Client Briefing: Private Prisons and Immigrant Detention

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Private Prisons and Immigrant detention

For more than a year, private prison and immigrant detention firms have been subjected to increased media scrutiny. In the U.K., the criminal investigation into G4S’s and Serco’s alleged electronic tagging fraud as well as the recently leaked footage depicting the torture of inmates at a G4S prison in South Africa has filled column inches and grabbed headlines. Meanwhile in the US, Corrections Corporation of America (CCA) has garnered similar attention as a result of its departure from the state of Idaho in the wake of scandal as well as the wrongful death lawsuit filed against it by an inmate following the death of her newborn. Prior to this, The GEO Group (GEO) made the news after the state of Mississippi terminated the company’s management contract. The state cited GEO’s “egregious” administration of the Walnut Grove Youth Correctional Facility, where the U.S. Department of Justice (DOJ) found the “brazen” sexual abuse of youth inmates to be “among the worst that [it had] seen in any facility anywhere in the nation.”

These types of incidents expose the private prison and immigration detention industry’s problematic business model.

Flawed business model and incentive structure

Employed by governments seeking to cut costs, private firms engaged in outsourced corrections and immigration-related detention activities face a two-fold structural problem. Firstly, to win contracts companies must undercut what may likely be an already anaemically funded public service. Secondly, having secured a contract, companies strive to maximize revenue (which is usually dependent on the number of people incarcerated, detained, or processed), while minimizing the associated costs (number of guards, training for staff, employee screening, employee supervision, facility maintenance, and inmate medical care). Cost-containment efforts are not unique to private prison and immigration companies, but the nature of their core operations ensures that there is considerable scope for negative stakeholder outcomes to arise as a result.

Under this business model, the rehabilitation of inmates, the recidivism rates of former inmates, and the appropriate handling of complex immigration matters are external to core revenue generating incarceration and processing activities. This model may lead companies to focus on incentives that are fundamentally misaligned with the broader, societal purpose of the services they offer. In essence, this business model appears to have created companies for which providing a service that is societally beneficial and supports a downward trend in crime is seen as a material threat potentially resulting in lost revenue. Indeed, in their financial filings both CCA and GEO explicitly stipulate that a reduction in crime rates, lenient and/or non-custodial sentencing, and the decriminalization of certain controlled substances pose a risk to their continuing operations. Highlighting this, in 2013, In the Public Interest found that 65 per cent of the private prison contracts examined contained so called “low-crime taxes” (i.e., incarceration quotas and/or occupancy guarantees requiring payments for unoccupied cells or unused capacity).

Meanwhile, this dubious incentive structure has also spawned far ranging industry efforts to maximize revenue by influencing corrections and immigration policy. In the decade leading
up to 2012, GEO, CCA and a smaller, private firm collectively spent approximately USD 45 million lobbying at the state and federal level. Despite protests that they do not attempt to influence policy related to sentencing and detention, the companies’ actions included lobbying against immigration reform proposals that could decouple immigration violations from incarceration and potentially deny these companies the opportunity to partake of the more than USD 2 billion per year that is currently spent on immigrant detention in the U.S.\textsuperscript{7} These companies have also turned to political action committees (PACs) and third-party political groups to advocate for the imposition of mandatory minimum sentences, as well as so called “truth in sentencing” laws that would deny prisoners parole.\textsuperscript{8}

**Human rights and social impacts**

Sustainalytics’ coverage of these companies indicates that this misalignment of incentives may also foster a reluctance to invest in even core operations. For instance, in 2007 following the suicide of an inmate at GEO’s Dickens County Correctional Center, inspectors deemed the facility to be “beyond repair” and conditions at the prison squalid, something that would later be cited as a “major contributing factor” to the inmate’s suicide. The former warden of the facility has stated: “They denied me everything. To buy a pencil with GEO, it took three signatures. They’re cheap.”\textsuperscript{9}

Cost containment efforts focus primarily on labour, which accounts for 60 per cent to 70 per cent of operating costs at correctional and immigration detention facilities. On average, employees at private facilities receive 58 fewer hours of training than their public sector peers, and earn between USD 5,327 and USD 14,901 less per year.\textsuperscript{10} When taken with the greater incidence of inmate-on-staff assaults at private facilities (some of which have an assault rate triple that of their public counterparts\textsuperscript{11}), an employee turnover rate of 52 per cent (in the U.S.) is understandable.\textsuperscript{12} Adequate staffing levels and inmate safety can also be affected by cost cutting measures. For example, CCA’s Idaho Correctional Center was chronically understaffed and, according to multiple inmate lawsuits, the facility used gang violence as an “inexpensive device to gain control over the inmate population.” All the while, according to CCA’s own admission, the company falsified staffing records regarding the number of guards on duty and hours worked.\textsuperscript{13}

The effects of cost containment can also undermine private facilities’ capacity to adequately screen and supervise employees. This can be seen historically in GEO’s (then Wackenhut’s) hiring of a known child molester as a lead care worker at its Coke County Juvenile Justice facility in 1999, which sparked one of the worst scandals in private prison history.\textsuperscript{14} More recent examples, all characterized by the absence of adequate employee supervision, include: the sexual exploitation of female asylum seekers held at CCA’s T. Don Hutto Immigration facility; G4S’s Oakwood Prison where a surprise inspection found that employees were “...compliant, almost to the point of collusion” with inmates and drug use was rampant; and GEO’s Walnut Grove Youth Correctional Facility where its staff, including the facility’s warden, sexually exploited inmates.

In the case of immigration detention and processing facilities, insufficient employee supervision may also subvert the accurate and lawful determination of immigration claims. At Serco’s Yarl’s Wood immigration detention facility in the U.K., employees have allegedly sexually exploited female detainees for the past several years. Female detainees were told
that the chances of winning their cases would improve if they acquiesced to employee sexual advances. Meanwhile, detainees who complained were swiftly slated for deportation.\textsuperscript{15}

These human rights violations, largely the by-product of cost containment and a perverse misalignment of incentives, have been seen time and again in Sustainalytics’ coverage of these companies.

**Business impact**

These controversies and incidents may also pose significant business risks if left unmanaged. Major claims of civil liability are common and can carry large reputational and financial costs, as seen in a USD 151 million civil suit filed against CCA in Idaho in 2010. Even though CCA eventually settled for an undisclosed sum, the lawsuit triggered events that recently cost the company its USD 29 million contract with the state. The incident has even spawned potential shareholder lawsuits against CCA related to possible breaches of fiduciary duty and other violations related to the understaffing of prison guards.

Additionally, a company could lose its “social license to operate,” though this outcome is less common. Without the implicit social license to operate, companies could not only lose their current contracts, but they could also lose future access to markets. For example, the states of Idaho, Texas, Mississippi, and Kentucky all ended their contracts with CCA in 2013, while GEO had to pull out of its Mississippi operations in 2012. In the U.K., Serco has already been disqualified from a contract to manage several prisons due the ongoing criminal investigation into its activities. But perhaps the prime example of the material business impacts of past controversial activities is that of G4S and its high profile and costly failure to meet its security commitments at the 2012 London Olympics (G4S reported a loss of GBP 91 million). For companies that depend so heavily on government contracts,\textsuperscript{16} being viewed as a serial liability poses significant potential reputational and financial risk.

Even with numerous social and business risks, these firms remain highly profitable\textsuperscript{37} and reportedly enjoy a high degree of flexibility with respect to their tax rates. According to a November 2013 report by the U.K. National Audit Office, G4S paid no U.K. corporate tax in 2012, while Serco only paid GBP 25 million. Meanwhile, CCA and GEO have both begun operating as real estate investment trusts (REITs) which allows them to avoid U.S. federal taxes on the majority of their income. Despite high profits and paying low (or no) taxes, our research has found no evidence that these firms are making the investments in human capital, infrastructure, and credible internal controls that could potentially mitigate the impact of the structural issues they face.

**Outlook and investor action points**

Each of these firms will likely continue to pose a serious reputational risk to investors due to the apparently inherent structural issues that serve to exacerbate human rights and business risks. However, as noted in our article on this topic last year,\textsuperscript{18} the financial risks posed may provide investors with some leverage to demand increased transparency on human rights issues from these firms and perhaps increased compliance with their own human rights policies. Additionally, the high profile controversies, subsequent scrutiny from officials, and management shakeups at both G4S and Serco\textsuperscript{19} could present something of an opportunity for engagement should these companies match their words with action.
Responsible investors should expect the following from any company engaged in private correctional and/or immigration services that claims to be serious about addressing the aforementioned issues:

- An actionable commitment to increased transparency regarding services rendered and associated billing practices, particularly when receiving public funds.
- An explicit commitment to maintaining safe inmate/detainee-to-staff ratios at all times.
- A link between executive compensation and outcome-based performance indicators:
  - For private prison operators long-term incentives could be linked to equal term recidivism rates among a company’s former inmates.
  - For both private prison and immigration services providers the health and safety of staff as well as inmates/detainees could be considered a key performance indicator when determining compensation.
- Increased investment in employee training coupled with the adoption of more stringent training standards in line with public sector peers.

Should private prisons and immigration detention facilities fail to implement meaningful changes; investors may choose to pursue further engagement or file shareholder resolutions. However, historically engagement efforts have made little progress, and shareholder resolutions to address these issues have faced considerable board-level opposition and enjoyed minimal success. Therefore some investors may find divestment the most prudent course of action.
Endnotes


16 In FY 2012 G4S depended on governments for 23% of its revenue while 43% of CCA’s was from the US Federal Government. During the same period governments comprised 90% and 86% of Serco’s and GEO’s customers respectively.

17 In FY 2012 the following profits before taxation were reported: G4S – USD 286.35 million; Serco – USD 494.16 million; CCA – USD 244.71 million; and GEO – USD 144.56 million.


19 In September 2012, G4S’ COO David Taylor-Smith and managing director for global events Ian Horsemam-Sewell announced their resignations. In May 2013, G4S’ CEO Nick Buckles announced his resignation. In October 2013, G4S’ chief executive for the UK Richard Morris resigned as did Serco’s CEO Chris Hyman.


