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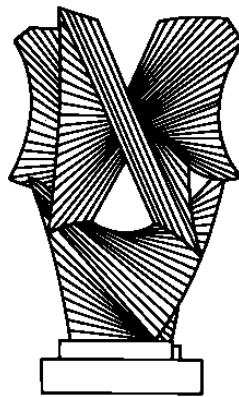
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## The Economics of Anticipatory Adjudication

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**THE LAW SCHOOL  
THE UNIVERSITY OF CHICAGO**

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# The Economics of Anticipatory Adjudication

*William M. Landes and Richard A. Posner*

## *Introduction*

A bedrock principle of the judicial power of the United States is that federal courts may decide concrete cases only – not hypothetical ones that may or may not develop into real cases sometime in the future. This principle has been inferred from Article III of the U.S. Constitution, which describes the jurisdiction of federal courts in terms of “cases” or “controversies” (considered synonyms), and has become embodied in a host of subsidiary principles. Thus, federal courts are not empowered to render advisory opinions; to decide lawsuits that are moot in the sense that a judgment would not give the party obtaining it a concrete benefit, or that are “unripe” (premature); to entertain a case brought by someone who, because he has not been injured or could not be tangibly benefited by winning the suit, is said to lack a personal stake in the outcome and hence cannot establish his “standing” to sue; to decide a collusive (friendly) suit, that is, one where the parties’ interests are not really adverse; or to decide a hypothetical case.<sup>1</sup> Federal courts are supposed to wait for an actual case to arise from a violation of law that has inflicted, or at the minimum is about to inflict, tangible harm on the party bringing the suit, who if he wins will be able to prevent or reduce the harm or shift the cost, or some of it at least, to someone else.<sup>2</sup>

Yet there are many seeming exceptions. Declaratory judgments often resolve questions involving legal rights or duties before a party has taken any action that might violate anyone’s legal rights. A related procedure, the suit to quiet title, permits a party to sue to remove a cloud on his title to real property so that he can act free of any claim to the property. A party to a contract who announces that he intends to break the contract in the future can be sued today (in federal court if a federal jurisdictional basis such as diversity of citizenship is present) for “anticipatory breach” even though, the time for his performance not having arrived, no actual breach can yet have occurred and, if he changed his mind, an actual breach might never occur. A litigant in federal as in state court can move for a preliminary injunction to head off anticipated as well as actual harm. The doctrine of collateral estoppel gives findings of fact made in one proceeding preclusive effect in future proceedings. Persons and firms subject to administrative regulations often can sue to enjoin enforcement of a regulation or have it declared invalid even though the regulation has not yet been applied to

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<sup>1</sup> For a helpful discussion of the doctrines derived from Article III that we discuss in this paper, see Lea Brilmayer, “The Jurisprudence of Article III: Perspectives on the ‘Case or Controversy’ Requirement,” 93 *Harvard Law Review* 297 (1979).

<sup>2</sup> This description doesn’t quite fit the case where the plaintiff is the prosecutor, whether a public prosecutor or a private bounty hunter; but in either case the plaintiff can be conceived of as a representative of the actual victims of the violation.

them, and if it were applied to them they could get it invalidated in the suit brought to require them to comply with it or to punish them for their noncompliance. Agency staff render legal advice (as in the Securities and Exchange Commission's no-action letters or the Internal Revenue Service's private letter rulings) and sometimes the agencies themselves render advisory opinions. Agencies are also empowered to issue declaratory orders, the administrative equivalent of declaratory judgments.

States are not bound by the limitations that Article III has been interpreted to impose on federal courts, and ten states allow their highest courts to render advisory opinions, at the request of the legislature or the governor, on the constitutionality of newly enacted state statutes or on other important issues. Federal administrative agencies, whether they are independent or part of the executive branch, are not subject to Article III either, and besides issuing advisory opinions many of them promulgate rules before a violation of the norm embodied in the rule has occurred—unlike common law courts, which to avoid criticism that they are acting prospectively, like a legislature or an agency, invariably apply even a newly declared norm to the litigants in the case before them and usually apply it to litigants in all pending cases. Preventive detention, for example refusing on the basis of a preliminary hearing to admit to bail a person accused of crime but not yet tried or convicted, is a form of anticipatory adjudication when bail is denied on the ground that the accused poses a danger to the community.

So what is going on? Obviously, much litigation (and related activity of a judicial or quasi-judicial character) is anticipatory, yet there is a reluctance to allow such litigation routinely. Does this reluctance make sense? Is the pattern of permission and prohibition sketched above coherent? Those are the issues discussed in this paper, along with such subsidiary questions as the following: Why do advisory opinions dealing with the constitutionality of state statutes and regulations have less precedential significance than opinions in "real" cases? Why does the Tax Court, which is not an Article III court, refuse to issue advisory opinions, while the Internal Revenue Service does issue them, in the form of its private letter rulings? Administrative agencies that have adjudicative powers, such as the Federal Trade Commission, nevertheless issue declaratory orders much less frequently than courts issue declaratory judgments; why this difference? We use economic analysis not only to answer these and other specific questions but also to bring out the commonality among issues that lawyers often place in unrelated doctrinal pigeonholes, to cast the light of economics on an area quintessentially of technical law,<sup>3</sup> and to explore the possibility that here as elsewhere the law makes more economic sense than most judges, lawyers, and

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<sup>3</sup> Law-school courses on federal jurisdiction or federal courts are redoubts of lawyers' law, so one is not surprised that the subject matter of such courses has been largely ignored by economists.

law professors believe. An interesting question that we do not discuss is why the use of anticipatory adjudication is (as it appears to be) growing relative to ex post adjudication.

It may seem obvious, and therefore not worth discussion, why resolving legal disputes before anyone is hurt would be, with only the rarest exceptions, a bad idea. It would consume potentially enormous resources by requiring courts to decide hypothetical, contingent, inchoate, premature, abstract, not yet fully developed disputes that, left alone by the courts for a time, might not require judicial resolution at all. In addition to multiplying the resources consumed in litigation and judicial decision making, anticipatory adjudication would (it may seem) inevitably increase the amount and hence the cost of judicial error.<sup>4</sup> There is greater risk of deciding a case incorrectly when there is little or no factual record and questions of injury, of damages, and of the social costs and benefits of the defendant's and the plaintiff's activities are therefore hypothetical.

But this is not the whole story. Anticipatory adjudication can provide vital information to firms or individuals uncertain whether a proposed course of action will expose them to liability in damages or to criminal or other penalties. Removing uncertainty on this score can confer two benefits. Some persons who would have run the risk of sanctions will decide not to do so if a court declares that their proposed actions are indeed unlawful. The harm that the action would have created as well as the cost of administering sanctions to the actor is thereby averted. And other persons, who would be deterred from acting by the risk of sanctions, will act if the court gives them a green light, and the result may be socially as well as privately beneficial action. Clearly, we face a complicated set of tradeoffs, which an economic model may help to sort out.

### *I. A Model of Optimal Anticipatory Litigation*

Our analysis<sup>5</sup> begins with the assumption that the legal consequences (which may of course depend on factual consequences) of a given action are uncertain. Otherwise an advisory opinion, a declaratory judgment, or any other form of

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<sup>4</sup> The costs of a judicial system can usefully be decomposed into administrative and error costs.

<sup>5</sup> Which borrows from Steven Shavell's and Louis Kaplow's pioneering analysis of the value of information provided by lawyers' advice rendered in advance of the client's taking an action that might be sanctioned. See Shavell's articles "Legal Advice about Contemplated Acts: The Decision to Obtain Advice, Its Social Desirability, and Protection of Confidentiality," 17 *Journal of Legal Studies* 123 (1988), and "Liability and the Incentive to Obtain Information about Risk," 21 *Journal of Legal Studies* 259 (1992); also Kaplow and Shavell, "Private versus Socially Optimal Provision of Ex Ante Legal Advice," 8 *Journal of Law, Economics, and Organization* 306 (1992). We modify their analysis to allow both for the possibility of a greater likelihood of legal error when a case is decided before rather than after a party acts and for the difference in costs of anticipatory and ex post adjudication itself. Our formal approach to legal error follows that of A. Mitchell Polinsky and Steven Shavell, "Legal Error, Litigation, and the Incentive to Obey the Law," 5 *Journal of Law, Economics, and Organization* 99 (1989).

anticipatory adjudication would provide no information and would therefore be all costs and no benefits. Thus, if A is considering poisoning B, A's obtaining a decision in advance on the lawfulness of the act would confer no benefit. As A already knows that his action is unlawful, an advisory opinion would give him no new information.<sup>6</sup> But let A be considering taking an action that would violate a possibly unconstitutional—not certainly unconstitutional or certainly constitutional—law, and he would benefit from learning with certainty whether the law was unconstitutional, because the information would enable him to optimize his actions. Or suppose that he is considering putting up a building on property that he believes—but again without certainty—that he owns. He would benefit from a resolution of any potential dispute over who owns the property before he begins construction. Or suppose he would like to use a new technology but is unsure whether it would infringe B's patent. Knowing the answer to this question would be valuable information for A to have before he decides whether to use the technology.

A fundamental question is why, if the problem is uncertainty, the private market for legal services is not the solution. A lawyer can advise on the likelihood of a particular course of action resulting in litigation adverse to his client and we suppose could guarantee his advice, although this is not important because we assume risk neutrality.<sup>7</sup> There are two answers to this question. The first and less important is that a judge may be a better predictor of the outcome of future litigation over an issue than a private lawyer, not because the judge is smarter but because he is predicting his own behavior or that of a member of his "club" (the judiciary); a countervailing factor is that the lawyer may have more information than the judge because the client will "level" with his lawyer, thanks to the attorney-client privilege. The more important consideration is that, provided the anticipatory adjudication has preclusive effect, that is, that it cannot be reversed by subsequent adjudication after the anticipated act materializes, the judge does not merely produce a different probability of a given outcome for the party to consider; he changes a probability distribution into a certainty, and this can affect behavior even if everyone is risk neutral. For example, a person who would not have acted if the probability of his being sanctioned afterward were .3 may act if anticipatory adjudication reduces that probability to zero, and a person who would have acted if the probability of his being sanctioned afterward were .7 may decide not to act if he discovers through anticipatory adjudication that his probability of being sanctioned is 1. It is no answer that the lawyer could guarantee his advice, because he will do it only for a fee equal to the risk that he assumes. This means that the client will have to pay a fee equal to

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<sup>6</sup> It might give B information that he is in danger of being poisoned, and also increase the likelihood that A will be apprehended and punished if he succeeds in murdering B. These however are not private benefits to A and would not motivate him to seek an advisory opinion.

<sup>7</sup> The provision of such advice by lawyers is the principal subject of the papers by Kaplow and Shavell referred to in note 5 above.

the expected cost of the ex post sanction, and if, we assume risk neutrality, will thus have gained nothing from the guarantee.<sup>8</sup>

a. *The Social Value of Acting*

Let A be contemplating an action that would yield him a benefit of  $X$ . Let  $p_e$  be the subjective probability to A that this action would result in a damages judgment, fine, forfeiture, permanent injunction, or other legal sanction against A that would impose upon him a cost of  $D$ . We assume that  $D > X$  in present-value terms, so that, if  $p_e = 1$ , A would not take the action; it would yield him a net loss. But  $p_e = 1$  is counterfactual in our analysis; we assume that  $0 < p_e < 1$  because either it is uncertain that a court would uphold the validity of the law that A will be accused of violating or A's act may fall outside the scope of a valid law. To simplify exposition we ignore other possible forms of uncertainty, including uncertainty over whether the action will inflict injury (and if so how much) and will actually precipitate a civil or criminal lawsuit, a possibility that we take up later, however, and we continue to assume that the parties are risk neutral.

If A takes the action, he faces not only a possibility of having to pay  $D$  but also a potential cost  $C$  of defending himself against a lawsuit brought in order to impose  $D$  on him. Nevertheless he will take the action as long as the present value of his expected net income from it,  $V_e$ , is positive, where

$$V_e = X - p_e D - C_e. \quad (1)$$

$V_e$  is net expected income from an action taken by A but not adjudicated, at a cost to A of  $C_e$ , until *after* A acts. We call adjudication that occurs after A acts "ex post adjudication" and denote it by the subscript "e."<sup>9</sup> The typical civil suit or

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<sup>8</sup> To explain, suppose the lawyer believes that the probability is .7 that a court will find A's act lawful after A acts. For a fee, the lawyer might guarantee to pay A's damages in the event the court finds against A after he acts. Given this guarantee, A can act without fear of liability. But this is not equivalent to anticipatory adjudication because A will have to pay an up front fee for the guarantee equal to .3 multiplied by damages plus litigation costs. Putting risk aversion to one side, this fee eliminates any benefit from the guarantee since A's expected damages from acting and risking paying damages if a court finds his act unlawful is equal to the fee A pays for the guarantee. In contrast, anticipatory adjudication just requires that A pay litigation costs for obtaining information on whether he can act without fear of liability.

<sup>9</sup> In contrast, the subscript "a" refers to anticipatory adjudication. So  $p_a$  for example is the probability that anticipatory adjudication will find A's prospective action unlawful.

It may be helpful to the reader if we define at this point the principal notation used in the paper:

$X$  = the benefit from A's act;

$p_e$  = the probability that ex post adjudication will sanction A's act;

$\square_1, \square_2$  = Type I and Type II error, respectively;

$p_a$  = the probability that anticipatory adjudication will find A's prospective act unlawful;

$D$  = the amount of damages A will pay if sanctioned ex post;

$C_e, C_a$  = the social cost of ex post and anticipatory litigation, respectively;

criminal prosecution is ex post in this sense because it is filed after the defendant has acted. We can see from equation (1) that A is more likely to act and risk sanctions the lower are  $p_e$  (the probability of being sanctioned),  $D$  (the cost of the sanction), and  $C_e$  (the cost of the ex post adjudication) and the greater  $X$  (the benefit from acting) is.

In order to evaluate the social gain or loss from anticipatory adjudication, we make the further assumption that  $V_e$  equals not only A's net income but also society's expected welfare when the court decides the lawfulness of A's act after he acts. Thus,  $X$ ,  $p_e$ ,  $D$ , and  $C_e$  denote both private and social values of these variables. This makes our initial definition of  $C_e$  incomplete, because it excludes both the plaintiff's (or prosecutor's) litigation costs and the costs of the judicial system itself to the extent that they are not fully borne by the litigants, in the form of court fees. Yet it does not follow that  $C_e$  will in every case understate the full costs of dispute resolution. A judicial decision may create a precedent that provides valuable information to other parties, and this external benefit would require a downward adjustment in the social costs of litigating A's dispute. Provisionally, we assume that these factors cancel out, so that  $C_e$  equals both the private and social costs of ex post adjudication. It would be simple enough, however, to adjust  $C_e$  both for the plaintiff's costs and for the precedential significance of the decision. Redefine  $C_e$  as A's litigation cost, and let  $g$  be a parameter that transforms  $C_e$  into a social cost. If the litigation has little precedential significance, if the plaintiff incurs substantial litigation costs, and if there are significant public subsidies for litigation,  $g$  is likely to exceed 1. But if the precedential significance of the decision is great,  $g$  could be less than 1 and could even take a negative value. A further complication is the possibility of an out-of-court settlement after A acts. To skirt it, we assume that if A is sued he can settle by paying an amount equal to  $p_e D + C_e$ . This makes  $V_e$  the same whether A litigates or settles.

We assume that if the court either invalidates the law or holds it inapplicable to A,  $D = 0$ ; that is (in a civil litigation), A has incurred no damages liability. This may seem unrealistic. A perfectly lawful action can cause "damage," in the sense of harm, even if the damage does not result in an award of legal damages or in any other legal sanction. Moreover, the amount of damage, especially in relation to the benefit to the actor ( $X$ ), may affect the court's decision on the validity or application of the law. We can model this case by supposing that A's action causes either high damage ( $D_h$ ) with a probability  $p_e$  or low damage ( $D_l$ ) with a probability  $(1 - p_e)$ , where  $D_h > X > D_l \geq 0$ . Then  $p_e D$  in equation (1) would become  $p_e D_h + (1 - p_e) D_l$ . Under a negligence regime A would be subject to

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$V_e$ ,  $V_a$  = the expected social value of A's act when adjudication takes place after (ex post adjudication) and before (anticipatory adjudication) A acts, respectively; and  
 $W_a$  = the expected private value to A of anticipatory adjudication.



sanction only if his act caused high damage (defined as harm that exceeded the benefit), while under strict liability he would be subject to sanction even if his act caused only low damage. As the more complicated model does not change any of our important results, we use the simpler approach for the most part, which assumes that  $D_l = 0$ .

*b. A Is Deterred from Acting in the Absence of Anticipatory Adjudication*

*1. Social benefits and costs.* Let  $V_e < 0$ , so that A decides not to act and by acting risk the sanction. A's decision is socially efficient because it is based on the full expected benefits and costs of the act given the information available at the time and because  $C_e$  reflects both A's and society's cost of ex post litigation. Now suppose that a court is willing to decide before A acts whether his prospective action would be lawful or not. Assume that the court's decision will be definitive. Then if it finds A's action lawful, A will undertake it, because he will gain  $X$  and face neither the prospect of being sanctioned nor the prospect of incurring litigation costs. Conversely, if the court finds the prospective action to be unlawful, A will refrain because otherwise he would incur  $D$ —which by assumption is greater than  $X$ —with certainty and would incur litigation costs to boot.

We assume that the court has less information before than after A acts, because in anticipatory adjudication the court must decide without the benefit of information generated by the act itself. Such information might enable more accurate measurement of the harms and benefits of an act (because they would be realized, rather than merely predicted) and a more precise characterization of the act, which might in turn enable a more confident determination of whether the act was prohibited.

The information deficit that characterizes anticipatory adjudication requires us to consider carefully the two types of error that might occur in such adjudication. We define  $\varepsilon_1$  as the probability that a court will find A's prospective act lawful but would have found it unlawful had it decided the case after A acted, and  $\varepsilon_2$  as the probability that a court will find A's prospective act unlawful but would have found it lawful had it decided the case after A acted. Thus  $\varepsilon_1$  is Type I error ("the probability of finding a guilty person innocent"), while  $\varepsilon_2$  is Type II error ("the probability of finding an innocent person guilty"). Of course both types of error occur in full-fledged, ex post adjudication as well as in anticipatory adjudication, and although we ignore that possibility in the formal analysis,  $\varepsilon_1$  and  $\varepsilon_2$  can be interpreted as the *incremental* Type I and Type II error incurred in anticipatory adjudication. We assume, plausibly, that  $(1 - \varepsilon_1) > \varepsilon_2$ , that is, that the probability that anticipatory adjudication will correctly find A's act to be unlawful is greater if ex post adjudication would have found A's act unlawful rather than lawful. To simplify further, we take as given the levels of legal error in anticipatory adjudication and, therefore, do not examine the social

and private decisions to spend resources to reduce errors and improve the accuracy of such adjudication.<sup>10</sup>

The difference between Type I and Type II error is particularly important in criminal litigation, where the latter is deemed to be much more costly than the former. In contrast, in the civil context Type I and Type II errors are usually assumed to be equally costly.<sup>11</sup> Nevertheless the distinction between the two types of error is important in explaining the pattern of anticipatory adjudication in the civil area.

Since anticipatory adjudication will inform A whether he will have to pay damages (or incur an equivalent legal sanction) if he acts, we can write  $V_a$ , the expected benefit to society (which, as we show shortly, differs from A's expected benefit), if A obtains a determination respecting the lawfulness of his conduct prior to acting, as

$$V_a = (1 - p_a)X - p_e \varepsilon_1 D - C_a \quad (2)$$

where

$$(1 - p_a) = (1 - p_e)(1 - \varepsilon_2) + p_e \varepsilon_1. \quad (3)$$

The first set of terms on the right-hand side of equation (2) is the gross expected benefit from anticipatory adjudication: the benefit ( $X$ ) from A's act discounted by the probability  $1 - p_a$  that anticipatory adjudication will find the act lawful. The probability  $(1 - p_a)$  is, in turn, as shown in equation (3), a positive function of the probability  $1 - p_e$  that A's act would have been found lawful if litigated ex post,<sup>12</sup> the probability that anticipatory adjudication would reach the same result (which equals one minus Type II error), and the probability of Type I error.

To calculate the net expected benefit of anticipatory adjudication, we must subtract from the gross benefit both  $p_e \varepsilon_1 D$ , which is the expected harm that results when anticipatory adjudication mistakenly exonerates a litigant who should be sanctioned, and  $C_a$ , the cost of anticipatory adjudication. We expect that  $C_a \leq C_e$ , because the availability of more information after than before a party acts is likely to increase the time devoted to discovery, pretrial maneuvering and motions, and the trial itself. Lack of information sometimes increases the cost of litigation because the parties hire more experts or

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<sup>10</sup> Two recent papers by Kaplow and Shavell investigate the optimal expenditure of resources to reduce error and improve the accuracy of adjudication. See Kaplow and Shavell "Accuracy in the Determination of Liability" (1992) and "Accuracy in the Assessment of Damages" (1992).

<sup>11</sup> The difference between these weightings of Type I and Type II error is captured in the different standards of proof. The prosecutor in a criminal case must prove guilt beyond a reasonable doubt, and this requirement creates a greater probability of Type I than of Type II error. The civil plaintiff need prove liability only by a bare preponderance of the evidence, implying a virtually equal probability of the two types of error.

<sup>12</sup> We have  $\partial(1 - p_a)/\partial(1 - p_e) = 1 - \varepsilon_2 - \varepsilon_1 > 0$  (from the assumption that  $(1 - \varepsilon_1) > \varepsilon_2$ ).

commission elaborate studies to estimate benefits and harms from the proposed course of action, but this is exceptional. Another reason to expect  $C_e$  to exceed  $C_a$  is that the stakes are apt to be higher in ex post litigation because an injury has occurred (see part 2.c). As a by-product, both Type I and Type II error may fall. These considerations are reflected in our model, since the differences between the costs of litigating anticipatory and ex post cases, and the incremental error of anticipatory adjudication, are among the variables that we take into account.

By assumption, A would not act if he could not determine in advance (that is, though anticipatory adjudication) that his act would not subject him to sanctions. So society's net expected benefit without anticipatory litigation is zero. With anticipatory litigation it can be positive, negative, or zero. As is obvious from equation (2), as well as intuitive, it is more likely to be positive the greater  $X$  and the smaller  $p_e$ ,  $\varepsilon_1$ ,  $\varepsilon_2$ , and  $C_a$  are. Alternatively, if there is very little doubt that A's act is unlawful and likely to cause significant harm (that is, if both  $p_e$  and  $D$  are high), the principal effect of anticipatory adjudication will be to allow some people to get away with their unlawful acts because of legal error. This may explain the traditional unavailability of anticipatory adjudication in criminal matters, which tend to have a high  $p_e$  and  $D$  (our poisoning case).

2. *Private versus social benefits.* The private and social benefits of anticipatory adjudication need not be equal. Anticipatory adjudication enables A to avoid any sanction for an unlawful act, for if he loses the anticipatory suit he will refrain from the act. From A's perspective, therefore,  $D$  drops out of the picture; the only cost of anticipatory litigation to A is  $C_a$ . A's expected gain is merely  $X$  discounted by the probability that the court will find his prospective act to be lawful. Hence A's ( $\neq$  society's) net expected gain of anticipatory litigation, or  $W_a$ , is given by

$$W_a = (1 - p_a)X - C_a \quad (4)$$

which differs from the social gain in equation (2) in that  $p_e\varepsilon_1 D$  has dropped out, so that  $W_a - V_a = p_e\varepsilon_1 D$ . The difference is caused by the fact that Type I error creates a private benefit to A (equal to  $p\varepsilon_1 X$ ) but a social loss [equal to  $p\varepsilon_1(X - D)$ ]. The greater are  $p$ , Type I error, and  $D$ , the greater (other things being equal) will be the difference between A's private gain from anticipatory adjudication and society's gain.

Criminal prosecution again provides a helpful illustration. If Type 1 and Type II error are assumed to be inversely related, then the effort to avoid Type II error in criminal litigation implies that Type I error is high in such litigation; and we have already noted that  $p$  and  $D$  are also likely to be high. Therefore  $V_a$  is likely to be negative while A's private benefit from anticipatory adjudication,  $W_a$ , could well be positive. It would be crazy if, in our poisoning hypothetical, the would-be poisoner could obtain an anticipatory adjudication in which the prosecutor would have to prove beyond a reasonable doubt that the poisoner would be guilty of murder. Since a fully anticipatory criminal adjudication would take

place before any criminal act was actually committed, a judgment of “guilty” would not result in the imposition of punishment; hence there would be no reason to employ the criminal standard of proof beyond a reasonable doubt, which is motivated by the heavy costs of criminal punishment to the convicted person. But this means that anticipatory criminal adjudication wouldn’t look much like criminal adjudication. We shall return to this point in part II, when we discuss preenforcement judicial challenges to statutes and administrative rules.

As equation (4) shows, A benefits from Type I error but not from Type II error, since errors of the latter type are against A.<sup>13</sup> Whether on balance A benefits from legal error is therefore unclear, although society clearly loses because both types of error impose social costs.

Our emphasis on the risk of error (or, more precisely, on the *incremental* risk of error) in anticipatory litigation may suggest a choice between litigation now, in advance of action, and litigation later. But remember that we are assuming in this part of the paper that if anticipatory adjudication is refused A will be deterred from acting by the threat of sanctions and there will be no subsequent adjudication. The presence of error costs in anticipatory adjudication may nevertheless make it socially undesirable to issue an advisory opinion or other anticipatory judgment that creates a positive probability that A will act. But what if the court does not know whether A will not act unless it renders an anticipatory adjudication? In that case the benefit of anticipatory adjudication will be a weighted average of the benefits when, in the absence of anticipatory adjudication, A does act (the case considered in the next section) and when, in that absence, he doesn’t act, with the weights equal to the probabilities of each of the two possibilities.

Our analysis implies that the private incentive to seek an anticipatory adjudication is always greater than the social incentive [because equation (4) has a greater value than equation (2)].<sup>14</sup> Indeed, unless the private cost of litigation ( $C_a$ ) is very great, courts would be flooded with requests for anticipatory adjudication by persons deterred from acting by the prospect of being sanctioned. We therefore predict that courts will be given greater discretion to refuse to hear a case before than after a party acts, enabling them to turn down

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<sup>13</sup> Since  $(1 - p_a) = (1 - p_e)(1 - \square_2) + p_e \cdot 1$ , it follows that  $W_a$  is increasing in  $\square_1$  but decreasing in  $\square_2$ .

<sup>14</sup> This is true as well in the alternative model in which A’s act causes damages of either  $D_h$  or  $D_l$  and  $D_h > X > D_l$ . Then the net social benefit of anticipatory adjudication equals  $(1 - p_a)X - (1 - p_e)(1 - \square_2)D_l - p_e \square_1 D_h - C_a$ , and A’s private benefit (which substitutes  $D_l$  for  $D_h$ ) equals  $(1 - p_a)(X - D_l) - C_a$ . With anticipatory adjudication, A always pays  $D_l$  if he acts (and never pays  $D_h$  because, if a court determines that his prospective act would if carried out cause actionable harm equal to  $D_h$ , he will not act). Since  $D_h > D_l$ , A’s private benefit exceeds the social benefit. Again Type I error ( $\square_1$ ) is a private benefit ( $\partial W_a / \partial \square_1 = p_e(X - D_l) > 0$ ) but a social cost ( $\partial V_a / \partial \square_1 = p_e(X - D_h) < 0$ ).

requests for anticipatory adjudication when the private gain is positive but the social gain negative. Specifically, assuming that courts are guided by efficiency concerns we expect them to turn down more such requests the greater  $p_e \varepsilon_1 D$  is. For if the private value of anticipatory adjudication is positive ( $W_a$ ), the social value ( $V_a$ ) is more likely to be negative the greater the probability that A's proposed action is in fact illegal, the greater the probability of the court's finding the proposed action legal in anticipatory adjudication when it is in fact illegal, and the greater the harm from (and hence, other things being equal, the more severe the sanction for) A's act. As we show later, ripeness, mootness, and related doctrines provide courts with convenient categories for refusing anticipatory adjudication when it is unlikely to be socially beneficial.

The social costs of anticipatory adjudication are amplified if, contrary to our assumption that A's private cost and the social cost of litigation are equal, the latter is greater. Let  $c_e$  and  $c_a$  denote A's private cost of ex post and anticipatory litigation. Then all A's who, but for anticipatory adjudication, would choose not to act because their net income from acting would be negative (that is,  $W_e < 0$  where  $W_e$  is A's private value, calculated by substituting  $c_e$  for  $C_e$ ) behave efficiently because  $V_e$  has an even greater negative value than  $W_e$  when  $C_e$  replaces  $c_e$ . The difference between the private and the social gain from anticipatory adjudication is also greater when the former nets out  $c_a$  and the latter nets out  $C_a$ . For then  $W_a - V_a = p_e \varepsilon_1 D + C_a - c_a$ . In the special (but, as we shall see, not always implausible) case in which  $c_a = 0$ , A will always have a positive gain from anticipatory adjudication [see equation (4)] even if the social costs ( $p_e \varepsilon_1 D + C_a$ ) are much greater and make  $V_a < 0$  in equation (2).

*c. A Will Act Even If He Cannot Obtain an Anticipatory Adjudication*

We turn to the case where, because  $V_e$  (the private and social value of A's act when only ex post adjudication is available to determine its lawfulness<sup>15</sup>) is positive, society wants A to act even if he cannot obtain an anticipatory adjudication, and to take his chances on being sanctioned later. The expected social gain from anticipatory adjudication in this case is the difference between  $V_a$  and  $V_e$ :

$$V_a - V_e = p_e(1 - \varepsilon_1)D - p_a X + (C_e - C_a), \quad (5)$$

where

$$p_a = p_e(1 - \varepsilon_1) + (1 - p_e)\varepsilon_2. \quad (6)$$

The expected benefit of anticipatory adjudication equals the probability,  $p_e(1 - \varepsilon_1)$ , of preventing a person from taking a socially harmful action multiplied by

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<sup>15</sup> Recall from equation (1) that we assume that society's and A's cost of ex post litigation are equal, so that  $V_e$  denotes both society's and A's value of acting without anticipatory adjudication.

the harm avoided ( $D$ ) by preventing the act, plus the likely savings in litigation costs from substituting anticipatory for ex post adjudication. The value of encouraging a socially beneficial action disappears, because by hypothesis such action would be taken if anticipatory adjudication were unavailable, assuming the private benefit exceeded the private cost.

Other things being equal, this expected benefit is greater the greater  $p_e$ ,  $D$ , and  $C_e - C_a$  are and the smaller is the probability of Type I error in anticipatory adjudication. There is, however, an offsetting cost from anticipatory adjudication in the case under consideration: the benefit ( $X$ ) that is given up both when a court correctly, and when it erroneously, condemns a proposed action that, but for the anticipatory adjudication, would have gone forward.<sup>16</sup> To calculate the net expected benefit of anticipatory adjudication we must subtract this expected cost of  $p_a X$ .

There are several interesting comparisons between the case where A will not act in the absence of anticipatory adjudication [equation (2)] and the case where he will [equation (5)]:

1. As in the earlier case, the private gain from anticipatory adjudication exceeds the social gain. The private gain equals

$$W_a - V_e = p_e D - p_a X + C_e - C_a \quad (7)$$

which exceeds  $V_a - V_e$  by  $p_e \epsilon_1 D$ , the expected private benefit from averting, through legal error in anticipatory adjudication, a deserved sanction that would have been imposed ex post.<sup>17</sup> So again the number of such persons requesting anticipatory adjudication will exceed the efficient number.

2. Legal error reduces the social benefit from anticipatory adjudication both when a person will act in the absence of such adjudication and when he will not. Moreover, the effect of changes in legal error are identical for (2) and (5). A unit increase in Type I error reduces the expected gain from anticipatory adjudication by  $p_e(D - X)$ , and a unit increase in Type II error reduces the expected gain by (1

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<sup>16</sup> It may seem odd to worry about a lost benefit from a murder or rape that a court correctly prevents. But since we have shown that criminal acts are poor candidates for anticipatory adjudication, the lost benefits in (5) are not likely to involve those types of activity.

<sup>17</sup> Another factor that would increase the difference between  $W_a - V_e$  and  $V_a - V_e$  is a positive difference (if one exists) between the social and private costs of anticipatory adjudication. However, if social cost also exceeds private cost in ex post adjudication, the net effect of the differences between the social and private cost of litigation on the difference between  $W_a - V_e$  (or, more correctly,  $W_a - W_e$  where  $W_e$  is as defined below) and  $V_a - V_e$  is uncertain. To see this, let  $c_e$  and  $c_a$  denote private costs of litigation and define  $W_e = X - p_e D - c_e$  as A's private gain from acting when litigation takes place ex post.  $V_a - V_e$  could exceed  $W_a - W_e$  if  $C_e - C_a$  was greater than  $c_e - c_a$ , although there is no a priori reason to assume that this will be the case.

$- p_e)X$ , whether A will or will not go forward with his proposed course of action if he does not obtain an anticipatory judgment authorizing it.<sup>18</sup>

3. An increase in  $p$ , the probability that A's act is actually unlawful, will reduce the social benefit of anticipatory adjudication in the case in which A will not act unless anticipatory adjudication is available to him, but it will increase the social benefit of that adjudication in the case in which A will act if there is no anticipatory adjudication.<sup>19</sup> The intuition behind this result is that in the former case, when  $V_e < 0$ , the only potential social gain from anticipatory adjudication is giving A a green light to act, and that expected gain is smaller the more likely it is that the act is unlawful. In the latter case, where  $V_e > 0$ , the social gain from such adjudication comes from inducing persons *not* to act, and that expected gain is larger the greater the probability that the contemplated act is unlawful.

4. The cost of anticipatory adjudication tends to lower its social benefit more when a person will not act without such adjudication than when he will. In the former case, there is a net litigation cost of  $C_a$ . In the latter case, the incremental cost of anticipatory adjudication will actually be negative if  $C_e > C_a$  and everyone who acts without anticipatory adjudication is sued afterward. If not everyone who acts is sued ex post, or if some of those suits are settled before trial, the incremental cost of anticipatory adjudication may be positive notwithstanding the assumed greater cost of litigating a dispute after a party acts than before. We predict therefore that courts will be more willing to provide anticipatory adjudication in cases in which the party is quite likely to act, and to be sued if he acts, for then the incremental cost of anticipatory adjudication may be slight or even negative. Alternatively, if in the absence of anticipatory adjudication A would not act or if he did the parties would be likely to settle out of court, we predict that courts will be less willing to provide anticipatory adjudication. If A in this situation seeks such an adjudication his suit may be dismissed on the ground that it is unripe, that he lacks standing, or that the suit presents no real case or controversy.

5. Suppose that A will act in the absence of anticipatory adjudication only because his private cost of litigation ex post is lower than the social cost—that is, he would not act if he faced  $C_e$  instead of  $c_e$ , where  $c_e < C_e$ . The social benefit of anticipatory adjudication,  $V_a - V_e$  in equation (5), will increase since now  $V_e$  is negative. Anticipatory adjudication becomes more valuable because it can prevent acts that prospectively have a negative expected value when the full social cost of ex post litigation is taken into account. The private benefit from

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<sup>18</sup> The derivatives are  $\partial Z/\partial \square_1 = -p_e(D - X) < 0$  and  $\partial Z/\partial \square_2 = -(1 - p_e)X < 0$  where  $Z = V_a$  when A doesn't act and  $V_a - V_e$  when A does act.

<sup>19</sup> We have  $\partial V_a/\partial p_e = -(1 - \square_2)X - \square_1(D - X) < 0$  where  $V_e < 0$ , and  $\partial(V_a - V_e)/\partial p_e = (1 - \square_1)(D - X) + \square_2 X > 0$  where  $V_e > 0$ . Notice, however, that an increase in  $p$  has another effect. It makes it more likely that a person will not act.

anticipatory adjudication, however, may not change if A's litigation cost is less than society's cost for both anticipatory and ex post adjudication, and in that event the private benefit could be less than the social benefit. In contrast, we showed earlier that for A's who will not act in the absence of anticipatory adjudication, the private benefit of such adjudication will always exceed the social benefit, even if (indeed especially if) the private cost of litigation is less than the social cost.

The analysis is similar if the ex post sanction A faces (call it  $d$ ) is less than the social damages ( $D$ ) of his act. This might occur if A lacks sufficient resources to pay  $D$ . Suppose A will act if he faces  $p_e d$  but not if he faces  $p_e D$ . In that case  $V_e$  will be negative but since A still acts, ex post adjudication will lead to inefficient conduct. This increases the social benefit of anticipatory adjudication that might prevent such conduct. But if A would not act even if the maximum ex post sanction that he was able to pay was  $d$ , the benefit of anticipatory adjudication will be unaffected by the discrepancy between  $D$  and  $d$ . We give an example from the criminal law in the next part.

## *II. Further Applications of the Model to Legal Doctrines*

We illustrated our model with abbreviated examples of legal rules and procedures. We now undertake a fuller examination of legal doctrine in light of our economic analysis, emphasizing the commonalities among a number of doctrines that lawyers have usually thought unrelated.

### *a. Declaratory Judgments*

Were there no error in anticipatory adjudication, its net social benefit would equal either  $(1 - p_e)X - C_a$  for a party who would not act in the absence of anticipatory adjudication, or  $p_e(D - X) + (C_e - C_a)$  for a party who would act in the absence of such adjudication. In the former case the net social benefit will be positive provided the cost of anticipatory adjudication is less than the expected gain from an efficient act (an act that would not be sanctioned ex post). In the latter case anticipatory adjudication will always create a net social benefit except in the unlikely event that the cost of such adjudication is much greater than the cost of ex post adjudication or the parties are more likely to incur anticipatory than ex post adjudication costs, for example because B drops his suit or the parties settle after A acts.

The no-error condition is most likely to be approximated in situations in which most or all of the information relevant to deciding the dispute exists before A acts—and of course in some cases delay in adjudication may result in a net loss of relevant information, in which event (contrary to our earlier assumption) there will be less rather than more legal error in anticipatory compared to ex post adjudication. That extreme case is not necessary to support our point. Suppose that Mr. A plans to marry Ms. B but is uncertain whether he already is legally married. No additional information would be generated



(though we may assume that none would be lost, either) by postponing the judicial decision until after A marries B, which in this case may mean that the case is never decided.<sup>20</sup> Or suppose that A would like to build a house on a parcel of land the title to which is uncertain. His going ahead and building will cast no additional light on the issue of title.

These are good cases for the use of the declaratory judgment, and in fact the rules concerning the issuance of declaratory judgments seem broadly consistent with our analysis of the device, which emphasizes error costs. A federal court will not issue such a judgment unless the dispute is fully ripe, a requirement normally not satisfied unless the facts bearing on the plaintiff's entitlement to judgment have already occurred, so that the no (incremental) error condition is approximated. It has always seemed a bit odd that the courts should insist that the declaratory-judgment procedure is fully consistent with Article III's requirement that federal courts may adjudicate only actual cases and controversies. The oddness is dispelled when it is understood that this requirement is related to a desire to minimize the error costs of anticipatory adjudication by identifying classes of cases, some of them declaratory-judgment actions, in which the facts bearing on legal entitlement are in existence rather than contingent even though no one has yet been injured, for example by making a bigamous marriage or by building on land owned by someone else.<sup>21</sup> Even where declaratory relief would meet the Article III criteria, the court has discretion to refuse to grant it; this is a further safeguard against the use of the device to obtain a private gain but impose a social loss.

Implicit in our model is another economic advantage of declaratory judgments. The ordinary *ex post* lawsuit has two phases: liability and remedy. Even when the plaintiff is seeking equitable relief rather than damages, the lawyers and the judge will have to spend some time formulating an appropriate decree. Because a party seeking a declaratory judgment has not yet acted, however, the court only determines liability; it does not specify a coercive (equitable) or monetary remedy. Thus,  $C_a$  will be small relative to  $C_e$  for declaratory judgments, and may be absolutely small as well. If the losing party will comply once the issue of liability is authoritatively resolved, he—in fact both

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<sup>20</sup> At least if we ignore the possibility that someone may know that A is already married but become aware of A's plans to marry again only after A marries B. This possibility could be taken care of by the court's requiring A to post some sort of public notice before the court will adjudicate the question whether A is already married.

<sup>21</sup> "In general, the declaratory-judgment technique seems most valuable in controversies in which the relevant facts are ascertainable before actual harm has been suffered." Note, "Judicial Determinations in Nonadversarial Proceedings," 72 *Harvard Law Review* 723, 731 (1959).

parties, plus the court—can economize on the expense of litigation by seeking only declaratory relief.<sup>22</sup>

In an effort to put some empirical flesh on our theoretical skeleton, we collected all federal district court opinions in 1991 in cases in which at least one party had requested declaratory relief.<sup>23</sup> There were 282 such cases in all. The largest category, consisting of 97 cases, were insurance cases. This is not surprising even though the federal courts' jurisdiction over insurance contracts is limited essentially to cases in which the parties are citizens of different states. Insurance, especially liability insurance, is a favorite area for declaratory judgment proceedings. An insurance company that violates its duty to defend against any claim within the potential scope of a liability policy that it has issued faces a threat of heavy sanctions, including punitive damages. It therefore has a strong interest in obtaining a definitive ruling, in advance, concerning the scope and application of the policy. Since that scope and application depend entirely on the terms of the insurance policy, the nature of the event giving rise to the claim in the liability suit, and the nature of that claim—all things that will be known at the time the declaration is sought—the error costs of anticipatory adjudication are low.

The second largest category in our sample, consisting of 58 cases, is judicial review of administrative action. This category illustrates the last economy of declaratory judgments that we identified, for these suits are brought against federal agencies, which can be expected to comply with an authoritative judicial declaration of the plaintiff's rights. This feature lowers the cost of anticipatory relative to ex post litigation because the former avoids the costs of the remedial phase of litigation.

As nearly as we can determine from the opinions, in none of the 170 cases in which declaratory relief was granted, but in 14 of the 67 in which it was denied (the others not having been finally decided by the end of 1991), would withholding adjudication have enabled the obtaining of additional information bearing on the merits of the suit.

#### b. *Res Judicata*

The doctrine of res judicata precludes the relitigation by either party of a case between them that has resulted in a final judgment on the merits. The doctrine of collateral estoppel (which we do not discuss in this paper) precludes the relitigation, in what may otherwise be an entirely different kind of case, of a specific issue (usually factual) that was actually litigated and determined in a case that went to final judgment. These doctrines are anticipatory in the sense

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<sup>22</sup> In this respect, declaratory judgment proceedings resemble bifurcated liability-damages trials, on which see William M. Landes, "Sequential versus Unitary Trials: An Economic Analysis," 22 *Journal of Legal Studies* 99 (1993).

<sup>23</sup> Details of our study are available from us on request.

that they control or influence the outcome of a future lawsuit. They relate to our earlier discussion in an even more direct sense, to which we will limit our analysis, because an important feature of anticipatory judgments is that they can be pleaded as *res judicata* in a subsequent case.

Suppose that if A obtains a declaratory judgment, giving him a green light to act, and he does act and is sued, and the court decides that the declaratory judgment had been issued in error, A will be sanctioned *ex post*—that is, the declaratory judgment will *not* be given preclusive effect. Since we are assuming in this example that *ex post* litigation reverses an error in anticipatory adjudication, it may seem a powerful case for rejecting *res judicata* as a general doctrine, at least in cases where the judgment sought to be given preclusive effect was rendered in an anticipatory rather than an *ex post* litigation. A fuller analysis, however, shows that this conclusion is incorrect.

1. *A will not act in the absence of anticipatory adjudication.* Consider first the situation in which  $V_e = X - pD - C_e < 0$ , so that A will not act in the absence of anticipatory adjudication. Let  $p_{e/a}$  be the (conditional) probability that A will be found liable for damages  $D$  in *ex post* litigation if he prevailed in anticipatory adjudication. So (recalling that  $1 - p_a$  is the probability that A's act will be found lawful in anticipatory adjudication),

$$p_{e/a} = p_e \varepsilon_1 / (1 - p_a). \quad (8)$$

If anticipatory adjudication operated with zero error, or if the judgment in that adjudication could be pleaded as *res judicata*,  $p_{e/a}$  would be zero. Otherwise it would be positive, but smaller than if A would act without the benefit of a favorable judgment in the anticipatory adjudication, because  $p_{e/a} < p_e$ .<sup>24</sup> The reason that A's who are successful in anticipatory adjudication are more likely to prevail *ex post* is not that a court is unwilling to change its mind (we are assuming that *res judicata* is not applied when the first adjudication was anticipatory) but that those A's who lose at the anticipatory stage will not act and hence will not be sued *ex post*.<sup>25</sup> Only A's who win anticipatory suits will

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<sup>24</sup> From equation (8) it follows that  $p_{e/a} < p_e$  if  $\square_1 < (1 - p_a)$ . Substituting (3) for  $1 - p_a$  and rearranging terms yields  $p_{e/a} < p_e$  if  $\square_1 < (1 - \square_2)$ . The latter condition holds because we have assumed that the probability that a court will find A's prospective act lawful is smaller when that act would be found unlawful *ex post*.

<sup>25</sup> For remember that we are discussing here A's who will not act without anticipatory adjudication—that is, without *prevailing* in anticipatory adjudication. The result in the text holds even though A's loss at the anticipatory stage may be reversed in *ex post* litigation. The probability of A's losing the anticipatory adjudication,  $p_a$ , equals  $p_e(1 - \square_1) + (1 - p_e)\square_2$ , and the probability of A's losing *ex post* given such a loss equals  $p_e(1 - \square_1)/p_a$  which is greater than  $p_e$  since  $\square_1 < 1 - \square_2$ . In the class of cases in which A will not act without anticipatory adjudication,  $V_e$ , the expected value of *ex post* adjudication, is equal to  $X - p_e D - C_e < 0$ , and will be an even greater negative number if A has already lost at the anticipatory stage, since then  $p_e(1 - \square_1)/p_a$  substitutes for  $p_e$ .

subsequently be sued, and this group is comprised of persons who are less likely to be sanctioned ex post than the universe of A's who seek and obtain anticipatory adjudication.<sup>26</sup>

If A wins the anticipatory adjudication, he will act, risking the (now lower) probability of being sanctioned ex post.<sup>27</sup> Still, the probability is positive, which reduces the private as opposed to social value of anticipatory adjudication. Earlier we showed that A's private value from anticipatory adjudication [equation (4)] exceeded the social value because it excluded  $-p_e \varepsilon_1 D$ , the expected harm created by Type I error. If, however, a court can correct its mistake ex post, A's private value from anticipatory adjudication will equal

$$W_{a^*} = (1 - p_a)(X - p_e/aD - C_e) - C_a \quad (9)$$

$$= (1 - p_a)X - p_e \varepsilon_1 D - (1 - p_a)C_e - C_a. \quad (10)$$

Putting to one side the additional cost of ex post litigation [which equals  $(1 - p_a)C_e$ ], we can see that the effect of rejecting res judicata is to align the private and social values of anticipatory adjudication [see  $V_a$  in equation (2)].

Ordinarily, a policy that aligns private and social values is socially desirable; but for several reasons this is not true here:

1. Litigating both before and after A acts doesn't alter A's behavior. If A wins at the anticipatory stage, he acts, even though there is some risk of an ex post sanction. If he loses at the anticipatory stage, he refrains from acting. Although fewer A's will seek anticipatory adjudication, because the net private benefits are now lower (i.e.,  $W_{a^*} < W_a$ ), those who do seek and obtain it, and receive a favorable judgment, will act. Holding them liable later, in an ex post litigation, while it will redistribute income to injured victims of legal wrongs, will not change the behavior that caused the wrong in the first place—it has already occurred. It is true that rejecting res judicata and thus enabling the correction of Type I error in anticipatory adjudication would have the effect of penalizing wrongful behavior; and it is counterintuitive that imposing an expected penalty will not change behavior. All it will do here, however, is affect the decision to seek anticipatory adjudication. As long as the judges, properly weighing the danger of Type I error and other relevant factors, reject inefficient requests (that

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<sup>26</sup> A numerical example will illustrate. Suppose  $p_e = .4$ ,  $\square_1 = .1$  and  $\square_2 = .1$ . For a party who gets the green light in anticipatory adjudication, the probability that he will be sanctioned ex post equals  $.04 / (.6 \times .9 + .4 \times .01) = .04 / .58 = .069$  compared to  $.4$  without anticipatory adjudication. Moreover, the former probability approaches zero as legal error approaches zero regardless of the size of  $p_e$ .

<sup>27</sup> *Why* A will act is straightforward. Consider the reverse. A gets the green light and decides not to act for fear of being sanctioned ex post. But then A would never have sought anticipatory adjudication in the first place because the best outcome—getting the green light—would still have a negative value (otherwise he would act) and in addition would impose on him a litigation cost of  $C_a$ .

is, where  $V_a < 0$ ) for anticipatory adjudication, the same A's will obtain favorable anticipatory judgments, and therefore act, as would do so if the judgment could be used as *res judicata* in an *ex post* lawsuit. The only (though not necessarily a negligible) social saving would come from the decline in the number of request for anticipatory adjudications.

The qualification "as long as the judges, properly weighing the danger of Type I error and other relevant factors, reject inefficient requests for anticipatory adjudication" is critical. If judges had no discretion to turn down requests for anticipatory adjudication and such decisions could be pleaded as *res judicata*, the number of anticipatory adjudications would exceed the socially efficient number. By aligning private and social values, rejecting *res judicata* would reduce the demand for and hence the number of socially excessive anticipatory adjudications, and the resulting social gain might more than offset the cost of additional *ex post* proceedings. This suggests two hypotheses: The more discretion that courts have to deny requests for anticipatory adjudication – and recall that judges *do* have discretion to decline to render declaratory relief, even if jurisdictional requirements are satisfied – (a) the more likely is the outcome of anticipatory adjudication to be treated as *res judicata* in *ex post* litigation, and (b) the greater is the precedential weight likely to be given to anticipatory judgments. Discretion allows judges to eliminate those requests where  $p_{\varepsilon_1}D$  is high and (for this or other reasons) the social value of anticipatory adjudication is significantly below A's private value. Without such discretion, courts may commit costly mistakes in anticipatory adjudication. One way to limit the consequences of such mistakes is to allow them to be corrected *ex post* by not giving anticipatory judgments precedential weight. In declining to give a decision much weight as precedent, courts sometimes do cite factors that may have denied the earlier court full information, such as that the full consequences of the defendant's actions could not have been known.

2. *Ex post* adjudication involves an expected cost that must be deducted from the social value of anticipatory litigation, when as a result of rejecting *res judicata* an *ex post* adjudication is a predictable error-correction follow-up to anticipatory adjudication. If the judgment in the anticipatory adjudication has *res judicata* effect, no *ex post* suits will be filed, and the costs of those suits will be saved. If every time A wins the anticipatory adjudication he will be sued after he acts, anticipatory adjudication will eliminate *ex post* litigation only if A loses in the first stage, so the social value of the device will decline by the expected cost of the subsequent litigation [which equals  $(1 - p_a)C_e$ ]. More realistically, if A wins the anticipatory adjudication he faces a probability rather than a certainty of being sued *ex post*. Moreover, the probability of A's losing *ex post* after he has won at the anticipatory stages is lower than  $p_e$ , which reduces the incentive for a plaintiff to sue *ex post*. And the parties may settle after A wins the anticipatory stage, since the outcome at that stage generates information about the likely outcome of *ex post* litigation. When these refinements are taken into account our

general argument – that res judicata reduces litigation costs – still holds, but with diminished force.

3. Apart from efficiency concerns, suppose it is thought a very good thing on corrective justice grounds to correct judicial error in order to prevent injurers from getting away with not compensating their victims. Even this would be a weak reason for refusing to treat anticipatory judgments as res judicata, provided that, as argued earlier, anticipatory adjudications with binding effect (such as declaratory judgment suits) tend to be limited to disputes in which the relevant information exists before a party acts, so that the error costs are unlikely to exceed those of ex post adjudication.<sup>28</sup>

2. *A will act in the absence of anticipatory adjudication.* For the party who will act in the absence of anticipatory adjudication (that is, for whom  $V_e > 0$ ), the social value of anticipatory adjudication equals  $p_e(1 - \varepsilon_1)D - p_aX + (C_e - C_a)$  [see equation (5)]; the private value equals  $p_eD - p_aX + (C_e - C_a)$  [see equation (7)]; and the private exceeds the social value by  $p_e\varepsilon_1D$ . It might seem that the principal private and social benefit of anticipatory adjudication – preventing A from undertaking a socially harmful action – would be eliminated (or at least greatly reduced) if the actor were not bound by an adverse judgment in the anticipatory adjudication, that is, if res judicata were rejected. But this turns out to be false.

Consider first the case where anticipatory adjudication gives A the green light to act. A will act: since  $p_{e/a} < p_e$ , the expected value of A's acting conditional on A's winning the anticipatory adjudication (which equals  $X - p_{e/a}D - C_e$ ), exceeds  $V_e > 0$ . It is true that because of Type I error that we are assuming is corrected in ex post litigation, some A's who succeeded in anticipatory adjudication will still be sanctioned. But, as we showed earlier, ex post sanctions do not prevent wrongful acts from occurring. Thus, eliminating res judicata for A's who get the green light to act in anticipatory adjudication actually reduces social welfare, by adding costly ex post litigation with no offsetting efficiency gain.<sup>29</sup>

Now suppose that A loses the anticipatory adjudication. If that outcome could be pleaded as res judicata, A would not act; for if he did, he would be

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<sup>28</sup> Another possible effect of rejecting res judicata may be to increase the size of legal error in anticipatory adjudication. Assuming ex post litigation corrects legal error in anticipatory adjudication, there may be less incentive to spend resources to improve accuracy at the anticipatory stage. Whether this reduces efficiency is unclear. Greater legal error reduces the value of anticipatory adjudication but reducing the expenditures on such adjudication will raise its value.

<sup>29</sup> Allowing for the extra cost of litigating ex post if A wins at the anticipatory stage, we have  $V_a = (1 - p_a)(X - C_e) - p_e\varepsilon_1D - C_a$ . Both the social ( $V_a - V_e$ ) and private ( $W_a^* - V_e$ ) values of anticipatory adjudication equal  $p_e(1 - \varepsilon_1)D - p_aX + p_aC_e - C_a$ . The social value falls because equation (5) included  $C_e - C_a$  as a benefit, since ex post litigation was assumed to be more costly than anticipatory litigation. Here  $V_a - V_e$  includes the smaller and possibly negative savings of  $p_aC_e - C_a$ .

sanctioned with certainty, and we know that  $X < D$ . But what if A is not bound by the adverse judgment in the anticipatory adjudication? Since the court may have mistakenly held A's prospective act harmful (thus committing a Type II error), might A act in the hope that the court will reverse its error? The answer is no; for if A would act in that situation, he would never have requested anticipatory adjudication to begin with (nor would an efficiency-motivated court have granted such a request) since both its social and private expected value would be negative.<sup>30</sup> That is, if anticipatory adjudication has no bearing on whether or not A acts, and ex post adjudication always follows A's act, anticipatory adjudication involves costs but no benefits. Granted, the assumption that ex post litigation always follow anticipatory adjudication is unrealistic. Indeed, since the party who loses the anticipatory adjudication will have an even lower probability of winning ex post litigation, he will have a reduced incentive to sue ex post, compared with the situation in which anticipatory adjudication is unavailable. Still, rejecting res judicata would raise litigation costs overall as long as some persons who lost at the anticipatory stage would seek to litigate ex post.

*c. Victim's Request for Anticipatory Adjudication: Injunctions, the Criminal Punishment of Preparatory Acts, and Anticipatory Breach of Contract.*

The focus of part I was on the social and private value of anticipatory adjudication to the party who seeks such an adjudication in order to authorize him to proceed with some act. What about the party who may be injured by that act? Shifting the focus to him is equivalent to asking whether he would prefer obtaining an injunction to prevent future harm or waiting until the defendant acts and seeking damages for any harm done by the act. While for A the choice is between seeking legal permission now and taking his chances on being sued later, the choice for B (the potential victim) is between suing now to prevent A from acting and suing later to recover damages for the injury inflicted by the act.

B might request anticipatory adjudication, or, equivalently, an injunction against A's acting. He would not do this if he thought that A would not act without such an adjudication, unless he had a strong desire for a precedent. For apart from the cost of suing, the court might make a mistake and find A's act lawful. Consider B's options if, even without the go-ahead signal of an anticipatory adjudication in A's favor, A will act, inflicting harm on B with probability  $p_e$ . B will be compensated ex post for his damages, so he has nothing to lose from sitting back and waiting for A to act except his litigation costs in the ex

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<sup>30</sup> If A acts even if loses the anticipatory adjudication, then  $V_{e/a} = X - [p_e(1 - \square_1)/p_a]D - C_e > 0$ , where  $[p_e(1 - \square_1)/p_a]$  is the probability that A will lose ex post, conditional on losing at the anticipatory stage. Multiplying by  $p_a$  yields  $p_a X - p_e(1 - \square_1)D - p_a C_e > 0$ , or alternatively  $p_e(1 - \square_1)D - p_a X + p_a C_e < 0$ . Then both the social and private value of anticipatory adjudication, which equals  $V_a - V_e = W_a^* - V_e = p_e(1 - \square_1)D - p_a X + (p_a C_e - C_a)$ , are both negative. We also know that A will act in the absence of anticipatory adjudication (since  $V_e > 0$  by assumption) and that he will act if he wins the anticipatory adjudication, since  $V_{e/a} > V_e > 0$ .

post suit.<sup>31</sup> If instead B asks the court to enjoin A before he acts, B faces an expected loss of  $p_e \varepsilon_1 D$ —his expected damages ( $p_e D$ ) discounted by  $\varepsilon_1$ , the probability that the court in an anticipatory adjudication will incorrectly find that A's act is lawful. The offset is the saving in litigation costs from anticipatory compared to ex post litigation. Unless those savings are great enough to compensate for the expected loss  $p_e \varepsilon_1 D$ , B will prefer to seek damages rather than an injunction or a declaratory judgment.

Once we relax some of the assumptions in our model, however, B's incentive to seek anticipatory relief emerges. To begin with, the risk of Type I error is reduced by the rule that findings and conclusions made in a preliminary-injunction hearing are tentative and may be reexamined in the full ex post litigation that will ensue if the preliminary injunction is denied and A goes ahead and acts. However, this rule does not apply to permanent injunctions.

Also, A may lack the resources to compensate B fully for the harm created by A's act (or, what amounts to same thing, the damage award rendered in ex post litigation is not fully compensatory). Then B's expected cost of ex post adjudication will equal his uncompensated harm ( $= p_e(D - d)$ , where  $d$  denotes the maximum that A can pay B) plus his litigation costs. These losses may more than offset B's expected loss from Type I error in anticipatory adjudication,<sup>32</sup> especially if that loss is reduced by the rule that findings of fact and conclusions of law made in the preliminary-injunction hearing are tentative.

We note several additional points:

1. Lacking sufficient resources to pay B's damages, A will be more likely to act if there is no anticipatory litigation, and hence will be less likely to institute such litigation (and more likely to oppose it, when it is instituted by B) because he has less to lose from ex post adjudication.

2. The social interest in anticipatory compared to ex post adjudication is greater when A cannot pay B's full damages, because, if A acts, the social benefit when adjudication takes place ex post is less than A's private benefit (that is,  $X - p_e D$  is less than  $X - p_e d$ ). This is the economic rationale for the criminal punishment of preparatory acts that inflict no harm (failed attempts, solicitations,

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<sup>31</sup> Of course, he will be compensated only if he is damaged and the act is unlawful, but that is why  $D$  must be discounted by  $p_e$ . We assume that the "American" rule is in force (no shifting of the winning party's attorney's fees to the losing party) and, as earlier, that ex post adjudication operates free from legal error.

<sup>32</sup> B's expected loss from ex post and anticipatory adjudication equal  $p_e(D - d) + C_e$  and  $p_e \varepsilon_1 D + C_a$  respectively so his gain from anticipatory adjudications equals  $p_e(1 - \varepsilon_1)D - p_e d + (C_e - C_a)$ , which is more likely to be positive the smaller is Type I error, and the larger is  $D$  relative to  $d$ . If  $d = D$  (so A can pay B's full damages) then B will prefer ex post litigation unless B's extra litigation cost (which equals  $C_e - C_a$ ) offsets the error costs ( $p_e \varepsilon_1 D$ ) of anticipatory adjudication.



and conspiracies and reckless driving that does not result in an accident),<sup>33</sup> a form of anticipatory adjudication instituted by the victim (represented by the state). For the completed act,  $D$  is likely to be far greater than  $d$ —indeed  $d$  will often be zero and  $D$  very high. The probability that the completed act would be unlawful is also very high given that the government’s burden in the preparatory-act case is the standard prosecutor’s burden of proof beyond a reasonable doubt. Type II error in this form of anticipatory adjudication is further minimized by the requirement that the attempt have progressed to the point where the defendant’s intention and capacity to commit the completed crime are clear. Conspiracy is punishable at an earlier point but requires proof of agreement, the agreement being some evidence that the defendant is actually dangerous.

3. Another form of victim-initiated anticipatory litigation in the criminal area is preventive detention. If bail is denied to an accused on the ground that he is likely to commit further crimes while he is out on bail awaiting trial, in effect the prosecutor as agent of the defendant’s potential victims is seeking on the basis of the bail hearing to prevent damage that may be difficult to deter by ex post adjudication, since, again,  $d$  may be much smaller than  $D$ . A complicating factor not present in our earlier examples is that the anticipatory adjudication may create error costs in the ex post adjudication, since being incarcerated while awaiting trial may make it more difficult for the defendant to prepare an adequate defense.<sup>34</sup>

4. Suppose as in the usual criminal case that the net social benefit of A’s acting ( $V_e = X - p_e D - C_e$ ) is negative, but that A will still act when adjudication is ex post because his private benefit ( $W_e = X - p_e d - c_e$ ) will be positive. Anticipatory adjudication is likely to be socially beneficial because  $p_e$  and  $D - X$  are high and Type II error is low.<sup>35</sup> Granted, the fact that Type I error may be high (because it is a criminal proceeding) reduces the benefit of anticipatory adjudication. Even though an acquittal on a charge of attempt, conspiracy, reckless driving, and so forth is not a green light to commit the completed crime, A will still act ( $X - p_e d > 0$ ) and cause net harm since, by assumption,  $V_e$  is negative. However, with A identified as a potential offender, his chances of being apprehended and convicted if he goes ahead and commits the completed crime after having been acquitted of the attempted crime will rise, so that even in the case where Type I error occurs there will be some benefit from the anticipatory adjudication.

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<sup>33</sup> Richard A. Posner, “An Economic Theory of the Criminal Law,” 85 *Columbia Law Review* 1193, 1217 (1985); Steven Shavell, “Criminal Law and the Optimal Use of Nonmonetary Sanctions as a Deterrent,” 85 *Columbia Law Review* 1232, 1249-1250 (1985).

<sup>34</sup> William M. Landes, “The Bail System: An Economic Approach,” 2 *Journal of Legal Studies* 79 (1973).

<sup>35</sup> From equation (5) we can write the net gain from this form of anticipatory adjudication (ignoring litigation costs) as  $p_e(1 - \square_1)(D - X) - (1 - p_e)\square_2 X$ , where  $D > X$ .

5. From B's standpoint a similar case to that of inadequate resources to satisfy a damages judgment is that in which B always suffers a harm equal to  $D$  if A acts, but, because of difficulty in establishing the existence or amount of harm or its causal relation to the defendant's conduct, there is some probability  $1 - p_e$  that the court in an ex post adjudication will deny B any damages or will cut them down. B also risks harm from anticipatory adjudication, because, if A gets the go-ahead to act, B will suffer damages when A acts. But B may still gain from anticipatory adjudication if he is more likely to prevent A from acting by winning anticipatory adjudication than he is to collect damages by winning ex post adjudication. Here, the greater Type II error, the smaller Type I error, and the bigger the cost savings of anticipatory adjudication, the more likely is B to prefer anticipatory to ex post adjudication.<sup>36</sup>

We mentioned the *preliminary* injunction, ordinarily sought to freeze the status quo while a suit either for a permanent injunction or for damages is wending its way to completion. The usual reason for seeking a preliminary injunction, and a precondition to obtaining it, is that the defendant's conduct is inflicting irreparable harm on the plaintiff—harm that cannot be rectified by the final judgment that will be entered at the end of the suit. Freezing the status quo may, however, impose irreparable harm on the defendant—and that is sometimes the real reason for the plaintiff's seeking a preliminary injunction. Courts decide whether to grant or deny a preliminary injunction by comparing the expected costs to both plaintiff and defendant of the two alternatives. Since the decision is anticipatory, it can be modeled, using the same notation as before, as follows: grant or deny the preliminary injunction depending on whether  $p_a D$  is greater or less than  $(1 - p_a)X$ , where  $p_a$  is the probability that the plaintiff B will win the suit (i.e., that the defendant is violating his rights), estimated before A acts;  $D$  is the irreparable harm to B if the preliminary injunction is denied; and  $X$  is the irreparable harm (i.e., the foregone gain) to A, the defendant, if it is granted.<sup>37</sup> This determination involves an implicit comparison of Type I and Type II errors. The greater Type I error, the more likely a court is to deny a preliminary injunction when the correct decision would be to grant it; and the greater Type II error, the more likely that a preliminary injunction will be granted when the correct decision would be to deny it.<sup>38</sup>

<sup>36</sup> B's expected loss from ex post and anticipatory adjudication equals  $(1 - p_e)D + C_e$  and  $[p_e \square_1 + (1 - p_e)(1 - \square_2)]D + C_a$ . The gain from anticipatory adjudication equals  $[(1 - p_e)\square_2 - p_e \square_1]D + (C_e - C_a)$  which is more likely to be positive the greater  $\square_2$ , the smaller  $p_e$  and  $\square_1$ , and the greater  $C_e - C_a$ .

<sup>37</sup> See Richard A. Posner, *Economic Analysis of Law* 553–54 (4th ed. 1992); [American Hospital Supply Corp. v. Hospital Products Ltd., 780 F.2d 589 \(7th Cir. 1985\)](#).

<sup>38</sup> From (6) we have  $p_a = p_e(1 - \square_1) + (1 - p_e)\square_2$ . Thus, the decision to grant or deny a preliminary injunction will depend on whether  $p_a D$  is greater or less than  $(1 - p_a)X$  or whether  $[p_e(1 - \square_1) + (1 - p_e)\square_2](D + X) - X$  is greater or less than zero. Thus, the smaller  $\square_1$  and the

Anticipatory breach of contract is a self-help remedy parallel to the preliminary injunction. Suppose A and B have a contract, with A's performance due at time  $t$ , and at  $t - 1$  A realizes that he will not be able to perform. There is no breach as yet, but by declaring breach now, A may be able to reduce  $D$  by giving B additional time to mitigate his damages by finding a substitute performer. Similarly, if B has reason to believe that A will not be able to perform when performance is due (though A denies this), B is entitled under the Uniform Commercial Code to demand adequate assurances of performance from A, failing which B can declare a breach and take steps to minimize his damages without waiting for A to free him from his contractual obligations. It might seem that A would always have an incentive to anticipate the breach, since the legal system will shift B's damages to him through B's suit for breach of contract and those damages will be lower if A has enabled B to reduce the damages. But if B's recovery ( $d$ ) in a lawsuit instituted after the breach occurs will not fully compensate him for his damages ( $D$ ), B's self-help remedy may be more effective than a suit against A.

#### d. *Advisory Opinions*

The cost of legal error helps to explain why many state courts are authorized to issue advisory opinions, at the request of the state's executive or legislative branches, often though not always on state constitutional issues, while federal courts are not authorized to issue advisory opinions on any subject.<sup>39</sup> Because the federal constitution is more difficult to amend than most state constitutions are, the costs of erroneous constitutional interpretations are greater at the federal than at the state level. At the state level an erroneous interpretation is less likely to prove irreparable; it can usually be corrected by an amendment in short order. The corrective remedy at the federal level is slower and costlier.

Modifying equation (2), we can write the net benefit of an advisory opinion requested by the government, for the case in which the government will not act without a favorable opinion, as

$$V_a = (1 - p_e)(1 - \varepsilon_2)X - p_e\varepsilon_1[k(D - X) + c] - C_a \quad (11)$$

where  $(1 - p_e)(1 - \varepsilon_2)X$  is the expected benefit when the government is given permission to act and  $p_e\varepsilon_1[k(D - X) + c]$  is the expected harm from a erroneous decision allowing the government to act when it shouldn't.  $X$  and  $D$  ( $> X$ ) here refer to the present value of benefits and harms,  $k$  denotes the fraction ( $< 1$ ) of  $D$

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greater  $\square_2$ , the more likely that a preliminary injunction will be granted. We note one small difference between this analysis and our analysis of anticipatory adjudication: in the latter, we assumed that  $X < D$  whereas in the former  $X$  may be greater or less than  $D$ .

<sup>39</sup> The prohibition against the issuance of advisory opinions by federal courts is based on (or rationalized in terms of) the requirement of "justiciability" believed to flow from the limitation of the federal judicial power in Article III of the Constitution to "cases or controversies." We examine justiciability more broadly in subpart f.

and  $X$  that will be realized before an erroneous decision is corrected, and  $c$  is the cost of an amendment to correct an erroneous decision. It is obvious from (11) (as well as common sense) that allowing the government to obtain advisory opinions is more likely to be socially beneficial when it is quick and cheap to correct an erroneous opinion by an amendment, since that implies low  $c$  and  $k$ .

In the case where the government would act in the absence of an advisory opinion and an amendment would correct an erroneous decision telling the government not to act when it should (Type II error), the net benefit of allowing advisory opinions is given by

$$V_a - V_e = p_e(1 - \varepsilon_1)(D - X) - (1 - p_e)\varepsilon_2(kX + c) + (C_e - C_a). \quad (12)$$

Here the benefit of an advisory opinions lies in preventing the government from acting when that is the correct outcome, while the cost lies in sometimes telling the government that it can't act when it should. Again the losses from the erroneous opinions will be small if they can be corrected by a constitutional amendment, so again the quicker and cheaper the amendment process is, the more likely the net benefit of advisory opinions is to be positive.<sup>40</sup>

Consistent with our analysis, we predict and find that advisory opinions are more common at the state than at the federal level (federal courts are forbidden to issue advisory opinions). At the federal level they are issued only by administrative agencies, whose advisory opinions, as we shall see, are readily corrected. It is also not unexpected that advisory opinions are generally given less precedential weight than opinions in adjudicated cases.<sup>41</sup> Courts are less likely to follow their advisory opinions than their regular opinions in subsequent cases, because the absence from the advisory-opinion setting of both an adversary presentation and information generated by experience with the statute (which has not yet been enacted) that is being opined on increases the risks of error. Giving advisory opinions less precedential weight is like correcting either or both Type I and Type II error. If a court in ex post litigation declines to follow an incorrect advisory opinion, the potential social loss caused by an erroneous advisory opinion would be discounted by  $k$ , which would then refer to the fraction of such erroneous opinions (weighted by the social loss imposed by them) that was not corrected by ex post litigation.

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<sup>40</sup> If an amendment corrected both Type I and Type II error, equation (11) would become  $(1 - p_e)[X - \varepsilon_2(kX + c)] - p_e\varepsilon_1[k(D - X) + c] - C_a$  and the value of an advisory opinion would thus be greater the smaller  $k$  and  $c$  were.

<sup>41</sup> Note, "Advisory Opinions on the Constitutionality of Statutes," 69 *Harvard Law Review* 1302, 1303-4 (1956). This is the rule, but Comment, "The State Advisory Opinion in Perspective," 44 *Fordham Law Review* 81, 82-83 (1975), suggests that in practice advisory opinions of state supreme courts are given the same weight as other opinions of those courts. To similar effect, see Commentary, "Advisory Opinions in Florida: An Experiment in Intergovernmental Cooperation," 24 *University of Florida Law Review* 328, 332-3 (1972).

The vast majority of advisory opinions concern internal governmental affairs (such as the scope of home rule, the extent of the governor's veto power, and the legality of state or local borrowing) rather than the rights of individuals or firms.<sup>42</sup> This makes sense, since with the normal requirements of standing unsatisfiable, a regular adversary proceeding might not result in significantly lower legal error than the advisory-opinion procedure. Although it would be somewhat lower—because once the statute is in operation its consequences can be observed, not just conjectured as when the statute is challenged in advance of enactment—we shall see that adjudications brought by parties who lack standing in the traditional sense can involve high legal-error costs.

Although we can see why states would be more likely to authorize advisory opinions than the federal government would be, this of course does not show that the costs of allowing federal advisory opinions would outweigh the benefits. Among the benefits would be the considerable savings in the time required to dispel legal uncertainty over some statute or other measure; in one state, the average time between the request for an advisory opinion and the opinion is a remarkable 7.5 *days*.<sup>43</sup> This benefit would have to be compared with the increased risk of legal error. A further consideration, however, which may help explain the rejection of advisory opinions at the federal level, is that beyond a point judicial systems encounter severe diseconomies of scale. Increases in demand for judicial services, unlike other services, cannot readily be accommodated by creating new "firms" (that is, new courts) without undermining consistency of legal doctrine, or by enlarging existing courts without greatly increasing decision costs.<sup>44</sup> Since the federal judiciary is already one of the nation's largest and busiest, the cost [both the  $c$  and  $C_a$  in equation (11)] of adding an advisory jurisdiction to it in circumstances where the government would not act in the absence of a favorable advisory opinion would be considerable.<sup>45</sup> True, there is an offsetting savings. When the government would act in the absence of an advisory opinion, its act may be followed by ex post litigation whose cost [ $C_e$  in equation (12)] will be saved by an advisory ruling. These savings, however, may be small. The weaker precedential significance given to advisory opinions implies that ex post litigation will not be eliminated. More important, standing and other doctrines of justiciability would prevent ex post litigation in many cases in which

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<sup>42</sup> Comment, note 39 above, at 106, 108–9.

<sup>43</sup> Commentary, note 39 above, at 337. In contrast, a study published in 1962 found that the average interval between the enactment of a federal statute and the Supreme Court's decision invalidating it was 8.7 *years*. Note, "The Case for an Advisory Function in the Federal Judiciary," 50 *Georgetown Law Journal* 785, 800 (1962).

<sup>44</sup> Posner, note 35 above, at 580–81.

<sup>45</sup> It may not be an accident that the largest state court systems, such as those of California, New York, and Texas, also do not issue advisory opinions.

government might have frequent resort to an advisory jurisdiction, for example to settle interbranch conflicts that do not affect private rights.

The analysis in this section thus predicts that the willingness of a state to permit its courts to issue advisory opinions will be negatively related both to the volume of litigation in the state and to the difficulty of amending the state's constitution. These are testable predictions.

*e. The Administrative and Judicial Processes Compared*

The amount of anticipatory adjudication (broadly construed) is vastly greater in administrative agencies than in courts. Imagine calling up a judge's law clerk and asking for legal advice! But that sort of thing is routine in many administrative agencies. And rules promulgated in advance of any harm are a routine part of administrative activity, while when done by judges they are derided as "dicta."<sup>46</sup> Yet at the same time, declaratory orders, the administrative counterpart of declaratory judgments, are extremely rare.<sup>47</sup> How to explain this pattern?

The essential point, we conjecture, is that when the costs of adjudication to the adjudicative institution itself (courts or agency, as the case may be), as distinct from the parties, are incorporated into the cost of litigation, anticipatory adjudication is much more costly for courts than for agencies; so is the risk of error. Most American courts have general rather than specialized jurisdictions. This both increases the number of potential requests for advice or advance rulings and, because the information economies enabled by specialization are not available, increases the risk of incremental error if the court does not have the benefit of a full adversary presentation. Stated differently but equivalently, it costs the court more than the agency to reduce the risk of error by the same amount. The "records" on which agencies act in rulemaking proceedings are of poor quality compared to trial records (they are full of hearsay and witnesses are not subject to cross-examination), but this is not critical because the agency does not come to the case without prior knowledge of the subject matter, as would a court.

Courts on the European continent differ from English and American courts in being more specialized and in having career judges rather than judges appointed

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<sup>46</sup> This derision, by the way, illustrates the important general point that anticipatory adjudications are likely to have less precedential force than ex post adjudications, because of higher error costs.

<sup>47</sup> Burnell V. Powell, "Sinners, Supplicants, and Samaritans: Agency Advice Giving in Relation to Section 554(e) of the Administrative Procedure Act," 63 *North Carolina Law Review* 339 (1985). However, though not remarked in Professor Powell's excellent article, the National Labor Relations Board routinely issues something closely akin to declaratory orders. nlr orders, though in form remedial, are not binding until enforced by a court. Often, if the respondent does not challenge the order in court but instead indicates his willingness to comply with it, the nlr will not seek judicial enforcement. See *nlrb v. p\*i\*e Nationwide, Inc.*, 894 F.2d 887 (7th Cir. 1990).

(or elected) from practice. We predict that those courts would render anticipatory adjudication more freely than Anglo-American courts do.

Statutes enforced by administrative agencies often prescribe heavy penalties for violations of agency rules. This places persons and firms subject to those rules in a quandary. If they believe that a rule is invalid and violate it in order to obtain a judicial determination of its validity, and they are wrong, they will pay a heavy penalty [this is the case of a high  $D$  with probability  $p_e$  in equation (1)]. If therefore they comply with the rule, they will forgo the opportunity to challenge it and they will thus lose a benefit equal to  $X$ . To prevent these losses, the Supreme Court held in the *Abbott Laboratories* case that persons subject to an agency rule can seek declaratory or injunctive relief before the rule goes into effect.<sup>48</sup> Since the penalties for violating agency rules are sometimes criminal, the “pre-enforcement” judicial review authorized by *Abbott Laboratories* illustrates the operation of anticipatory adjudication in a criminal context. Because losing such a review proceeding does not result in the imposition of a criminal penalty—the plaintiff has not yet violated the rule, so hasn’t yet committed a crime even if the rule is valid—the criminal burden of proof is not imposed.

Although the cost of anticipatory adjudication is generally lower to an agency than to a court because of greater specialization and larger staff (see next paragraph), it might appear puzzling that agencies make less rather than more use of declaratory orders than courts do of declaratory judgments. An agency, however, has substitute anticipatory procedures that cost less because they do not require satisfaction of the conditions of an Article III case or controversy—conditions imposed on courts in declaratory judgment proceedings as in other proceedings because of the courts’ lack of specialized knowledge.

Advice by agency staff deserves separate consideration. Often such advice is not binding, in recognition of the high potential error costs, since the staff has less information about the correct decision of the case than the members of the agency, who are the authoritative decision makers (commissioners of the ftc, members of the nlr, etc.). This reduces the benefits of the advice. At the same time, its costs may be very low—even zero. With less to gain or lose from the advice, a person wishing advice from the agency may spend little or no money on employing a lawyer to frame his request in the manner most likely to elicit a favorable ruling. This is a common consequence of the offer of the Internal Revenue Service to answer taxpayers’ questions. The answers have no binding effect, so taxpayers do not hesitate to put questions to the irs without bothering to obtain the assistance of a lawyer. The irs’s private letter rulings are binding, so

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<sup>48</sup> *Abbott Laboratories v. Gardner*, 387 U.S. 136 (1967). There is a close parallel, outside the administrative context, in the rule of *Ex Parte Young* which permits a declaratory or injunctive action for the purpose of testing the validity of a statute before the person bringing the action has violated it. See *Illinois v. General Electric Co.*, 683 F.2d 206 (7th Cir. 1982).

taxpayers invariably hire counsel to frame and support the request for such a ruling.

We can see now why it seems so odd to imagine persons' being permitted to request advice from judges' law clerks. Either law clerks would have to be trained in rendering advisory opinions over the whole extent of their courts' jurisdiction, or, if their advice were nonbinding, they would be flooded with requests for nonbinding advice because persons making such requests would not have to hire lawyers to frame the request—in effect they would be “hiring” the law clerks, at zero cost, as their lawyers. Either way, the character of judicial staffs would be transformed. This hypothetical situation underscores our earlier point that anticipatory adjudication is unlikely to be worthwhile when all it does is replace private legal advice.

#### f. *Justiciability*

The legal term *justiciability* refers to the complex of limitations on federal judicial competence that has been found to be implicit in Article III of the Constitution. The plaintiff must actually have been (or be about to be) injured by the defendant's conduct (standing). The relief sought by the plaintiff must actually be beneficial to him (mootness). The parties' dispute must have progressed to the point where it is plain that they *have* a dispute (ripeness), so ordinarily a person cannot challenge the constitutionality of a statute if it is unclear whether the statute will even be applied to him. The dispute must be real, not contrived or collusive. If any of these requirements is not satisfied, the suit will be dismissed on the ground that the plaintiff is seeking an advisory opinion.

The concept of justiciability can be interpreted, though only in part, as a limitation on anticipatory adjudication. For example, if an ex post suit is unripe, or we can't tell whether the plaintiff B is likely actually to be injured, the suit becomes equivalent to anticipatory adjudication with substantial legal error ( $\epsilon_1$  and  $\epsilon_2$ ). It is not strictly anticipatory, because A has acted; but a more realistic view of “action” would make it comprehend the entire sequence of acts that must occur before there will be full information about A's and B's legal entitlements. So if A has acted (perhaps by passing a statute potentially but not certainly applicable to B) but the impact of the act on B is not yet determinable (perhaps because the scope of the statute is unclear and has yet to be defined by the government agency responsible for enforcing it), an immediate suit by B to invalidate the statute would be, functionally, “anticipatory.”<sup>49</sup>

B would have an interest in bringing such a suit if his expected recovery were greater than if he waited. This condition is more likely to be fulfilled the smaller

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<sup>49</sup> Suits for injunctions, or motions for preliminary injunctions, which we have classified as anticipatory, are usually of the same character: the defendant has already acted, but the plaintiff sues before he has been injured, or injured badly.



Type I error is (by which A would escape liability for harming B); the greater Type II error (for such error means that B collects from an “innocent” A—one who would be exonerated from liability in a ripe suit); and the greater the litigation cost savings to B from an early suit.<sup>50</sup> We showed in part I that the greater Type I and Type II error is, the lower is the social benefit of anticipatory adjudication and the more likely that the benefit will actually be negative. So deeming a suit “unripe” is a convenient label for refusing to adjudicate a dispute when the social benefit from waiting probably exceeds the increase in cost, if any, of deferring adjudication until more information is available. In some cases there will be no increase in cost from waiting: Either the availability of additional information facilitates convergent estimates of a trial outcome and so makes settlement more likely, or B’s fear that A’s action will injure him proves groundless so that there is no ex post litigation at all.

In the case of a collusive suit, which often will be motivated by the parties’ desire to obtain authoritative legal advice in order to guide their choice of actions, the court will lack the benefit of an adversary presentation. The likelihood of legal error will again be great. Anglo-American courts lack adequate staff to investigate and resolve factual and legal questions without the aid of the parties, and that “aid” will be warped if the parties agree on the outcome of the case. As in the case of an unripe suit, greater legal error will reduce the benefit of both anticipatory and ex post adjudication.

Let us examine the case in which, after a full trial and a decision by the trial court, and while the case is pending on appeal, something happens to “moot” the case. Maybe the plaintiff was a food distributor suing for permission to sell some exotic food that he had imported into this country, the food had been impounded pending the resolution of the suit, and while impounded the food spoiled and now can no longer be sold. The appeals court will dismiss the suit as moot, without reaching the merits. And yet, on the one hand, since all the relevant facts bearing on the controversy over the denial of permission exist and are unaffected by the fact that the case has become moot, error costs would not be increased by the appeals court’s deciding the case; while, on the other hand, since the plaintiff can no longer benefit from winning the suit, why doesn’t he just abandon it, in which event the issue of mootness would itself be moot? The first point suggests that cases shouldn’t be dismissed on grounds of mootness, the second that the issue of mootness is unlikely to arise.

The point about error costs is correct. The second point, however, ignores the fact that once the case has been submitted and is awaiting decision, A’s

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<sup>50</sup> Let B’s expected recovery equal  $p_a D - C_a$  in the unripe suit and  $p_e D - C_e$  in the ripe suit where  $p_a$  and  $p_e$  are defined as before— $p_a$  reflects legal error because the suit being unripe is anticipatory. The difference between B’s expected recovery in the unripe and ripe suit will equal  $[(1 - p_e)\square_2 - p_e\square_1]D + (C_e - C_a)$  which is more likely to be positive the greater  $\square_2$ , the smaller  $\square_1$ , and the greater  $C_e - C_a$ .

incremental litigation cost is zero and A may expect to undertake similar acts in the future. Thus the issue becomes one of anticipatory adjudication—the value of a decision in the present case provides guidance or resolution in a subsequent suit. In our hypothetical case, a decision that provides information on the lawfulness of A's act—even though B's dropping the case gives A the go-ahead to act now and receive  $X$ —may be valuable to A because he thinks he may someday want to import a similar food again. A favorable decision will have precedential value to him, while an adverse decision will allow him to escape a future liability by avoiding the commission of an act that is sure to be sanctioned. But it is unclear whether the social benefit from deciding a moot case is positive. Apart from the cost to the judiciary of deciding the case, the benefit of the decision will be less than if the parties had an actual dispute to be settled, because the probability of their having a future dispute is less than 1. Nevertheless, the legal-error costs are lower than in other cases where anticipatory adjudication is refused. In the special case of an issue capable of repetition but avoiding judicial review (say the legality of abortion, where a challenge to an abortion statute will be mooted after nine months by the birth of the child, but the woman anticipates a subsequent pregnancy that she may want to abort), courts allow a “moot” case to be decided. The case is technically moot because by the time it is decided the woman will have either had the abortion or had the child. But since *ex post* adjudication is therefore infeasible—should she again get pregnant and again sue to invalidate the statute she will again be unable to obtain an adjudication before her pregnancy ends—the incremental legal-error costs of anticipatory adjudication are actually negative, because anticipatory adjudication is the only available method of avoiding an erroneous denial of legal rights.

In all of these cases, although we have been emphasizing error costs, an equally important consideration is that the value of anticipatory adjudication is less, the smaller the likelihood that *ex post* adjudication will occur if anticipatory adjudication is refused. A central concern of the “case or controversy” requirement of Article III (which subsumes such doctrines as ripeness, mootness, no advisory opinions, and standing) is with avoiding the costs of anticipatory adjudication when the adjudication is likely to be not a substitute for an *ex post* adjudication but a net addition to the judicial workload.

When we turn to the doctrine of standing, we encounter an aspect of justiciability that is only tangentially related to anticipatory adjudication, although the underlying concern with legal error as a basis for refusing adjudication is similar. The conventional rationale for the requirement of standing is that if a plaintiff isn't tangibly hurt by the defendant's conduct, or, hurt or not, doesn't have anything tangible to gain from a judgment against the defendant, he won't put up a good fight and the court will face a one-sided presentation, which will increase the risk of legal error. This is the ground on which federal taxpayers are barred from bringing suits to challenge public

spending programs that may result in an increase in federal income tax rates and citizens are barred from challenging government programs that they dislike but can't demonstrate a common law type of injury from (maybe the challenged program degrades the environment—in another country). Yet it is apparent that the organizations which bring such suits have both the desire and the resources to mount a vigorous defense of their position, so that the court will in fact have the benefit of a balanced adversary presentation of the relevant factual and legal issues.

Two economic rationales can be conjectured for the doctrine of standing when it is applied to bar suits by nonvictims. The first, illustrated by the examples of taxpayer and citizen suits, is that it cuts down on the role of interest groups in the litigation process, perhaps in recognition that, almost by definition, such groups have effective political remedies. Second, in some cases rules of standing are necessary in order to allocate property rights to legal claims. If A violates B's legal rights to B's injury, but anyone can sue to redress the violation, B's rights may be illusory. Lacking effective legal protection, he may substitute some less efficient method of self-protection. Potential tort victims, for example, may take excessive care to avoid being injured, if their ability to obtain compensation for a tortious injury is undermined by a litigation derby, even though it might be more efficient for potential injurers to take more care instead. The social function of legal rights will therefore be impaired.<sup>51</sup>

### *Conclusion*

We have developed an economic model to examine a variety of issues united by the common thread that a person or firm is seeking a ruling from a court or agency in advance of the sort of actual or imminently threatened harm that is required for a classic adjudication. We have argued that the traditional reluctance of generalist courts, such as the federal courts, to engage in anticipatory adjudication can be explained on economic grounds. We further have argued that the apparent exceptions to this reluctance, as well as the more receptive attitude of administrative agencies toward anticipatory adjudication, can also be explained in terms of the elements of our model. Our analysis suggests that there are many issues within the forbidding (to economists) domain of federal jurisdiction and administrative law that can be illuminated by economics, as well as connected with the aid of economics to subjects, such as res judicata, criminal punishment of preparatory acts, preliminary injunctions, and anticipatory breaches of contract, that generally are believed to belong to separate and unrelated fields of law.

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<sup>51</sup> In an earlier article we analyzed the benefits of giving victims a property right in their suit rather than allocating this right on a first come, first serve or other basis. See William M. Landes and Richard A. Posner, "The Private Enforcement of Law," 4 *Journal of Legal Studies* 1 (1975).

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