A RESPONSE TO PROFESSOR REILLY'S *INCENTIVIZING CORPORATE AMERICA TO ERADICATE TRANSNATIONAL BRIBERY WORLDWIDE*: WHAT IS THE ROLE OF UNCERTAINTY IN DISCLOSURE OF NON-COMPLIANCE?

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Professor Peter Reilly's article[1] makes a significant contribution to the literature on the Federal Corrupt Practices Act. Corrupt business practices are immoral and, albeit potentially profit maximizing for a firm that escapes detection, have no social utility. Ideally, there should be complete compliance; realistically, we know that the world is not perfect. Professor Reilly's article deals with an important question: Upon discovery of a violation, how is voluntary disclosure maximized?[2] Starting from the premise that voluntary disclosure is a good thing, the article argues that government should provide greater transparency regarding specific and calculable benefits that can be achieved through self-reporting.[3] The focus is on reducing the uncertainty around the potential reward for self-reporting; positive incentives are made clearer.[4] If the risks and rewards are calculable, the argument goes, a corporation can make the necessary calculation that, in the end, would result in greater degree of voluntary disclosure.

In this response, for the purpose of stimulating thought and debate, I play the devil's advocate and explore how uncertainty of outcome can possibly affect disclosure.[5] For starters, one could plausibly argue that clearer exposition of the benefit of disclosure should not affect the frequency of disclosure so long as either (1) the probability density of the potential spread of outcomes is known and normally distributed, or (2)

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1. Peter R. Reilly, *Incentivizing Corporate America to Eradicate Transnational Bribery Worldwide: Federal Transparency and Voluntary Disclosure Under the Foreign Corrupt Practices Act*, 67 FLA. L. REV. 1683 (2015).

2. *Id.* at 1686.

3. *Id.*

4. *Id.* at 1725, 1731–32. In this response, I assume, as Professor Reilly does, that discovery of a violation does not automatically result in voluntary disclosure. *Id.* at 1686. Professor Reilly quotes a partner in a leading national law firm: "Voluntary disclosure is a business decision . . . . What are the costs and benefits?" *Id.* (quoting Laurence Urgenson, Partner at Mayer Brown LLP, who is quoted in Rachel Louise Ensign, *Why Companies Might Opt to Self-Report Potential Bribery Issues*, WALL ST. J. (Nov. 2, 2014)).

5. This response is generally informed by the law and economic scholarship dealing with the relationship between uncertainty and liability. *See generally* Tom Baker, Alon Harel & Tamar Kugler, *The Virtues of Uncertainty in Law: An Experimental Approach*, 89 IOWA L. REV. 443 (2004); Richard Craswell & John E. Calfee, *Deterrence and Uncertain Legal Standards*, 2 J.L. ECON. & ORG. 279 (1986); John E. Calfee & Richard Craswell, *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 VA. L. REV. 965 (1984).

the uncertainty is such that the corporation has no other option but to assume an equal probability distribution of outcomes under the principle of indifference.[6]

Suppose the following: P = probability of discovery of misconduct, S = sanction for misconduct, B = benefit gained from self-reporting of misconduct. Assuming that a rational, risk neutral company seeks to minimize sanctions, the company has the following choice to make.

Cost of disclosure (C_d): $C_d = S - B$

Cost of non-disclosure (C_n): $C_n = P \times S$

If these variables were known more clearly,[7] the decision criteria would be fairly clear: if $C_d > C_n$, don't disclose; if $C_d < C_n$, disclose; if $C_d = C_n$, indifferent. A simple algorithmic cost-benefit analysis will drive the decision.

Now, suppose we introduce some uncertainty around the benefit of self-reporting, a margin of uncertainty noted as: $\pm E$. The cost of self-disclosure must be rewritten as:

Cost of disclosure (C_d^*): $C_d^* = S - B \pm E$

In the final outcome, the uncertainty can disappoint (+E) or delight (−E) the self-disclosing corporation in its negotiation with the government. If so, what is the new calculus for each of the three previous situations?

Case 1: $C_d = C_n$. In this case, the corporation is indifferent between disclosure and non-disclosure. The introduction of uncertainty does not change the behavior of the firm. If ($C_d = C_n$), then the new outcomes are either [($C_d + E$) > C_n] or [($C_d - E$) < C_n] with equal probability of either outcome. The net result is that there is still indifference with risk neutrality.

Case 2: $C_d > C_n$. In this case, the corporation would not disclose. However, consider what happens when uncertainty is introduced. If the uncertainty works to the disappointment of the corporation (+E), then:

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6. There is a significance between true uncertainty and risk. *See* Robert J. Rhee, *Toward Procedural Optionality: Private Ordering of Public Adjudication*, 84 N.Y.U. L. Rev. 514, 548 (2009) ("Many years ago, Frank Knight distinguished the concepts of risk and uncertainty: risk connoting a future state of known distribution, and uncertainty connoting a future state of unknown distribution or imperfect information.") (citing Frank H. Knight, Risk, Uncertainty and Profit 233–34 (Dover 2006) (1921)). The principle of indifference states "two events are equally probable if we have no reason to suppose that one of them will happen rather than the other." Robert J. Rhee, *A Price Theory of Legal Bargaining: An Inquiry into the Selection of Settlement and Litigation under Uncertainty*, 56 Emory L.J. 619, 654 n.160 (2006) (citing M.G. Bulmer, Principles of Statistics 8 (1979)).

7. For example, statistical notions of probability govern the probability of discovery, the quantum of penalties and benefits, and the probability of assessment for each quantum of penalty and benefit.

$$C_d{}^* > C_d > C_n$$

The corporation would have more incentive not to disclose, but the added incentive does not change behavior. The result is still no disclosure (only with a firmer conviction now). Under this situation, the frequency of disclosure does not change. However, if the uncertainty works to the delight of the firm (—E), then:

$$C_d > C_d{}^* \ [<=>] \ C_n$$

Since $(C_d > C_d{}^*)$, it is now unclear whether $(C_d > C_n)$. A situation of non-disclosure would flip to disclosure if: $E \geq (C_d - C_n)$. This also suggests that as uncertainty increases, there would be greater frequency of disclosures (which is intuitive since if $E = S$, disclosure is a certainty).

In a case where the corporation would not disclose at the outset, with the introduction of uncertainty, there would be an increase in disclosures because: (1) the downside does not change the frequency of non-disclosure; (2) the upside changes the cost-benefit analysis to a potential point where it increases the frequency of disclosure.

Case 3: $C_d < C_n$. In this case, the corporation would disclose. If the uncertainty works to the disappointment of the corporation (+E), then:

$$C_d < C_d{}^* \ [<=>] \ C_n$$

Where previously the cost-benefit analysis suggested disclosure, non-disclosure may be better in a set of cases. If the uncertainty works to the delight of the firm (—E), then:

$$C_d{}^* < C_d < C_n$$

The corporation would have more incentive to disclose, but the added incentive does not change behavior. The result is still disclosure (only with a firmer conviction now).

In a case where the corporation would disclose at the outset, with the introduction of uncertainty, there would be a decrease in disclosures because: (1) the downside changes the cost-benefit analysis to a potential point where it increases the frequency of non-disclosure; (2) the upside does not change the frequency of disclosure.

Thus far, the introduction of uncertainty seems to work a wash. In some circumstances in which there would otherwise be non-disclosures $(C_d > C_n)$, there would be a subset of cases where there would be some disclosure when *E* offsets or exceeds the difference. In some circumstances that would otherwise be disclosures $(C_d < C_n)$, the effect would be the opposite. We would expect this to be the case because we assumed an expectation by the corporation of either a normally distributed *E* or the application of the principle of indifference.

However, the effect of uncertainty is not so deterministic. There are

several factors that are subject to varying degrees of uncertainty. In addition to the uncertainty surrounding the benefit gained from self-reporting *B* (the specific concern in Professor Reilly's article), a corporation cannot be certain of the probability of discovery *P* and the potential level of sanction *S*.[8] This suggests that in fact the level of disclosure is subject to the expected levels of *S* and *B*, and the uncertainty associated with *P*, *S*, and *B*. If the level of *S* is sufficiently high, there will be perfect compliance with the law. If the benefit of disclosure equals the sanction (B = S), there will be perfect disclosure. Several intuitions then follow.

The incentive to disclose is a function of the magnitude of *B* in relation to the outcome and the uncertainty associated with non-disclosure. If the magnitude of *B* is high and the corporation knows it, then there will be a high frequency of disclosure. However, from a policy perspective, this might not be a good thing if the net sanctions (S — B) are so light that corporations are not sufficiently deterred from corrupt practices. It's a slap on the wrist. If *P* is fairly high and the uncertainty surrounding S is fairly moderate (assuming the world is not ideal from the perspective of the corporation with a high magnitude *B*), then the corporation would desire a high degree of uncertainty surrounding the magnitude of *B*. In essence, the corporation would have a call option. The floor is fairly known and the disclosure represents a potential upside. Therefore, the magnitude of *B* cannot be high *and* known. Also, if the uncertainty surrounding *B* could allow for the possibility of a high magnitude *B*, it could incentivize disclosure where the adverse alternative is fairly known.

The most difficult cases to assess are where there are significant uncertainties all around. The probability of detection is difficult to assess; the magnitudes of *S* and *B* are variable; the probabilities of the magnitudes of *S* and *B* are significant. It is the proverbial crap shoot, which is not an inaccurate description of a difficult situation a corporation may find itself upon learning that its employees or agents engaged in corrupt practices. In such situations, the corporation's only control lever may be its sense that it can affect the magnitude of *B* during its negotiations. Perhaps this is unrealistic, but perhaps as in criminal law or litigation in general the conduct of a party may ultimately bear on the liability. If post-disclosure conduct constitutes an element of the uncertainty of the ultimate outcome *ex ante*, the corporation may have an incentive to disclose despite a high level of uncertainty. In other words, if an algorithmic cost-benefit analysis fails for reason of high uncertainty all around, a person may desire the outcome that grants the possibility, at least, of control over the uncertainty, though it may have been an illusion

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8. *See* 15 U.S.C. § 78ff (setting varying levels of penalties).

ex post. Ironically, there must be some uncertainty, or more properly described flexibility in the standard, for the possibility of controllability to affect behavior.

By suggesting the potential link between uncertainty of the benefit of disclosure and the rate of disclosure, Professor Reilly's article makes an important contribution toward conceptualizing the liability and deterrence scheme under the Federal Corrupt Practices Act. One important policy end is to incentivize the self-reporting of violations. Professor Reilly is correct to note that, for a subset of cases, reducing uncertainty surrounding the benefit of self-reporting may result in greater voluntary disclosure. However, a plausible argument could be made that some degree of uncertainty in the standard can both advance the interest of the government and the corporation.