likelihood of accidents. Whatever characteristics information concerns, as long as liability is properly determined, the private incentive to acquire information under strict liability will be optimal because individuals bear all the costs and benefits of their decisions. Under negligence, individuals who take due care escape liability for harm they cause, so that the private value of information that allows them to choose care optimally will exceed the social value. And when information concerns the prediction of errors that will be made in ascertaining any characteristics relevant to liability, the private incentive to obtain advice will be socially excessive even under strict liability, because such advice induces individuals to modify their behavior in accordance with mistakenly applied rules.

20. In (20),  $e$  would be weighted by  $p(x_u) - p(x_i(e))$  rather than by  $p(x_u)$ . It is straightforward to verify that this term would be positive (because greater weight is placed on higher values of  $e$ ). The modified term could be greater or less than the third term in (20) (the weight on all values of  $e$  is less for the modified term, but the weight falls more for lower values of  $e$ , which may be negative).

#### 4.2 Uncertainty about Whether Strict Liability or the Negligence Rule Applies

Consider the case in which individuals' only uncertainty concerns the form of liability (and the legal system assesses conduct without error). Then, there is no private or social value from obtaining information. Whichever rule prevails, individuals will be induced to take optimal care. Because individuals' actions will therefore be the same regardless of the rule, there is no value to knowing it in advance. The situation would, of course, differ if one took into account the decision whether to engage in the activity at all, since expected total costs are greater under strict liability.<sup>21</sup>

#### 4.3 Areas of Law in Which Our Analysis Is Relevant

Although strict liability and negligence apply mainly in the domain of accident law, analogous rules are employed more broadly. For example, in many areas of regulation, the form of liability is similar to negligence: if a standard is met, there is no liability or fine, despite the fact that harm might be caused.

We should note, however, that our analysis is limited to ex ante legal advice about potential liability. The analysis of other types of ex ante advice may differ. For instance, advice concerning how to make contractual obligations legally binding would tend to be mutually advantageous to affected parties and thus have private and social values that were similar, whereas advice designed to seek bargaining advantages in relation to other parties in a transaction would not have this tendency and thus might be expected to have a positive private value that exceeds its social value (the latter possibly being zero or negative). Also, advice rendered ex post (concerning the conduct of litigation), which has been studied elsewhere (see Kaplow and Shavell), involves different elements. Because such advice is given after individuals act, it does not have an obviously beneficial effect in guiding behavior; the social value of advice is therefore unclear, but the private value is positive.

#### 4.4 Advice That Subverts Law Enforcement

We have not discussed legal advice that allows individuals to reduce expected liability for acts they commit (such as by facilitating concealment of behavior). Clearly, such advice is generally undesirable because it reduces the effectiveness of law enforcement.

#### 4.5 The Case Where Expected Sanctions Do Not Equal Expected Harm

We assumed in our analysis that expected sanctions equaled expected harm. Expected sanctions are, however, often less than expected harm, especially where the likelihood of imposing sanctions is significantly less than unity.<sup>22</sup> This possibility affects the analysis of legal advice, although the influence on our results is ambiguous. Consider the situation in Section 2 (where uncertainty concerns the actual level of harm an act may cause) under strict liability and

21. The results also would differ in the presence of legal error.

22. In addition to partial enforcement, expected sanctions may be less than expected harm to the extent that a portion of the population is anticipated to be contributorily negligent.

assume that expected liability is only half of expected harm. If an individual is advised that harm is high and thus increases his level of care, his savings in liability payments will be only half the reduction in harm, so his benefit from advice will be less than the social benefit. If he learns that harm is low and thus decreases his level of care, his increase in liability payments will be only half the increase in harm, so his gain (his savings in expenditures on care minus the increase in liability payments) will exceed the effect on social welfare. Hence, no clear conclusion can be drawn about how a deviation between expected sanctions and expected harm influences the relationship between the private and social values of advice.<sup>23</sup>

There are, however, contexts in which an unambiguous effect might be predicted. Consider two examples. First, assume that expected sanctions are less than expected harm because the injurer expects to be unable to pay the entire damage judgment when harm is high (the judgment-proof problem). Then, as just stated, when individuals learn that harm is high, they increase their level of care, producing a social benefit that exceeds their private benefit. But when they learn that harm is low, the private and social benefits of their reduction in care are equal, because expected liability does equal expected harm when harm is low. Thus, the social value of advice would exceed its private value. Second, assume that expected sanctions are less than expected harm because the injurer expects that if harm is low victims will have insufficient incentive to sue. Then, the reasoning from the previous case is reversed: the social benefit of reductions in care will be less than the private benefit, whereas the social benefit of increases in care will equal the private benefit. Thus, the social value of advice would be less than its private value.

#### 4.6 Systematic Biases in Uninformed Individuals' Estimates of Liability

Individuals' estimates of expected liability may be systematically biased (which is another reason that expected sanctions may not equal expected harm). Such biases affect the relationship between the private and social values of advice in a straightforward manner. For example, if uninformed individuals systematically and incorrectly believed that liability exceeded actual harm, they would take excessive care. The private and social values of information would be greater than otherwise, because on average information would lead to greater adjustments in behavior. But this higher private value would not be fully appreciated for the very reason that individuals' estimates are systematically biased. Thus, individuals would have too little incentive to purchase advice. Similarly, if individuals systematically underestimated lia-

23. To illustrate, suppose that an individual who learns that harm is high increases expenditures on care from 10 to 12, which decreases expected harm from 50 to 40. His benefit is half the decrease in harm ( $10 \times 50\% = 5$ ) minus the increase in cost of care (2), which is 3. In contrast, the social benefit is the entire decrease in harm (10) minus the increase in the cost of care (2), or 8, which exceeds the private value by 5. Suppose also that if he learns that harm is low, he decreases expenditures on care from 10 to 4 and expected harm rises from 10 to 20. His benefit is the savings in expenditures on care (6) minus the increase in liability ( $10 \times 50\% = 5$ ), or 1. The social benefit is  $6 - 10 = -4$ , which is less than the private benefit by 5.

bility, they would not fully appreciate the benefit of advice and thus would have too little incentive to purchase it.<sup>24</sup>

#### 4.7 Risk Aversion

If individuals are risk averse, they will behave differently and the value of advice will change. Nevertheless, the results concerning the relationship between the private and social values of advice are largely unchanged. The reason is that the private benefit of reducing risk is a social benefit to an equal extent, so risk aversion does not create or tend to offset any divergence between the private and social values of advice that arises on account of other factors.

#### 4.8 Litigation Costs

Accounting for litigation costs may affect our conclusion that the incentive to obtain legal advice is socially excessive under the negligence rule. The reason is that an individual who obtains legal advice about the due care standard takes due care in all instances (whereas uninformed individuals are sometimes negligent). The exercise of due care provides a social benefit that injurers do not enjoy: when injurers are not negligent, victims will not sue (assuming they are aware that due care has been taken),<sup>25</sup> which saves victims' litigation costs and court costs.<sup>26</sup> Because this savings is not a benefit for injurers, there is a tendency under the negligence rule (running counter to those we discussed) for the private value of advice about potential liability to be less than the social value.<sup>27</sup>

#### 4.9 Policy to Correct Inappropriate Acquisition of Information about the Law

Our analysis suggests that when strict liability governs and expected sanctions equal expected harm, the private demand for ex ante legal advice will be socially appropriate, other factors aside. When advice concerns how individuals should behave under the negligence rule or whenever it concerns legal error under any rule, however, the demand for ex ante legal advice tends to be excessive. Consideration of other factors, such as biases in individuals' estimates of expected sanctions or litigation costs, raised the possibility that the demand for legal advice is inadequate.<sup>28</sup>

24. For discussion and caveats about systematic biases (in a different model), see Kaplow (1990).

25. Often, victims may not initially be aware of whether due care has been taken, but may learn about this early in discovery, before a significant portion of litigation costs have been incurred. See, for example, Farber and White's study of malpractice suits.

26. Litigation costs would have other effects in our model, as some suits may be discouraged and injurers' incentives would differ because, if sued, they must pay their legal costs in addition to damages.

27. Under strict liability, it is also true that savings in victims' litigation costs and court costs are not a benefit to injurers. But acquiring information may either raise or lower the amount of litigation, because an informed injurer may either reduce or increase his level of care, producing more or fewer accidents.

28. Another reason that the demand for legal advice may be inadequate is that legal advice might have a public-good aspect. For example, providers of advice may have lower costs after

Divergences between the private and social values of advice may be relevant to policy. The state might employ a tax or subsidy scheme to better align private demand for legal advice with its social value, or legal advice might be regulated directly, as through rules of ethics. In addition, the effect of liability rules on incentives to obtain legal advice is yet another factor bearing on the choice among them.

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advice is provided to some individuals, because the research involved in learning of actual liability may cost little to disseminate (although one might imagine ways in which providers could mitigate this problem).