Securitizing American Justice

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SECURITIZING AMERICAN JUSTICE

In a world of scarcity, governments must balance their limited resources with their unlimited wants.¹ The rational governmental actor seeks to maximize societies’ utility by efficiently and effectively deploying its scarce resources.² To achieve this objective, governments often hire the private sector to provide goods and services.³ The belief behind this move is that the private sector may be more effective at allocating these scarce resources than the public sector.⁴

A relatively new scheme that appears to meet this criteria is the public-private partnership (“PPP”).⁵ The PPP is a securitization vehicle used by governments to raise capital from private investors.⁶ This method allows governments to create a net-positive social and economic benefit to society because governments can provide a much needed infrastructure project (a social benefit) while simultaneously encouraging private investment.⁷ While securitization can be an effective means to raise money for critical infrastructure projects, the potential to securitize key components of the justice system threatens to impose significant social costs. Not only does it run the risk of failing to meet short-term public policy objectives, such as reducing prison costs, overcrowding, and recidivism, but it also may undercut societies’ perception of an effective justice system. Citizens’ distrust of the justice system can have real social and economic costs: one need only look to the riots in Ferguson, Missouri (2014), and Baltimore, Maryland (2015).⁸

² Id.
⁴ Id.
⁵ MICHEL FLEURIET, INVESTMENT BANKING EXPLAINED: AN INSIDER’S GUIDE TO THE INDUSTRY 1040 (McGraw-Hill eds., 2008).
⁶ Id.
⁷ Id.
I. PPP Case Study: Beneficial Outcomes of Securitizing Government Assets

The overhaul of the Chicago Skyway Toll Road ("CSTR") is a prime example of how securitizing a government asset can maximize social utility. In 2005, Chicago hired Goldman Sachs to help the city raise $1.8 billion dollars to rebuild the then-dilapidated CSTR. Based on Goldmans' advice, Chicago determined that the best method to fund the project was to sell debt-instruments backed by future revenue generated from the CSTR. In other words, Chicago looked to securitize the CSTR to attract private investment. To do this, Chicago and Goldman entered into a PPP. The City of Chicago then sold Goldman a 99-year lease to own & operate the CSTR. In turn, Goldman created a special purpose entity ("SPE") to sell institutional investors long-term debt backed by future toll revenue generated from the CSTR. The sale of these asset-backed bonds generated approximately $1.4 billion dollars to fund the project. By purchasing bonds issued to build the CSTR, investors bore the cost of the project. However, their investments were secured by the future toll revenue from the CSTR. At the other end, Chicago was able to provide the public with a much needed infrastructure project without risking taxpayer money.

Securitization of the CSTR project was largely successful because the project generated a net-positive social and economic benefit: it provided Chicago with a desperately needed infrastructure while spurring industry and investment. When this type of financing is used to fund infrastructure projects, it can clearly produce a positive social and economic benefit. However, this strategy may not produce such benefit when used in the legal system. This can be determined from looking at how private investment in the criminal justice system and lawsuit funding has fallen short of reaching public

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9 Fleuriet, supra note 5.
10 Id.
11 Id.
12 Id.
13 Id.
15 Fleuriet, supra note 5, at 1051.
16 Id.
17 Id.
18 Id.
19 Id.
20 Id. at 1040.
policy objectives. Specifically, it has failed to reduce prison costs, recidivism, overcrowding, and improved access to justice. More broadly, it has discredited the justice system as a whole.\footnote{Infra Part III.}

II. PRIVATIZING THE JUSTICE SYSTEM


In the criminal justice system, privatization was a promising tool meant to cut prison operating costs, alleviate inmate overcrowding, and reduce recidivism.\footnote{See Dana Joel, A Guide to Prison Privatization, HERITAGE FOUND. (May 24, 1988), http://www.heritage.org/research/reports/1988/05/bg650-a-guide-to-prison-privatization.} In 2010, a study found that forty states spent a total of $39 billion on their prison systems for the fiscal year.\footnote{Christain Henrichson & Ruth Delaney, The Price of Prisons: What Incarceration Costs Taxpayers, VERA INST. (Feb. 29, 2012), http://www.vera.org/pubs/special/price-prisons-what-incarceration-costs-taxpayers.} This money was spent on the six million individuals under “correctional supervisions.”\footnote{John W. Whitehead, Jailing Americans for Profit: The Rise of the Prison Industrial Complex, HUFFINGTON POST: CRIME (Apr. 10, 2012, 6:51 PM), http://www.huffingtonpost.com/johnwwwhitehead/prisonprivatization_b_1414467.html.} PPPs were set up to allow private enterprises to finance, design, build, and operate correction facilities and services.\footnote{Leonard C. Gilroy et al., Public-Private Partnerships for Corrections in California: Bridging the Gap Between Crisis and Reform, REASON FOUND. & HOWARD JARVES TAXPAYER FOUND., APR. 2011, AT 1, 3–4 (Apr., 2011), http://reason.org/files/private_prisons_california.pdf.} It was believed that the private sector would compete for these lucrative government contracts by offering competitive prices and high quality services.\footnote{Id. at 19.} Geo Group, Inc. and American Corrections Corp. of America are two publicly traded companies that were created to profit off of prison privatization.\footnote{Fleuriet, supra note 5, at 1051.} The problem with these PPPs, was that Federal and State
governments paid these contractors per inmate housed. These contractors generally contracted with states to build prisons with at least 1,000 beds, maintain an occupancy rate of 90%, for a term of at least twenty-years. Thus, instead of helping reduce the prison population, and cut costs, contractors were perversely incentivized to house as many inmates as cheaply as possible. This avenue would ensure a steady flow of revenue that could be distributed back to shareholders.

Another area of the justice system that ended up leading to negative results was the emergence of third-party litigation financing. In this scheme, a third-party funds litigation for a share of the eventual recovery. There are two ways potential investors can gain access to award damages: 1) they can contract with the litigants themselves or 2) they can contract with the litigant’s attorney to take a percentage of the attorney’s fees. The success of these ventures has attracted the attention of institutional investors such as Swiss bank, Credit Suisse, and Allianz. This practice has given rise to litigation finance firms whose operations are focused solely on funding legal claims. Buford Capital is one of these firms that is publicly traded on the NYSE and has approximately $500 million worth of assets under management. Scholars argue this form of financing reduces access to justice by encouraging litigants to bring claims that otherwise may have not been brought without outside funding. However, an investor’s goal to maximize returns on funding legal claims does not necessarily match-up with the broader legal policy of improving access to justice. The reason here is that investors are more likely to fund litigation where the existing law advantages plaintiffs. Thus, these

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29 Id.
30 Id.
31 Id.
33 Id.
35 Shepherd, supra note 32, at 3.
37 Shepherd, supra note 32, at 3.
38 Id.
39 Id.
investors tend to fund claims of corporate litigants who have a significant chance of obtaining substantial judicial awards.\textsuperscript{40}

As demonstrated in the above sections, private investors are making significant sums of money off ventures that appear to minimally advance the interests of justice. This has caused some to feel as though the justice system is being co-opted for the benefit of big business.\textsuperscript{41} More importantly, critics feel this bias renders the system unable to legitimately produce fair and equitable results. Combine this with the fact that only 31\% of Americans believe the justice system is effective, and it seems very likely that people may look outside the justice system to solve their disputes.

\textbf{III. JUSTICE FOR SALE-SECUORIZING THE AREAS OF THE JUSTICE SYSTEM}

Securitization of government projects through the use of PPPs, combined with corporate penetration into various aspects of the legal field, makes it conceivable that the next step in this field is to securitize some of these ventures. Currently, nothing is stopping a major company like American Corrections Corp. from issuing securities backed by government leases or service contracts in the prison industry. Like the CSTR project, investors can hold bonds secured by income derived from housing inmates. As for litigation financing, it seems logical that the next step in the industry would be to securitize potential damage recoveries. Much like mortgage-backed securities, investors would potentially be able to own tranches of litigation-backed securities. However, all this runs the risk of further misaligning private and public interests through complicated security transaction. More issues would be created for an already flawed justice system. The idea that elements of the justice system can be bought and traded runs the risk of further distorting societies’ own sense of justice.

If federal and state governments want to avoid such problems, they need to better align private and public interest in this area or completely ban the activity. A start would be to pay private prisons based on performance rather than volume of prisoners. Furthermore, more must be done to ascertain the legality of litigation financing because it distinctly hints of claim assignment - something prohibited under the law. These preliminary measures may guide

\textsuperscript{40} Id.
\textsuperscript{41} Banking on Bondage, supra note 22.
the future of justice-system investment. To do any less will send a powerful message to the public that justice is for sale.

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