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# SCHOLARLY PERSPECTIVES

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# REGULATORY CAPACITY AND STATE ENVIRONMENTAL LEADERSHIP: CALIFORNIA'S CLIMATE POLICY\*

Ann E. Carlson

California has led the country on environmental policy since at least the 1960s, when it first tackled the state's notorious air pollution. But in the last decade, its role as an environmental leader has eclipsed its own impressive history. California has enacted the world's most ambitious policy to tackle greenhouse gas emissions. Its program to do so—and some musings on the reasons for its leadership—are the focus of this essay.

I. INTRODUCTION

California's climate policy seems categorically different from its past environmental leadership. The state is not simply regulating a single product (say, automobiles) or a particular sector of the economy (say, electric utilities). Nor is it tackling a problem of particular importance to the state (say, air pollution). Instead, the effort to regulate climate change is truly an economy-wide one. And the state is engaging in this extensive regulatory activity even though reducing greenhouse gas emissions will produce very few environmental benefits for California given the global nature of the problem of climate change.<sup>1</sup>

Scholars have long puzzled over why some states emerge as environmental leaders. Explanations range from the political benefits such leadership can produce for political actors,<sup>2</sup> to perceived economic benefits,<sup>3</sup> to the political preferences of a state's voters.<sup>4</sup> All of these seem to explain at least a portion of California's climate change leadership.

In a separate article I have suggested that still another part of the causal story is that federal law has created state environmental leaders through a complex dynamic I call iterative federalism—the idea here is that federal law has singled out a state or group of states to engage in regulatory experimentation, experimentation that has then led to federal adoption of the policies that have emerged from the experiment, which has in turn led to state innovation and so forth. The two notable examples of iterative federalism are both contained in the Clean Air Act: California's designation as the regulatory leader on automobile emissions and the Northeastern states' authority to regulate ozone pollution on a regional basis. These designations have, I argue, led to state and regional leadership on climate change.<sup>5</sup>

Here I want to concentrate on a related—but distinct—part of the story about climate change leadership in California. The story is less about *why* California has taken the lead (voter preferences, for example, are obviously relevant), though I think my story is relevant to causality. My focus instead is on *how* California has been able to do so—not just to pass ambitious legislation but to implement, largely on time, a regulatory program of vast and complex scope. My story here is a relatively simple but largely overlooked one: prior to enacting ambitious climate change legislation, the state had created regulatory institutions of extraordinary sophistication and capacity and real political agility. Without such regulatory capacity, the state simply could not lead as ably or quickly as it has.

My claim, then, has relevance to the larger debate about federalism and environmental leadership. In addition to already proffered theories about why some states engage in aggressive environmental regulatory activity, I suggest that a state's regulatory capacity is an important part of the story. Regulatory capacity does not, of course, exist in a vacuum. States lead in a particular environmental area and develop regulatory expertise necessary to implement their environmental policies. But that regulatory expertise can, in turn, lead to further environmental leadership, which can in turn solidify and enhance regulatory expertise. Regulatory expertise and environmental leadership, in other words, are mutually reinforcing in ways we have previously overlooked.

Of course an important factor in a state using its regulatory capacity to engage in additional environmental policy making is previous regulatory success. A state is less likely to engage in ambitious new environmental regulation unless its previous efforts have succeeded, both politically and in measurable environmental outcome. Such past regulatory success—in particular in air pollution regulation—helps explain why California has been willing to lead on climate change regulation. In repeatedly achieving demonstrable regulatory success by reducing automobile emissions, California's Air Resources Board (CARB) has won the confidence of both the public and of elected officials. Federal law has played an important role here: by singling the state out to lead on mobile source emissions under the Clean Air Act, the federal government has encouraged the development of significant regulatory expertise.<sup>6</sup> That regulatory expertise has, in turn, led to the state legislature relying on CARB to develop ambitious climate policy.

But there is also more to the story. While federal law granted California special status, it did not require the state to actually use that status, nor did the federal government direct California in how to use its leadership role. In the 40 years of experience under the Act, California's air board has developed into one of the most sophisticated and well-regarded environmental agencies in the world. The agency has managed to remain popular through most of its decades of existence. It seems to have managed, too, to avoid being captured by the industry it most regularly regulates, the auto industry. Why

and how, then, has the agency managed to develop such independence and expertise?

I briefly suggest several possible explanations in this article. These explanations are meant to stimulate a broader conversation about what creates effective bureaucratic administration and about what makes certain states environmental leaders in a broader federal system. For example, the structure of the CARB—which is also the agency implementing California’s climate change legislation—has been important to the state’s regulatory successes. CARB is regulated by an independent board comprised of political appointees that come from a variety of pre-designated professional backgrounds.<sup>7</sup> This structure appears both to insulate the board from intense political partisanship and agency capture while at the same time providing it with politically accountable leadership. The agency is also well-funded, with a dedicated revenue stream financed by regulated parties. This funding mechanism has largely, though not completely, insulated the agency from California’s fiscal woes and has provided the agency with the budget necessary to fund a large and professional staff.<sup>8</sup> And the agency has had continued and visible success in its primary mission—reducing air pollution—that has made it trusted and popular among legislators.

In highlighting these features of California’s regulatory agency, I do not mean to downplay more conventional explanations for the state’s leadership. California’s voters across the political spectrum, for example, are supportive of strong environmental policies—they recently turned back an initiative to halt the implementation of the state’s climate policies with conservative, rural counties joining their coastal, urban counterparts in doing so.<sup>9</sup> California’s political leaders campaign openly on pro-environmental platforms; indeed the most notable was a Republican, Governor Arnold Schwarzenegger, who not only signed AB 32 into law but consistently championed the legislation.<sup>10</sup> My aim, instead, is to highlight a feature of California governance—its regulatory competence—that has helped make such leadership possible and effective.

Before describing the environmental regulatory capacity California has created, I set forth below the parameters of California’s plan to implement its climate legislation. I focus in particular on one of the principal components of the plan, a cap-and-trade program to regulate large industrial and energy sources, in order to demonstrate the breadth and sophistication of the regulatory effort. But I first provide an overview of and background about the central components of the state’s climate plan. I then turn to some of the distinctive qualities of California’s lead regulatory agency on climate policy, including its funding sources, its political structure and its size, in order to provide at least a partial explanation for the state’s climate accomplishments.

California's first significant legislation addressing climate change regulation, passed in 2002, ordered CARB to develop greenhouse gas emissions standards for automobiles.<sup>11</sup> The state followed the car standards in late 2006 with a much more sweeping bill, AB 32, the California Global Warming Solutions Act.<sup>12</sup> AB 32 required California to roll back its greenhouse gases to 1990 levels by 2020 and largely delegated the determination of how to do so to CARB. The legislation did include a number of deadlines, along with guidance to the Board about how to carry out its task, but is remarkable for its relative brevity: the entire legislation is 10 pages long. By way of comparison, the only comprehensive climate bill to pass a house of Congress, the American Clean Energy and Security Act (also known as Waxman-Markey), was 1,427 pages.<sup>13</sup>

The 10-page bill delegating broad authority to CARB contained a rather Herculean task: cut the state's emissions by 20 percent (the amount necessary to achieve 1990 levels) with no adjustment for population or economic growth. California is expected to add more than four million people between 2010 and 2020, according to the state's Department of Finance (significantly lower than pre-recession projections but still an increase of 11.5 percent).<sup>14</sup> CARB is to achieve these reductions by 2020 and to have a fully operational mandatory cap in place by January 1, 2012. The legislation also required CARB to meet several other important deadlines, including setting the overall emissions budget to be achieved (set by CARB in December 2007 at 427 metric tons of CO<sub>2</sub>e); the preparation and approval, by January 1, 2009, of a scoping plan setting forth the measures the state will take to achieve the emissions budget (approved in December of 2008);<sup>15</sup> and the adoption of a mandatory reporting rule by January 1, 2008 (approved).<sup>16</sup>

The magnitude of CARB's scoping plan to implement the state's emissions goals is impressive. It includes a Renewable Electricity Standard of 33 percent by 2020;<sup>17</sup> a Low Carbon Fuel Standard;<sup>18</sup> Regional Transportation Targets for local governments (required by a separate bill, SB 375);<sup>19</sup> vehicle efficiency measures including the use of low friction oil and solar reflective automotive paint and window glazing;<sup>20</sup> power requirements for ocean-going vehicles while in port;<sup>21</sup> a Million Solar Roofs program;<sup>22</sup> energy efficiency measures for residential, commercial and industrial sources;<sup>23</sup> and a cap-and-trade program covering 85 percent of the state's emissions.<sup>24</sup> In addition, the scoping plan relies on emissions reductions from automobile standards that are now federal in nature but that began as state standards developed by CARB.<sup>25</sup> Each of these programs is independently complex: the Regional Transportation Targets, for example, require CARB to develop greenhouse gas emissions targets for each of 18 metropolitan planning organizations around the state. These MPOs must then prepare plans to demonstrate how they will meet their targets; CARB must in turn approve the plan or

require the MPO to submit an alternative plan.<sup>26</sup> The point here is not to catalogue the complexity of each independent scoping plan measure, but rather simply to show how far reaching and complicated CARB's regulatory efforts are.

The cap-and-trade program is in some sense the centerpiece of CARB's efforts, covering 85 percent of the state's emissions.<sup>27</sup> Some of the emissions reductions required under the cap come from complementary policies that require sources to reduce emissions in mandated ways (for example the 33 percent Renewable Energy Standard will require the state's utilities to shift away from carbon-intensive fuels to alternative ones, with concomitant greenhouse gas emissions reductions that will help them meet their emissions reduction requirements under cap-and-trade).<sup>28</sup> But the cap will require covered entities to make additional reductions and will ensure that the state meets its overall emissions reduction goals even if the complementary policies fail to produce their expected reductions.

C. AB 32 and  
Cap-and-Trade

The sophistication of the state's cap-and-trade program is worth highlighting both because the program is so central to the accomplishment of the state's goals and also to illustrate the complexity of the regulatory task CARB faces.

As with all cap-and-trade programs, its basic parameters are as follows: A total amount of allowable pollution is set (the cap). Those subject to the cap are allocated allowances (in sum equal to the cap) that allow them to pollute (one ton per allowance, with the total number of allocated allowances equal to the cap). And emitters may meet their allocated amount in one of three ways. They may use all of their allowances. They may cut their pollution to levels below the amount they've been allocated and trade/sell the excess allowances to those who need them. Or they may pollute in excess of the amount of allowances allocated and make up the difference by purchasing allowances from those emitters who don't need all of theirs.<sup>29</sup>

California's program covers 600 facilities. It began in 2012 with electric utilities and large industrial facilities and will expand to include fuel distributors in 2015. The cap will decline two percent annually until 2015 and three percent annually beginning in 2015.<sup>30</sup> The cap-and-trade program will allow emitters to bank allowances for use in future years and will allow a three-year compliance period in order to allow for year over year changes in production and output.<sup>31</sup>

The cap-and-trade program will also allow emitters to use offsets—emissions reductions from outside the capped sector—to meet a portion of their compliance obligations (up to eight percent). CARB has adopted four offset protocols: Urban Forestry, Livestock Manure, Ozone Depleting Substances destruction and U.S. Forest projects.<sup>32</sup> The genesis of these offset protocols has its roots in state law, but with extensive

assistance from a non-profit organization, Climate Action Reserve. CAR, as it is known, began as a sister organization to California's Climate Action Registry, established by state law in 2001 to begin voluntary greenhouse gas emissions reporting.<sup>33</sup> CAR is incorporated as a non-profit and includes on its board leading state officials (both past and present), including the California Secretary for Environmental Protection. Additional members include local California officials, representatives of stakeholder groups like the California Farm Bureau, Shell Oil, local utilities and the Natural Resources Defense Council, and international officials from Canada and Mexico.<sup>34</sup> Its funding comes from account holders who register with the Climate Action Registry.<sup>35</sup> CAR's task is to develop stringent offset protocols through a multi-stakeholder process for use in North American carbon markets.<sup>36</sup>

CARB has adopted but modified four of CAR's offset protocols. Many, but not all, of the changes are technical ones designed to incorporate the offset protocols into a regulatory system. Some, however, are more substantive: CARB modified the Urban Forestry protocol, for example, to disallow greenhouse gas emissions reductions from building energy use that CAR believes will result from an increase in urban tree planting.<sup>37</sup>

In addition to the substantive provisions of its cap-and-trade program, the state has adopted a sophisticated suite of measures to maximize the liquidity and transparency of its cap-and-trade market. These include emissions registries requiring annual reporting of emissions, the reporting of spot market prices, quarterly auctions, a requirement that investor-owned utilities sell their allowances and receive the proceeds, and the establishment of an allowance reserve that will make a certain number of allowances available at a pre-established price in the event that prices spike.<sup>38</sup>

Though one can quarrel with certain of the provisions CARB has adopted—many observers support the auctioning of allowances rather than giving them to emitters as CARB has largely done, for example, and the question of offsets remains a controversial one—the agency appears to have used the experience of other cap-and-trade programs to learn from the mistakes of those programs and to borrow their best practices. For example, the most controversial cap-and-trade program to date, at least among Californians, is the South Coast Air Quality Management District's (SCAQMD) Regional Clean Air Incentives Market (RECLAIM) program. RECLAIM established a cap-and-trade program for utilities and large industrial facilities to limit NO<sub>x</sub> and SO<sub>x</sub> emissions.<sup>39</sup> The program is notable for being the only cap-and-trade program to date to breach its cap—when total pollutants emitted exceeded the capped amount allowable—during the 2001 energy crisis in California. Allowance prices per ton of pollutant had averaged below \$2,000 per ton, but in 2001—with record temperatures and an energy market reeling from partial deregulation—demand for energy spiked dramatically. The region's utilities increased output, hence increasing emissions of the capped pollutants, but



failed to have sufficient allowances to meet their allocated amounts under the program. Allowance prices spiked to a high of \$124,000 in 2000. Rather than cutting emissions, the utilities breached the cap. In response, SCAQMD pulled the utilities out of the program.<sup>40</sup>

CARB appears to have heeded lessons learned from the RECLAIM program by building in several mechanisms to avoid unanticipated allowance price spikes. These include allowing for banking, which provides flexibility to emitters to meet their allowance allocation burdens; using a three-year compliance period; establishing an allowance reserve program to provide a set percentage of allowances at a pre-established price in case of a price spike; independent market monitoring and so forth.<sup>41</sup> The EPA had criticized the RECLAIM program for, among other things, failing to build in sufficient flexibility for emitters to meet their allocation obligations and CARB appears to have followed the EPA's recommendations by building in more flexibility.<sup>42</sup> In a recent study of the potential for gaming and market manipulation in CARB's cap-and-trade program, we concluded that "CARB's proposed carbon market is much less vulnerable to market manipulation than the California power market was in 2000-01."<sup>43</sup>

The RECLAIM example is but one of several that illustrate the ways in which CARB has structured its program to avoid mistakes of other programs and to use their best practices. CARB has taken measures to improve offset integrity, learning from mistakes made by the European Union in its European Trading System; improve transparency in emissions reporting, again learning from the ETS experience; and improve the regulation of the allowance spot market based on the experiences of several cap-and-trade programs, including the Acid Rain Trading Program and the ETS.<sup>44</sup>

Of course until the cap-and-trade program has fully incorporated all emitters and has operated for several years, it is impossible to know whether it will accomplish its goals of cutting emissions cost-effectively and in a manner that allows for a relatively smooth functioning of the market it is creating. But so far it has succeeded in creating a carbon market with the highest allowance prices in the world (necessary to stimulate innovation and to adequately price the externalities carbon emitters create) while maintaining stability in prices.<sup>45</sup> Whether or not California's cap-and-trade program achieves all its goals, my aim here is merely to demonstrate that the agency has approached the task of adopting and implementing its program with sophistication and timeliness.

The preceding section is meant to show that CARB's accomplishments in implementing AB 32, to date, demonstrate rather remarkable regulatory capacity. The agency has in five years put together an economy-wide plan to cut carbon emissions dramatically through an array of sophisticated policy mechanisms that will touch virtually every sector of the economy. The mechanisms include land use regulations, a low carbon fuel standard, automobile standards, a Renewable Electricity standard, a cap-and-trade

D. AB 32  
Accomplishments

program and sector-specific measures aimed at large sources like ocean-going vessels.

Two other observations are worth making about the five-year process to implement AB 32. First, CARB has implemented AB 32 on time. Indeed the agency has met virtually all the deadlines established in the original AB 32 legislation: to adopt mandatory reporting of emissions by January 1, 2008 (Health & Safety Code Sec. 38530(a)); to set a statewide emissions limit both for 1990 and 2020 (since the statutory goal is to cut greenhouse gases to 1990 levels by 2020) by January 1, 2008 (Health & Safety Code Sec. 38550); to identify by June 30, 2007 and adopt implementing regulations by January 1, 2010 for “discrete, early action greenhouse gas emission reduction measures that can be implemented prior to the” implementation of the statewide cap (Health & Safety Sec. 38560.5); to prepare a scoping plan setting out “the maximum technologically feasible and cost-effective reductions in greenhouse gas emissions . . . by 2020” (Health & Safety Sec. 38561); to adopt regulations by January 1, 2011 to implement the measures that will be required to meet total emissions limits, with the regulations becoming effective January 1, 2012 (Health & Safety Sec. 38562).<sup>46</sup>

Though meeting statutory deadlines may seem like an unremarkable achievement, CARB’s actions contrast rather dramatically with the Environmental Protection Agency, which is notorious for missing deadlines. Indeed before issuing its performance standard to reduce greenhouse gas emissions from electric utility steam generating units, the EPA faced a deadline set by court order. The parties agreed to extend the deadline but the EPA failed to meet the second deadline as well.

A second major accomplishment is that CARB has been able to stay on schedule in implementing AB 32 through two different gubernatorial administrations, one Republican (Schwarzenegger) and one Democratic (Brown), and through four different Board Chairs (Dr. Alan Lloyd, Cindy Tuck, Dr. Robert Sawyer and current chair Mary Nichols).<sup>47</sup> Again as a point of contrast, it is hard to imagine the EPA experiencing a change in presidential and secretarial leadership when the executive branch changes political parties without experiencing significant upheaval and delay in implementing a major policy change.

### III. CARB AND REGULATORY CAPACITY

**M**y point in recounting CARB’s experience in implementing AB 32 is not that the choices CARB has made are perfect, or even the best choices they could have made. I mean simply to demonstrate that their technical and political success in implementing a program of extraordinary complexity has required significant agency competence that is a necessary underpinning of California’s climate leadership. California could not have implemented such wide-ranging climate policy without the extraordinary regulatory capacity it has developed over the past several

decades. Indeed it is not at all clear the California legislature would have passed AB 32 without the confidence that its lead agency on the legislation possesses such extraordinary capacity. One of the most influential environmental legislators in the state, Senator Fran Pavley (author of California's mobile source greenhouse gas legislation), was at the time of AB 32's passage a member of the Assembly and a leading co-author of the bill.<sup>48</sup> Pavley expressed certainty that the bill might never have passed had it contained a detailed plan for reducing emissions and that the Legislature's confidence in the competence of CARB is what made passage possible.<sup>49</sup> It seems hard to imagine that the Legislature would have vested power in CARB to devise an economy-wide program that will regulate virtually all aspects of the state's economy unless it had tremendous confidence in CARB's regulatory capacity. And whether or not the sophistication of CARB is what led to the bill's success, it seems uncontroversial to say that its regulatory capacity has made possible the on-time implementation of an extraordinarily ambitious program to reduce greenhouse gases.

What is less clear is exactly how the state has built such sophisticated capacity. I offer several preliminary suggestions.

CARB's budget structure plays an important role in its regulatory success. Between the time AB 32 passed in 2006 and the implementation of the cap-and-trade program CARB adopted as part of its delegated authority, California experienced one of the worst budget crises in its history. Each of the fiscal years beginning in 2009 required the closing of massive budget deficits in the tens of billions of dollars. The state made huge spending cuts to virtually every program in the state, from education to the judiciary.<sup>50</sup> CARB, however, was largely (though not completely) immune from the budgetary crisis facing other state programs.

From 2007-08, prior to the recession, to 2012-13, CARB's staffing went from 1151.8 positions to 1273.2 positions, with no decline in between.<sup>51</sup> Much of the increase was from the new program to implement AB 32 but the agency's other programs also held their own. That's because the agency receives the vast majority of its funding from fees raised from regulated parties. These funds include the Air Pollution Control Fund, the Vehicle Inspection and Repair Fund, and the California Ports Infrastructure, Security and Air Quality Improvement Account.<sup>52</sup> And, importantly, as of July 2010, CARB established—based on statutory authorization contained in AB 32—the AB 32 Cost of Implementation Fee Regulation. The new regulation imposed fees on approximately 300 large greenhouse gas emitters, including natural gas distributors, cement manufacturers and electricity generators, among others. The fee funds all of CARB's program administrative needs. Additionally, prior to the implementation of the fee, CARB was allowed to borrow program start-up funds, funds it is now paying back with the AB 32 fees.<sup>53</sup>

CARB's revenue stream benefits the agency in a number of ways. It allows agency leaders to plan the implementation of programs going forward with the assurance that funds will be available to hire necessary staff. Because CARB sets the fees based on its own anticipated program needs, it can set the fees at the amount necessary to cover what the agency actually needs for implementation. And guaranteed revenue streams also insulate CARB from the types of political pressures other agencies—most notably the federal Environmental Protection Agency—routinely face in the budget process. EPA's efforts to regulate greenhouse gas emissions, for example, have routinely faced drastic budget cuts by House Republicans, though to date those efforts have not succeeded.<sup>54</sup> CARB's record of on-time implementation of extraordinarily complex regulatory programs is due in no small part to the fact that the agency has the staff necessary to carry out its responsibilities. This is a luxury not afforded to government programs that lack their own protected revenue.

## 2. CARB's Organizational Structure

CARB has two organizational attributes that may contribute to its regulatory competence. First, it has a board appointed by the Governor with Senate approval that includes representatives from the state's four largest air districts and requires representation by people with expertise in automotive engineering, the health effects of air pollution and either law, science or agriculture. The board members serve part time except for the chair, who is drawn from the board's membership and serves full time.<sup>55</sup> This combination of expertise combined with political accountability may work particularly effectively in providing leadership that is both expert and politically sensitive. Second, the agency has a staff that is highly professional and well-paid. The staff includes highly technically competent engineers, sophisticated lawyers, high level policy experts, and salaries that can exceed \$115,000 annually, combined with generous health and pension benefits.<sup>56</sup> The professional expertise and compensation seems obviously key to attracting and keeping highly competent staff, a necessity for the development of a regulatory scheme as wide-ranging as AB 32.

While independent budget lines and a well-staffed agency are important conditions for regulatory success, they do not by any means guarantee that an agency will pursue strong and well-crafted environmental policy.

## 3. Success Begets Success

California's early and ongoing successes in regulating air pollution—with demonstrable results—provide an obvious metric for observers, including elected officials, to have faith in the agency. This faith can, in turn, translate into protection from significant budget cuts and willingness to delegate broad authority to the agency. And the positive reputation of the agency has a number of additional benefits, including the ability to attract top-notch staff and receive some political protection during pitched battles with regulated parties and other interested communities over regulatory approaches.

The successes CARB has achieved in reducing air pollution are too lengthy to describe in detail here. But several examples help illustrate the point. CARB's principle jurisdiction in regulating air pollutants is over mobile sources (local air districts have principle responsibility for stationary sources). Since 1970, the state has cut nitrous oxide emissions from cars by more than 99 percent.<sup>57</sup> More generally, a 2003 quote from then-CARB Chairman Alan Lloyd describes the success of California's Low Emissions Vehicle regulations as follows:

[W]e've seen the near impossible accomplished with gasoline vehicles: zero evaporative emissions, exceedingly clean exhaust—cleaner, in some cases, than the outside air entering the cabin for ventilation purposes, and emission control systems that are twice as durable [as] their conventional forbearers, forecasted to last an astonishing 150,000 miles.<sup>58</sup>

The decline in automobile emissions, combined with stationary source regulation, has led to rather remarkable achievements in overall air quality. In the South Coast basin, for example, which leads the country in air pollution, the decline in the number of days in violation of the federal one hour ozone standard is staggering. Between 1973 and 1980, the basin violated the standard 644 times; between 2003 and 2011, by contrast, the district violated the standard *a total of 2 times in 8 years*.<sup>59</sup>

These successes are real and visible to political leaders and their constituents. And the success of the agency, combined with its statutory power to regulate mobile sources, led to the first legislation to regulate greenhouse gas emissions prior to the adoption of AB 32. AB 1493, passed in 2003, delegated to CARB the task of developing the country's first greenhouse gas emissions standards for automobiles.<sup>60</sup> Despite intense legal and political battles over whether the state had the legal authority to issue such standards, when President Obama was elected president he used the state's standards to negotiate with the auto manufacturers and extend the standards to the rest of the country.<sup>61</sup> Again, success appears to have begotten more success for the agency, lending it credibility and continued support from political leaders. Senator Pavley, who authored AB 1493, said that "CARB had done a great job with AB 1493.... And since auto emissions are the most significant contributor to GHG emissions in the state, they could use their proven expertise on mobile sources and expand to stationary sources too."<sup>62</sup>

In short, CARB's success in reducing air pollution and its long experience regulating automobile emissions led the legislature to entrust it with the power to develop the country's first greenhouse gas emissions standards for cars. When CARB accomplished that task with such success, the legislature had the faith to delegate vast amounts of regulatory power to the agency to implement an economy-wide climate program. CARB's history, in other words, led to its future.

#### IV. CONCLUSION

Many factors contribute to state environmental leadership, many of which have received significant scholarly attention. My aim here is to suggest that a state's regulatory capacity is one previously overlooked explanation for why a state may emerge as an environmental leader in a particular substantive area. I also aim to begin a conversation about what leads to successful regulatory capacity, focusing here on agency structure, revenue sources and history as potentially important variables.

- \* Ann E. Carlson is the Shirley Shapiro Professor of Environmental Law at UCLA School of Law and the Faculty Co-Director of the Emmett Institute on Climate Change and the Environment. I thank faculty participants in workshops at Emory and Minnesota Law Schools for extremely helpful comments. This article is an abridged version of Ann E. Carlson, *Regulatory Capacity and State Environmental Leadership: California's Climate Policy*, 24 *FORDHAM ENVTL. L. REV.* 63 (2013).
1. See J.R. DeShazo & Jody Freeman, *Timing and Form of Federal Regulation: The Case of Climate Change*, 155 *U. PENN. L. REV.* 1499, 1516-1520 (2007); Kirsten H. Engel and Barak Y. Orbach, *Micro-Motives and State and Local Climate Change Initiatives*, 2 *HARV. L. & POL. REV.* 119, 120-122 (2008).
  2. See DeShazo & Freeman, *supra* note 1, at 1519.
  3. See Engel & Orbach, *supra* note 1, at 132; Barry G. Rabe, Mikael Roman, & Arthur N. Dobelis, *State Competition as a Source Driving Climate Change Mitigation*, 14 *N.Y.U. ENVTL. L. J.* 1, 32-42 (2005).
  4. See Richard L. Revesz, *Federalism and Environmental Regulation: A Public Choice Analysis*, 115 *HARV. L. REV.* 553, 636-41 (2001).
  5. See Ann E. Carlson, *Iterative Federalism and Climate Change*, 103 *Nw. L. REV.* 1097, 1099-1100 (2008).
  6. *Id.* at 1138.
  7. *About the Selection of Our Board*, CAL. AIR RES. BD., <http://www.arb.ca.gov/board/about.htm> (last updated May 2, 2013).
  8. AB 32 implementation is funded by a fee imposed on greenhouse gas emitters, the authorization for which was contained in the original legislation. CAL. HEALTH & SAFETY CODE § 38597 (West Supp. 2014); see also *AB 32 Cost of Implementation Fee Regulation*, CAL. AIR RES. BD., <http://www.arb.ca.gov/regact/2009/feereg09/feereg09.htm> (last updated Aug. 22, 2011).
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  16. See AB 32, *supra* note 12.
  17. See *California Renewable Energy Overview and Programs*, CAL. ENERGY COMM'N, <http://www.energy.ca.gov/renewables/> (last updated April 10, 2013).
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  20. *Status of Scoping Plan Recommended Measures*, CAL. AIR RES. BD., 1, 4, [http://www.arb.ca.gov/cc/scopingplan/status\\_of\\_scoping\\_plan\\_measures.pdf](http://www.arb.ca.gov/cc/scopingplan/status_of_scoping_plan_measures.pdf) (last visited June 18, 2014).

21. *Id.* at 4.
22. *California's Climate Plan*, CAL. AIR RES. BD., 5 (Jan. 27, 2010), [http://www.arb.ca.gov/cc/facts/scoping\\_plan\\_fs.pdf](http://www.arb.ca.gov/cc/facts/scoping_plan_fs.pdf).
23. *Id.* at 5.
24. Though CARB is the principal regulatory agency implementing AB 32 it does have help from the California Energy Commission and the Public Utilities Commission, both of which have authority over the Renewable Electricity Standard program. *RPS Program Overview*, CAL. PUBLIC UTIL. COMM'N, <http://www.cpuc.ca.gov/PUC/energy/Renewables/overview.htm> (last updated Mar. 1, 2013). The Energy Commission also has authority over energy efficiency programs, including appliance and building standards. *Building Energy Efficiency Program*, CAL. ENERGY COMM'N, <http://www.energy.ca.gov/title24/> (last visited June 18, 2014).
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26. *2010 California Regional Transportation Plan Guidelines*, CAL. TRANSP. COMM'N, 137 (Apr. 12, 2010), [http://www.catc.ca.gov/programs/rtp/2010\\_RTP\\_Guidelines.pdf](http://www.catc.ca.gov/programs/rtp/2010_RTP_Guidelines.pdf).
27. *See California's Climate Plan*, *supra* note 22, at 1.
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29. For an explanation of cap-and-trade, see ROBERT N. STAVINS, BROOKINGS INST., A U.S. CAP-AND-TRADE SYSTEM TO ADDRESS GLOBAL CLIMATE CHANGE 8-9 (2007).
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31. *Id.*
32. *Compliance Offset Program*, CAL. AIR RES. BD., <http://www.arb.ca.gov/cc/capandtrade/offsets/offsets.htm> (last updated June 11, 2014).
33. *See About Us*, CLIMATE ACTION RESERVE, <http://www.climateactionreserve.org/about-us/> (last visited June 18, 2014).
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39. *See Regional Clean Air Incentives Market*, S. COAST AIR QUALITY MGMT. DIST., <http://www.aqmd.gov/home/programs/business/about-reclaim> (last visited June 18, 2014).
40. For an extensive analysis of RECLAIM, see Cutter et al., *supra* note 38, at 17, 43-46.
41. *Id.* at 4-7.
42. *Id.* at 18.
43. *See* Cutter et al., *supra* note 38, at 44.
44. *Id.*
45. Justin Gillis, *A Price Tag on Carbon as a Rescue Plan*, N.Y. TIMES, May 30, 2014, <http://www.nytimes.com/2014/05/30/science/a-price-tag-on-carbon-as-a-climate-rescue-plan.html>.
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- (CEQA). The lawsuit required CARB to revise its Environmental Impact Report in order to consider alternatives to cap-and-trade more fully. As a result, the cap-and-trade program will begin as scheduled on January 1, 2012 and will include at least two auctions during the 2012 calendar year but emitters will not face compliance obligations until January 1, 2013.
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  48. *See All Things Considered: California Lawmakers Adopt Tough Climate Rules*, NAT'L PUB. RADIO, (Aug. 31, 2006), available at <http://www.npr.org/templates/story/story.php?storyId=5744849>.
  49. Conversation with Senator Fran Pavley, California Senate (Sept. 11, 2011), confirmed in e-mail between Senator Pavley and author (Jan. 15, 2013) (on file with author).
  50. *California Budget Crisis*, N.Y. TIMES, [http://topics.nytimes.com/topics/news/national/usstatesterritoriesandpossessions/california/budget\\_crisis\\_2008\\_09/index.html](http://topics.nytimes.com/topics/news/national/usstatesterritoriesandpossessions/california/budget_crisis_2008_09/index.html) (last visited June 18, 2014).
  51. *See Governor's Budget, 2009-10 Proposed Budget Detail: 3900 Air Resources Board, 3-Yr Expenditures & Positions*, CAL. DEPT. OF FIN., <http://www.ebudget.ca.gov/2009-10-EN/StateAgencyBudgets/3890/3900/spr.html> (last visited June 18, 2014); *Governor's Budget, 2013-14 Proposed Budget Detail: 3900 Air Resources Board, 3-Yr Expenditures & Positions*, CAL. DEPT. OF FIN., <http://www.ebudget.ca.gov/2013-14/StateAgencyBudgets/3890/3900/spr.html> (last visited June 18, 2014).
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  55. *See About the Selection of Our Board*, CAL. AIR RES. BD., <http://www.arb.ca.gov/board/about.htm> (last updated May 2, 2013).
  56. *See Classifications and Salaries*, CAL. AIR RES. BD., <https://web.archive.org/web/20131004031241/http://www.arb.ca.gov/personnel/transactions/clspay.htm> (last updated May 16, 2013) (accessed by searching for the relevant page in the Internet Archive Index).
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  59. *Ozone Trends Summary: South Central Coast Air Basin*, CAL. AIR RES. BD., <http://www.arb.ca.gov/adam/trends/trends2.php> (last visited Feb. 11, 2013).
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## Sharon Dolovich

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Professor Dolovich has conducted a landmark empirical study of the L.A. County Jail's practice of segregating vulnerable prisoners for their own protection. The first article growing out of this research, "Strategic Segregation in the Modern Prison," 48 *American Criminal Law Review* 1 (2011), received the Ezekiel Webber Prize and a 2012 Dukeminier Award. Her most recent article, "Two Models of the Prison: Accidental Humanity and Hypermasculinity in the L.A. County Jail," 102 *Journal of Criminal Law & Criminology* 965 (2012), also received these two honors. Among other projects, Professor Dolovich is currently focused on a critical examination of Eighth Amendment doctrine as it applies to prison sentences and prison conditions.



# TWO MODELS OF THE PRISON: ACCIDENTAL HUMANITY AND HYPERMASCULINITY IN THE L.A. COUNTY JAIL\*

Sharon Dolovich

This Article considers what can be learned about humanizing the modern American prison from studying a small and unorthodox unit inside L.A. County’s Men’s Central Jail.<sup>1</sup> As a formal matter, this unit—known as K6G—is the same as every other in Men’s Central, but for one key difference: its residents are exclusively gay men and transgender women.<sup>2</sup> In reality, however, life in the unit contrasts dramatically with life in the rest of the Jail. Most notably, whereas the Jail’s general population (GP) is almost entirely governed by rules created and violently enforced by racially stratified gangs, K6G is wholly free of so-called “gang politics” and the threat of collective violence (a.k.a. riots) that gang rule creates. K6G is also relatively free of sexual assault—no small feat given that the people housed in this unit would otherwise be among the Jail’s most vulnerable residents.<sup>3</sup> Although very far from ideal, in these and other ways, life in K6G is markedly safer and more humane than elsewhere in the Jail.

I. INTRODUCTION

A close study of K6G’s unusual environment strongly suggests that at least some of the destructive pathologies endemic in the Jail’s GP are not inevitable, even in a facility with the deep structural problems L.A. County confronts. These problems—including overcrowding, violence, gang control, and a “perverse” sexual culture in which the strong prey on the weak<sup>4</sup>—are not unique to L.A. County. To the contrary, many jail and prison administrators nationwide to some degree face the same issues. A clear understanding of how the K6G unit operates, what distinguishes it from GP, and how to explain the difference may thus have much to offer those committed to making life in custody safer and more humane, not only in L.A. County, but in prisons and jails all over the country.<sup>5</sup>

This Article is part ethnography and part policy assessment. What emerges is a portrait of two very different inmate cultures—the “two models” of the Article’s title. The first model, which reigns in the Jail’s GP units and to a greater or lesser extent in men’s prisons and jails all over the country, puts intense pressure on residents to seem “hard and tough, and [not] show weakness.”<sup>6</sup> This pressure, which I call the *hypermasculinity imperative*,<sup>7</sup> can feed a culture of belligerence, posturing, emotional repression, and ready violence that rewards both indifference to others and a willingness of the strong

to victimize the weak. In such an environment, gangs flourish and trauma abounds.<sup>8</sup> The second model, found in K6G, is free of any hypermasculinity imperative. In K6G, one instead finds a surprising sense of relative ease, along with open emotional expression, the overt development of mutually supportive friendships and intimate relationships, and demonstrations of creativity and even levity. One also finds in K6G a collective and determined rejection of any efforts to introduce into the unit either the gang code in force in the rest of the Jail or the racial segregation that goes with it.

What explains the difference? This is the puzzle this Article aims to resolve. At first, the answer may seem to lie in the sexual identity<sup>9</sup> of K6G's residents, who are (or are pretending to be<sup>10</sup>) uniformly gay men and trans women. And to be sure, the sexual identity of the people in K6G does help to explain the form of life that has emerged, which in turn contributes to the relatively healthy character of the unit. Yet the primary explanation for this character turns out to be much more basic, and not at all contingent on the sexual identity of the people K6G serves. Put simply, thanks to a variety of unrelated and almost accidental developments, K6G is a place where people feel safe enough to relax and be themselves.<sup>11</sup>

In men's prisons,<sup>12</sup> hypermasculine posturing is a mechanism of self-protection employed by people who feel vulnerable to harm; behind bars, people will only relax and let down their guard when they feel safe from physical or sexual violence. And as a general matter, all men in GP must be vigilant to avoid making a misstep in the wrong company that, by making themselves seem weak, could expose them to violence as well as ongoing harassment and abuse. By contrast, the relative ease of life in K6G exists not because K6Gs are gay and trans, but because they do not fear being victimized or violently punished by other prisoners for being themselves.

K6G thus suggests a dramatic possibility about the realities of contemporary American penalty, one that merits further attention and study: in American prisons and jails, prisoners' hypermasculine posturing and its ensuing pathologies arise not from an inherent preference for violence, but from a not-unreasonable belief that nothing else will secure their physical safety. To put the point another way, in many cases, it may not be the prisoners who make the prison, but rather the prison—and in particular the widespread failure of the system to treat those in custody as people deserving of protection—that makes the prisoners.

This Article draws on original research conducted in the Jail over seven weeks in the summer of 2007.<sup>13</sup> During that time, I observed the operation of K6G and the Jail more generally,<sup>14</sup> sat in on K6G classification interviews, spent countless hours in the officer's booth overlooking the K6G dorms, and had many informal conversations with unit residents, custody officers, and other staff.<sup>15</sup> I also conducted one-on-one

interviews, structured around a 176-question instrument,<sup>16</sup> with a random sample of K6G's residents.<sup>17</sup> The account of K6G offered here is based on data gathered through this process. In addition, over the course of my research, I learned much about life in the Jail's GP through the formal interviews, through informal conversation with a range of people with direct experience of the Jail's GP,<sup>18</sup> and through direct observation of the GP dorm that, due to its fortuitous proximity to the K6G dorms, served as my control.<sup>19</sup> The account of GP offered here is drawn from what I learned through these various channels, supplemented and reinforced by some of the many studies, articles, and personal testimonials that describe life in general population units in men's prisons and jails<sup>20</sup> around the country.<sup>21</sup>

**I**n significant ways, life in K6G is no different than life in GP. K6G is still jail, and locking people up inevitably inflicts all sorts of harms—physical, psychological, and emotional—even on those detained under model conditions. And K6Gs, as with people in the Jail more generally, hardly live in model conditions, as is clear from K6G's decrepit and dirty physical plant, crowding, random violence, usury, and so on. There are, however, some notable aspects of life in the unit that make K6G a more appealing prospect than GP. Most obviously, people in K6G feel far safer from physical and sexual violence than they would in GP. This difference was a constant and unmistakable theme in my interviews.<sup>23</sup> Also noteworthy was the range of answers given to the question: *If you had five words to describe life in K6G, what would they be?*<sup>24</sup> As one would expect from a description of life in jail, several of the listed words carried a negative connotation. But taking the responses to this question as a whole, even more remarkable is the number of words that suggested a *positive* experience of incarceration in K6G, including “fun” or “wow” (8), “exciting” (1), “easy,” “easier,” or “easy-going” (4), “relax” or “relaxing” (2), “nice” or “good” (3), “peaceful” or “calm” (3), “learning experience” (3), and “serene” (1).

K6G's appeal, and in particular its promise of relative safety, reaches well beyond its designated population, so that every day, men who are not gay pretend to be so in order to gain access to the unit.<sup>25</sup> By far the most common reason for the pursuit of safety through “reverse-passing” in K6G was the desire for a respite from the gang politics and consequent pressure and danger that define daily life in the Jail's GP.

In L.A. County's gang culture, there are four groupings into which prisoners are divided<sup>26</sup>: Blacks; Whites; “Sureños” or “Southsiders,” who are native-born Latinos from south of Fresno; and “Paisas,”<sup>27</sup> who are foreign-born Latinos.<sup>28</sup> Every single person in GP is expected to affiliate with one of these four racialized groupings, and to obey the rules they set down. At their most basic, these rules arise from two foundational principles: racial segregation<sup>29</sup> and mutual “respect.” The corollaries of these two principles are the two cardinal sins: racial mixing and interracial disrespect. Behavior is strictly controlled

II. GP AND K6G: TWO MODELS OF THE PRISON<sup>22</sup>

and rigidly policed by the gangs themselves to guard against transgressions, and the commission of any offense may bring swift and violent reprisal, often from the wrongdoer's own gang.<sup>30</sup>

The rigid observation of these rules means that, for the most part, life in the Jail's GP appears remarkably calm. It is, however, crucial to understand that this seeming calm masks the intense stress created for GP residents by the imperative to follow the rules or risk violent reprisal. It also masks the ever-present possibility of collective violence. In this highly calibrated system, collective violence—a.k.a., riots—can break out at any time. Often, the people who fight will not even know why they are fighting, but their knowledge of the reasons is irrelevant. The preeminent obligation for all prisoners caught up in this system is to “jump in” (i.e., join the fight) whenever the signal is given. Those who fail to respond to this signal know that they can expect to be violently punished by their own gangs once the dust has settled.<sup>31</sup> The system just described, with its rigid code of conduct and violent penalties for violations, is known in the Jail as “gang politics” or just “politics.” These politics make life in GP scary, stressful, and dangerous.<sup>32</sup>

Why are there no gang politics in K6G? The best way to answer this question is by exploring yet another notable difference between GP and K6G: the absence in K6G of any pressure to perform a hypermasculine identity. This hypermasculinity imperative<sup>33</sup> is a staple of life in GP, not only in L.A. County, but in men's prisons and jails all over the country,<sup>34</sup> in which literally hundreds of thousands of men<sup>35</sup> are spending their days doing their best to appear “hard and tough, and [not] show weakness.”<sup>36</sup> The archetype of the stoic, weightlifting, muscle-bound prisoner has its origins in this dynamic.<sup>37</sup> But in prison, displays of strength and toughness alone are not always sufficient proof of masculinity for men anxious about others' perceptions of their gender identities. In such an environment, any sign of weakness is like blood to sharks; it draws the abusive attention of other (fearful) men trying to avoid being victimized themselves. The imperative not to be seen as weak can dominate the lives of men in custody, especially in high-security facilities. Men cannot be perpetually violent, but they can be—and in the worst prison environments, must be—constantly vigilant lest they convey an impression of vulnerability. Among the qualities explicitly suppressed to this end are any that might be associated with femininity: emotional expression, sensitivity, kindness, etc. In this culture, these behaviors can be code for weakness and signal a person's availability for victimization.

The imperative of hypermasculine performance sparked by anxiety about gender identity is to a greater or lesser extent a feature of life in virtually all male-dominated environments.<sup>38</sup> But in prison, there is a second source of internal pressure to engage in this performance, one that may be expected to arise in contexts in which participants



are systematically regarded with some combination of contempt and indifference and thus routinely made to feel worthless and invisible. For men in this position, hypermasculine performance can provide a way to garner some power, status, and respect<sup>39</sup> in a climate that offers them few if any other means to do so.<sup>40</sup>

In the Jail's GP, gang politics and the hypermasculinity imperative are mutually reinforcing. On the one hand, the violent enforcement of the gang code elicits hypermasculine behavior by those eager to demonstrate compliance. On the other hand, the imperative to prove one's toughness and thereby command respect creates a constituency for the regime imposed by the gangs.

In K6G, neither of these forces is present. There are no gang politics; everybody "intermingle[s] with everybody,"<sup>41</sup> and efforts to organize K6G residents along gang lines get nowhere.<sup>42</sup> But there is also no hypermasculinity imperative. In K6G, there is no premium on seeming hard or tough, on being stoic, on suppressing one's feelings. As a consequence, the people in K6G are free to have relatively ordinary human reactions and interactions, and to be themselves.<sup>43</sup>

The absence of any hypermasculinity imperative in K6G distinguishes the unit from GP in other notable ways. Somewhat counterintuitively, K6G's freedom from gang politics and the pressure to perform a hypermasculine identity has the effect of making one-on-one physical altercations between dorm residents far more common in K6G than in GP. This is because, in the Jail's GP units, as in the California prisons, the gangs have a monopoly on inmate-on-inmate violence. By contrast, aggression in K6G is much looser. As one of my subjects explained it, "in K6G, I only have to worry about me fighting with another person, [over] a personal issue."<sup>44</sup> By contrast, "[in] general population, if they jump, if the others jump, I have to jump too."<sup>45</sup>

K6G thus poses a paradox: although K6G dorms are more overtly antagonistic than GP, more chaotic, more likely to be the site of physical altercations, K6G's residents—many of whom have previously done time in GP, whether in the Jail or in state prison or both—uniformly feel safer and more able to relax in K6G than they would in GP. That this situation seems paradoxical, however, only indicates the need for a more precise description of the violence GP inflicts, the safety K6G provides, and the (relative) humanity K6G represents. K6Gs know they still face an ongoing threat of physical violence in the K6G dorms. They might be the target of a random assault by someone who is mentally ill. They might be hurt by someone to whom they owe a debt. They might get into a brawl with someone they provoked or who provoked them. At the same time, however, they do *not* fear being the victim of sexual or physical predation because they are gay or trans or do not otherwise fit the model of the tough alpha male. And they do not fear being forced at a moment's notice to engage in physical violence against

people with whom they have no issue—indeed, whom they may affirmatively like and respect—in order to avoid being physically disciplined later for failing to jump in, or seeming weak in the eyes of men looking for ready victims.

There is another crucial dimension to the safety K6G provides—again, despite the real possibility of bodily assault from a number of quarters—that is largely separate from the threat of physical violence. I am referring here to the *psychological* violence of life in GP, and the *psychological relief* to be had from living in an environment where people need not be constantly on their guard against doing or saying anything that might violate the culture's strict behavioral norms or otherwise expose themselves as weak and thus as a target. In K6G, there is no hypermasculinity imperative, because there is no one in the unit with either an investment in having other people behave a certain way or the broad support required to implement a regime in which people are always being watched and judged. When, on occasion, a newcomer tries to “start something,” they are quickly shot down.<sup>46</sup> This freedom from scrutiny and the need to be on one's guard is a large part of what makes the place feel so safe. The sense of safety it confers is partly physical, because an environment where hypervigilance is required is one in which a person may be physically victimized if he fails to keep the mask in place. But again, it is also psychological, because once people are able to relax the vigilance and self-restraint, it becomes possible for them to stay connected to who they are and to the essential aspects of their personhood.

All this raises a question: if this is what violence and safety mean for the people in K6G—and arguably, by extension, for many people in the Jail's GP—what would humane carceral conditions look like? The experience of K6G suggests at least a partial answer to this question. Humane conditions are those in which people feel safe both from the threat of physical harm and from the need to be constantly on their guard, lest they say or do anything that might suggest human vulnerability. Humane conditions allow people to maintain and develop a connection to their own identity and sense of self. In this article, I identify several factors that have—almost accidentally—come together to make K6G a relatively safe and humane environment in these three important respects (i.e., protecting people from physical harm; affording them psychological relief from the need for constant vigilance; and creating mechanisms by which they can remain connected to—and to develop—who they are as people).

### III. WHAT MAKES K6G K6G?

#### A. Creating a Safe Space in the L.A. County Jail

W

hat explains this dramatic difference, the absence in K6G of destructive dynamics that are found not only in the Jail's GP but to a greater or lesser degree in many men's carceral facilities around the country?<sup>47</sup> It is tempting to try to explain the unusual climate of K6G by the sexual identity of its residents. And, as will be seen, sexual identity is not irrelevant here. But it would be

misguided to look no further than this factor to explain K6G's distinctive environment. K6G is full of people well acquainted with the GP code. Many have spent years in GP units pretending to be straight to avoid being victimized or escaping the worst effects of this cultural system by hooking up with a stronger prisoner, exchanging regular sexual access and obedience for protection from assault by others.<sup>48</sup> For people with direct experience of GP suddenly to relax and engage openly in the very behaviors known to endanger them elsewhere in the Jail, something more has to be true about their new environment besides simply being in close proximity to other gay men.

That "something more" is simple: unlike men in the Jail's GP, people in K6G independently feel sufficiently safe and protected that they do not have to posture or look to the gangs for protection. The puzzle then becomes: how, in a facility as violent and dangerous as Men's Central, have people in K6G come to feel secure enough to abandon many of the artifices on which men in GP routinely rely for self-protection? There is no single answer to this puzzle. Instead, my research suggests several factors that have come together to help create the conditions in which the people in K6G feel safe enough to relax and be themselves—factors that are only contingently connected to the sexual identity of people in the unit. These factors include: (1) an institutional commitment to rigorous implementation of the consent decree that first established K6G, and which requires strict physical separation between K6Gs and GPs at all times; (2) the fact that for almost its entire history, the unit has been run by the same two officers, who have treated unit residents with respect, evenhandedness, and concern for their well-being; and (3) the small size of the unit, which, together with a high recidivism rate and the automatic reclassification to K6G of former unit residents who return to the Jail, has fostered over time a sense of community and personal connection in the unit. There is also a possible fourth factor: the degree of attention K6G has received from outside organizations, media outlets, and even researchers like me.

Arguably, none of these factors alone would have been enough to make K6G's relative humanity possible. None, moreover, was the intended result of deliberate efforts to reduce the appeal of gang politics or hypermasculine performance. Instead, each emerged almost accidentally in the wake of the 1985 court order that created K6G. Together, they have helped create a relatively safe space in which hypermasculine performance is unnecessary. At the same time, the K6G experience demonstrates that, once the conditions of safety are in place, the resulting culture can have its own positive second-order effects, enabling the subsequent emergence of multiple avenues of healthy self-expression, which can in turn help to mitigate the destructive and dehumanizing effects of imprisonment and further promote a relatively healthy climate for the people inside.<sup>49</sup> In short, to a significant extent, K6G is a case of accidental humanity begetting a virtuous circle of desirable effects, a vivid contrast to the frequent inhumanity of incarceration in American prisons and jails and the vicious circle of violence and abuse it can yield.

B. Identity Theories:  
Looking to Sexual  
Difference

Thus far, the sexual identity of K6G's residents has been kept as much as possible on the sidelines so that the outsized salience of this factor would not obscure the other consequential differences between the two models. It would, however, be folly to suggest that K6G's unusual character has nothing to do with the sexual identity of unit residents. In what follows, I explore three possible ways that the sexual identity of K6G's residents might be thought to explain as a first-order matter the absence of gang politics and hypermasculine posturing in the unit. As will be seen, these claims rest to some extent on stereotypical characterizations. At the same time, as to each, more careful examination of the underlying premises turns out to deepen in significant ways our understanding of K6G's relatively safe and humane character, and to offer insights into how to make carceral conditions safer and more humane, not just for gay men and trans women, but for all people in custody.

1. They Can't

One possible explanation for the K6G difference is that K6G's residents, being gay or trans, are unable to perform a hypermasculine identity and thus to conform to the dictates of the gangs, which demand self-presentation as hard, tough, and potentially violent. There are obvious flaws in this explanation. For one thing, as Jeannie Suk rightly notes, heterosexuals have no monopoly on masculine performance.<sup>50</sup> Even more to the point, every day in prisons and jails around the country, gay men housed in GP units successfully conform their behavior to the hypermasculinity imperative to the degree demanded by their respective institutional environments. Certainly, being gay does not preclude gang membership,<sup>51</sup> as was evident from the many (temporarily inactive) gang members in K6G.<sup>52</sup>

Given that gay men and trans women are known to be at heightened risk of victimization in custody, it does seem likely that K6G houses a higher proportion of people<sup>53</sup> who are less able to successfully perform a hypermasculine identity.<sup>54</sup> Yet if K6G contains a disproportionate number of people likely to be victimized in GP, it also contains a sizable number of people who could—and have—successfully engaged in hypermasculine performance in GP. Those in this group know the game, can play the game, and have experienced first-hand the way that failing to do so in certain circumstances can put one at risk. It does, however, seem hard to credit the notion that, absent other contributing factors, the people in K6G—many of them repeat players with a long history of confinement in the Jail, in the state prison, or both—would put aside all they know about how to survive in custody just because others in the unit are weaker than they are. This is especially implausible since in the usual case, the presence of weaker people in one's housing unit is generally not a reason to leave off hypermasculine posturing but a welcome relief, since it means that one may not have to work as hard to avoid becoming a target. Other factors must therefore be at work. And as has been seen, in K6G, a host of structural conditions only contingently related to sexual identity of unit residents have come together to make those men otherwise

able to successfully perform a hypermasculine identity feel sufficiently safe and secure not to have to bother doing so, however many potential victims may be in the vicinity.

The evident appeal of K6G's less pressured environment suggests a second explanation for the K6G difference hinging on the sexual identity of K6G's residents: considering the relative ease of life in K6G, with the room it creates for emotional expression, meaningful interpersonal engagement, creativity, and even levity, unit residents would simply prefer not to play the game.<sup>55</sup> No doubt, there *are* men in custody who would choose the high-stakes, high-pressure atmosphere of a hypermasculine culture over the relatively relaxed and comfortable environment of K6G. But the fact that, given the choice, some men would prefer GP to K6G does not mean that this is true of all or even most men in custody. To imagine otherwise is to fundamentally misunderstand the experience of life in GP. Most of the men who perform a hypermasculine identity in the Jail's GP or in other GP units where this imperative governs do so not by choice, but because they feel they have no choice. Just because people play the game does not mean they do so willingly. To the contrary, given the stakes of unsuccessful hypermasculine performance in many men's carceral facilities, it seems more likely that, as to most people—gay or straight—participation in this “desperate and dehumanized context”<sup>56</sup> is driven far more by an understandable desire to avoid victimization than by enthusiasm for what the culture demands.<sup>57</sup>

2. They Don't  
Want To

There is yet a third possible explanation for the K6G difference grounded in the sexual identity of K6G's residents: the people in K6G eschew the hypermasculine culture of GP because they do not need what it provides. This is a more promising direction, which recognizes that men who conform to the dictates of GP's prison culture do so not because they prefer it but because they feel compelled.<sup>58</sup>

3. They Don't  
Need To

Four benefits in particular appear to accrue from hypermasculine performance: (1) *sexual satisfaction*, at least for those men prepared to “punk” or “turn out”—both euphemisms for rape—the weakest of their fellow prisoners, thereby reframing them as “female” and thus as desirable sexual partners;<sup>59</sup> (2) *proof of manhood*; (3) *safety* from men looking for weaker people to victimize; and (4) *respect*. The question then becomes: how is it that people in K6G can get these benefits without hypermasculine performance, but men in the Jail's GP cannot? And to what extent is the reason grounded in the sexual identity of unit residents? If sexual identity proves the whole of it, this would certainly seem to negate the generalizable lessons from the K6G experience. As we will see, however, sexual identity is not the whole of it. And it turns out that even where this factor does in part explain the K6G difference, it is still possible to distill generalizable insights from the reasons why.

Consider the first two benefits hypermasculine posturing provides men in GP: sexual satisfaction and proof of manhood. The open sexuality in K6G means that, as Suk puts it, people will be able to satisfy their “sexual orientation within the confines of the prison

by being sexually dominant will be able to express that identity through consensual sexual liaisons with other K6G residents who prefer to take a sexually subordinate role. Indeed, the presence in K6G of people with a range of gender identities means that even nonsexual interactions will regularly affirm the masculinity of male-identified residents of the unit. This is by contrast to GP, in which “prisoners [who] have very little communication with women ... feel as if they have lost certain features of their masculine identity.”<sup>61</sup>

K6G powerfully illustrates the humanizing effects of sexual expression,<sup>62</sup> both in terms of the sexual satisfaction it affords and as a means for reinforcing and affirming gender identity, i.e., the first two benefits of hypermasculine performance on our list. Realistically, for a variety of reasons,<sup>63</sup> the lack of access to women will continue to be among the “pains of imprisonment” for most men in custody for the foreseeable future.<sup>64</sup> Still, the K6G example underscores the importance for all prisoners of “conjugal visits” by spouses or lovers; of family visits that allow people in custody extended time with children outside the limiting and often oppressive environment of the visiting room; of weekend furloughs; and of any other programs that afford the opportunity for people to perform their preferred gender roles in a socially productive and personally affirming way. These programs would allow for sexual release, a valuable benefit in itself. More importantly still, “[m]aintaining healthy bonds with their children and spouses helps [male] inmates reaffirm their masculinity, and reduces their need to establish a manly self-image by victimizing other inmates.”<sup>65</sup>

The second generalizable lesson to emerge from recognizing the importance of the sexual satisfaction and secure gender identities K6Gs enjoy is entwined with the third benefit hypermasculine performance provides men in GP: physical safety. Without the assurance of physical protection, there would *be* no open sexuality in K6G. Simply being housed with their objects of desire is not enough; people also have to feel safe enough to act on their desires. The feeling of relative safety K6Gs enjoy, a benefit only contingently related to the sexual identity of unit residents, is the main reason people in the unit feel no need for hypermasculine posturing or gang involvement. But even assuming Suk is right that the pathologies found in GP arise to a large degree because heterosexual-identified men in custody lack access to their objects of desire, the K6G example is still instructive for the broader humanizing project, since it offers a model for protecting vulnerable prisoners from the pathological effects of this deprivation. In other words, even absent any possibility of wholly resolving the problem of sexual frustration in prison, the foregoing account of K6G at the very least offers insight into how to keep safe those people at risk of being victimized as a result.

Specifically, the K6G model suggests the wisdom of (1) identifying and separating out likely victims from likely predators for housing purposes;<sup>66</sup> (2) maintaining a strict boundary between likely victims and likely predators; (3) monitoring units in an ongoing way to identify emergent predators; (4) automatically removing predatory indi-

viduals as soon as they become known; (5) ensuring continuity of staffing as much as possible to allow staff to get to know the people in their custody as individuals; and (6) fostering a culture of respect toward people in custody as a way of, among other things, creating channels of communication between staff and prisoners that may help staff to identify threats and resolve problems when they arise.<sup>67</sup>

There is, however, one final urgent need hypermasculine posturing provides men in GP that bears consideration here, and that is *respect*. For men in prison, the experience of incarceration not only “besieges” their masculinity, but it can also systematically demean and humiliate them.<sup>68</sup> For at least some of these men, hypermasculine performance may be the only way they have to assure themselves (and others) that they matter. The harder and more dangerous a person can seem, the more others will be forced to pay heed.<sup>69</sup>

On this score, too, K6Gs turn out to be less dependent on hypermasculine performance to get what they need. And here again, the reason why is only contingently related to the sexual identity of K6G’s residents. Unfortunately, men in custody are often treated like “a breed apart, . . . the scum of the earth.”<sup>70</sup> By contrast, in a variety of ways, the people in K6G are made to feel like human beings who matter. The most obvious way is through the explicit institutional commitment to keeping people in K6G safe from physical harm—perhaps the ultimate form of respect. But there are other features of K6G that are also affirmatively humanizing in this sense. For example, K6G is a place where the officers in charge of the unit know everyone personally and are thus able to some extent to interact with them as *people* and not just as “inmates.”

There is arguably even something respectful and affirming in the Jail’s efforts to identify at intake which individuals are “homosexual”<sup>71</sup> and therefore belong in K6G. The notion that there might be something humanity-affirming about an official inquiry into people’s sexual orientation—for purposes of identity-based segregation, no less—is admittedly counterintuitive.<sup>72</sup> But K6G’s high recidivism rate means that, at any given time, most people in the unit have been there before, likely many times. This feature, combined with the fact that the benefits of K6G are common knowledge among people familiar with the Jail, means that most people who answer “yes” at intake to the question *Are you homosexual?*<sup>73</sup> (and indeed, many people who answer in the negative) know full well that an affirmative answer offers the prize of classification to K6G. In other words, most people who answer “yes” to this question at intake are glad to be able to do so and experience the inquiry as evidence of the Jail’s commitment to making sure that they will be kept relatively safe while in custody. We should not, in other words, overlook the humanizing power of simply acknowledging that people are worthy of official protection.

Of course, one should not overstate the validation and respect enjoyed by K6G's residents. People in K6G are still incarcerated, and still treated in many ways just like inmates.<sup>74</sup> But it nonetheless appears that, despite the many demoralizing and even humiliating aspects of life in the unit, K6G's residents are made in various ways to feel that their safety and well-being are issues of institutional concern. They thus have a sense that they are regarded as people who matter, despite their being incarcerated.

In this aspect of the K6G experience is a crucial lesson that is both eminently generalizable and self-evidently valid: people in custody should be treated as much as possible like human beings. Just as violence begets violence and chronic insecurity begets behaviors that instill fear in others, treating people with respect and consideration seems far more likely to spark a virtuous circle, promoting behaviors that will further promote humane, and humanizing, carceral conditions.

Perhaps the most destructive and dehumanizing aspect of life in the Jail's GP—and in other GP units where the hypermasculinity imperative governs—is the way it can require people to work so hard to suppress, and even in some cases to destroy, the most vulnerable and essential parts of themselves. By contrast, people in K6G not only do not need to suppress (and thus alienate themselves from) their core humanity, but they can engage in behaviors that allow them to connect to, nourish, and even develop their own personal identities and senses of self. They do this through sex and romantic relationships, yes, but they also do it through other forms of personal expression and interpersonal connection. When people in the unit laugh, sing or dance, and even when they complain, argue, or express unhappiness or irritation or jealousy, they are being human, manifesting natural human reactions that connect them to their authentic selves.<sup>75</sup> Life in K6G, like life in the Jail more generally, offers few socially productive channels for self-development.<sup>76</sup> Yet in the free space it creates for open emotional expression and honest interpersonal engagement, K6G allows unit residents the ability—all too rare in custody—to remember and to realize who they are.

If there is something to this account, it suggests the value of creating channels for men in GP to (re)connect to their core selves and of providing those who need it a way to develop a sense of themselves as something other than tough guy or gang member. Helping people in custody to grow as people and to cultivate self-respect might help to counter incarceration's most dehumanizing effects. Indeed, for those with positive self-images—as, for example, students, veterans, skilled tradesmen, husbands,<sup>77</sup> or fathers—hypermasculine posturing by fellow prisoners may well seem not just unnecessary but affirmatively absurd, a lot of foolish bluster.

Being forced to engage in hypermasculine posturing creates its own vicious circle; by severing people from a sense of their own humanity and forcing them into behaviors



more likely to prompt self-loathing than self-respect, it makes them even more dependent on the status and (fear-based) respect that successful hypermasculine performance can generate. The K6G experience, by contrast, suggests a crucial connection between being treated as human, the ability to feel and act human, and the refusal to adopt behavioral codes that only dehumanize both self and others. This may be the most important lesson K6G has to teach, and it has no necessary connection with the sexual orientation or gender identity of the people in the unit.



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1. In corrections, prisons and jails serve distinct purposes. Prisons provide long-term housing, typically for sentenced offenders serving terms of longer than one year, although the precise cut-off can vary by state. See Margo Schlanger, *Inmate Litigation*, 116 HARV. L. REV. 1555, 1579 n.76 (2003). Jails hold sentenced prisoners serving short terms, typically less than one year (although recent shifts in California in the wake of *Brown v. Plata*, 131 S. Ct. 1910 (2011), have led the state to require county jails to retain custody of “N3”—i.e., non-violent, non-serious, non-sex related—offenders for their full sentences, however lengthy, see Overview, *AB 109 & AB 117 Public Safety Realignment of 2011*, CAL. DEP’T OF CORR. & REHAB., [http://www.cdcr.ca.gov/realignment/docs/AB\\_109-PowerPoint-Overview.pdf](http://www.cdcr.ca.gov/realignment/docs/AB_109-PowerPoint-Overview.pdf) (last visited Jun. 4, 2012); Andy Furillo, *Sacramento Judge Sentences Drug runners to 13 Years Each in ‘County Jail Prison,’* THE SACRAMENTO BEE, Apr. 22, 2012, <http://www.sacbee.com/2012/04/21/4431234/sacramento-judge-sentences-drug.html>). In addition, jails house individuals awaiting trial but denied bail, convicted offenders awaiting sentencing, and prisoners sent from state or federal prison to serve as witnesses in trials, whether their own or those of others. See Schlanger, *supra*, at 1579 n.76. The role of jails in providing housing for detainees with court dates explains why jails are typically situated adjacent to courthouses, although L.A. County is so large that most Jail inmates with court dates have to be bused from the Jail to their respective courthouses.

Given these differences, it might be wondered what a study of life in a jail has to teach about life in prison. The answer is that, although there will be some significant differences between prisons and jails in terms of both operation and culture, the aspects of the Jail culture on which this Article focuses are also to be found to a varying degree in many men’s prisons and jails around the country. At the same time, the hypermasculinity imperative, although a staple of prison life, may be at its height in jail, when men who are on their way to prison look to make a reputation as someone not to be “messed with.” The high turnover typical of jails also increases the pressure on detainees to maintain a tough-guy image, since people are constantly being thrown into close quarters with new and unknown companions, any one of whom could prove to pose a threat. This is especially true in the L.A. County Jail, which admits over 160,000 people a year despite an average daily count of no more than 19,000. The massive size of the L.A. County Jail system compels repeat players to forge self-protective alliances with strangers—hence the strong gang culture. Thus although the hypermasculine culture found in the Jail’s GP is a standard feature of life in many men’s prisons, in the jail environment, the pressures are at their sharpest, which makes the jail an ideal context for the study of this phenomenon. One hopes that, with a commitment to meaningful reform and proper institutional design, that toxic culture might be replaced with one more like that of K6G, not only in L.A. County, but in all carceral facilities governed by a hypermasculinity imperative. See Terry Kupers, *Toxic Masculinity as a Barrier to Mental Health Treatment in Prison*, 61 J. CLINICAL PSYCHOL. 713, 714 (2005) (describing toxic masculinity as “the constellation of socially regressive male traits that serve to foster domination, the devaluation of women, homophobia and wanton violence” in male prisons).

2. The term “transgender” denotes people whose gender identity does not match their birth sex. Throughout this Article, I use the term “trans women” to refer to people who were born biologically male but who self-identify and self-present as women.

3. See HUMAN RIGHTS WATCH, NO ESCAPE: MALE RAPE IN U.S. PRISONS 52 (2001), available at <http://www.hrw.org/legacy/reports/2001/prison.report.html> (“[G]ay inmates are much more likely than other inmates to be victimized in prison.”); JUST DET. INT’L, LGBTQ DETAINEES CHIEF TARGETS FOR SEXUAL ABUSE IN DETENTION I (2009) (citing VALERIE JENNESS ET AL., VIOLENCE IN CALIFORNIA CORRECTIONAL FACILITIES: AN EMPIRICAL EXAMINATION OF SEXUAL ASSAULT (2007)), available at [http://justdetention.org/en/factsheets/JD\\_Fact\\_Sheet\\_LGBTQ\\_vD.pdf](http://justdetention.org/en/factsheets/JD_Fact_Sheet_LGBTQ_vD.pdf) (“67 percent of inmates who identified as LGBTQ reported having been sexually assaulted by another inmate during their incarceration, a rate that was 15 times higher than for the inmate population overall.”); VALERIE JENNESS, THE VICTIMIZATION OF TRANSGENDER INMATES, at slide 14 (2006), available at <http://ucicorrections.seweb.uci.edu/files/2013/06/Victimization-of-Transgender-Inmates.ppt> (“59% of [California’s] transgender population reported sexual victimization as compared to 4% of the general prison population.”).
4. See Wilbert Rideau, *The Sexual Jungle*, in LIFE SENTENCES 73, 75 (Wilbert Rideau & Ron Wikberg eds., 1992) (describing the “perverse [sexual] subculture” of Angola prison).
5. Of course, some realism is appropriate here. Even assuming that humane imprisonment is not an oxymoron—arguably an open question—making the conditions in American prisons and jails truly humane would require at a minimum a wholesale redesign of existing penal institutions and a significant drop in the number of people in custody. In the meantime, there are real people—at present, over 2.3 million of them, see *infra* note 35—being held in prisons and jails around the country. This simple fact creates an imperative to make current carceral conditions, if not wholly humane, then at least as safe and humane as possible.
6. See Derrick Corley, *Prison Friendships*, in PRISON MASCULINITIES 106 (Don Sabo et al. eds., 2001).
7. See Sharon Dolovich, *Strategic Segregation in the Modern Prison*, 48 AM. CRIM. L. REV. 1, 14-16 (2011).
8. See Craig Haney, *The Perversions of Prison: On the Origins of Hypermasculinity and Sexual Violence in Confinement*, 48 AM. CRIM. L. REV. 121, 128 (2011) (citing Nancy Wolff and Jing Shi, *Trauma in Incarcerated Persons*, in HANDBOOK OF CORRECTIONAL MENTAL HEALTH 277, 293 tbl. 11-3 (Charles L. Scott ed., 2nd ed. 2010)).
9. Throughout this Article, I use the term “sexual identity” as shorthand for the sexual orientation and gender identity of K6G’s residents. I do so for brevity’s sake only, and do not intend to suggest that the two are not distinct and very different categories.
10. There are almost certainly some men in the unit who are neither gay nor trans, but merely pretending to be so. I address this phenomenon at length elsewhere. See Dolovich, *supra* note 7, at 25-43.
11. K6G provides segregated housing for all gay men and trans women detained in the Jail. Before people may be admitted to K6G, classification officers must determine that they meet the standards for admission, meaning that they are found to be either “homosexual” or male-to-female transgender. See Dolovich, *supra* note 7, at 24 (explaining that the decision was made in the early 1990s to house the male-to-female transgenders in K6G with the gay men). Once admitted, K6G residents are kept physically separated from the rest of the Jail’s population. This program thus entails state-sponsored, identity-based segregation. In a companion piece, I address several objections that might be made to such an undertaking, and consider at some length whether, in light of its many admittedly troubling aspects, such a unit should even exist. Here, I focus instead on the ultimately far broader question of K6G’s implications: what life is like in a carceral unit populated exclusively by

gay men and trans women, the contrast between life in that unusual unit and life in GP, and what this contrast might teach us about making the experience of incarceration in general safer and more humane. I recognize that this enterprise may expose me to the charge that, by seeking the means to improve carceral conditions, I may only be further entrenching a fundamentally illegitimate penal system. This is a risk of reform efforts in any context. People must make their own calculations as to the right course, and, as I explain elsewhere, for me, the alleviation of immediate suffering is the greater imperative. *See id.* at 10-11.

12. In this Article, I focus on men's prisons, although some of the lessons to be drawn from K6G—most notably the need to keep people in custody safe from harm, to treat them with respect, and to provide access to humanizing pursuits—apply equally to women's prisons.
13. UCLA IRB # G07-01-106-03. For a detailed description of the research protocol, see Dolovich, *supra* note 7, at 92–99.
14. This enterprise was made possible by Chief Alex Yim, who generously allowed me open access to all parts of the facility.
15. I took lengthy field notes each day and dictated the notes each night, when what I had seen was still fresh in my mind.
16. I developed this instrument with the help of my colleague, Joe Doherty. It is published in its entirety at Dolovich, *supra* note 7, at 99–110.
17. *See id.* at 5 n.21 (explaining the constitution of my sample, including its racial makeup). In all, I interviewed thirty-two residents, almost 10% of the unit's population at the time. Interviewees were assigned random interview numbers. The interviews were recorded and later transcribed. Most interviews encompassed multiple audio files, which were saved—and therefore transcribed—alphabetically, with the sequence restarting each day. Citations to these interview transcripts will be referenced hereinafter in the following manner: Int. # (Interviewee number), at file # (i.e. A–G) page # (transcript page reference); e.g., Int. 46, at C3. The interview process yielded fifty-one hours of audio recordings, which were subsequently transcribed. I thank the UCLA Academic Senate, the UCLA Dean's Office, Harvard Law School, and Georgetown University Law Center for their generous support of this costly enterprise.
18. This group of informants included custody officers and other staff, then-current GP residents, including trustees and people in the GP unit next to the K6G dorms, and people in K6G who had previously done time in the Jail's GP.
19. *See* Dolovich, *supra* note 7, at 94. I also learned about life in the California prisons more generally, both through the formal interviews (since many of my interview subjects had previously spent time in state prison), and through informal conversations with other K6G residents who had also done time in state prison.
20. *See, e.g.,* K.C. CARCERAL, PRISON, INC. (Thomas J. Bernard ed., 2006) (discussing an unnamed, privately operated prison in the American South); T.J. PARSELL, FISH: A MEMOIR OF A BOY IN A MAN'S PRISON (2006) (discussing Michigan prisons); WILBERT RIDEAU, IN THE PLACE OF JUSTICE (2010) (discussing Louisiana's Angola prison); MICHAEL G. SANTOS, INSIDE: LIFE BEHIND BARS IN AMERICA (2006) (discussing federal prisons); Haney, *supra* note 8; Christopher D. Man & John P. Cronan, *Forecasting Sexual Abuse in Prison: The Prison Subculture of Masculinity as a Backdrop for "Deliberate Indifference,"* 92 J. CRIM. L. & CRIMINOLOGY 127, 164–75 (2001).
21. Although there are obviously differences between prisons, the GP culture I describe in this Article represents the baseline from which positive departures, although welcome, are notable. *See* Haney, *supra* note 8, at 127 n.22 (noting that although not all jails and prisons are the same in terms of the pathologies they create, it is nonetheless possible to

make generalizations that are “normatively correct in many correctional settings” even if not “universally applicable,” and that “the lack of universality does not undermine the capacity of the jail and prison context to generate tremendous psychological pressure that is felt by virtually all inmates, even though it may dramatically transform the behavior of only some”). To illustrate the variance: a person I met at San Quentin State Prison reported a range of experiences during his many decades in the California prison system. He described being at Vacaville State Prison in the early 1980s, and found the inmate culture there to “accommodate all types of people,” including “[gang] dropouts, child molesters, [and] gangbangers from all sides.” There was, in Vacaville at the time, a “high level of acceptability.” This was “the only prison [he had] ever seen or heard of that two gays could sit on the yard and kiss, even get caught having sex with no repercussions.” By contrast, in the late 1980s, he was at Folsom State Prison where “there was an average of one stabbing every three days. No transgenders here, some gays, way undercover. No mixing of races in any way. Sometimes the air [was] so thi[ck] with tension that it was hard to breath[e]. A person had to live by the code that their race or gang set, with just survival being the daily goal.” Letter from Jeffrey Scott Long to author, (Feb. 2012) (on file with the author). Kenneth Hartman confirms Long’s account of Folsom prison in the 1980s. Hartman reports that, on his arrival at Folsom shortly after being sentenced to LWOP in the early 1980s, he and the other new arrivals were met by a prison official, who offered two “admonitions”: “If you try to escape, we’ll kill you. If you put your hands on one of my guards, we’ll kill you. Other than that, we don’t give a shit what you do to each other.” According to Hartman, “[n]o more accurate description of Folsom [wa]s ever offered.” KENNETH E. HARTMAN, *MOTHER CALIFORNIA: A STORY OF REDEMPTION BEHIND BARS* 35 (2009).

22. I use the term “prison” here in its broader, less technical sense, to refer to custody facilities in general. *See supra* note 1 (explaining the difference between jails and prisons and explaining why the study of a jail yields models of custody also relevant to prisons).
23. During my research, I conducted in-depth qualitative interviews with a random sample of approximately 10% of K6G’s residents. *See supra* note 17. For a detailed description of the research protocol, see Dolovich, *supra* note 7, at 92–99 (Methodological Appendix); *id.* at 100–10 (reproducing the questionnaire used in my interviews).
24. *See* Dolovich, *supra* note 7, app. B, at 102 q.35. I then followed up by asking for an explanation of each descriptor offered. These questions, which proved very effective in eliciting a picture of life in K6G, were Joe Doherty’s idea.
25. This phenomenon is known as “reverse-passing.” To this, some may object that sexuality is more dynamic and complex than the binary gay/not gay variable would allow, and that even men who may not “seem” gay in the conventional sense of the term may experience same-sex attraction and thus not identify as “straight.” This is no doubt the case. But my assertion in the text that some men lie to get access to K6G is not based on a failure to credit either the complexity of sexual identity or the range of ways people might understand and relate to their own sexuality. It is based on the frank admissions of many men whose classification interviews I observed that their claims of being gay, made in their initial sorting interview, had in fact been outright fabrications. Although one’s stated self-understanding can certainly be complicated by fear of the implications of connecting with those parts of oneself that are in conflict with prevailing social norms, it would be a mistake to allow theoretical sophistication to blind us to the possibility that, in many cases, the most accurate explanation is also the most obvious. Sometimes, in other words, a lie is just a lie. And my experience in K6G leaves me confident that the phenomenon of men seeking access to K6G by pretending to be gay is a frequent occurrence. For more

extended discussion of this phenomenon and how it plays out during the second stage of the classification process, see Dolovich, *supra* note 7, at 30–43.

26. To say “is divided” rather than “divides itself” may strike some as a failure to understand the extent to which the prisoners themselves design, operate, and enforce this system. But two factors of the system’s operation make it more appropriate to describe the gang structure as one in which prisoners are assigned their affiliation rather than choosing it themselves. First, even those who seemingly choose their own affiliation really have little choice in the matter, since even those who would prefer to have no part of this structure are compelled, often under threat of physical reprisal, to participate. Second, in many ways, prison officials actively support and even strengthen gang control over the prison culture, even to the point of assigning individuals to one of the four groups. On this point, Philip Goodman’s ethnographic work in the California prison system’s reception centers is essential reading. See Philip Goodman, “*It’s Just Black, White, or Hispanic:*” *An Observational Study of Racializing Moves in California’s Segregated Prison Reception Centers*, 42 *LAW & SOC’Y REV.* 735 (2008). As Goodman shows, the assignment of race is often a “negotiated settlement” reached by officers and inmates collaborating together to arrive at a given racial characterization. *Id.* at 737. At least one of my interview subjects suggested that at times, officers make the decision themselves about the “race” to which a given prisoner will be assigned. This subject, an older American-born Latino, described how California state prison officials assigned him to the Paisas. Int. 60 at, C7–8. This was a wise choice, since this decision allowed him to avoid having to run with the Southsiders, a more disciplined and demanding operation with strenuous rules with which he might have had a hard time complying.
27. “Paisa” or “paisano” literally means “fellow countrymen.” See also Jennifer Waite, *Prison Slang 104: Chicano Slang*, YAHOO! VOICES (Aug. 12, 2009), <http://voices.yahoo.com/prison-slang-104-chicano-slang-3985278.html?cat=17> (explaining that, in prison, “paisa” is a “slang term for Mexican immigrants who have not yet assimilated,” and that it “[c]an be used derogatorily [sic], but is not necessarily an insult”).
28. Goodman’s work suggests that in the California prisons, the four designated groups are Blacks, Whites, Southsiders, and “Others.” See Goodman, *supra* note 26, at 736. In L.A. County, anyone who does not fit one of the four designated categories listed in the text (i.e., who qualifies as an “Other”) is expected to “run with” the blacks, although they may have to pay a tax to do so.
29. Again, it bears emphasizing that the “racial” segregation so strenuously enforced in this particular social system is governed by a cultural construction of the category of race that is unique to this context.
30. I am well aware that the cultural system I am describing here is deeply offensive and troubling. The fact of the description should in no way be taken as evidence of endorsement. To understand K6G and the difference it represents, it is necessary that the larger gang culture be understood, which is why I am describing it in such detail here.
31. As one of my (black) respondents explained, “[i]f a Mexican and a black fight, and another Mexican jumps on the black and beat on the black, I may be called to where I have to jump in and fight. And if I don’t, then the blacks may all beat me up later.” Int. 119, at C4.
32. This effect came through clearly in my interviews, as subjects described their experiences of life in GP. One (white) respondent described it as follows:  
I was scared to death. Because where I was [housed], I was with nothing but Mexicans. They were all gang bangers [i.e., someone deeply involved in the gang culture], every one of them were gang bangers. I forget what clique they were from. But in [the overhead light in my cell] we had thirty-two shanks, knives, handmade knives. And then one day somebody

disrespected one of the Mexicans, and the Mexicans they all went off on the whites. The only reason why they didn't go off on me is because our tank had all those shanks in them. And that's the only thing that saved me from being jumped on by six other gang bangers.  
Int. 123 at E6.

33. See Dolovich, *supra* note 7, at 15—17.
34. See *supra* note 20.
35. There are at present over 2.3 million people being held in prisons and jails in the United States, see Sharon Dolovich, *Exclusion and Control in the Carceral State*, 16 BERKELEY J. CRIM. L. 259, 307 & n.151 (2011), the vast majority of whom are men. See U.S. DEP'T OF JUSTICE, JAIL INMATES AT MIDYEAR 2010—STATISTICAL TABLES (NCJ 233431) 7 (Apr. 2011); U.S. DEP'T OF JUSTICE, PRISONERS IN 2010 (NCJ 236096) 15—16 (Dec. 2011) (reporting that as of midyear 2010, 656,360 of the 748,728 people being held in local jails were men and that 1,499,573 men but only 112,822 women were under the jurisdiction of state and federal correctional authorities).
36. Corley, *supra* note 6, at 106; see also Yvonne Jewkes, *Men Behind Bars: "Doing" Masculinity as an Adaptation to Imprisonment*, 8 MEN AND MASCULINITIES 44, 53 (2005) (“‘Wearing a mask’ is arguably the most common strategy for coping with the rigors of imprisonment, and all prison researchers will be familiar with the sentiment that inmates feel it necessary to adopt a façade while inside.”).
37. Don Sabo, *Doing Time, Doing Masculinity: Sports and Prison*, in PRISON MASCULINITIES, *supra* note 6, at 61, 65. Indeed, in men's prisons, muscles are arguably “the sign of masculinity.” *Id.* (quoting BARRY GLASSNER, BODIES: WHY WE LOOK THE WAY WE DO (AND HOW WE FEEL ABOUT IT) 114 (1988)).
38. See, e.g., E. Timothy Bleecker & Sarah K. Mumen, *Fraternity Membership, the Display of Degrading Sexual Images of Women, and Rape Myth Acceptance*, 53 SEX ROLES 487, 492 (2005) (citing research “reveal[ing] differences in attitudes and behaviors between fraternity and non-fraternity men that are reflective of acceptance of hypermasculinity” and finding that “[f]raternity men report a belief in male dominance and the inferiority of women” and “use language and possess pictures of women that are judged as degrading”); Donald L. Mosher & Silvan S. Tomkins, *Scripting the Macho Man: Hypermasculine Socialization and Enculturation*, 25 J. SEX RES. 60, 74 (1988) (describing the “macho ritual” following “boot camp in the military” during which “[t]he recruit, shorn of his civilian dignity [is] hazed as a coward, a faggot, a mama’s boy, and the like, [and] undergoes an ordeal,” after which he “assume[s] his new military identity as a warrior” and celebrates by “go[ing] to the bar, get[ting] drunk, get[ting] laid, get[ting] into a fight with an outgroup member, and do[ing] something daring”); Megan N. Schmid, Comment, *Combating a Different Enemy: Proposals to Change the Culture of Sexual Assault in the Military*, 55 VILL. L. REV. 475, 492 (2010) (“[T]he military distances itself from persons perceived as not masculine, such as women and homosexuals, which may explain the restrictions on these groups. . . . As an example, drill instructors at boot camp put down male recruits by feminizing them, calling them ‘pussies,’ ‘sissies,’ or ‘girls,’ to teach them that ‘to be degraded is to be female.’”); Christine Sgarlata Chung, *From Lily Bart to the Boom-Boom Room: How Wall Street’s Social and Cultural Response to Women Has Shaped Securities Regulation*, 33 HARV. J.L. & GENDER 175, 180-81 (2010) (“In Wall Street lore, the movers and shakers of the securities markets are almost invariably men—they are the ‘masters of the universe,’ the ‘Big Swinging Dicks,’ the regulators, the decision-makers, and even the scoundrels thought to have shaped the markets and our system of securities regulation. Women, by contrast, are portrayed as social and cultural outsiders . . . presumed to lack the



skills and characteristics necessary to navigate Wall Street.”); Valentine M. Moghadam, *Women, Gender, and Economic Crisis Revisited*, 10 PERSP. ON GLOBAL DEV. & TECH. 30, 37 (2011) (“The masculinist institution par excellence may be the military, but hyper-masculinity is also a defining feature of the corporate domain—with its risk-takers, rogue traders, reckless speculators, and manipulative financiers.”).

39. There is a direct connection here to Elijah Anderson’s “code of the street,” which governs life for many men in custody when they are free. This makes the transition from hypermasculine performance on the streets to hypermasculine performance in prison a seamless one:

At the heart of the code is the issue of respect—loosely defined as being treated “right” or being granted one’s “props” (or proper due) or the deference one deserves. . . . The rules of the code in fact provide a framework for negotiating respect. With the right amount of respect, individuals can avoid being bothered in public. This security is important, for if they are bothered, not only may they face physical danger, but they will have been disgraced or “dissed” (disrespected).

ELIJAH ANDERSON, *CODE OF THE STREET: DECENCY, VIOLENCE, AND THE MORAL LIFE OF THE INNER CITY* 10, 33-34 (1999).

40. See Haney, *supra* note 8, at 135 (“In many ways, maintaining some semblance of self esteem in prison requires [men in this position] to do whatever they can do in order to avoid becoming even *more* ‘failed or fallen.’”). Indeed, for many people in custody, respect of this form may be the only respect they will ever enjoy. See Telephone Interview with Cameron Saul, Case Manager, Tarzana Treatment Ctr. (Oct. 27, 2011) (describing a friend who preferred the gang life in prison to freedom, since “on the streets,” he is “nobody” and “get[s] no respect,” whereas in prison, [he has] power . . .”).
41. Int. 140, at B9.
42. As one of my respondents recalled, “there was a time when a couple of the inmates tried to turn it into a political thing and they tried to segregate it with Blacks, Whites and it didn’t fly. It didn’t fly.” Int. 71, at A7. Another of my respondents explained that active gang members “are not taken seriously in [K6G] . . . [I]f they are causing too much of a problem, Bloods or Crips, [or] whichever, I’m pretty sure we would probably whup them . . . to stop problems for everybody.” Int. 119, at B12; see also Int. 89, at C3 (“K6Gs are usually nicer than people in mainline. You know, you ain’t got nothing to prove. There’s no stripes in the K6G dorm, you know, not a bunch of testosterone . . . unchecked.”).
43. See Int. 119, at B2 (“I don’t have to put up any front [in K6G] . . . I don’t have to alter my attitude or tell a fake jailhouse story. I can just be myself.”); Int. 79, at E1 (“People [in K6G] are more free to be who they are.”).
44. Int. 47, at D7–8.
45. *Id.* at D8.
46. K6G’s “easy-going program” is a big part of what makes it so appealing to many men with a long history of time in GP, who feel the need for a break from the gang life that governs life in the rest of the Jail.
47. See *supra* notes 20, 21. See also Hartman, *supra* note 21, at 2 (“In every jail and juvenile camp I learned the same lesson. No one ever wanted to know what I did for a living; they wanted to see if I was predator or prey. Shoved against a wall, surrounded in a dark alley, looking into the barrel of a battered service revolver, I always got the same message: Will you stand up and fight or will you bow down?”).
48. See Dolovich, *supra* note 7, at 11–19 (explaining the process by which weaker prisoners “hook up” with more powerful prisoners in a protective pairing).

49. If the specifics of that emergent culture reflect in some way the sexual identity of its residents, they are still best understood not as the *cause* of the collective feeling of safety and security in the unit, but as its *effects*.
50. See Jeannie Suk, *Redistributing Rape*, 48 AM. CRIM. L. REV. 111, 116 (2011). To the contrary, “the phenomenon of gay masculinity is well known.”
51. Indeed, more than once during my research, I was treated to a demonstration of just how easily some men—even those who, given the choice, would prefer to perform something of a stereotypical gay identity—can switch into hard-core gangster mode. In one such case, my informant explained that were he sent to GP and forced to assume a gangster persona, it would be no different for him than life in the streets, since as a member of a local “set” of a well-known national gang, he perpetually performed this identity with his “homeboys” when he was free. In this culture, everyone, regardless of sexual orientation, faces pressure to perform an exaggerated version of the hegemonic masculine ideal to avoid the aspersions of weakness that lead to victimization.
52. In my interviews, I asked two related questions: *Are there any gang members in K6G?* and *Are there any gang politics in K6G?* See Dolovich, *supra* note 7, at 106 qq.105–06. My subjects unanimously answered the former question in the affirmative and the latter in the negative.
53. Again, for the reasons provided above, it is mistaken to imagine that no one in K6G is able to successfully perform a hypermasculine identity. To the contrary, as I have discussed elsewhere, the nature of the unit’s admissions criteria, which focus on sexual identity rather than one’s ability to handle oneself on the mainline, makes the program very likely to be overinclusive as to its protective purpose. See Dolovich, *supra* note 7, at 39.
54. Moreover, given the stigma attached to being gay in prison and in the hypermasculine culture of the gangs in particular, it may be that the gang members one finds in K6G are less able to enforce the behavioral code of GP since they may have less “juice” within the gang structure as a whole and thus may be—or may be believed to be—weaker than their straight colleagues. This relative weakness, whether real or simply perceived, may thus undermine from the get-go any efforts by gang members in K6G to rule the dorms. On the other hand, even if there is something to this notion, given the gangs’ desire to enlarge their sphere of influence, they may yet be inclined to stand up for their colleagues in K6G, notwithstanding the averred homosexuality of the gang members in K6G. Were it indeed the case that gang members in K6G suffer the equivalent of being cut loose or diminished in status and support because of their sexual identity, and were this process to contribute appreciably to the difference between K6G and a GP, it would suggest that prison and jail administrators committed to increasing the safety of their GP units should redouble their efforts to disrupt coordinated gang activity. I am grateful to Justin Levitt for raising this fascinating issue, which merits further inquiry.
55. This explanation too trades on stereotypes; it suggests that gay men and trans women—being “soft”—would prefer a space like K6G, whereas heterosexual men would prefer to live in a context defined by hypermasculine performance. This way of construing the matter is problematic in two related respects: (1) it frames the undoubted preferences of people in K6G for a less pressured environment as somehow a function of insufficient toughness, and (2) it frames a preference for the culture of GP as the mark of a “real man.”
56. Haney, *supra* note 8, at 124.
57. At this point, some readers may start considering how to calculate the proportion of dissenters required to shift the dynamics of a hypermasculine culture to one in which people would feel freer to relax and be themselves. Frameworks for approaching this

puzzle suggested by readers of earlier drafts include game theory (and specifically the “stag hunt” game, *see generally* Robert van Rooij, *Book Review*, 85 *STUDIA LOGICA* 133, 133–36 (2007) (reviewing BRIAN SKYRMS, *THE STAG HUNT AND THE EVALUATION OF SOCIAL STRUCTURE* (2003))), social network theory, social capital theory, and social ecology. I thank Alex Stremitzer, Joe Doherty, and Daria Roithmayr for these suggestions. My sense is that each of these frameworks has something interesting to offer to make sense of the dynamics I describe, and I hope others will be moved to undertake such analyses. Whatever perspective one adopts, it will be impossible to understand the persistence of GP’s culture of hypermasculinity without recognizing the deep collective fear of nonconformity that exists among prisoners, and the relationship between this fear and the institutional failure to ensure the physical safety and security of the people in custody. My goal in this Article is to illuminate that connection, which, as I have sought to show, must rely more on ethnography than on abstract theoretical frameworks, at least in the first instance.

58. The full version of this Article also addresses a fourth possible explanation: that it is the *men in GP* who, because of their sexual orientation, can’t or won’t conform to the norms of life in K6G. It argues that, even if a GP dorm full of heterosexual-identified men who felt safe enough to leave off the gang politics and hypermasculine posturing may ultimately look very different than K6G, life in such a dorm would necessarily be an improvement over the current GP experience—even if the only difference were an easing of pressure on unit residents and a measure of freedom from the fear and anxiety that currently attend life in many men’s general population units.
59. *See* Dolovich, *supra* note 7, at 15–17 (explaining the relationship between this process and the hypermasculine culture of GP); Rideau, *supra* note 4, at 75 (explaining that, in the Louisiana prison system, rape is generally referred to as “‘turning out,’ a nonsexual description that reveals the nonsexual ritualistic nature of what is really an act of conquest and emasculation, stripping the male victim of his status as a ‘man’ [and] redefin[ing] him as a ‘female’ in this perverse subculture”).
60. Suk, *supra* note 50, at 117.
61. Rachel Wyatt, *Male Rape in U.S. Prisons: Are Conjugal Visits the Answer?*, 37 *CASE W. RES. J. INT’L L.* 579, 594 (2006). As Sykes observed:  

Like most men, the inmate must search for his identity not simply within himself but also in the picture of himself which he finds reflected in the eyes of others; and since a significant half of his audience is denied him, the inmate’s self-image is in danger of becoming half complete, fractured, a monochrome without the hues of reality. James E. Robertson, *Cruel and Unusual Punishment in United States Prisons: Sexual Harassment Among Male Inmates*, 36 *AM. CRIM. L. REV.* 1, 13 (1999) (quoting GRESHAM M. SYKES, *THE SOCIETY OF CAPTIVES* 71, 71—72 (1958)).
62. *See generally* Brenda V. Smith, *Rethinking Prison Sex: Self-Expression and Safety*, 15 *COLUM. J. GENDER & L.* 185 (2006).
63. Most obviously, these reasons include the need for gender segregation in custody and the fact that, even assuming gender integration of some sort, the men would still greatly outnumber the women.
64. Sykes, *supra* note 61, at 71.
65. Wyatt, *supra* note 61, at 597; *see also id.* at 598 (“There is also evidence that prison systems in other countries successfully use conjugal visits to lower rates of inmate sexual assault.”).

66. This is the approach recommended by the National Prison Rape Elimination Commission and adopted by the U.S. Department of Justice in the National PREA Standards. *See* 28 C.F.R. § 115.41-42 (2012).
67. Admittedly, to the extent that GP's worst aspects do stem from sexual deprivation, it may not be possible to erase the threat of predation entirely, since even were all possible steps taken to protect victims and deter predatory behavior, some men may still be driven by their sexual needs to seek to "feminize" other prisoners, by force if necessary, to transform them into desirable sexual partners. (I am grateful to Doug NeJaime for pushing me to recognize this point.) Still, deploying these strategies would surely mitigate whatever harm might result from this situation—an undeniably positive result.
68. *See* Carolyn Newton, *Gender Theory and Prison Sociology: Using Theories of Masculinities to Interpret the Sociology of Prisons for Men*, 33 *HOW. J. CRIM. JUST.* 193, 197 (1993) (quoted in Robertson, *supra* note 61, at 12).
69. Consider this excerpt from an interview conducted by criminologist Lonnie Athens, with a boy in his mid-teens who had recently been convicted of armed robbery: After I busted that dude's head open, the principal kick me out of school for the rest of the year.... Everybody, my people and close friends, thought I had gone too far on the dude.... But nobody in the school or around my neighborhood would fuck with me after that. People said, "James is crazy. Don't go heads up at the dude like that because he will fuck you up." Most people made sure that they gave me plenty of space and stayed mellow around me. They paid me more respect and said "Hi" to me when I walk by. People may have thought I went too far on that dude, but I later knew what I did was right. It must've been right because nobody was giving me shit anymore. The way people acted made me come alive. It swelled up my head.
- RICHARD RHODES, *WHY THEY KILL: THE DISCOVERIES OF A MAVERICK CRIMINOLOGIST* 134 (1999) (quoting LONNIE ATHENS, *THE CREATION OF DANGEROUS VIOLENT CRIMINALS* 78-79 (1992)); *id.* at 135 (observing that people in the late stages of becoming a dangerous violent criminal may find themselves "a welcome and desired companion among malevolent groups for whom having violent reputes is a social requirement") (quoting ATHENS, *supra*).
70. *See e.g.*, Sharon Dolovich, *Cruelty, Prison Conditions, and the Eighth Amendment*, 84 *N.Y.U. L. REV.* 881, 932-34 (2009) (describing the way the culture of the prison teaches prison officials to see prisoners as "a breed apart, . . . the scum of the earth") (quoting KELSEY KAUFFMAN, *PRISON OFFICERS AND THEIR WORLD* 231 (1988)).
71. *See* Dolovich, *supra* note 7, at 26 (explaining how K6G's classification officers interpret the requirement that people classified to K6G be "homosexual"); *see also* Stipulation and Request for Dismissal Order at 4, *Robertson v. Block*, No. 82-1442 (C.D. Cal. July 17, 1985).
72. For further discussion of this feature of K6G, and responses to objections that might be raised to the program on this basis, *see* Dolovich, *supra* note 7, at 54–87.
73. For detailed discussion of the Jail intake process of which this question forms a part, *see* Dolovich, *supra* note 7, at 27–29.
74. Indeed, in some ways they are treated even worse than other people in the Jail, since their status as K6Gs—publicly announced through their distinctive light blue uniforms—frequently exposes them to verbal harassment when they are out of the dorms, both by GPs and by homophobic deputies. *See* Dolovich, *supra* note 7, at 57–58. For discussion of the color-coded uniforms, and an explanation as to why, despite their obvious

drawbacks, it is still in the best interests of people in the unit that their uniforms remain distinctive, see Dolovich, *supra* note 7, at 61–62.

75. This is not to celebrate those who indulge every impulse to complain, to argue, or to pick fights with others in the unit. But these are normal human behaviors, and it is through dealing with the costs of violating collective norms of mutual respect—as happens when people in K6G treat others badly and are criticized for it by others in the dorms—that one grows as a moral subject. These interactions are relatively rare in GP, where the reigning moral code is very different than that which governs in the free world. But this is the stuff of real life—learning through interactions with others how one should behave. And this is as it should be in a community of human beings who must learn to get along with one another.
76. Senior Deputy Randy Bell and Deputy Bart Lanni (K6G’s supervising officers) do their best to provide stimulating and challenging programming for the K6Gs. But even they cannot overcome the fact that available opportunities for people in the unit—most of whom rarely leave the dorms—are necessarily deeply diminished.
77. *See e.g.*, HARTMAN, *supra* note 21, at 72-75 (describing how the possibility of being closer to the woman he loved—and who eventually became his wife—inspired him to leave behind the thug life he had found in Folsom prison and to pursue a psychologically healthier path).





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# COMPARATIVE EFFECTIVENESS RESEARCH AS CHOICE ARCHITECTURE: THE BEHAVIORAL LAW AND ECONOMICS SOLUTION TO THE HEALTH CARE COST CRISIS\*

Russell Korobkin

Since the 1960s, health care spending in the United States has consistently increased—often by significant amounts—as a percentage of gross domestic product (“GDP”).<sup>1</sup> Accounting for 5.2% of GDP in 1960, health care expenditures grew to 7.2% of GDP in 1970, 9.2% in 1980, 12.5% in 1990, 13.8% in 2000, and 17.9% in 2011.<sup>2</sup> In 2013, the Congressional Budget Office predicted that without sharp, systemic change, 22% of domestic economic production will be devoted to health care by 2038.<sup>3</sup>

INTRODUCTION

As total health care spending has increased, so too has the cost of private health insurance. As of 2013, the average cost of insurance coverage for a single adult with an employer-sponsored plan was \$5,884, and a standard employer-sponsored policy for a family of four ran \$16,351.<sup>4</sup>

The United States is a wealthy country, so it is not obvious that it should not spend such a large share of its national resources on medical care. But rapidly increasing costs, coupled with the well-known fact that the health and longevity of Americans lag behind those of citizens of other developed nations that spend less of their wealth on medical care,<sup>5</sup> at least suggests that the nation probably allocates an inefficiently large fraction of national resources to health care, compared to competing goods and services. At a bare minimum, the continuing rapid escalation of health care costs will—if unchecked—result in the nation allocating a larger percentage of national wealth to medical care than is efficient at some point in the not-too-distant future.

The primary market-based approach to reining in health care costs is generally referred to in policy discussions as “consumer directed health care” (“CDHC”). The simple idea underlying CDHC is that patients will demand less care if they are burdened with a greater responsibility for paying the actual cost of that care than is common in our current system, in which costs are largely borne by public or private health insurance with little patient cost sharing.<sup>6</sup> CDHC implicitly relies on the “rational choice” assumption of neoclassical economics that, given the proper incentive structure,

individual consumers will allocate resources between medical care and other goods and services (and, within the category of medical care, between competing treatment options) in a manner that maximizes their “subjective expected utility” (“SEU”).<sup>7</sup> As I explain below, there are compelling reasons to believe, however, that most consumers, as boundedly rational decisionmakers, would be particularly bad at making efficient trade-offs when asked to make point-of-service medical care decisions.

This Article describes a novel, “choice architecture” approach that can help individuals to more optimally allocate their resources between medical care and other goods and services. Under this approach, the government would produce and dispense information concerning the costs and benefits of medical treatments sufficient to enable consumers and health insurers to contract for what I call “relative value health insurance” (“RVHI”), a product that covers medical interventions that meet or exceed a given level of cost-effectiveness.

Having survived Supreme Court review,<sup>8</sup> the landmark 2010 health care reform legislation, the Patient Protection and Affordable Care Act (“ACA” or “the Act”) is now set to significantly expand access to medical care.<sup>9</sup> While most commentators agree that the Act is unlikely to have more than a modest effect on stemming the rapidly increasing cost of medical care,<sup>10</sup> a relatively overlooked provision can serve as the starting point for the promotion of RVHI. The Act provides significant funding for government-sponsored “comparative effectiveness research” (“CER”),<sup>11</sup> designed to evaluate the relative efficacy of different treatment options for a particular condition or ailment.

To facilitate the market for RVHI, government-sponsored CER should be used to evaluate different treatments for various medical conditions and rate them on a scale of “1” (high) to “10” (low) in terms of cost-effectiveness. Health insurance agencies could then use these transparent ratings as the basis for different coverage offerings. For example, an insurance company might offer three plans: (1) a policy that covers only treatments with a rating of “3” or higher at annual premium price \$X, (2) a policy that covers only treatments rated “5” or higher at annual premium price \$Y, and (3) a policy that covers only treatments rated “7” or higher at annual premium price \$Z.

Consumers of health care would then decide at the time they purchase insurance—not at the time of illness—whether they wish to purchase relatively “shallow” insurance that covers only the most cost-effective interventions at a correspondingly modest price, or relatively “deep” insurance that covers increasingly less cost-effective treatments but at a higher price. The simple numerical rating scale would provide boundedly rational consumers with a useful tool for allocating resources between their medical care and other goods and services. If consumers wish to forgo expensive medical treatments that provide limited benefits, health care cost inflation will decrease. If consumers choose to buy high-priced insurance that covers marginally beneficial services, health care cost inflation will continue until marginal costs exceed marginal benefits, but these increases will represent an efficient allocation of national wealth.

The economically efficient amount of medical care is provided when its marginal cost equals its marginal benefit. When an individual patient decides whether to obtain treatment, however, he will usually compare its expected benefits only to the marginal cost of that care to him. When marginal costs are borne by a third party, the individual patient has a private incentive to overconsume care, a problem known as “moral hazard.”<sup>12</sup>

As medical technology improves, the scope of the moral hazard problem increases. Because private or public insurance finances most medical care, producers of new drugs, medical products, diagnostic devices, and the like know that there will be a market for new treatments that promise to reduce mortality or morbidity, almost without regard to the cost of such innovations. As more medical interventions with such positive expected benefits are developed, inefficient marginal overconsumption of medical care occurs at an increasing rate.<sup>13</sup> This is the case even if the total value of a new medical technology exceeds its total cost,<sup>14</sup> and even if patients sometimes also inefficiently *underconsume* care because they misestimate its value or because they can externalize high costs that arise tomorrow when they fail to take cheaper preventative measures today.<sup>15</sup>

In current academic and policy debates, CDHC is the conceptual approach to reducing the costs of medical care that most directly seeks to address the problem of moral hazard. Proponents of CDHC propose increasing the marginal financial cost of medical care imposed directly on patients, thus providing patients with a greater incentive to equate marginal cost with marginal benefit.<sup>16</sup> To satisfy this goal, CDHC proponents support policies that subsidize or otherwise encourage health insurance with high annual deductibles or high copayments at the point of service.<sup>17</sup>

The fundamental problem with the CDHC approach is that it assumes a heroically implausible level of decisionmaking ability on the part of patients faced with treatment choices at the time of illness. The theoretical power of CDHC to rationalize medical care decisions requires consumers to make two kinds of judgments with a high degree of skill: First, they must be able to interpret complex, probabilistic information concerning the consequences of various treatment alternatives (including forgoing treatment) in an unbiased manner. Second, given the differences in attributes of different treatment alternatives, they must be able to select the alternative with the combination of attributes, including price, that will provide the most overall utility. Only when these requirements are satisfied, such that we can say that consumers have made “accurate” decisions—those that maximize their expected utility subject to constraints—can we be confident that the efficient amount of social resources will be allocated to medical care.

Notwithstanding the prevalence of rational-choice-based economic models of behavior that assume such capabilities, social scientists now broadly recognize

that most decisionmakers, and especially consumers, are boundedly rational: our limited working memory and cognitive capacity causes us to simplify complicated decisionmaking problems and seek mental shortcuts to solving them, economizing on decisionmaking costs but compromising accuracy of outcomes.<sup>18</sup> Put another way, faced with a difficult question, people often answer an easier one instead, often without even recognizing the substitution that is taking place. As Nobel Laureate Daniel Kahneman describes this process, our mind operates a “System 1” function, which automatically assesses and responds to data but is poor at logic and statistical reasoning, and a “System 2” function, which deliberately and laboriously makes more reasoned judgments but requires substantially more effort.<sup>19</sup> Because the mind prefers to conserve effort, it tends to favor System 1. Unconscious reliance on System 1 makes it possible for us to navigate the complexities of daily life reasonably well without being struck by paralysis, but the shortcuts on which it relies will sometimes lead to suboptimal decisions.

Reliance on the mind’s System 1 function means that consumers fail to make accurate decisions in many contexts. But what we know about the decisionmaking process suggests that making medical care decisions at the point of service is particularly problematic.

C. Empirical  
Research  
on Medical  
Decisionmaking

It is almost always difficult to determine whether a particular decision is an accurate reflection of an individual’s deeply held values, since there is no foolproof way of eliciting what exactly those values are or how they compare to one another. But, consistent with the theoretical account above, the existing empirical research on decisionmaking in the medical care context provides substantial circumstantial evidence that, contrary to the assumption of CDHC proponents, patients are unlikely to do a very good job of making efficient medical care decisions at the point of treatment. Studies do suggest that patients are more conservative about seeking medical care when they are forced to spend their own dollars on that care.<sup>20</sup> Thus, the fundamental prediction of microeconomic theory that demand falls as price rises is borne out in the medical care context. This indicates, as supporters of CDHC like to argue, that CDHC would probably encourage healthy price competition among providers of medical care.<sup>21</sup> One consistent finding, dating back to the well-known RAND study,<sup>22</sup> however, is that patients demand less care when faced with increasing marginal costs<sup>23</sup> but do not do well at distinguishing between high- and low-value interventions.<sup>24</sup> For example, studies have found that patients with higher cost-sharing obligations economize by not taking prescription drugs only to have “higher rates of serious adverse events[ ] and . . . emergency department visits,” the costs of which offset any prior savings.<sup>25</sup>

III. RELATIVE  
VALUE HEALTH  
INSURANCE

**R**ather than hoping against evidence that patients will be able to make optimal resource-allocation decisions at the point of service or offering financial incentives to physicians to break trust with their patients, a better approach

to rationalizing the amount of resources allocated to medical care would be to facilitate patient contracting for different depths of medical care when purchasing insurance coverage, before treatment is needed. I call insurance coverage fashioned in this way “relative value health insurance” (“RVHI”). Patients who wish to devote relatively fewer resources to medical care and more to competing goods and services could purchase relatively shallow insurance that covers only the most cost-effective medical interventions; patients who wish to devote relatively more resources to medical care could purchase insurance that would cover increasingly less cost-effective interventions.

For this ex ante, contractual approach to succeed, however, careful attention must be paid to the choice architecture of the decisionmaking process. Complex information concerning what medical interventions would and would not be covered by different insurance products must be presented in a way that is tractable enough to enable boundedly rational consumers to make purchasing decisions that reflect their individualized preferences for allocating their resources between medical care and other goods and services. This function can be satisfied by the government better facilitating private contracting for health insurance by producing and analyzing comparative effectiveness research, using funding already provided by the ACA as a starting point.

An important feature of the “managed care” revolution in the provision of medical care, which reached its high-water mark in the 1990s,<sup>26</sup> was the widespread institution by health insurance companies of “utilization review.” With medical care cost exploding and nearly all health insurance contracts written to cover “medically necessary” care,<sup>27</sup> insurance contracts began to require that the insurer pre-approve certain interventions to ensure that the prospective procedures were, in fact, medically necessary. Through utilization review, insurers became willing to deny coverage to policyholders for treatments recommended by their physicians, a practice that was exceedingly rare prior to the rise of managed care.<sup>28</sup>

As part of the public backlash against managed care cost-containment efforts,<sup>29</sup> forty-four states and the District of Columbia enacted “external review” statutes,<sup>30</sup> which give patients the right to challenge an insurer’s medical necessity-based denials of care in a quasi-judicial procedure.<sup>31</sup> Prevailing patients are entitled to an order requiring the insurer to provide or pay for the requested treatment.<sup>32</sup> In most jurisdictions, external reviewers determine medical necessity de novo and based on a statutory definition of medical necessity, rather than merely applying an insurer’s definition of the term (if the insurer even defines the term, which insurers often do not).<sup>33</sup> According to most statutory definitions, medical necessity depends entirely on whether a treatment has any clinical efficacy, regardless of the magnitude of the benefit. The relevant standards rarely include any hint of cost–benefit balancing or consideration of cost-effectiveness, except to the extent that a treatment is not considered “medically necessary” if there is an equally efficacious treatment available (presumably at a lower price).<sup>34</sup> Consequently, health insurers have little if any legal

## A. The Legal Status of Relative Value Health Insurance

### 1. Limitations on Ex Post Utilization Review

space to mitigate moral hazard by refusing to cover low value treatments at the point of service.

Consistent with this legal structure, health insurers now generally pay for any treatment recommended by a treating physician that offers the potential for any positive clinical benefit unless explicitly excluded from the contractual scope of coverage.<sup>35</sup> When insurers do deny a physician's treatment proposal and subsequently defend their position to external review boards, the issue is nearly always either whether the disputed treatment is at all effective for treating the patient's condition<sup>36</sup> or whether a requested procedure is cosmetic or lifestyle-related rather than medical in nature.<sup>37</sup>

There is a strong public policy justification for limiting the ability of insurance companies to deny coverage through utilization review conducted at the point of treatment. Insurance companies that sell mid-quality health care at a mid-range price could plausibly use the utilization review process to deny even mid-quality medical care to their customers. If permitted the discretion to judge "medical necessity" after receiving customers' premium dollars, insurance companies would face a clear conflict of interest: the more treatments they deny, the more dollars would flow to their bottom lines.<sup>38</sup> Put another way, aggressive ex post utilization review could mitigate patient moral hazard but at the cost of creating insurer moral hazard; insurers have an incentive to provide too little medical care because they benefit from cost savings while patients bear much of the cost of not receiving treatments.

Although understandable, the legal limits placed on utilization review by external review laws have the unfortunate consequence of requiring consumers to purchase "Cadillac"-quality health care at a Cadillac price, even if they would prefer to purchase "Chevrolet"-quality health care at a more modest price.<sup>39</sup> This limitation of options works out well for two groups: wealthy individuals who are able to purchase deep medical care coverage without liquidity constraints forcing them to skimp on other highly valued goods and services, and those consumers who place a particularly high subjective value on even marginally beneficial health care compared to the other goods and services that they might have to forgo because medical care consumes so much of their income. External review laws have the consequence of requiring consumers who would prefer cheaper and less comprehensive coverage to buy deeper coverage than they wish to purchase or go without any coverage at all. With the new ACA "individual mandate," most people who choose the latter option will now be fined.<sup>40</sup>

## 2. Ex Ante Exclusions

The legal limitations on point-of-treatment utilization review by insurers contrast starkly with the fact that, in most cases, insurers may legally refuse to pay for interventions that are explicitly excluded by the insurance contract.<sup>41</sup> A patchwork of state "mandated benefits" laws requires insurers to cover specified categories of treatments.<sup>42</sup> Pre-ACA federal law includes a handful of private insurance treatment mandates,<sup>43</sup> and the ACA requires that a set of minimum benefits be included in all insurance policies sold

in the individual and small-group markets.<sup>44</sup> Beyond these mandates, however, insurers may legally exclude specified interventions from coverage, and courts routinely uphold their right to do so as a matter of freedom of contract.<sup>45</sup>

Against this background, there is no impediment, in theory, to insurers excluding from coverage treatments that fail to satisfy a cost–benefit test, as long as the exclusions can be adequately specified at the time of contracting. Further, there is no impediment to insurers offering multiple products, priced differently, that exclude from coverage specifically enumerated categories of care.

If insurance companies may legally sell health insurance that covers only cost-effective treatments, why does no such product exist in the marketplace? The primary impediment to the sale of health insurance that covers only cost-effective interventions appears to be the difficulty of adequately specifying the relevant coverage exclusions *ex ante*.<sup>46</sup> There are three related problems:

## B. The Information Problem

First, there is very little solid information about even the basic effectiveness of most medical interventions—according to some estimates, there is scientific evidence for the efficacy of less than half the treatments doctors recommend.<sup>47</sup> Even clinical practice guidelines are notoriously based on consensus opinion rather than scientific fact.<sup>48</sup> There is even less information about the comparative effectiveness of alternative plausible interventions.<sup>49</sup> Even when the law requires a treatment, such as a new pharmaceutical, to obtain regulatory approval before being marketed, its producers usually must demonstrate only that it is safe and effective relative to a placebo rather than comparatively effective *vis-à-vis* other treatment options for the same condition. This dearth of information makes it extremely difficult for any insurer interested in marketing a policy that covers treatments that satisfy a cost-effectiveness standard to identify *ex ante* which treatments are, in fact, cost-effective.

Scholars have long advocated for insurers to contract to provide care that satisfies a well-specified cost–benefit algorithm, which the insurer would then apply at the point of treatment.<sup>50</sup> This creative idea has fallen on deaf ears in the marketplace, probably because the lack of good data would likely subject any insurer’s attempt to apply the algorithm to second-guessing, charges of moral hazard, and lawsuits.

Second, the measures of marginal effectiveness of competing interventions are dynamic; the measures can change quickly when new effectiveness data is produced, when new interventions are developed, or when the market changes (such as when a drug goes off-patent). Even if an insurer could fully specify cost-effective interventions at the time of contracting, the lag time between contracting and use of services would mean that, at the point of treatment, a policy would cover some no-longer-cost-effective interventions and would not cover some now-cost-effective interventions.

Third, a detailed list of covered and excluded interventions would provide far too much information for boundedly rational consumers to take into account at the time of contracting. Consumers have the working memory to take into account only a handful of attributes when making purchasing decisions, and they almost invariably selectively consider only the most salient product attributes when bombarded with information.<sup>51</sup> Except for patients with significant preexisting conditions, there would be an extremely low probability that any potential condition-intervention pair would become relevant during the policy period. This suggests that consumers are likely to ignore most detailed coverage information. If consumers did not incorporate information provided at the time of contracting into their purchase decisions, the same reverse moral hazard problem associated with post-contractual utilization review would exist: insurers would have a profit incentive to claim to provide cost-effective care but actually not provide even cost-effective care.<sup>52</sup>

### C. CER and Relative Value Ratings

These informational impediments that prevent insurers from marketing insurance policies that cover only cost-effective treatments can only be overcome with a significant investment in “comparative effectiveness research” (“CER”). The goal of CER is to provide a firmer scientific understanding of the relative clinical benefits of competing medical treatments, services, and interventions.<sup>53</sup> The American Recovery and Reinvestment Act of 2009 (commonly known as the “stimulus bill”) provided \$1.1 billion to three agencies to conduct CER.<sup>54</sup> The ACA doubled down on this investment, providing \$500 million annually beginning in 2013 to 2014.<sup>55</sup>

For CER to facilitate RVHI, its findings should be used to assign scores to potential medical interventions for different conditions based on marginal costs and marginal benefits. I call such scores “relative value ratings,” and I propose that they range from a high score of “1” (extremely cost-effective) to a low of “10” (not at all cost-effective), although other scales would be plausible as well. As an illustration of how the ratings scale would work, consider the following three examples:

\* Standard treatment regimens for cardiovascular disease are understood as one of the great success stories of improved medical technology in the second half of the twentieth century. In 2004, health economist David Cutler estimated that the expected lifespan of an average forty-five-year-old would increase by 4.5 years as a result of this technology, at a total cost of about \$30,000.<sup>56</sup> This intervention—or set of interventions—would likely earn the highest possible relative value rating of “1” for patients with relevant symptoms.

\* At the other end of the relative value spectrum, consider an intervention that harkens to President Obama’s example of the two different colored pills with identical effectiveness and radically different prices. According to an executive of a health insurance company, the brand-name acne medication, Minocin PAC, retails for \$668 per month, which is \$618 more than the generic equivalent. The brand-name product is distinguished only by the inclusion of an ingredient designed to have a soothing effect on the user’s skin.<sup>57</sup> This



medication, which offers a minimal marginal benefit and comes at a very high cost compared to the alternative, would presumably earn a relative value rating of “10.”

\* In between these examples is lumbar discectomy, a common surgical procedure for patients with herniated spinal discs.<sup>58</sup> In a recent study, 1,191 surgery-eligible patients with herniated discs were randomly assigned to receive either surgery or nonsurgical medical management. The researchers measured the benefits (i.e., reduced pain, increased physical mobility) and costs (direct and indirect, including lost labor productivity) for each group for a two-year period.<sup>59</sup> The analysis revealed a slight marginal benefit of surgery, on average, but at a much higher cost. Consequently, the researchers calculated that the cost of surgery per marginal “quality-adjusted life year” (“QALY”) is slightly more than \$69,000 for patients younger than age sixty-five.<sup>60</sup> Based on this data, lumbar discectomy for a herniated disc would likely receive a middling relative value rating—perhaps a “5.”

In a perfect world, all relative value ratings would be based on the results of randomized, double-blind experiments—the “gold standard” of medical research.<sup>61</sup> Realistically, however, the rating authority would usually have to rely on less definitive sources of scientific evidence, including retrospective analyses of clinical data. Many relative value ratings would apply to all patients with a particular condition, but different subgroups could receive different ratings when justified by the best available evidence. For example, a particular treatment with a score of “5” for an average patient might be awarded a score of “3” for patients who have a comorbidity that makes the treatment more likely to benefit them.

With an established set of relative value ratings issued by an expert group, whose members would not profit from higher or lower health care expenditures, insurance companies would be able to contract with patients for health insurance that pays for care rated at or above a specified relative value score. A Level 8 policy—i.e., one that covers all interventions rated “8” or better—would cover a deeper array of treatments than would a Level 3 policy. A Level 8 policy would also cost more, of course. The market would set the precise difference in price, determined by each health insurer’s projections of the difference in its cost of covering the relevant array of interventions for a subscriber population.

With relative value ratings available to enable insurers to specify different depth of care levels at the time customers make insurance purchasing decisions, a variety of slightly different products could flourish, depending on consumer preferences. For example, rather than marketing policies that provide no coverage for treatments that fall below a specified relative value level threshold, insurers might choose to sell policies that offer some coverage for all rating levels but vary cost-sharing arrangements based on the rating level of treatments. Interventions rated a “1” might qualify for 100 percent payment, for example, whereas interventions rated a “10” might require a 50 percent copayment.

The fundamental benefit of RVHI, enabled by relative value ratings, is its ability to help boundedly rational consumers to more rationally allocate their resources between medical care and other desirable goods and services. Secondary benefits of RVHI include aligning the interests of patients and physicians and providing incentives for the efficient innovation and pricing of medical care advances.

A. Better “Choice  
Architecture” for  
Consumers than  
CDHC

In a world of hyper-rational individuals, people can be expected to make choices and express preferences that maximize their SEU and, assuming limited externalities, maximize social efficiency in so doing. The role for policymakers is to facilitate access to information. If individuals are incompetent decisionmakers, paternalistic intervention with substituted decision-making becomes appropriate.<sup>62</sup> When individuals are boundedly rational decisionmakers, the best policy response is often to structure choices in a way that helps decisionmakers to maximize accuracy at a realistic level of cost and effort.<sup>63</sup> This policy focus has been called “choice architecture,”<sup>64</sup> which reflects the fact that preferences are constructed (as an architect constructs buildings) rather than simply uncovered (as an archaeologist uncovers objects through excavation), and that it is possible for constructed choices to be more accurate or less accurate depending on how they are presented.<sup>65</sup> Creating the rating information that would facilitate RVHI can be understood as choice architecture that assists boundedly rational consumers in acting through private markets to register their preferences for allocating resources between medical care and other goods and services.

1. Complexity

Most obviously, RVHI would reduce the complexity individuals must navigate when making trade-offs between medical care and competing goods and services compared to point-of-treatment decisionmaking required under CDHC proposals. Rather than being asked to understand pros and cons of numerous treatment options, with difficult-to-compare attributes (such as mortality and various measures of morbidity) and a range of probabilistic outcome possibilities, consumers would need only to understand a single depth-of-coverage rating. They would then make resource-allocation decisions by trading off price against depth of coverage (i.e., a Level 4 policy for \$4,000 per year, a Level 5 policy for \$4,900 per year, or a Level 6 policy for \$6,200 per year).

The extent to which consumers could accurately make the trade-off between the cost of insurance and depth of coverage depends not only on collapsing the virtues and vices of various medical interventions into a single metric but also on the ability of consumers to achieve a qualitative understanding of the different rating levels—that is, the difference in medical care they could expect by purchasing a Level 6 policy rather than a Level 5 policy. An important virtue of relative value ratings is that their qualitative nature can be communicated to consumers relatively readily. At the time of insurance enrollment, consumers could consult the current list of relative value ratings for all treatments, organized by condition, which would provide concrete examples of what interventions would be covered by policies set at different rating levels. Consumers would not need to understand the nuances of each intervention on the list; they would need only to skim the list to obtain a qualitative sense of the dis-

tinctions between rating levels. Whatever cost–coverage trade-off a consumer made, he would know that his premium dollars would cover the most relatively valuable medical interventions and would not cover those of relatively lesser value. Paying a higher price for deeper coverage would buy access to increasingly more marginally beneficial care.

Perhaps the most obvious practical problem with moving to a relative value system is the paucity of data with which to make relative value judgments. Even assuming that ratings could be based on data less definitive than double-blind, randomized, controlled studies of a broad cross-section of patients, there is currently insufficient information on which to base reasonably informed ratings for the vast majority of medical interventions.<sup>66</sup> This same problem helped doom Oregon’s effort to employ a cost-effectiveness standard for determining Medicaid coverage in the 1990s.<sup>67</sup> It would take years of significant funding of the CER endeavor, plus a more efficient institutional structure for conducting CER, before we could hope to have good information for most treatments.<sup>68</sup>

While discouraging, this reality need not undermine the move to relative value ratings. The present lack of data might require that all commonly accepted treatments for which there is no good comparative effectiveness data be grandfathered into the system with a rating of “1.” For new interventions to obtain a rating—necessary for reimbursement under relative value insurance policies—the Patient-Centered Outcomes Research Institute could require drug or device manufacturers to submit comparative effectiveness data. In the meantime, congressionally allocated funds for CER could fund relative value research on common conditions or treatments for which large sums of money are spent without the support of scientific evidence.

Launching a ratings system by giving the highest possible rating to interventions that we simply do not know enough about and thus cannot reasonably rate on a relative value scale will mean that, in the early years of RVHI, the moral hazard problem endemic in the medical system will still be severe. As time progresses and more new interventions come on line that are not grandfathered in at high ratings levels, the moral hazard problem will gradually recede. Although a delay in phasing relative value ratings into the health insurance system is not optimal, it is important to remember that, in the current state of the world, every intervention recommended by a doctor is essentially granted a relative score of “1” by health insurance plans, and the current system offers no hope of this ever changing. A phased-in system of relative value ratings offers the promise of bending the curve of health care costs over time, even if improvements would be gradual.

Other countries that have instituted some form of cost-effectiveness analysis into their health care systems have used this type of grandfathering. Australia, for example, began requiring cost-effectiveness data in 1992 for all *new* pharmaceuticals before the country’s national drug formulary would consider providing them. It then added similar requirements for services, procedures, and diagnostics some years later.<sup>69</sup>

## V. OBSTACLES

### 1. Getting from Here to There



- \* Russell Korobkin is the Richard C. Maxwell Professor of Law at UCLA School of Law. This article is an abridged version of Russell Korobkin, *Comparative Effectiveness Research as Choice Architecture: The Behavioral Law and Economics Solution to the Health Care Cost Crisis*, 112 MICH. L. REV. 523 (2014).
1. See Council of Econ. Advisors, *The Affordable Care Act and Trends in Health Care Spending*, WHITE HOUSE, 2 (2013), [http://www.whitehouse.gov/sites/default/files/docs/fact\\_sheet\\_implementing\\_the\\_affordable\\_care\\_act\\_from\\_the\\_erp\\_2013\\_final1.pdf](http://www.whitehouse.gov/sites/default/files/docs/fact_sheet_implementing_the_affordable_care_act_from_the_erp_2013_final1.pdf).
  2. *National Health Expenditure Tables*, CENTERS FOR MEDICARE & MEDICAID SERVICES, tbl.1, <http://www.cms.gov/NationalHealthExpendData/downloads/tables.pdf> (last visited Sept. 15, 2013).
  3. *The 2013 Long-Term Budget Outlook*, CONG. BUDGET OFFICE, 43–44 (Sept. 2013), [http://www.cbo.gov/sites/default/files/cbofiles/attachments/44521-LTBO2013\\_0.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/44521-LTBO2013_0.pdf); cf. Sally T. Burner et al., *National Health Expenditures Projections Through 2030*, HEALTH CARE FINANCING REV., Fall 1992, at 1, 2 (estimating that health care spending will rise to 32 percent of GDP in 2030); Council of Econ. Advisors, Exec. Office of the President, *The Economic Case for Health Care Reform*, WHITE HOUSE, 2 (June 2009), [http://www.whitehouse.gov/assets/documents/CEA\\_Health\\_Care\\_Report.pdf](http://www.whitehouse.gov/assets/documents/CEA_Health_Care_Report.pdf) (estimating that health care spending will rise to 28 percent of GDP in 2030).
  4. THE KAISER FAMILY FOUND. & HEALTH RESEARCH & EDUC. TRUST, EMPLOYER HEALTH BENEFITS: 2013 ANNUAL SURVEY, 3, 12 (Aug. 20, 2013) [hereinafter KFF 2013 Annual Survey], available at <http://kaiserfamilyfoundation.files.wordpress.com/2013/08/8465-employer-health-benefits-20132.pdf>.
  5. As of 2013, the United States ranked fifty-first in the world in terms of life expectancy. *Country Comparison: Life Expectancy at Birth*, CENTR. INTELLIGENCE AGENCY, <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2102rank.html> (last visited Sept. 15, 2013). In 2011, the United States ranked fourth in terms of per capita health care expenditures. See *Health Financing: Health Expenditure Per Capita Data by Country*, WORLD HEALTH ORG., <http://apps.who.int/gho/data/node.main.78?lang=en> (last visited Sept. 15, 2013). Compared to twelve other industrial nations, relative health care spending per capita increased in the United States between 1975 and 2010 while relative life expectancy for middle-aged citizens decreased. Peter A. Muennig & Sherry A. Glied, *What Changes in Survival Rates Tell Us About US Health Care*, 29 HEALTH AFF. 2105, 2111 (2010).
  6. Under typical twenty-first century “managed care” insurance plans, coinsurance rates (in the form of deductibles and copayments) are very low. See, e.g., KFF 2013 ANNUAL SURVEY, *supra* note 4, at 126 (showing rates of 3% for health maintenance organization plans, 15% for preferred provider organization plans, and 4% for point-of-service plans for in-network primary care physician office visits). Patient cost sharing has, in fact, been decreasing as a percentage of total U.S. health care expenditures for fifty years. See *National Health Expenditure Tables*, *supra* note 2, tbl.3. In 2002, less than 14% of U.S. health care spending came directly from patients. MICHAEL F. CANNON & MICHAEL D. TANNER, HEALTHY COMPETITION: WHAT’S HOLDING BACK HEALTH CARE AND HOW TO FREE IT 53 fig. 4.1 (2d ed. 2007).
  7. See Russell Korobkin, *What Comes After Victory for Behavioral Law and Economics?*, 2011 U. ILL. L. REV. 1653, 1655 (2011) (discussing the concept of subjective expected utility).

8. Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566 (2012) (plurality opinion in part).
9. Following the Supreme Court's ruling that made the Act's expansion of Medicaid eligibility optional for states, *id.* at 2607–08 (plurality opinion), the Congressional Budget Office ("CBO") estimated that an additional twenty-five million Americans will obtain public or private health insurance coverage by 2023. Jessica Banthin & Sarah Masi, *CBO's Estimate of the Net Budgetary Impact of the Affordable Care Act's Health Insurance Coverage Provisions Has Not Changed Much over Time*, CONG. BUDGET OFF. (May 14, 2013), <http://www.cbo.gov/publication/44176>.
10. *See, e.g.*, Michael K. Gusmano, *Do We Really Want to Control Health Care Spending?*, 36 J. HEALTH POL. POL'Y & L. 495, 495 (2011) (noting that "few analysts accept" the administration's claim "that health care reform will reduce spending"); Richard S. Saver, *Health Care Reform's Wild Card: The Uncertain Effectiveness of Comparative Effectiveness Research*, 159 U. PA. L. REV. 2147, 2149 (2011) ("Many health policy experts believe that the [ACA] . . . does not sufficiently address intractable cost and quality problems . . .").
11. *See* Harold C. Sox, *Comparative Effectiveness Research: A Progress Report*, 152 ANNALS INTERNAL MED. 469, 470–71 (2010), available at <http://annals.org/article.aspx?articleid=746204#xref-ref-10-1>.
12. *See, e.g.*, Katherine Baicker & Dana Goldman, *Patient Cost-Sharing and Healthcare Spending Growth*, J. ECON. PERSP., Spring 2011, at 47, 52–53.
13. *See, e.g.*, Peter R. Orszag & Philip Ellis, *The Challenge of Rising Health Care Costs—A View from the Congressional Budget Office*, 357 NEW ENG. J. MED. 1793, 1794 (2007) ("The bulk of [health care] spending growth . . . [results] from the development and diffusion of new medical technologies and therapies. . . [E]vidence strongly suggests that many treatments and services are provided to patients who could do just as well with less expensive care.").
14. *See* David M. Cutler & Mark McClellan, *Is Technological Change in Medicine Worth It?*, HEALTH AFF., Sept.–Oct. 2001, at 11, 18, 21 (claiming that advances in certain technologies return 6 to 7 dollars of benefits for every dollar of cost).
15. *See generally* Ronen Avraham, *Private Regulation*, 34 HARV. J.L. & PUB. POL'Y 543, 556–57 (2011) (discussing the problem of underuse); Amitabh Chandra et al., *Patient Cost-Sharing and Hospitalization Offsets in the Elderly*, 100 AM. ECON. REV. 193, 194 (2010) (finding that increases in copayments for prescription drugs can reduce drug utilization spending but simultaneously increase hospitalization costs).
16. *See, e.g.*, Amelia M. Haviland et al., *Growth of Consumer-Directed Health Plans to One-Half of All Employer-Sponsored Insurance Could Save \$57 Billion Annually*, 31 HEALTH AFF. 1009, 1009, 1012–13 (2012).
17. *See, e.g.*, Allison Woo et al., *Consumer-Directed Health Arrangements*, KAISEREDU.ORG, <http://web.archive.org/web/20121124013523/http://www.kaiseredu.org/Issue-Modules/Consumer-Directed-Health-Arrangements/Background-Brief.aspx> (last updated June 2006) (accessed by searching for KAISEREDU.org in the Internet Archive index) ("[The term] 'consumer-directed health care' . . . applies to a broad range of health plan designs . . . but is most commonly used to describe the combination of a high-deductible health insurance plan with a tax-preferred savings account used to pay for routine health care expenses.").

18. See, e.g., James R. Bettman et al., *Constructive Consumer Choice Processes*, 25 J. CONSUMER RES. 187, 187 (1998).
19. See DANIEL KAHNEMAN, THINKING, FAST AND SLOW 12, 28 (2011).
20. See, e.g., PAUL FRONSTIN & SARA R. COLLINS, FINDINGS FROM THE 2007 EBRI/COMMONWEALTH FUND CONSUMERISM IN HEALTH SURVEY 9 (2008), available at [http://www.commonwealthfund.org/~media/Files/Publications/Issue%20Brief/2008/Mar/Findings%20From%20the%202007%20EBRI%20Commonwealth%20Fund%20Consumerism%20in%20Health%20Survey/Fronstin\\_consumerism\\_survey\\_2007\\_issue\\_brief\\_FINAL%20pdf.pdf](http://www.commonwealthfund.org/~media/Files/Publications/Issue%20Brief/2008/Mar/Findings%20From%20the%202007%20EBRI%20Commonwealth%20Fund%20Consumerism%20in%20Health%20Survey/Fronstin_consumerism_survey_2007_issue_brief_FINAL%20pdf.pdf).
21. See, e.g., CANNON & TANNER, *supra* note 14, at 6–11.
22. See Willard G. Manning et al., *Health Insurance and the Demand for Medical Care: Evidence from a Randomized Experiment*, 77 AM. ECON. REV. 251 (1987).
23. See *id.* at 258; Baicker & Goldman, *supra* note 12, at 55 (calling this finding of the RAND study “remarkably resilient in [similar] studies over time”).
24. See Manning et al., *supra* note 22, at 265–66; Baicker & Goldman, *supra* note 12, at 65 (concluding that increasing patient cost sharing at the point of service “would reduce use of both low-value and high-value services”).
25. Peter J. Neumann et al., *Do Drug Formulary Policies Reflect Evidence of Value?*, 12 AM. J. MANAGED CARE 30, 30 (2006); see also John Hsu et al., *Unintended Consequences of Caps on Medicare Drug Benefits*, 354 NEW ENG. J. MED. 2349, 2356 (2006).
26. See Nan D. Hunter, *Managed Process, Due Care: Structures of Accountability in Health Care*, 6 YALE J. HEALTH POL’Y L. & ETHICS 93, 121 (2006) (noting that from 1992 to 1998, enrollment in “managed care” forms of health insurance increased by over 50 percent).
27. See E. HAAVI MORREIM, HOLDING HEALTH CARE ACCOUNTABLE: LAW AND THE NEW MEDICAL MARKETPLACE 47 (2001).
28. See M. GREGG BLOCHE, THE HIPPOCRATIC MYTH : WHY DOCTORS ARE UNDER PRESSURE TO RATION CARE, PRACTICE POLITICS, AND COMPROMISE THEIR PROMISE TO HEAL 105 (2011).
29. See Mark A. Hall, *State Regulation of Medical Necessity: The Case of Weight-Reduction Surgery*, 53 DUKE L.J. 653, 664 (2003) (identifying from interviews that “public backlash” is one reason for insurers becoming ““managed care lite”—i.e., scaling back on the list of procedures that require medical necessity review prior to treatment”).
30. *An Update on State External Review Programs, 2006*, AHIP CENTER FOR POL’Y & RES., app. B at 8 (July 2008), [www.ahip.org/PDFs/StateExternalReviewReport.pdf](http://www.ahip.org/PDFs/StateExternalReviewReport.pdf).
31. The breadth of these statutes varies, but all permit patients to challenge treatment requests declined on the basis that they were not medically necessary. Hunter, *supra* note 26, at 129. The U.S. Supreme Court upheld the enforceability of these statutes when they were challenged as preempted by the federal ERISA regime. *Rush Prudential HMO, Inc. v. Moran*, 536 U.S. 355, 359 (2002).
32. Hunter, *supra* note 26, at 136.
33. See Hall, *supra* note 29, at 666 (“[F]or the most part, insurers . . . cannot enforce [individualized medical necessity standards] when a case goes to external review . . .”). A handful of state statutes instruct the reviewer to apply the insurer’s standard. See ALASKA STAT. § 21.07.050(D)(1) (2012); ARIZ. REV. STAT. ANN. § 20-2537(E) (2013); KAN. STAT. ANN. 40 22a15(c) (Supp. 2012); OR. REV. STAT. § 743.862(2) (2011); WIS. STAT. ANN. 632.835(3m) (West 2004 & Supp. 2012).

34. California's statute, for example, states that medical necessity must be determined based on the evidence of a service's effectiveness, expert opinion, standards of medical practice, and a treatment's likelihood of providing a benefit to the patient for which other treatments are not clinically effective. CAL. HEALTH & SAFETY CODE § 1374.33(b) (West Supp. 2013). North Carolina appears to be one exception to this trend. *See* N.C. GEN. STAT. § 58-3 200(b) (2011).
35. Hall, *supra* note 29, at 655, 658, 671 ("Insurers have largely abandoned their direct attempts to limit the utilization rate for most medical procedures."); *see also* PETER J. NEUMANN, USING COST-EFFECTIVENESS ANALYSIS TO IMPROVE HEALTH CARE: OPPORTUNITIES AND BARRIERS 24 (2005).
36. Even denials on this basis are risky in light of external review statutes that impose a relatively low standard of proof on the patient. Gregg Bloche describes a recent HealthNet plan denial of a physician-recommended unusual treatment on the ground that there was insufficient proof of its efficacy. Bloche, *supra* note 28, at 21, 28 (footnote omitted). The denial was subsequently overturned on independent review notwithstanding Bloche's analysis that the scientific basis for the treatment included "flawed studies published in second-line journals . . . [with] methodological deficiencies [that] left lots of room for quibbling." *Id.*
37. *E.g.*, Hall, *supra* note 29, at 658 ("Medical necessity review is now taking place mainly at the margins, focusing on treatments that might be considered cosmetic, custodial, or lifestyle enhancing rather than medically indicated."). Bariatric surgery, breast reduction surgery, Viagra prescriptions, residential care, and power-operated wheelchairs are frequent subjects of dispute. *See, e.g.*, Carole Roan Gresenz & David M. Studdert, *External Review of Coverage Denials by Managed Care Organizations in California*, 2 J. EMPIRICAL LEGAL STUD. 449, 457 tbl.1 (2005) (breaking down California external review challenges by service type); *see also* Hall, *supra* note 29, at 655–62 (discussing the dispute over bariatric surgery across jurisdictions).
38. *See* Russell Korobkin, *The Efficiency of Managed Care "Patient Protection" Laws: Incomplete Contracts, Bounded Rationality, and Market Failure*, 85 CORNELL L. REV. 1, 35 (1999).
39. CLARK C. HAVIGHURST, HEALTH CARE CHOICES: PRIVATE CONTRACTS AS INSTRUMENTS OF HEALTH REFORM 5 (1995).
40. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 1501, 124 Stat. 119, 242 (2010) (titled "Requirement to maintain minimal essential coverage").
41. *See* Hall, *supra* note 29, at 669 (noting that the exclusion of specific treatments succeeds by "keep[ing] the issue away from external reviewers").
42. Employer-sponsored self-funded health plans, in which the employer retains the risk rather than purchasing third-party insurance, are exempt from state-level benefits mandates as a consequence of the preemptive effects of ERISA. *See* Russell Korobkin, *The Battle over Self-Insured Health Plans, or "One Good Loophole Deserves Another"*, 5 YALE J. HEALTH POL'Y L. & ETHICS 89, 89 (2005).
43. For example, private insurance policies must cover the cost of new mothers spending forty-eight hours in the hospital postpartum and ninety-six hours following a Cesarean-section delivery. Newborns' and Mothers' Health Protection Act, 29 U.S.C. § 1185(a) (2006).
44. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 1302, 124 Stat. 119, 163 (2010).



45. There are known examples of neutrals hearing appeals of treatment denials under state external review laws ordering an insurer to cover a treatment deemed “medically necessary” even though it is clearly excluded from coverage by the policy. *See Gresenz & Studdert, supra* note 37, at 464–65. These decisions, however, are clearly outliers and are not justified by external review statutes themselves. Hall, *supra* note 29, at 667–68.
46. *See Neumann, supra* note 35, at 145 (noting that “practical limits on the details specified in contracts” impede insurers contracting with patients from considering cost-effectiveness as part of coverage decisions); Baicker & Goldman, *supra* note 12, at 52 (“[I]t is impossible to write down contingent contracts that cover the infinite array of health outcomes.”).
47. INST. OF MED., *LEARNING WHAT WORKS BEST: THE NATION’S NEED FOR EVIDENCE ON COMPARATIVE EFFECTIVENESS IN HEALTH CARE* (2007), reprinted in LEIGHANNE OLSEN ET AL., INST. OF MED., *LEARNING WHAT WORKS: INFRASTRUCTURE REQUIRED FOR COMPARATIVE EFFECTIVENESS RESEARCH* 333, 341 (2011).
48. Saver, *supra* note 10, at 2172; Pierluigi Tricoci et al., *Scientific Evidence Underlying the ACC/AHA Clinical Practice Guidelines*, 301 JAMA 831, 833 (2009).
49. *Cf. Saver, supra* note 10, at 2150 & n. 7.
50. *See, e.g., Havighurst, supra* note 39, at 93–96; Einer Elhauge, *Allocating Health Care Morally*, 82 CALIF. L. REV. 1449, 1502–04 (1994).
51. Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1222–34 (2003).
52. *Cf. id.* at 1234–44 (analyzing the market consequence of consumers not considering product attributes in their decisionmaking behavior).
53. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 6301, 124 Stat. 119, 727 (2010).
54. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 804, 123 Stat. 115; *see also Comparative Effectiveness Research Funding*, HHS.GOV/RECOVERY, <http://wayback.archive-it.org/3909/20130927155638/http://www.hhs.gov/recovery/> (accessed by searching for HHS.GOV/RECOVERY in the Internet Archive Index).
55. Patient Protection and Affordable Care Act §§ 6301(d)–(e) (2010).
56. DAVID M. CUTLER, *YOUR MONEY OR YOUR LIFE: STRONG MEDICINE FOR AMERICA’S HEALTH CARE SYSTEM* 48–56 (2004).
57. *This American Life: Someone Else’s Money: One Pill Two Pill, Red Pill Blue Pill* (radio broadcast Oct. 16, 2009), available at <http://www.thisamericanlife.org/radio-archives/episode/392/someone-elses-money?act=1#play>.
58. Anna N.A. Tosteson et al., *The Cost Effectiveness of Surgical Versus Nonoperative Treatment for Lumbar Disc Herniation over Two Years*, 33 SPINE 2108, 2108 (2008).
59. *Id.*
60. *Id.*
61. M. Gregg Bloche, *The Invention of Health Law*, 91 CALIF. L. REV. 247, 268–69 (2003).
62. If basic values and stable preferences are so heterogeneous that decisions that maximize SEU for one maximize SEU for all, substituted decisionmaking might be justified as a way to minimize transaction costs.
63. *See Robin Gregory et al., Valuing Environmental Resources: A Constructive Approach*, 7 J. RISK & UNCERTAINTY 177, 178–79 (1993).

64. *See generally* RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* (rev. ed. 2009).
65. *See* Gregory et al., *supra* note 63, at 179.
66. *E.g.*, Carl E. Schneider & Mark A. Hall, *The Patient Life: Can Consumers Direct Health Care?*, 35 *AM. J.L. & MED.* 7, 22–23 (2009) (“‘Evidence-based medicine’ is today’s watchword, but there is decent evidence for only a fraction (albeit a large fraction) of medicine. . . . [T]reatments’ cost-effectiveness. . . . is even less available than information about efficacy.”).
67. Neumann, *supra* note 35, at 64–65.
68. For a thoughtful essay on how to provide institutional support for large-scale CER, see Robert B. Giffin & Janet Woodcock, *Comparative Effectiveness Research: Who Will Do the Studies?*, 29 *HEALTH AFF.* 2075 (2010).
69. Neumann, *supra* note 35, at 97.







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# PRIVATIZATION'S PROGENY\*

Jon D. Michaels

These ought to be heady times for government service contracting. Once a controversial hobbyhorse of libertarian policy wonks and conservative ideologues, service contracting is now mainstream, championed by leading officials across the political spectrum. Once the target of serious legal challenges, contracting emerged from those early courtroom battles not only unscathed, but also emboldened by the judiciary's tacit endorsement. And, once believed too dangerous to be introduced in contexts calling for the exercise of sovereign power, service contracting is now ubiquitous in military combat, municipal policing, rule promulgation, environmental policymaking, prison administration, and public-benefits determinations.

I. INTRODUCTION

But times are changing. Privatization's proponents have always relied on government service contracting<sup>1</sup> to promote its four-fold agenda: boosting efficiency, maximizing budgetary savings, enhancing unitary control over the administrative state, and reaping political dividends. Now, however, these proponents are also branching out. They are experimenting with newer, more compelling instruments that provide surer, quicker routes to promote privatization's fiscal, political, and programmatic aims. In short, they are empowering a new generation poised to advance the privatization agenda in ways traditional service contracting never has. They are empowering privatization's progeny.

The first of privatization's progeny is the *marketization of bureaucracy*. Much of traditional service contracting's perceived payoff has come from the private sector's superior ability to discipline its workforce and to keep labor costs down. Unlike most business executives, government agency heads have long been (as some see it) saddled with above-market labor costs, powerful collective-bargaining units, and civil-service laws that effectively tenure government employees. For decades, those frustrated with government labor policy have turned instead to service contracting. Far easier to contract around the civil service than to uproot its legal foundation, contracting proved a palatable (if insidious) means of infusing market principles into government services without actually having to tear apart the bureaucracy.

Today, however, there is less of a need to conceal privatization's true purposes. Across the United States, elected officials as conservative as Wisconsin's Scott Walker and

as liberal as California's Jerry Brown are taking direct aim at the bureaucracy. We see evidence already that public-sector compensation is being slashed, that government workers' collective-bargaining rights are being curtailed, that civil-service jobs are being converted into at-will employment positions, and—most importantly—that even more drastic changes are forthcoming.

In short, we no longer need service contracts to mask the bitter taste of radical reform. Now that overhauling the civil service and refashioning the government workforce in the private-sector's image is a much easier pill to swallow, privatization's proponents need not rely as much on service contractors. By cutting out the contractor-middleman, they can instead funnel previously outsourced responsibilities into a "marketized" bureaucracy that provides new, in-house opportunities to reap efficiency and cost-savings gains, and to achieve greater unitary executive control over the administrative state.

The second of privatization's progeny is *government by bounty*. Although privatization's proponents hail the successes of government contracting, they also recognize that the traditional service contract is not a perfect instrument.<sup>2</sup> Their disillusionment with the traditional contractual form does not, however, imply wholesale disillusionment with privatization's core objectives. Rather, it simply means that those proponents might well be seeking surer ways to align principal-agent incentives, spur innovation in public administration, save money, and drum up political support. In these respects, even a purely marketized bureaucracy might not be the answer, regardless of how closely it now resembles service contracting. Instead, dissatisfaction with traditional contracts might lead policymakers even farther away, as it were, from government control, toward bounties that accord greater autonomy and assign greater risk to private actors.

In effect, bounties are government-sponsored bets or prizes. Unlike traditional contractors, bounty seekers invest their own resources to advance public aims. And, unlike traditional contractors, bounty seekers get reimbursed and rewarded only if they successfully carry out their specified tasks. Thus, the thinking goes, bounty seekers will be highly motivated to serve the government well. Innovations such as social-impact bonds, FDA priority-review vouchers, R&D prize competitions, prediction markets, and the leasing of toll roads to the private sector exemplify the breadth and depth of bounty arrangements starting to crop up across the administrative state.

Accordingly, with privatization converting government bureaucracies and colonizing new markets, we find ourselves on the brink of a great expansion, an expansion both faithful to the principles underlying the push to privatize and apostatic to its conventional form. This Article marks this important moment. It identifies the forces beginning to sap (still-popular) traditional service government contracting of its unique utility



and luster. It explains the generational expansion from privatization being virtually coextensive with service contracting to privatization now beginning to operate across a broader range of platforms. And, it grapples with the institutional fragmentation and legal de-stabilization hastened by the emergence of privatization's progeny.

**P**rivatization's popularity [today] enables it to branch out from service contracting—to convert and colonize previously inhospitable realms, refashioning them as better, more potent versions of government contracting. The forces fueling this conversion and colonization funnel some government responsibilities centripetally inward, that is, into the bureaucracy. Other responsibilities are pushed centrifugally outward, deeper into the private sector, where the government encourages the market to decide which private actors will advance public programs (and in what ways).

## II. PRIVATIZATION'S GENERATIONAL EXPANSION

In effect, we're witnessing a generational expansion. Though service contracting remains a staple feature of contemporary public administration, new upstarts are poised to supplement traditional contracting, advancing the privatization agenda in ways that contracting never has.

Among those frustrated by what they see as costly, unresponsive bureaucracy, it has long been apparent that the civil service needed to be transformed. Because overhauling the civil service would be time-consuming and politically treacherous, these critics quickly realized that the better way to restructure the civil service was to bypass it. This was true regardless of whether their underlying frustration with bureaucracy sounded in efficiency, budgetary constraints, or political control.

### A. Marketization of the Bureaucracy

Recently, however, opportunities presented themselves to attack bureaucracy head-on. Across the nation, governments began revising their employment policies, chipping away at both the compensation and legal protections government workers long enjoyed. Given today's efforts to dismantle the civil service (led by, among others, libertarians, Tea Party activists, and even politically moderate elected officials hamstrung by spiraling budget deficits), marketization is poised to make even greater inroads going forward. Thus, what once was done through circumventing the civil service one contract at a time can now be achieved not only more directly, but also more comprehensively—as the government workforce increasingly is made to resemble what we would encounter in the private sector.

This section captures the nascent marketization of the bureaucracy, as evidenced by unprecedented revisions to civil servants' collective-bargaining rights, wages and benefits, and job security. These revisions speak precisely to how successful the privatization movement has been. The quest for greater efficiencies, budgetary savings, and more

complete unitary control over the administrative state has become so strong that it is converting parts of the bureaucracy into a near-facsimile of a private workforce—and, with it, lessening the need to contract.

### 1. Diminution of Collective-Bargaining Rights

It is open season on government workers. It has been so even before Governor Scott Walker captured the nation's attention by taking aim at Wisconsin's public employees. The current movement to weaken public-sector collective-bargaining rights dates back nearly a decade and spans party lines. Those early reductions in bargaining rights were modest, but paved the way for more drastic cutbacks today.

### 2. Base Pay and Benefit Reductions

Government jobs, even low-skilled ones, have long served as a gateway to the middle class. Similar opportunities for socioeconomic advancement were once a reality within the private sector too. Over the past few decades, however, private-sector base compensation has lagged behind government pay for all but the most highly skilled.

Of late, [p]oliticians across the ideological spectrum have taken steps to limit or reduce government workers' salaries and benefits. At least forty-four states and countless cities and counties have, in just the past few years, slashed government wages. Perhaps most dramatically, the State of California and cities in Pennsylvania have sought to lower government pay to the minimum wage.

Equally significant, a substantial number of civil-service jobs are being casualized—that is, converted from full-time to part-time employment. Long a reality in the private sector, casualization translates to less generous pay, fewer, if any, benefits, fewer opportunities to rise within the ranks, and greater job vulnerability.

The fact that the government is increasingly mirroring private-sector employment practices supports the claim that, indeed, we are experiencing a marketization of the bureaucracy. More to the point, it suggests that the gap between private- and public-sector labor costs is shrinking. (Given the substantial transaction costs associated with service contracting, complete equalization is, of course, unnecessary for labor arbitrage.) With this narrowing gap,<sup>3</sup> those elected officials and agency heads who have traditionally turned to service contracting now have a more direct path to budgetary savings.

### 3. Incentive-Based Compensation

Another long-standing, efficiency-based critique of public-sector labor policy zeroes in on government's inability to provide civil servants with the requisite incentives to perform exceptionally. This perceived shortcoming is becoming less and less acute. Over the past few years, governments at every level have expanded eligibility for monetary performance bonuses and for off-scale, merit-based promotions.

[I]n this respect too the public sector is embracing the logic and custom of the market. Like the cutbacks to public-sector base compensation, these newly introduced market practices lessen the imperative to contract out.

The last piece to the marketization puzzle is job (in)security. Historically, government workers enjoyed protection against adverse employment actions absent cause. A safeguard against efforts to overly politicize the bureaucracy, for-cause protection nevertheless encouraged greater service contracting. Specifically, over the past few decades, some of those agencies frustrated with civil servants' employment protections (which they viewed as enabling bureaucratic slack and obstruction) preferred to hire service contractors. They hired contractors precisely because private-sector workers lacked the civil servants' employment protections—and thus had greater incentive to follow the Administration's lead.

4. Job (In)security

Today, this arbitraging opportunity is all but vanishing. Many states have reclassified substantial numbers of civil-service jobs as at-will employment—so much so that a majority of state employees across the country now report that their job security has lessened considerably. Similar, though to date more modest, employment conversions are occurring at the federal level.

As this marketization drift continues, government workers increasingly shorn of tenure protections will more closely resemble their private-sector counterparts. And, the more these workers resemble their private-sector counterparts, the less the agencies will find reason to contract around them.

Privatization is not just converting the government workforce into a carbon copy of what we would find in the private sector. It is also opening new frontiers, pushing public responsibilities further and deeper into the marketplace. Policy entrepreneurs have, of late, experimented more aggressively with what I call government by bounty. Championed by those who prize efficiency, who want to cut costs, and who seek to score political points, these government gambles do not conform to the traditional government service contract either in form or substance. Yet they are entirely faithful to the underlying principles that motivate such contracting. That is to say, they are borne out of the belief that though profits and competition encourage excellence in public administration, traditional service contracts do not fully exploit these market advantages.

B. Government by  
Bounty

Bounty initiatives depart from traditional service contracting in three significant ways. First, bounty initiatives are high-risk, high-reward. Unlike fee-for-service government contractors, bounty participants receive valuable awards only if they carry out government programs successfully; where they fail, bounty participants are on the hook for most, if not all, of their expenditures. Second, bounty initiatives shift monitoring costs from the government to private participants. They do so precisely because, unlike

traditional contracting, the high-risk, high-reward schemes place the onus on private participants to strive for success and, at the same time, limit the government's financial responsibility for programmatic failure. Hence agent slacking becomes a problem for the private provider, not the government. Third, bounty initiatives entail greater participatory independence. The government either does not select the specific private participants to advance public aims—or, it does not determine the actual payment or payment rate. Rather, market forces and sometimes government-appointed third parties determine which individuals and firms participate—or, they determine the payment amount or rate.

Appreciating government by bounty requires envisioning a very big tent. As a matter of substance, bounty initiatives span the administrative horizon. As a matter of structure, some bounty arrangements take the form of quasi-options, others are open offers, and still others resemble standard contracts, albeit with forms of consideration largely foreign to traditional contracting. And, as a matter of vintage, many are newly conceived; but some date back hundreds of years—and are now being revived after decades, if not centuries, of relative dormancy.

Social-impact bonds are one of the newest bounty initiatives. Largely unheard of just a few years ago, today these bonds are sparking interest and programming across the United States. In addition to projects in the works at the federal level, New York (City and State), Massachusetts, Minnesota, Connecticut, and Cuyahoga County (Cleveland) are currently designing social-impact bond programs of their own.<sup>4</sup> These programs combat, among other things, homelessness and criminal recidivism.

Social-impact bonds work as follows: Government agencies enter into agreements with private “bond organizations.” Bond organizations in turn screen, select, and finance private providers to design and administer social-service programs. With the bond organization serving as a go-between, the providers are further removed from government control than we are accustomed to when either government workers or traditional service contractors carry out public responsibilities. Moreover, it is the private bond organization—not the government—that bears most of the start-up and operational costs. If, after a predetermined number of years, the program achieves agreed-upon benchmarks of success, the government reimburses the organization for the costs incurred—and awards additional bonuses too. But, if the program does not meet the benchmarks, the bond organization recoups either none of its expenditures or only a fraction of what it initially invested. This means that the government does not subsidize the private provider's lack of success, and that the onus is on the bond organization to police the provider's progress.

Like a game of telephone, where the conveyors of the original message embellish its content and heighten its tonal inflections, the transmission of privatization's agenda from one vessel to others leaves us with a similarly transformed end product. Coming to terms with this transformed end product clues us in to the ambition, the reach, and the broader impact privatization's progeny are likely to have on the administrative state.

This Part explores the collateral effects of the shift from service contracting to bureaucratic marketization and government by bounty. It shows how privatization's progeny are poised to reverse longstanding public priorities, renegotiate the relationship between the Market and the State, and dictate changes to how the government allocates political and fiscal risk. Moreover, this Part forces us to take stock of the underappreciated virtues and vices of both the old regime (populated primarily by civil servants and traditional service contractors) and the new one (inhabited also by marketized government workers and bounty seekers).

Invariably, these explorations invite us to wrestle with some of the key legal, political, and normative debates of our time: how we balance political responsiveness and independent expertise in public administration; how we assign tangible value to abstract concepts such as participatory democracy, intergenerational sovereignty, and distributive justice; and, how we respond to the synthesis of Market and State practices. These are, of course, significant and relevant questions. They highlight the salience of this inquiry. And, they add texture to the illustrations and case studies.

Marketized bureaucracy is not a cloned offspring. It differs from its service-contracting forebearer in important ways. In what follows, I discuss how marketization's wholesale restructuring of government labor policy threatens to, among other things, normalize a "teach-to-the-test" mentality among government workers [increasingly compensated on the basis of often-hard-to-measure performance metrics]. I [next] consider how marketization's conversion of the bureaucracy—that is, the market's refashioning the government workforce in its own image—threatens to crowd out redistributive government employment practices.

A. Marketized  
Bureaucracy's  
Privatization  
Agenda—And  
Beyond

One of the signature features of marketization is its promotion of businesslike performance evaluations for government employees.

1. Marketization's  
Wholesale  
Restructuring of  
Government Labor  
Policy

Given the complexity and sensitivity of [many] governmental responsibilities, it is likely that [the] imposition of performance-based rewards and sanctions on government employees will not accurately track effort. [Those] marketized personnel might become frustrated by the potentially tenuous relationship between effort and compensation [and] refocus their mission (or be directed to refocus their mission) [in] pursuit of goals that are readily obtainable and easily measured. This response to marketization might

rationalize their work and pay—albeit at the risk of contravening the agency’s best practices, if not its legislative mandate.

Imagine, for instance, environmental or workplace-safety investigators who have always emphasized preventative measures, working (in hard-to-measure ways) with regulated firms to help them comply with the relevant laws and regulations. Now, post-marketization, those investigators might focus instead on meeting enforcement-sanction quotas. Workers’ emphasis on fines might introduce objective evaluation standards, but lying in wait for finable violations to occur is not necessarily the best (or even a better) approach to public regulation.

## 2. Marketization’s Conversion of the Bureaucracy

Marketization’s overhaul of government labor policy also seemingly crowds out opportunities to route ancillary, socioeconomic[ally redistributive] programs through government labor policy.

Consider the U.S. Postal Service. The Postal Service is not just about delivering mail. In the post-WWII era, it, like most conventional government agencies, has served also as an implicit anti-poverty and affirmative-action program. It is doubtful that the Postal Service would have been successful in advancing civil rights or elevating families if—as many today are advocating—we treated the Service as nothing more than a quasi-commercial enterprise expected to operate in the black. For many Americans, and particularly for Americans of color with limited educational and private-sector opportunities, a job with the Postal Service served as their ticket into the middle class and as a springboard for their kids to go to college.

Indeed, an argument could be made that the Postal Service has been a more successful anti-poverty program than the landmark, but much maligned, AFDC/TANF programs. Daniel Patrick Moynihan suggested as much. In the 1960s, Moynihan argued that for less than the price of federal subsistence programs, the Postal Service could hire a person “who raises a family, pays his taxes, . . . and delivers the mail.” Moynihan indicated that we should not hold it against the Postal Service that its labor costs are high. Rather, he urged, we should recognize the positive externalities (which aren’t readily credited to the Postal Service) generated by helping employees ascend into the middle class.

Moynihan’s view is, of course, a selective one. Others might look at the exact same program through the lens of special-interest set-asides. For starters, the comparatively generous pay awarded to government workers raises the price of mail delivery. It also engenders inequalities between federal postal workers and similarly situated private-sector workers. Ought, for example, FedEx and UPS employees with similar training and similar work responsibilities lag so far behind? Where is their entree to the middle class? What about their kids’ education? These disparities between federal employees and everyone else are made worse if the inflated government labor costs divert funds away from means-tested, anti-poverty programs.

Calls for cutting wages, benefits, and the overall number of letter carriers are now ubiquitous in our highly marketized political climate. Excoriated for awarding high salaries and generous pensions to low-skilled workers, the Postal Service is starting to heed these calls.

While it is certainly clear that the “mission” of private competitors UPS and FedEx is to turn a profit, the Postal Service has traditionally had a broader set of objectives. For better or worse, the forces of marketization are seemingly and summarily changing that—not just within the Postal Service but also all across the administrative state.

Challenges seemingly arise, too, as we move outward from traditional contracting’s orbit. These challenges are, in large part, a function both of bounties’ defining characteristics and of the need to sweeten the bounty proposal to encourage private participation.

B. Government by  
Bounty’s Privatization  
Agenda—And  
Beyond

For privatization’s proponents, the shifting of risks that are within a private actor’s control makes perfect sense. Such a shift promotes efficiency. But this risk shifting is not necessarily advantageous to private actors, many of whom prefer the financial security that fee-for-service contracting affords. To maximize the desirability of the bounty, governments might therefore work to ameliorate other types of risk, specifically those beyond the bounty seeker’s control. In so doing, governments might choose to sign away future policymaking discretion—discretion of the sort that, when left in public hands, could compromise the bounty seeker’s ability to secure its reward. Such risk-removing decisions are fraught ones, at least for those alarmed by a government’s willingness to enter into long-term political pre-commitments that bind—to the point of disenfranchising—future generations of citizens.

2. Bartering  
Sovereignty

Consider, for example, the recent spate of transportation-infrastructure arrangements that operate as bounties. These arrangements involve states and cities transferring operational control over roads, bridges, and parking facilities to private firms.<sup>5</sup> Firms lease the facilities, paying the government for the right to collect and keep user fees. Leases for the likes of the Chicago Skyway and the Indiana Toll Road (both entered into in the mid-2000s) run between seventy-five and ninety-nine years—and have already netted governments billions of dollars. By design, the lease payments are heavily front-loaded. Such payment structures provide an immediate windfall to fiscally beleaguered governments. For example, Chicago’s Skyway lease enabled the city to set up a \$500 million rainy-day fund, which “raised the city’s credit rating and lowered its borrowing costs.” (It is for this reason that many jurisdictions are attracted to such leases’ temporal cost savings, which take the form of *de facto* loans.<sup>6</sup>)

These transportation-infrastructure leases possess the telltale attributes of a high-risk, high-reward bounty. The private party antes up by committing to a long-term lease. It then works to ensure revenue collection (which it keeps) exceeds the combined costs of the lease payments, management, and maintenance.

But risks abound.

The value of the lease could be greatly diminished if the government later decides to mandate lower user-fee rates, to compete with the leased infrastructure by constructing new, alternative transportation options, or to increase the cost of continued maintenance by ratcheting up environmental regulations requiring leaseholder compliance. The more the government is willing to tie its own hands regarding incidentally related public policymaking, the less risky (*and more valuable*) the lease becomes to private bidders. Fiscally strapped governments thus have strong incentives to pre-commit to allowing the lessee to set parking and toll rates and refraining from subsequent policy interventions—such as building new roads, bridges, or parking structures—that lessen demand for the lessee’s infrastructure.<sup>7</sup>

All else being equal, governments might want to lower user fees during times of economic dislocation. Or, if traffic congestion or pollution becomes intractable, governments might want to charge particularly high rates, effectively (and purposely) discouraging car use. Finally, if changes in labor, housing, transportation, or environmental policy so demand, governments might want to respond by building new transportation conduits. But under what we might call “sovereignty-abdicating” provisions to bounty agreements, governments promise not to compete against the leaseholder’s services by offering new public transportation and parking options. They also promise not to adjust user fees, thus denying themselves—and successor governments—opportunities to subsidize or tax certain transportation choices.

Such sovereignty-abdicating provisions are already in operation. This is surprising if only because we traditionally have not treated sovereignty as just another bargaining chip. That might have been for good reason. After all, doing so systematically disenfranchises members of the public—both today and into the future. Once policy decisions are signed away, citizens are forced to use market power, rather than the political process, to voice concerns.

But perhaps the historical reluctance to barter sovereignty has greater rhetorical purchase than real-world utility. For all we know, citizens might well prefer a money-for-sovereignty tradeoff. Citizens might arrive at that preference because of their own financial troubles, because they do not especially value (or even engage in) democratic exercises, or because even if they do prize such participation, they have come to doubt



whether their input registers. [Nevertheless, these pre-commitments incident to bounties raise] normative and legal questions about whether sovereignty should be alienable—and more practical ones such as whether bartering governments are properly pricing it.

**T**his Article has identified dramatic changes currently transforming our bureaucracies, markets, and contemporary political culture; and, it suggested that these changes are opening new pathways that offer surer, quicker routes to promote the very objectives that have long-motivated service contracting. [Additionally, it has] addressed challenges we are likely to encounter as these new pathways become more heavily trafficked.

IV. CONCLUSION

While monumental in their own right, marketization and government by bounty bespeak something potentially even bigger. They bespeak yet more evidence that this century's administrative state will be increasingly guided by very different principles from those that long drove the modern welfare state. They bespeak the fact that government today really is commingling political and businesslike agendas in ways both liberating and threatening.



\* Jon D. Michaels is a Professor of Law at UCLA School of Law. This essay is an abridged version of an already published article. Jon D. Michaels, *Privatization's Progeny*, 101 GEO. L.J. 1023 (2013). For purposes of this excerpt, only select explanatory notes that appeared in the published work have been retained and renumbered (and, in some instances, revised to omit cited references).

1. Though government contracting and privatization are often treated synonymously . . . this Article treats government contracting as one specific instrument that advances the privatization agenda. See . . . Daphne Barak-Erez, *Three Questions of Privatization*, in *COMPARATIVE ADMINISTRATIVE LAW* 493, 495-97 (Susan Rose-Ackerman & Peter L. Lindseth eds., 2010) (describing nine forms of privatization, only one of which is government service contracting).
2. Among other things, traditional service contracts are costly to monitor; and, poor performance is often difficult to sanction.

Because of the unique risk-shifting arrangements associated with government by bounty (where the private partner assumes the financial risks associated with programmatic failures), these turns away from traditional service contracting promise greater efficiency gains and cost savings. Put simply, government by bounty is a *fee-for-service* relationship. Contractors, by and large, get paid regardless of their success in accomplishing assigned tasks. RALPH C. NASH, JR., STEVEN L. SCHOONER & KAREN R. O'BRIEN, *THE GOVERNMENT CONTRACTS REFERENCE BOOK* 525 (2d ed. 1998) (“[Government] [c]ontracts are of two basic types: fixed-price contracts and cost-reimbursement contracts. . . . Under a fixed-price contract, the contractor agrees to perform the work called for by the contract for the firm-fixed-price stated in the contract. . . . Under a cost-reimbursement contract, the Government agrees to reimburse the contractor for the costs it incurs in performing the contract and, usually, to pay a fee representing the contractor’s profit for performing the contract.”).

3. [T]he private labor market is also a dynamic one. Thus, there is always the possibility that changes in the private workforce affect marketization’s arbitraging opportunities.
4. Social-impact bonds are more firmly established in the United Kingdom. EMILY BOLTON, SOC. FIN., *SOCIAL IMPACT BONDS: UNLOCKING INVESTMENT IN REHABILITATION* (2010), available at [http://www.socialfinance.org.uk/sites/default/files/SF\\_CriminalJustice.pdf](http://www.socialfinance.org.uk/sites/default/files/SF_CriminalJustice.pdf); *Performance Bonds: Who Succeeds Gets Paid*, *ECONOMIST* (Feb. 17, 2011), <http://www.economist.com/node/18180436>; Alan Travis, *Will Social Impact Bonds Solve Society’s Most Intractable Problems?*, *GUARDIAN* (U.K.) (Oct. 5, 2010), <http://www.guardian.co.uk/society/2010/oct/06/social-impact-bonds-intractable-societal-problems>; John Loder et al., *Financing Social Value: Implementing Social Impact Bonds 1* (Jan. 2010) (unpublished manuscript), available at [http://archive.youngfoundation.org/files/images/SIB\\_paper\\_Jan\\_10\\_final.pdf](http://archive.youngfoundation.org/files/images/SIB_paper_Jan_10_final.pdf).
5. These leases are more akin to service than construction contracts, BOT (Build-Operate-Transfer) arrangements or BOOT (Build-Own-Operate-Transfer) arrangements. For discussions of these contracts and other private-public arrangements, see E. R. YESCOMBE, *PRINCIPLES OF PROJECT FINANCE* 10-11 (2002). There is no building or construction component to the transportation-infrastructure leases discussed in this section—just private responsibility for management and maintaining existing public resources.

6. The government's "repayment" of these effective loans takes the form of foregone government-revenue generation over the life of the lease.
7. Needless to add, governments cannot make assurances about policy decisions outside of their legal authority. A city or state has little influence over federal environmental or transportation policy. The risk that another political jurisdiction will interfere with the terms of a lease thus falls into the category of risks outside the control of both parties to the lease.







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James Park, who teaches Business Associations and Securities Regulation, is a widely published scholar in the fields of securities regulation and corporate law. Before joining the UCLA Law faculty, he was a member of the Brooklyn Law School faculty, where he was an assistant professor from 2007-2010 and an associate professor from 2010-2013.

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His publications have appeared in the *California Law Review*, *Duke Law Journal* and *Michigan Law Review*. His most recent publications include "Securities Class Actions and Bankrupt Companies," 111 *Michigan Law Review* 547 (2013) and "Rules, Principles, and the Competition to Enforce the Securities Laws," 100 *California Law Review* 115 (2012).





# SECURITIES CLASS ACTIONS AND BANKRUPT COMPANIES\*

James J. Park

When targeting temporary stock price declines, securities class actions often create unwarranted costs for otherwise healthy companies. Lawsuits have questionable value when directed at fluctuations that reflect market overreaction to short-term developments. However, securities class action attorneys, who receive a substantial percentage of any recovery, have significant monetary incentives to link such fluctuations to a theory of securities fraud.

INTRODUCTION

Securities class actions directed at frauds involving large public companies that suddenly filed for bankruptcy, such as Enron and WorldCom, present a powerful counterexample to this critical account. The stock prices of these companies did not just fluctuate and recover, they precipitously and completely collapsed after revelations that financial statements were overstated by billions of dollars. Though shareholders typically are wiped out in bankruptcy, Enron and WorldCom investors recovered billions of dollars from companies that essentially were frauds through securities class actions.<sup>1</sup>

In the wake of Enron and WorldCom, it has become more difficult to argue that securities class actions never serve a useful purpose for shareholders.

Though the Enron and WorldCom cases were the focus of much attention, very little is known about the subset of securities class actions involving bankrupt companies. The context of bankruptcy should be interesting to scholars of securities litigation because it includes the cases where shareholders suffer the greatest harm. The resolution of securities class actions where a bankrupt company is the issuer may shed light on the way in which context affects how parties and courts assess the merit of lawsuits.

There are two competing views as to the relationship between bankruptcy and securities fraud. Companies approaching bankruptcy have greater incentives to commit fraud in order to save the company or the jobs of managers. There thus might be a causal relationship between bankruptcy and securities fraud. On the other hand, the context of bankruptcy could lead parties and judges to more readily assume that fraud was present in bankrupt companies. This perception could reflect hindsight bias, the tendency to overestimate the predictability of events, leading to the conclusion that management knew of the danger of bankruptcy but failed to disclose it.

This study assesses the relationship between bankruptcy and securities fraud by analyzing a data set of 1,466 consolidated class actions filed from 1996 to 2004, of which 234 (approximately 16%) cases involved a company that was in bankruptcy during the pendency of the class action (“bankruptcy cases”). The study tests two hypotheses: (1) bankruptcy cases are more likely to have actual merit than cases where the issuer is not bankrupt (“non-bankruptcy cases”); and (2) bankruptcy cases are more likely to be perceived as having merit than non-bankruptcy cases, even if they do not necessarily have more merit.

The results of the study indicate stronger support for the second hypothesis than the first. The evidence is mixed with respect to whether bankruptcy cases are more likely to involve valid allegations of fraud than non-bankruptcy cases. While bankruptcy cases are somewhat more likely to involve accounting restatements than non-bankruptcy cases, they are not more likely to have other indicia of merit such as insider trading allegations, parallel Securities and Exchange Commission (SEC) actions, or a pension fund lead plaintiff. On the other hand, bankruptcy cases are more likely to succeed than non-bankruptcy cases. Bankruptcy cases are less likely to be dismissed and are more likely to result in significant settlements and settlements by third parties than non-bankruptcy cases.

Regression analysis shows that bankruptcy cases are more likely to succeed even when controlling for factors relating to the merit of the case. Logistic regressions were estimated with various measures of success as the dependent variable and various indicia of merit, case controls, and a bankruptcy variable as independent variables. For all three regressions, the bankruptcy variable was statistically significant at the 1% level.

This bankruptcy effect is evidence that bankruptcy cases are treated differently by parties and courts. The most likely explanation is that bankruptcy is a heuristic judges use to avoid dismissing cases, perhaps counteracting the tendency of judges to use heuristics to dismiss securities class actions. Though the use of the bankruptcy heuristic is troubling to the extent it reflects hindsight bias, a bankruptcy heuristic is not so problematic if securities class actions serve a more useful purpose than non-bankruptcy cases. Indeed, in bankruptcy cases, shareholder losses are permanent rather than temporary and compensation to shareholders for fraud is less likely to be a circular payment from shareholders to themselves. Judges may be influenced not only by hindsight bias but policy considerations in favoring bankruptcy cases.

This Article is divided into four parts. Part I discusses the relationship between securities fraud and bankruptcy. Part II describes the data set and provides some descriptive statistics. Part III analyzes the data set. Part IV discusses the results of the study.

Securities class actions involving bankrupt companies are of interest because there is an intuitive relationship between bankruptcy and securities fraud. There are at least two possibilities. First, there could be an actual correlation between bankruptcy and securities fraud. Managers may have greater incentive to commit fraud when a firm is heading toward bankruptcy. Second, there is no such correlation but there is a tendency to jump to unwarranted conclusions when a bankrupt company is accused of fraud, even when the company is innocent.

Bankruptcy is a context where we may see a greater incidence of fraud than with respect to solvent companies. Managers have greater incentive to commit fraud in the period leading up to bankruptcy. Alternatively, managers of companies that fall into bankruptcy could be more likely to commit fraud because of incompetence.

#### A. Actual Fraud

There are many reasons why a company finds itself in a position where it files for bankruptcy. Some developments leading to bankruptcy are the result of unavoidable macroeconomic trends, but others are at least partly the result of poor decisions by management who fail to make necessary investments and make bad strategic decisions. A new company may find that expected demand for its product never materializes. An established company can find that the market for its products and services shifts unexpectedly, leaving the company without enough revenue to cover its expenses. A company could overexpand, leaving it difficult to cover higher expenses such as financing costs.

The managers of a company have incentives to mask developments that foreshadow bankruptcy. Management could genuinely believe that the company's poor performance is an aberration that is not indicative of future trends. They might fear that if disappointing results are released, the market will overreact. Instead of reporting bad results, managers can stretch ambiguous accounting standards to report results they believe are more indicative of future trends, hoping to buy some time to save the company.

On the other hand, management can be motivated by selfish personal interest rather than a genuine belief that what they are doing is best for the company. Misrepresenting the company's performance will give managers time to exercise options or sell stock before the company's collapse. Fraud might allow a manager to keep his job while hoping that a miracle will turn the company around.

There might also be a correlation between bankruptcy and securities fraud because managers presiding over bankrupt companies are more likely to be incompetent and thus more likely to misrepresent material facts about the company. Bankruptcy may not cause fraud but the same factors that cause a company to go bankrupt can make it

more likely that there is fraud in such companies. Competent managers are more likely to avoid bankruptcy and are also more likely to avoid committing fraud. If that is the case, there would be a greater likelihood of fraud in bankrupt companies.

#### B. Perception of Fraud

Even if fraud is not more likely in bankrupt companies, there may be a perception that bankruptcy is associated with fraud. One reason for this perception is the risk of hindsight bias, the tendency to “overstate the predictability of outcomes.” Because bankruptcy is a significant and calamitous event for a public corporation, factfinders may assume that insiders with superior knowledge relative to investors must have known that bankruptcy was imminent. If that is the case, the failure to acknowledge through disclosure the risk of the developments that ultimately caused the bankruptcy will more likely be perceived as fraudulent.

To survive a motion to dismiss, any securities class action complaint alleging a violation of Rule 10b-5, must “state with particularity facts giving rise to a strong inference that the defendant acted with” scienter, that is, fraudulent intent.<sup>2</sup> This burden can be met by alleging that the defendant acted recklessly with respect to a disclosure. Recklessness has been defined by one circuit as “an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.” Given the high subjective standard for liability in Rule 10b-5 cases, hindsight bias may not be a factor in all cases, but in a close case, hindsight bias can lead decisionmakers to conclude that in light of a company’s bankruptcy, management must have been aware of a risk that was not disclosed to investors.

The risk of hindsight bias may also influence the decision of defendants to settle cases for significant amounts. Tom Baker and Sean Griffith find through interviews of participants in the settlement process of securities class actions that D&O insurers focus on what they call “sex appeal” in negotiating the settlement amount of a securities class action.<sup>3</sup> In other words, defendants themselves are subject to hindsight bias, or are at least wary of the effects of hindsight bias, in determining the value of a claim. Bankruptcy is an obvious context that will add “sex appeal” to a case, resulting in a greater likelihood that settlements in bankruptcy cases will be significant.

## II. DATA SET AND DESCRIPTIVE STATISTICS

This Part describes the data set used in this study. The data set consists of 1,466 consolidated securities class actions filed from 1996 through 2004. During this period, there were 234 securities class actions involving companies that were in bankruptcy during the pendency of the securities class action. Bankruptcy cases thus make up 16% of the securities class actions in the data set. On average, from 1996 to 2004, there were 25 securities class actions per year involving bankrupt companies.

Table 1 summarizes the number of bankruptcy cases filed from 1996 to 2004.

Table 1. Summary Data on Number of Bankruptcy Cases in Data Set by Year (1996–2004)

Year	Number of Securities Class Actions	Number of Bankruptcy Cases	% of Securities Class Actions that were Bankruptcy Cases
1996	84	13	15.5
1997	139	17	12.2
1998	198	28	14.1
1999	173	26	15.0
2000	184	32	17.4
2001	155	38	24.5
2002	186	34	18.3
2003	163	33	20.2
2004	184	13	7.1
Total	1466	234	16.0

Consistent with findings from other studies, a high percentage of the cases in the data set settled or were dismissed. 30.8% of the cases in the data set ended in dismissal. 47.7% of the cases in the data set ended in a settlement of \$3 million or more, a common threshold used in determining whether a settlement is significant in size. A small percentage of settlements, 7.6%, involved payments from parties other than the issuer such as auditors, underwriters, and individual directors or officers.

Table 3. Summary of Case Results for Data Set (1996–2004)

Result	Number of Cases	Percent of Data Set (1,466 Observations)
Dismissed	452	30.8
Significant Settlement (\$3 million or more)	700	47.7
Third Party Settlement	112	7.6

Using the data set of securities class actions just described, this Part tests two hypotheses relating to the relationship between securities fraud and bankruptcy discussed earlier. First, securities class actions against bankrupt com-

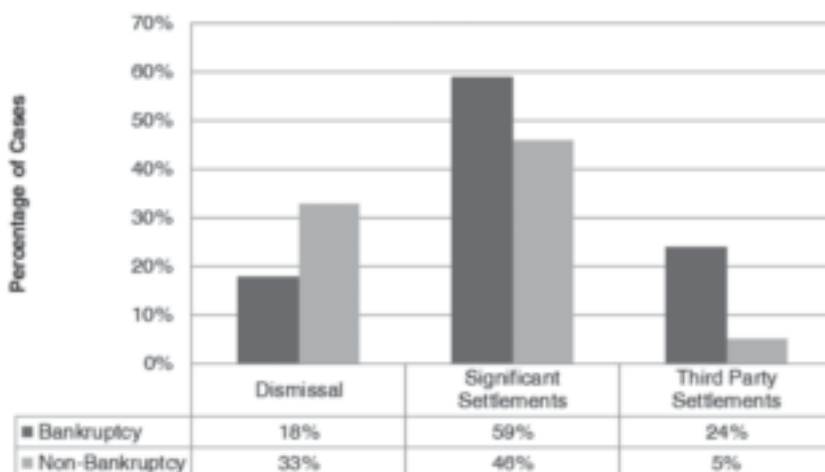
panies are more likely to have merit than securities class actions against non-bankrupt companies. Second, securities class actions do not have more merit than securities class actions against non-bankrupt companies but are perceived as having more merit. Stronger support exists for the second hypothesis than for the first.

The study found that bankruptcy cases are more likely to succeed than non-bankruptcy cases in terms of litigation results. However, the evidence is mixed with respect to whether bankruptcy cases are more likely to have indicia of merit than non-bankruptcy cases. The higher success rate of bankruptcy cases provides support for both the actual merit and perception of merit hypotheses. On the other hand, the fact that bankruptcy cases succeed without clear evidence of greater indicia of merit, indicates there is stronger support for the perception of merit hypothesis rather than the actual merit hypothesis.

## 1. Litigation Results

I examined whether bankruptcy cases are more likely to be successful than non-bankruptcy cases based on whether they are less likely to be dismissed, more likely to lead to a significant settlement, and more likely to result in a third party settlement. By all three measures, bankruptcy cases were more likely to end successfully than non-bankruptcy cases. A lower percentage of bankruptcy cases (18%) were dismissed than non-bankruptcy cases (33%). A higher percentage of bankruptcy cases (59%) resulted in significant settlements than non-bankruptcy cases (46%). A higher percentage of bankruptcy cases (24%) had third party settlements than non-bankruptcy cases (5%). All of these differences were statistically significant at the 1% confidence level. Figure 1 summarizes these results.

Figure 1. Litigation Results

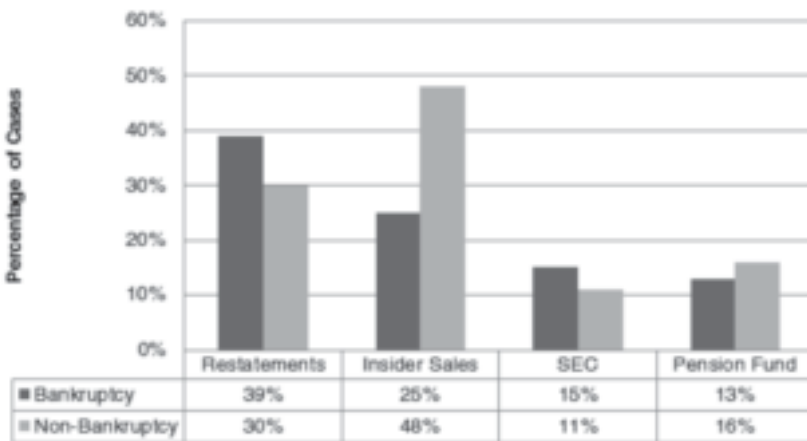


Judged by success, there is evidence supporting the two hypotheses that bankruptcy cases are more likely to have merit or are perceived to have more merit than non-bankruptcy cases. The difference appears to be most pronounced with respect to third party settlements.

2. Indicia of Merit

I next compared rates of indicia of merit between bankruptcy and non-bankruptcy cases. There was a statistically significant positive association between bankruptcy cases and restatements, though the difference was not large (39% of bankruptcy cases have an accounting restatement compared to 30% of non-bankruptcy cases). There was no statistically significant difference in the percentage of pension fund lead plaintiffs and parallel SEC actions for bankruptcy cases. There was a statistically significant association between bankruptcy cases and insider sales, but the association was negative, meaning that bankruptcy cases were less likely to have allegations of insider sales that could support a scienter requirement than non-bankruptcy cases. Figure 2 summarizes these results.

Figure 2. Indicia of Merit



Thus, because bankruptcy cases are more likely to have restatements, there is some support for the hypothesis that there is a difference in actual merit between bankruptcy and non-bankruptcy cases. However, the support is not unambiguous, suggesting that the success of bankruptcy cases may reflect perception of merit rather than actual merit.

D. Logistic Regression Analysis

Comparing rates of success and indicia of merit give a rough sense of whether bankruptcy cases have more merit, but fully understanding the relationship between bankruptcy and merit requires additional analysis. Though we know that bankruptcy cases are more likely to succeed than non-bankruptcy cases, simple comparisons do not explain why bankruptcy cases are more successful. Is it because they have actual

merit, or does the mere fact that a company is bankrupt impact the result? Many factors can influence whether a securities class action succeeds, and fully understanding the relationship between bankruptcy and the outcome of securities class actions requires analysis of additional variables that can affect the outcome of a case. Regression analysis can help us further understand why bankruptcy cases are more likely to succeed than non-bankruptcy cases.

Though we have examined litigation results and indicia of merit separately until this point, there is an obvious relationship between the success of a lawsuit and the presence of indicia of merit. A suit is more likely to succeed if it has indicia of merit such as allegations of a restatement or a pension fund lead plaintiff. Judges are less likely to grant motions to dismiss if indicia of merit are present. Moreover, parties are more likely to settle cases for significant amounts, and third parties are more likely to contribute to a settlement, if indicia of merit are present.

In addition to indicia of merit, the fact that a company is bankrupt could have an effect on the success of a lawsuit. As noted earlier, the fact of bankruptcy might itself influence the decisions of judges and parties independently from the existence of objective indicia of merit.

Simple models can be constructed that test the relationship between success and indicia of merit. A bankruptcy variable can be included to test whether the fact of bankruptcy influences whether a securities class action will be successful. If the bankruptcy variable is not statistically significant, we might conclude that bankruptcy cases are generally decided the same way as non-bankruptcy cases. If the bankruptcy variable is statistically significant, there is evidence that the fact of bankruptcy has an impact apart from the merits.

I estimated logistic regressions<sup>4</sup> with the various measures of litigation results (dismissal, significant settlements, and third party settlements) as the dependent variable and independent variables reflecting indicia of merit such as restatements, pension fund lead plaintiff, insider sales, and parallel SEC actions. I included an independent variable reflecting whether the case is a bankruptcy case. The regressions also had case controls such as the size of the company measured by total assets, whether the complaint alleged section 11 claims, length of class period, and whether the case was filed in the Second or Ninth Circuit. Variables such as the year the case was filed as well as industry of the issuer were also included.

For all three regressions, the bankruptcy variable is statistically significant at the 1% confidence level. As the perception of merit hypothesis might predict, even when controlling for indicia of merit and other factors, bankruptcy is negatively associated with dismissal and positively associated with significant settlements and third party settle-



ments. Thus, the study finds support for a “bankruptcy effect” where bankruptcy cases are more likely to succeed than non-bankruptcy cases.

By all three measures of success for securities class actions, controlling for other variables that are predictors of a successful suit, bankruptcy is associated with successful securities class actions.

The evidence indicates that bankruptcy cases are more likely to succeed than non-bankruptcy cases, though they are not likely to have greater rates of most indicia of merit. The regressions suggest that bankruptcy has an independent influence on the success of a bankruptcy case, apart from indicia of merit, indicating that judges and parties perceive bankruptcy cases as more likely to have merit. This Part assesses these results and concludes that there is stronger support for accepting the hypothesis that bankruptcy cases are perceived to have merit, than the hypothesis that bankruptcy cases are actually more meritorious. Bankruptcy is a heuristic that judges use to avoid dismissing cases.

#### IV. DISCUSSION

The bankruptcy effect likely reflects some difference relating to the merits of bankruptcy cases. The question is whether the difference is an actual difference or one of perception. On balance, there is some support for both possibilities, though the evidence more clearly supports the perception of merit hypothesis.

##### A. Bankruptcy Effect: Merits or Perception?

Perhaps the strongest evidence in support of the actual merit hypothesis is that bankruptcy cases are more likely to be associated with accounting restatements than non-bankruptcy cases. Bankruptcy cases are more likely to involve situations where final period agency costs are in play, leading to greater incidence of actual fraud than non-bankruptcy cases where the incentive to commit fraud may not be as strong. On the other hand, the difference is arguably not a large one (39% of bankruptcy case have restatements compared to 30% of non-bankruptcy cases).

The most powerful evidence against the actual merit hypothesis is that measurable indicia of merit such as allegations of insider trading, SEC proceedings, and pension fund lead plaintiffs are not present at statistically significant higher rates in bankruptcy cases. Some of these indicia, such as the presence of a pension fund lead plaintiff, are arguably stronger indicators of merit than the simple existence of a restatement. Restatements can occur by mistake and a showing of fraudulent intent is usually necessary to prevail in a securities class action. Pension funds presumably evaluate cases holistically, weighing all possible indicia of merit, both obvious and non-obvious. The presence of a credible third party who can assess the merits of a case is a stronger indicator of merit than the presence of a restatement.

The regression results, moreover, are evidence that perception of merit rather than actual merit explains the tendency of bankruptcy cases to succeed at higher rates than non-bankruptcy cases. By controlling for various indicia of merit that might explain lower dismissal rates and higher rates of significant and third party settlements, the logistic regressions isolate an independent bankruptcy effect that is evidence that the greater success of bankruptcy cases is not solely explained by the actual merits. A skeptic might respond that the regressions only control for obvious indicia of merit. There could be non-obvious measures of merit that cannot be easily scrutinized through empirical study. Such non-obvious indicia of merit could be correlated with bankruptcy and thus explain the bankruptcy effect. This argument is ultimately unconvincing without the identification of particular non-obvious indicia of merit associated with bankruptcy. Moreover, some of the obvious indicia of merit, such as the pension fund lead plaintiff variable, also reflect assessment of non-obvious indicia of merit. This study's analysis of obvious indicia of merit indicates that perception rather than actual merits is driving the success of bankruptcy cases.

#### B. The Bankruptcy Heuristic

The perception of merit hypothesis is consistent with the intuition that judges tend to decide complex cases using heuristics, or mental shortcuts. The fact of bankruptcy is likely a heuristic that influences how judges and parties perceive the merits of bankruptcy cases, leading to higher success rates for those cases relative to non-bankruptcy cases. The issuer's bankruptcy filing is known by the judges and parties in the bankruptcy cases in this data set and can thus readily serve as a way of sorting good cases from bad cases. The "bankruptcy effect" found through regression analysis is evidence that in some cases, a bankruptcy heuristic tilts the scales against dismissal or in favor of a significant settlement.

The use of bankruptcy as a heuristic for merit is somewhat different from the judging heuristics that scholars have focused on. For the most part, heuristics have been discussed as a way by which judges can dismiss cases quickly to clear their dockets. In contrast, the use of a bankruptcy heuristic is a way that judges will allow certain cases to proceed. The bankruptcy effect counteracts the tendency of judges to dispose of securities class actions at an early stage. The existence of heuristics that make it less likely that cases will be dismissed might make it more difficult to conclude that judges always discriminate against securities class actions.

The tendency to use a bankruptcy heuristic can be problematic by leading to unjust results. If judges are less likely to dismiss bankruptcy cases, parties may take this into account in settling a case. A bankruptcy provides a hint of scandal that influences parties to settle for significant amounts. Knowing this, plaintiffs could be more aggressive in bringing securities class actions against bankrupt companies so they can extort settlement payments.

On the other hand, the bankruptcy effect may not be as problematic if one believes there are stronger policy reasons for securities class actions when the issuer has filed for bankruptcy. The compensatory rationale for securities class actions is more compelling when a securities class action involves a bankrupt company. The loss by shareholders is likely significant and permanent rather than fleeting. Without a securities class action, shareholders typically receive little or nothing in bankruptcy.

Perhaps judges treat bankruptcy cases differently because they believe the policy reasons are stronger for securities class actions when they involve bankrupt rather than solvent companies. To come to this conclusion, judges need not have a full appreciation for the nuances of shareholder compensation for securities fraud but only need an intuition that the context of bankruptcy provides a better case for compensation. Judges could be dismissing these cases at lower rates because they believe that greater scrutiny of the facts through discovery is necessary to unpack the relationship between the bankruptcy and the securities fraud allegations, and that such inquiry is more likely to be worthwhile than when the case involves a healthy company. Bankruptcy cases might thus succeed because judges take on a broad view of merit that includes policy considerations and not just indicia of merit relating to the existence of fraud.

The use of bankruptcy as a heuristic is a likely explanation for the bankruptcy effect. Though hindsight bias is a factor, policy reasons might also be why bankruptcy cases are decided differently. Whatever the reason, given the ambiguity of the concept of securities fraud, we can expect judges and parties to rely on context in calculating the value of these cases.

**T**his study began by advancing two hypotheses relating to the difference between bankruptcy and non-bankruptcy cases. The first was that there is a difference in actual merits consistent with the view that fraud is more likely in a last period context. The second was that there was no actual difference in merits but that bankruptcy cases are perceived to have more merit than non-bankruptcy cases. Stronger support was found for the second hypothesis. Even when controlling for various indicia of merit, there is a bankruptcy effect that makes it more likely that these cases will succeed. This finding likely reflects a form of hindsight bias on the part of judges who decide these cases.

CONCLUSION

This study has implications for understanding the role of securities class actions. Perhaps the most compelling cases brought by investors involve companies that fall into bankruptcy in the wake of a fraud. The study of bankruptcy cases shows that judges use heuristics not only to dismiss securities class actions but also to deny motions to dismiss. This tendency could reflect hindsight bias as well as the belief that there is a core set of cases where there is greater consensus as to the utility of securities class actions. Certainly, context matters in the way that judges and parties assess the merit of securities class actions.



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1. See *In re Enron Corp. Sec., Derivative & “ERISA” Litig.*, No. MDL-1446, 2008 WL 4178151 (S.D. Tex. Sept. 8, 2008) (approving \$7 billion settlement fund including settlements by gatekeepers); *In re WorldCom, Inc. Sec. Litig.*, No. 02 Civ. 3288(DLC), 2005 WL 2319118 (S.D.N.Y. Sept. 21, 2005) (approving \$6 billion in settlements including settlements by gatekeepers).
  2. 15 U.S.C. § 78u-4(b)(2) (2006).
  3. Tom Baker & Sean J. Griffith, *How the Merits Matter: Directors’ and Officers’ Insurance and Securities Settlements*, 157 U. PA. L. REV. 755, 787 (2009).
  4. A logistic regression is a regression where the dependent variable is dichotomous, that is, can only take on the value of 0 or 1.





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