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# CAN A PRIVATE CORPORATE ANALYSIS OF PUBLIC AUTHORITY ADMINISTRATION LEAD TO DEMOCRACY?

JONATHAN ROSENBLUM\*

## I. INTRODUCTION

Over the past eighty-five years “public authorities”<sup>1</sup> have increasingly colonized the provision of public services. State and local governments are more frequently creating public authorities and empowering them to perform public services that were once performed by state and local governments because public authorities are believed to be “businesslike” in the provision of public services. This claim rests on their private corporate structure. While public authorities perform public tasks, they are specifically designed around a private corporate structure. Politicians utilize the private corporate structure because they think that it will emulate the private sector’s success in achieving increased efficiency, expertise and independence in the delivery of public services.<sup>2</sup> The pri-

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1. Public authorities are quasi-public, independent entities generally created to provide one public service or undertake one public project such as transportation, school construction, housing, redevelopment or financing. Examples of public authorities include the Metropolitan Transportation Authority, the Tennessee Valley Authority, and the Housing Authority of the City of Los Angeles.

2. See ROBERT G. SMITH, PUBLIC AUTHORITIES, SPECIAL DISTRICTS AND LOCAL GOVERNMENT 53-87, 125-50 (1964) (“The two most frequently repeated arguments proffered in favor of the creation of public authorities are: . . . they [are] ‘business-like’ . . . and . . . ‘out of politics’”); see also KATHRYN A. FOSTER, THE POLITICAL ECONOMY OF SPECIAL-PURPOSE GOVERNMENT 18 (1997); DIANA B. HENRIQUES, THE MACHINERY OF GREED, PUBLIC AUTHORITY ABUSE AND WHAT TO DO ABOUT IT 1 (1986) (“[C]ommon wisdom for much of this century has been that public authorities . . . are simply too businesslike and efficient to fall prey to the corruption and managerial disarray that infect less businesslike, less efficient, more ‘political’ units of traditional government.”); Gerald E. Frug, *Beyond Regional Government*, 115 HARV. L. REV. 1763, 1781-82 (2002) (stating that the use of public authorities is mostly based on “efficiency,” “expertise” and independence and not on “equality”); see generally David J. Barron, *Reclaiming Home Rule*, 116 HARV. L. REV. 2255, 2300 (2003) (“[U]rban reformers . . . deployed the corporate analogy that had once pointed back to an image of the incorruptible segmented private city . . . to promote an urban future in which expertise and efficiency would shape

vate corporate structure, politicians claim, makes public authorities “independent,” “outside and above politics,” “the very epitome of prudence, efficiency, economy” and “free . . . from political interference, bureaucracy and red tape.”<sup>3</sup>

Part of the claim that public authorities increase efficiency and expertise in the delivery of public services is rooted in their ability to avoid many state and local regulations. In particular, public authorities are able to raise capital much more quickly than state and local governments because public authorities, unlike state and local governments, can issue debt without having to seek a public referendum. Use of the private corporate structure enables public authorities to avoid the often lengthy and costly process of submitting a request for the issuance of debt to the public.<sup>4</sup> Because of the

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municipal governance. If the great cities of the day were like private businesses, it was only because they, like modern corporations, should be run by principles of expertise and efficiency. . . .”).

3. HENRIQUES, *supra* note 2, at 2 (quoting Robert Moses in ROBERT A. CARO, *THE POWER BROKER: ROBERT MOSES AND THE FALL OF NEW YORK* (1974) and Austin J. Tobin, former director of the Port Authority of New York and New Jersey); *see also* FOSTER, *supra* note 2, at 18; SMITH, *supra* note 2, at 53-87, 125-50; New York State Comptroller, Alan G. Hevesi, *Public Authority Reform, Reining in New York's Secret Government* 3 (Feb. 2004) [hereinafter *Public Authority Reform*] (“The benefits of public authorities include their ability to finance public improvements without increasing taxes . . . to avoid the use of broad-based dedicated revenue streams, to finance the public takeover of private enterprises, to remove entities and associated operations from the direct control of elected officials, and to provide a more flexible management environment than is typical of government.” (citing Office of the State Comptroller, *Study No. 4, Public Authorities in New York State: A Financial Study, Comptroller's Studies for the 1967 Constitutional Convention* (June 1967) (citing the Report of the Temporary State Commission on Coordination of State Activities (1956)))).

4. *See generally*, JOHN C. BOLLENS, *SPECIAL DISTRICT GOVERNMENTS IN THE UNITED STATES* 44 (Univ. of Cal. Press 1957) (discussing the issuance of bonds by special district governments); NANCY BURNS, *THE FORMATION OF AMERICAN LOCAL GOVERNMENTS, PRIVATE VALUES IN PUBLIC INSTITUTIONS* 16 (1994) (summarizing Bollens's argument as well as more recent explanations for the existence of special district governments); *see, e.g.*, Carr-Gottstein Props. v. State, 899 P.2d 136 (Alaska 1995); Campbell v. State Road & Tollway Auth., 276 Ga. 714 (2003); *In re Anzai*, 936 P.2d 637 (Haw. 1997); Train Unlimited Corp. v. Iowa Ry. Fin. Auth., 362 N.W. 2d 489 (Iowa 1985); Wilson v. Ky. Transp. Cabinet, 884 S.W.2d 641 (Ky. 1994); Employers Ins. Co. of Nev. v. State Bd. of Exam'rs, 21 P.3d 628 (Nev. 2001); Bulman v. McCrane, 312 A.2d 857 (N.J. 1973); Schulz v. New York, 84 N.Y.2d 231 (1994); Fent v. Okla. Capitol Improvement Auth., 984 P.2d 200 (Okla. 1999); Mun. Bldg. Auth. v. Lowder, 711 P.2d 273 (Utah 1985); Dykes v. N. Va. Trans. Dist. Comm'n, 411 S.E. 2d 1 (Va. 1991); Dep't of Ecology v. State Fin. Comm., 804 P.2d 1241 (Wash. 1991); Dieck v. Unified Sch. Dist. of Antigo, 477 N.W.2d 613 (Wis. 1991).

ease with which public authorities can issue debt, they have grown faster than any other public or quasi-public entity<sup>5</sup> and now issue more debt than all the cities and states combined.<sup>6</sup> Today, thousands of public authorities perform individual public functions formerly performed by state and local governments. Their operation translates into billions of tax dollars each year, as the majority of principal and interest on public authority debt is paid from the state general funds through complex leases and contracts.<sup>7</sup> The widespread use of public authorities has led critics to refer to them as the “fourth branch of government,”<sup>8</sup> “phantom governments”<sup>9</sup> and “underground government[s].”<sup>10</sup>

Despite their rapid growth and increased issuance of debt, public authorities have received little critical analysis.<sup>11</sup> The studies to date focus on how well public authorities function as public agencies and look at the effects of failing to apply typical public oversight and accountability measures to them.<sup>12</sup> As a result, the

5. See Frug, *supra* note 2, at 1782-83 (stating that the number of special purpose governments in the United States is “increasing rapidly”).

6. See Bernard F. Hillenbrand, *Forward* to SMITH, *supra* note 2, at ix; see also Richard Briffault, *The Disfavored Constitution: State Fiscal Limits and State Constitutional Law*, 34 RUTGERS L.J. 907, 925 (2003) (citing WILLIAM D. VALENTE ET AL., CASES AND MATERIALS ON STATE AND LOCAL GOVERNMENT LAW 647 (William D. Valente ed., 5th ed. 2001)).

7. See Jameson W. Doig & Jerry Mitchell, *Expertise, Democracy, and the Public Authority Model: Groping Toward Accommodation*, in PUBLIC AUTHORITIES AND PUBLIC POLICY: THE BUSINESS OF GOVERNMENT 96-97 (Jerry Mitchell ed., 1992) (stating that public authorities are not financially self-sufficient and are ultimately liabilities of the state).

8. OFFICE OF THE STATE COMPTROLLER, NEW YORK STATE COMPTROLLER’S STUDIES ON ISSUES ON PUBLIC FINANCE, STATEWIDE PUBLIC AUTHORITIES: A FOURTH BRANCH OF GOVERNMENT? (1972) [hereinafter A FOURTH BRANCH OF GOVERNMENT].

9. See BOLLENS, *supra* note 4, at 30.

10. *Public Authority Reform*, *supra* note 3, at 3 (quoting A FOURTH BRANCH OF GOVERNMENT, *supra* note 8).

11. See BOLLENS, *supra* note 4, at 44; FOSTER, *supra* note 2, at 4 (quoting CHRISTOPHER HAMILTON & DONALD T. WELLS, FEDERALISM, POWER, AND POLITICAL ECONOMY 134 (1990); Doig & Mitchell, *supra* note 7, at 19; SMITH, *supra* note 2, at 5).

12. See, e.g., DONALD AXELROD, SHADOW GOVERNMENT: THE HIDDEN WORLD OF PUBLIC AUTHORITIES 92-117, 310-19 (1992); BOLLENS, *supra* note 4, at 88-92, 247-63; JOHN C. BOLLENS & HENRY J. SCHMANDT, THE METROPOLIS, ITS PEOPLE, POLITICS, AND ECONOMIC LIFE 444 (3d ed. 1975); BURNS, *supra* note 4, at 11-13; FOSTER, *supra* note 2, at 218-33; HENRIQUES, *supra* note 2, at 105-29; Dennis C. Muniak, *Economic Development, Political Conflict, and the Creation of the Metropolitan Washington Airports Authority*, in PUBLIC AUTHORITIES AND PUBLIC POLICY: THE BUSINESS OF GOVERNMENT *supra* note 7, at 99-104; 138-51; MAX A. POCK, INDEPENDENT SPECIAL DISTRICTS: A SOLUTION TO THE METROPOLITAN AREA PROBLEMS 99-104, 138-51 (1985); Advisory Comm’n on Intergovernmental

recommendations are confined to a tinkering with current institutions and often call only for improved oversight.

There has been no attempt to examine public authorities for what they are — private corporate structures.<sup>13</sup> Proponents of public authorities are able to point to little, if any, data justifying the assumption that the private corporate structure as applied to public authorities results in improved efficiency, expertise and independence. In this article, I test this assumption by examining the performance of the private corporate structure against one set of relevant norms derived from the private sector.

There is no existing standard establishing what efficiency, expertise and independence mean for public authorities or whether public authorities are actually achieving these goals. But criteria have been established to evaluate private corporate structures in the private sector. I propose to apply one set of private corporate criteria to assess public authorities' performance. Based on these criteria, I show that public authorities do not function at a level that matches the private corporate structure in the private sector. If the public authority model is not achieving the assumed benefits of effi-

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Relations, *Governmental Functions and Processes: Local and Areawide* 80-99 (1974) [hereinafter *Advisory Comm'n 1974*], available at <http://www.library.unt.edu/gpo/acir/Reports/policy/A-45.pdf>; Advisory Comm'n on Intergovernmental Relations, *Urban America and the Federal System* 5, 87-89 (1969) [hereinafter *Advisory Comm'n 1969*], available at <http://www.library.unt.edu/gpo/acir/Reports/information/m-47.pdf>; Advisory Comm'n on Intergovernmental Relations, *The Problem of Special Districts in American Government* 64-84 (1964) [hereinafter *Advisory Comm'n 1964*], available at <http://www.library.unt.edu/gpo/acir/Reports/policy/A-22.pdf>; Advisory Comm'n on Intergovernmental Relations, *Alternative Approaches to Governmental Reorganization in Metropolitan Areas* (1962) [hereinafter *Advisory Comm'n 1962*], available at <http://www.library.unt.edu/gpo/acir/Reports/policy/a-11.pdf>; Final Report of the Assembly Interim Committee on Municipal and County Government, House Resolution 500, California State Assembly, Vol. 6, No. 22 at 19 (Jan. 11, 1965) [hereinafter *California State Assembly Res. 500*].

13. See generally Steven B. Frates, *Improving Government Efficiency and Effectiveness and Reinvigorating Citizen Involvement*, 33 PERSP. ON POL. SCI. 99, 99 (Mar. 22, 2004) (discussing federal independent agency efficiency and expertise and noting that “[g]iven the large number of independent governments in our federal system, it would seem logical to assume that a marketplace-like comparison of government cost would quickly reveal which governments operate most efficiently. This market-like comparison of government cost does not take place, however, and until it does, systemic improvement in government efficiency will not likely occur”); see, e.g., AXELROD, *supra* note 12, at 315-17 (“To discard [public authorities] would be to throw the baby out with the bath water.”); MITCHELL, *supra* note 7, at 19.

ciency, expertise and independence, how can the provision of public services be remodeled to provide these benefits?

Part II sets forth a brief historical account of public authorities and their relationship to the public and private sectors. It then describes the proliferation of public authorities and briefly surveys the literature criticizing public authorities. Part III sets forth three criteria used to evaluate corporations in the private sector. The criteria are based on: (1) corporate responsibility to and from shareholders; (2) market forces restricting, evaluating and disclosing information on corporations; and (3) board of directors' responsibilities to and from the corporation. I test public authorities against these three private corporate criteria by asking three corresponding questions. For the shareholders, I ask whether public authorities are responsible to anyone or operate in anyone's interests the way private corporations work in shareholders' interest. For market forces, I ask what restricts, evaluates and discloses whether public authorities are successfully meeting that interest the way the market does in the private sector. And for the board of directors, I ask what organizational form steers public authorities the way boards of directors do in private corporations. Part III concludes that when tested against these private corporate norms, public authorities do not necessarily improve upon the efficiency or expertise in delivering public services.<sup>14</sup>

In Part IV, I propose a different way of thinking about the distribution and performance of public services. Public authorities were, after all, an experiment and there is no reason to stop experimenting. I approach this proposal by generating normative questions from the questions used in Part III. Instead of asking who are the shareholders in public authorities, I ask, whose interest should be represented in the performance of these public functions? Instead of asking what are the market forces that restrict, evaluate and disclose information on public authorities, I ask, how should we evaluate the delivery of public services? Finally, instead of asking how are public authorities organized, I ask, how should the distri-

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14. Some readers, citing the inadequacies of the private sector standards, may question the use of private corporate governance standards as a bar to gauge success. But this only highlights the inadequacies of public authorities. Public authorities failed to achieve the current private corporate governance standards, however low or high.

bution of public services be organized? The answers to these questions result in a proposed unified service organization establishing policy for public services to a region. As proposed, the regional organization would set goals and allocate funds to the appropriate entities to achieve those goals. The region's municipalities would generate an agenda for the regional organization, which would then direct and fund the entities to carry out the approved agenda. Examples of entities that the organization could fund include public authorities and cities. Different from most calls for regional forms of government or cooperation, which are rooted in the inequalities among local jurisdictions,<sup>15</sup> this proposal is rooted in the inefficiencies that extend from public authorities as highlighted by the private corporate comparative analysis.

## II. PUBLIC AUTHORITIES AND EXISTING REFORMS

The idea that the public sector could adopt a businesslike approach to providing public functions has a long and colorful history in the United States. Since 1607, when the British arrived on boats owned by private companies and chartered by King James I to colonize America, government institutions in the United States have experimented with the use of private sector corporations and techniques to perform public functions.<sup>16</sup> Not until the creation of public authorities, however, did the crossover of private sector techniques into the public realm to perform public functions grow exponentially.

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15. See, e.g., PETER CALTHORPE & WILLIAM FULTON, *THE REGIONAL CITY* (2001); Paul Boudreaux, *E Pluribus Unum Urbs: An Exploration of the Potential Benefits of Metropolitan Government on Efforts to Assist Poor Persons*, 5 VA. J. SOC. POL'Y & L. 471 (1998); Richard Briffault, *The Local Government Boundary Problem in Metropolitan Areas*, 48 STAN. L. REV. 1115 (1996); Sheryll D. Cashin, *Localism, Self-Interest, and the Tyranny of the Favored Quarter: Addressing the Barriers to New Regionalism*, 88 GEO. L.J. 1985, 2000-01 (2000); FRUG, *supra* note 2; James A. Kushner, *A Comparative Vision of the Convergence of Ecology, Empowerment, and the Quest for a Just Society*, 52 U. MIAMI L. REV. 931 (1998); Georgette C. Poindexter, *Towards a Legal Framework for Regional Redistribution of Poverty-Related Expenses*, 47 WASH. U. J. URB. & CONTEMP. L. 3 (1995); Laurie Reynolds, *Intergovernmental Cooperation, Metropolitan Equity, and the New Regionalism*, 78 WASH. L. REV. 93, 93-98 (2003); Peter Salsich Jr., *Thinking Regionally About Affordable Housing and Neighborhood Development*, 28 STETSON L. REV. 577 (1999).

16. See MITCHELL, *supra* note 7, at 22-23.

## A. *Proverbial Camel's Nose Under the Tent*

### 1. Creation of Public Authorities

Prior to the nineteenth century there was little distinction between public corporations, such as cities, and private corporations.<sup>17</sup> A distinction was drawn in 1819 when the United States Supreme Court ruled that corporations holding individual rights were private and were to be classified differently from corporations performing state functions.<sup>18</sup> The distinction created a grey area where corporations assuming "private" characteristics performed "public" functions, and corporations assuming "public" characteristics performed "private" functions.<sup>19</sup>

While the distinction between public and private corporations was being legally articulated, state and local governments were wrestling with increased debt. Between the Revolutionary War and the early nineteenth century, state and local governments almost unanimously avoided public debt.<sup>20</sup> By the end of the nineteenth century almost every city and state had experienced some debt crisis.

In the early part of the nineteenth century, cities and states, particularly in the North and Midwest, sought to grow.<sup>21</sup> With the

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17. See GERALD E. FRUG, RICHARD T. FORD & DAVID J. BARRON, *LOCAL GOVERNMENT LAW* 24 (3d ed. 2001); GERALD FRUG, *CITY MAKING: BUILDING COMMUNITIES WITHOUT BUILDING WALLS* 38-45 (1999) [hereinafter *CITY MAKING*] (describing early foundations of public corporations).

18. *Dartmouth Coll. v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819) (striking down state-enacted amendment to private corporate charter because it infringed on private contract rights); see *id.* at 668-69 (Story, J., concurring) (holding that public corporations, like cities, have "public political purposes only . . . although they involve some private interests; but strictly speaking, public corporations are such only as are founded by the government for public purposes."); *CITY MAKING*, *supra* note 17, at 38-45 ("The very purpose of the distinction was to ensure that some corporations, called 'private,' would be protected against domination by the state and that others, called 'public,' would be subject to such domination."); see also *Terrett v. Taylor*, 13 U.S. (9 Cranch.) 43 (1815) (distinguishing between state power over private and public corporations in holding unconstitutional state statutes seizing corporate lands).

19. See cases cited *infra* note 76 (setting forth examples of public authorities as private and public entities).

20. See CHARLES R. ADRIAN & ERNEST S. GRIFFITH, *AMERICAN CITY GOVERNMENT: 1775-1870* 212-13 (1976); FOREST McDONALD, *STATES RIGHTS AND THE UNION: IMPERIUM IN IMPERIO 1776-1876* 30 (2000) (quoting the Virginia General Assembly late eighteenth century resolution that the assumption of state debt is "repugnant to the Constitution of the United States").

21. See ADRIAN & GRIFFITH, *supra* note 20, at 213-15.

advent of the steam locomotive and the coming of the Industrial Revolution, local governments issued bonds and redirected the proceeds to developers to construct railroads and canals.<sup>22</sup> As a result, record debts were set across the region.<sup>23</sup> Shortly after the Civil War, the southern states also found themselves with record debts following a drop in property values, residual costs from the war and damaged infrastructure, including prisons, bridges and railroads.<sup>24</sup>

In addition to record debt, cities and states were struggling with government mismanagement and corruption, especially in the subsidizing of railroads.<sup>25</sup> Public bonds to secure construction of railroads and canals were often issued to political allies or were issued hastily, as competition for the railroads was fierce.<sup>26</sup> When railroad barons abandoned projects leaving cities and states with massive debt and no railroad, there was a general outcry for government reform.

In response to rising debt, mismanagement, and corruption, state constitutions were amended to require voter approval in the form of a referendum before cities and states could bind taxpayers

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22. See DENNIS ZIMMERMAN, *THE PRIVATE USE OF TAX-EXEMPT BONDS* 20 (1991).

23. See ADRIAN & GRIFFITH, *supra* note 20, at 213-15; see also Briffault, *supra* note 6, at 911-12, 915, 917 (stating that debt rose so quickly that nine states defaulted on their bonds and four repudiated at least part of their debt) (citations omitted); JAMES A. MAXWELL, *FINANCING STATE AND LOCAL GOVERNMENTS* 179 (1965) (noting the increase in borrowing to fund canals, highways, and railways).

24. See also BENJAMIN U. RATCHFORD, *AMERICAN STATE DEBTS* 162-67, 173-74 (1941).

25. See ADRIAN & GRIFFITH, *supra* note 20, at 214 (stating that many cities and states provided upfront capital to private railroad companies to build railroads to their city or state; when the railroad companies let the projects die, the cities, states and taxpayers were left with massive debt obligations and no railroads); New York State Constitutional Convention Committee, *Problems Relating to Taxation and Finance* (1938) (stating that every state, except eight, had issued debt for railroads or canals by 1836); see also Briffault, *supra* note 6, at 911, 917 (attributing massive debt and losses to state supported turnpikes, canals, and railroads during the early nineteenth century in the hopes of increasing economic development); Stewart E. Sterk & Elizabeth S. Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 WIS. L. REV. 1301, 1308 (1991) (finding that the 1837 depression led to a decrease in railroad value, causing major losses in state supported debt); see generally MAXWELL, *supra* note 23, at 179 (stating that nine states and one territory defaulted on their debt during this period).

26. See generally RATCHFORD, *supra* note 24, at 79-81.

to future debt obligations.<sup>27</sup> In fact, “[b]y 1870 the popular referendum had become a major part of fiscal policy-making in America[ ].”<sup>28</sup> While the referendum requirement had little effect on government corruption and mismanagement, it stabilized state and local borrowing.<sup>29</sup> New York State’s debt, for example, was almost gone by 1893.<sup>30</sup>

With the arrival of the Progressive Era in the late nineteenth and early twentieth centuries came a new wave of debt. Cities and states were increasingly compelled to improve the distribution of services and eliminate corruption and mismanagement.<sup>31</sup> While public services were increasingly being demanded, cities were annexing adjacent suburbs, enlarging all major metropolitan areas and increasing their population four to sixty-five times.<sup>32</sup> Along

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27. See ADRIAN & GRIFFITH, *supra* note 20, at 198, 215 (“In early nineteenth century, it became commonplace to require a referendum on proposed bond issues and tax levies beyond a certain level.”); Briffault, *supra* note 6, at 911-12, 915, 917 (stating “the vast majority of state constitutions impose some limitation on the ability of their state and local governments to incur debt” in response to massive debt) (citations omitted). A typical constitutional referendum requirement can be found in Article VII, section 11 of the New York State Constitution, and states in relevant part: “no debt shall be hereafter contracted by or in behalf of the state, unless such debt shall be authorized by law . . . . No law shall take effect until it shall, at a general election, have been submitted to the people, and have received a majority of all the votes cast for and against it at such election.” N.Y. CONST. art. VII, § 11; *see also* MICH. CONST. art. IX, § 15; S.C. CONST. art. X, § 13; UTAH CONST. art. XIV, § 3.

An additional provision to reduce corruption and collusion with private corporations stated that “[t]he money of the state shall not be given or loaned to or in aid of any private corporation or association, or private undertaking.” N.Y. CONST. art. VII, § 8; *see also* Schulz, 86 N.Y.2d at 233 (finding that this provision was incorporated into New York’s constitution in response to the state’s subsidizing of private railroad companies). This too has been circumvented. *See, e.g.*, *Giordano v. Ridge*, 737 A.2d 350 (Comm. Ct. of Penn. 1999) (upholding state transfer of funds to city and then to private corporation because constitution only prohibited state from transferring funds to private corporation).

28. ADRIAN & GRIFFITH, *supra* note 20, at 215.

29. *See also* MAXWELL, *supra* note 23, at 180.

30. *See Problems Relating to Taxation and Finance*, *supra* note 25, at 67.

31. *See* ERNEST S. GRIFFITH, A HISTORY OF AMERICAN CITY GOVERNMENT, THE PROGRESSIVE YEARS AND THEIR AFTERMATH 1900-1920 32, 106 (1974); MITCHELL, *supra* note 7, at 25-26; Barton, *supra* note 2, at 2286-87, 2302-03 (noting the concern for corruption and favoritism).

32. *See* Frug, *supra* note 2, at 1766-67 (citing a description of nineteenth century city expansion in VICTOR JONES, METROPOLITAN GOVERNMENT 122-35 (1942); R.D. MCKENZIE, THE METROPOLITAN COMMUNITY 191-98, 336 tbl. ix (1933); PAUL STUDENSKI, NAT’L MUN. LEAGUE, THE GOVERNMENT OF METROPOLITAN AREAS IN THE UNITED STATES

with an increase in services and serviced areas came an uncontrolled increase in costs.<sup>33</sup> In trying to meet the public's demand for social services, cities and states found themselves in a financial quagmire. They wanted to provide the services, but did not want to raise taxes. Moreover, with the constitutional referendum requirement in place, they found it difficult to raise debt, as the public often refused to approve such actions. With few alternatives, politicians looked for new and innovative funding methods.<sup>34</sup>

It was in this time of financial need that cities and states turned to the private sector for inspiration. By the early twentieth century, the private sector had reformed its management practices. Railroad companies had devised new management methodologies to respond to their geographically vast and operationally complex functions. They implemented the first widespread use of a management system consisting of a board of directors, top-level managers (for example, chief executive officers) and a large number of salaried and middle managers.<sup>35</sup> The railroad companies also developed modern business accounting with sophisticated financial, capital and cost accounting procedures.<sup>36</sup> By the 1880s, the railroad innovations were seen as a model of efficiency and became

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65-85 (1930); JON C. TEAFORD, *CITY AND SUBURB: THE POLITICAL FRAGMENTATION OF METROPOLITAN AMERICA, 1850-1970*, 32-63 (1979); KENNETH T. JACKSON, *Metropolitan Government Versus Suburban Autonomy: Politics on the Crabgrass Frontier*, in *CITIES IN AMERICAN HISTORY* 442, 444-48 (Kenneth T. Jackson & Stanley Schultz eds., 1972); Chester C. Maxey, *The Political Integration of Metropolitan Communities*, 11 *NAT'L MUN. REV.* 229, 229-30 (1922).

33. See ADRIAN & GRIFFITH, *supra* note 20, at 225; GRIFFITH, *supra* note 31, at 32, 171; see also BOLLENS, *supra* note 4, at 51 (noting the need for increased financing turned to transportation for the newly annexed areas).

34. See GRIFFITH, *supra* note 31, at 181; see also Briffault, *supra* note 6, at 912, 918 (setting forth one of the funding methods as states directing cities to borrow on their behalf because constitutional amendments originally only prohibited state borrowing; this practice was subsequently banned by constitutional amendments) (citations omitted).

35. See ALFRED D. CHANDLER, *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS* Ch.3 (1977); see also *THE RAILROADS: PIONEERS IN MODERN MANAGEMENT* (Alfred D. Chandler ed. 1979) [hereinafter *THE RAILROADS*] (reprinting five nineteenth century documents detailing the business organizational changes in the railroads).

36. See CHANDLER, *supra* note 35, at Ch. 3; see also *THE RAILROADS*, *supra* note 35.

standard operating procedures.<sup>37</sup> Soon other corporate sectors followed suit and adopted a similar corporate structure.<sup>38</sup>

Observing the increase in efficiency of the private sector, politicians imported the private corporate structure into the public sector to form public authorities and to make the provision of public services more businesslike.<sup>39</sup> Politicians found unusual support for public authorities in good government groups — politicians' usual critics. Good government groups believed that the businesslike structure would reduce corruption and increase efficiency by loosening control and abuse of funds by corrupt government personnel and putting the provision of services in the hands of an independent entity.<sup>40</sup> The private corporate structure, it was hoped, would solve the same woes in the public realm as it had done in the private sector.<sup>41</sup>

The most important aspect of public authorities for politicians, however, was that they could evade many of the constitutional restrictions on debt.<sup>42</sup> As a businesslike structure, public authorities were granted a quasi-public status, which was not subject to the referendum requirements, limiting state and local governments.<sup>43</sup> As

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37. See CHANDLER, *supra* note 35, at Ch. 3.

38. See *id.*, at Ch. 6.

39. See generally GRIFFITH, *supra* note 31, at 61 (“The emphasis [of the reforms in the early twentieth century] was clearly on a businesslike handling of municipal affairs, reflecting its usual strong business-tinged origins.”).

40. See GRIFFITH, *supra* note 31, at 36-38, 171 (finding that groups such as the Muckrakers challenged the “old order of spoils, padded contracts, and special tax favors” with a “businesslike approach”); DAVID OSBORNE & TED GAEBLER, *REINVENTING GOVERNMENT: HOW THE ENTREPRENEURIAL SPIRIT IS TRANSFORMING THE PUBLIC SECTOR* 13-14 (discussing the “Progressives’” attack against government corruption and “[t]o keep major projects like bridges and tunnels out of the reach of politicians, they created independent public authorities.”). See also GRIFFITH, *supra* note 31, at 57, 189, 298.

41. See generally FOSTER, *supra* note 2, at 15; Frug, *supra* note 2, at 1773.

42. See *Schulz*, 84 N.Y.2d at 244, 247 (holding the purpose of public authorities is to “protect the State from liability and enable public projects to be carried on free from restrictions otherwise applicable”) (citations omitted); BURNS, *supra* note 4, at 16 (“technical financing maneuver[s] . . . has become accepted wisdom about why we have [public authorities]”) (citation omitted); HENRIQUES, *supra* note 2, at 4 (“the public authority provided the legal smokescreen behind which essential government work could be done and paid for”). See also BOLLENS, *supra* note 4, at 132, 150 (citations omitted).

43. Public authorities are created by state enacted general and specific enabling legislation that establishes the basic corporate entity. See, e.g., CAL. GOV. CODE §§ 54240–54245 (allowing almost any public entity to enter into leaseback agreements

the high court in New York State put it almost one hundred years later, “[i]n theory, a public authority would . . . ‘protect the State from liability and enable public projects to be carried on free from restrictions otherwise applicable.’”<sup>44</sup>

With the advent of public authorities, state and local debt increased drastically in the 1920s.<sup>45</sup> As seen in Figure One, state debt, including that of state public authorities, increased by over 1,000% in thirty years, and local debt did almost the same.<sup>46</sup> How public authorities were to be exploited over the next eighty-five years could not have been imagined in the early twentieth century.<sup>47</sup>

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to issue debt); CAL. PUB. UTIL. CODE §§ 130050.2, 130051 (West 2006) (establishing the Los Angeles County Metropolitan Transportation Authority with a fourteen-member board); MICH. COMP. LAWS SERV. § 830.412(2) (LexisNexis 2006) (establishing the Michigan State Building Authority with a five-member board appointed by the governor with the advice and consent of the senate); 24 P.S. §§ 791.2 (establishing the Pennsylvania Public School Building Authority with nine members of a “body politic and corporate”); V.T.C.A., GOV. CODE §§ 1232, 1232.052 (establishing the TFA with a seven member board of directors appointed by the governor with the advice and consent of the senate).

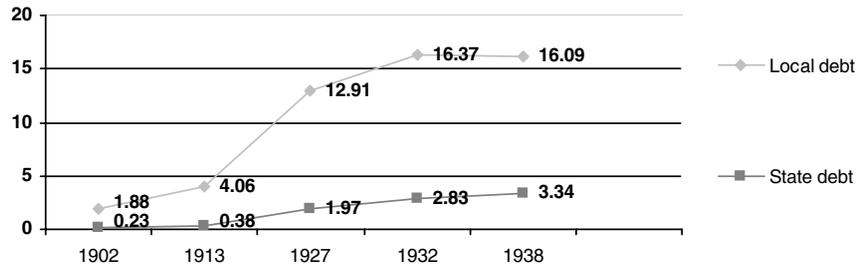
44. *Schulz*, 84 N.Y.2d at 244 (citations omitted).

45. Partially because there is no set definition for “public authority” there are conflicting views on when the first public authorities were created. Several authors have given the distinction to the 1921 creation of the Port of New York Authority. *See, e.g.*, MITCHELL, *supra* note 7, at 26-27 (citation omitted). Other authors have noted, however, that several years prior to 1921 individual entities were created out of special districts to begin bonding. *See, e.g.*, SMITH, *supra* note 2, at 7-13.

46. MAXWELL, *supra* note 23, at 181. *See also* GRIFFITH, *supra* note 31, at 176.

47. *See* GRIFFITH, *supra* note 31, at 298 (“The trend by 1920 was toward state supervision of the special districts. . . . A few, notably those created to handle ports and commerce, were what came to be called ‘authorities.’ By 1920 there were twelve of these — only the barest beginnings of their later proliferation.”).

FIGURE ONE: STATE AND LOCAL DEBT AT THE TURN OF TWENTIETH CENTURY, INCLUDING PUBLIC AUTHORITY DEBT<sup>48</sup>  
(IN BILLIONS)



## 2. Expansive Growth of Public Authorities<sup>49</sup>

Despite brief periods of reprieve, public authorities have grown steadily since their inception.<sup>50</sup> The first big boom after the initial creation of public authorities occurred following World War II and mirrored post-war urban flight.<sup>51</sup> Public authorities were employed to assist in funding new infrastructure and to provide public services for new suburban areas without increasing taxes.<sup>52</sup> Often these public authorities were created at the behest of private developers to assist in funding infrastructure to support their suburban

48. MAXWELL, *supra* note 23, at 181 (includes public authorities on the state and local levels).

49. HEAT WAVE, ERIC KLINENBERG (2002) ("It quite often happens that a phenomenon is insignificant only because one fails to take it into account." (quoting GASTON BACHELARD, *THE NEW SCIENTIFIC SPIRIT* (Arthur Goldhammer trans., Beacon Press 1984))).

50. See generally FOSTER, *supra* note 2, at 2 (noting that from 1952 to 1992 public authorities and local government entities not entitled to tax increased by 19,215, amounting to a 156% increase, while municipalities, counties and townships increased by only 1,917, amounting to a 5% increase).

51. See MITCHELL, *supra* note 7, at 33-34 (stating that public authorities were increasingly employed during the 1950s as America went on a "construction spree"). See also PETER HALL, *CITIES OF TOMORROW* 291-94 (1988) (stating that the suburban boom was brought on by mass construction of new roads, local exclusionary land use practices (zoning), government-guaranteed mortgages through the Federal Housing Authority, and the baby boom); KENNETH T. JACKSON, *THE FEDERAL HOUSING ADMINISTRATION, in CRABGRASS FRONTIER: THE SUBURBANIZATION OF THE UNITED STATES* 203-09, 213-18 (1985).

52. See generally *Public Authority Reform*, *supra* note 3, at 8 (noting New York's post-war attempts to keep taxes low by employing public authorities) (citation omitted).

projects.<sup>53</sup> The purpose of public authorities was to “provide an agency which [could] finance the utilities, the various public improvements, the recreational facilities, etc., which [were] necessary and helpful for converting raw land into marketable subdivision property.”<sup>54</sup>

The expansive use of and amount of debt generated by public authorities steadily grew and by the 1960s they were “financing, constructing, and managing public housing, bridges, tunnels, roads, mass transit systems, university dormitories, sewer systems, sport stadiums, parks, convention centers, bus stations, landfills, and power plants” all over the country.<sup>55</sup> In 1949, state non-guaranteed long term debt issued by public authorities amounted to almost \$1 billion *less* than state debt. By 1963, it amounted to \$21 billion *more* than state debt.<sup>56</sup> This was the first sign that public authorities were becoming “known as ‘borrowing machines’ whose uses were seemingly unlimited.”<sup>57</sup>

Once used for a combination of reasons, including providing public services, increasing efficiency and reducing corruption, public authorities in the mid-1960s were employed solely to issue debt.<sup>58</sup> These public authorities generated capital quickly when states and cities hit the debt limits.<sup>59</sup> In 1967 the New York State

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53. See Cal. State Assembly Res. 500, *supra* note 12, at 12.

54. *Id.*; see also Keith Aoki, *Race, Space, and Place: The Relation Between Architectural Modernism, Post-modernism, Urban Planning, and Gentrification*, 20 *FORDHAM URB. L.J.* 699, 766-70 (1993) (describing 1950s' urban conditions that led to “large-scale urban renewal projects” and flight to the suburbs).

55. MITCHELL, *supra* note 7, at 37.

56. MAXWELL, *supra* note 23, at 201, 261; U.S. Census Bureau, *State and Local Government Finances*, vol. 4, no. 5, tbl. 15 (1977); U.S. Census Bureau, *State and Local Government Finances*, vol. 4, no. 5, tbl. 15 (1972); U.S. Census Bureau, *State and Local Government Finances*, vol. 4, no. 5, tbl. 15 (1967).

57. MITCHELL, *supra* note 7, at 37.

58. See Briffault, *supra* note 6, at 922 (finding public authority bonds are used “solely to evade the debt limits. These bonds do not involve using the state to provide extra security for public authority bonds; instead, their only purpose is to enable the state to use a public authority to circumvent the state constitution”); *Public Authority Reform*, *supra* note 3, at 4, (“[I]n the 1960s public authorities were established to finance housing and urban development initiatives without the need for a statewide referendum. From the 1970s to the present, a number of public authorities have been established with the sole purpose of issuing debt on behalf of the State or local governments. At the State level, seventeen public authorities accounted for \$105 billion in outstanding debt at the end of 2002 — including about \$34 billion in State-supported debt.”).

59. See MITCHELL, *supra* note 7, at 22.

Comptroller analyzed thirty-one public authorities and found: “Public authorities have grown in size and number, and have somewhat changed in character. . . . In the newer financial-type authority, the authority finances the construction of facilities but does not operate the facility.”<sup>60</sup>

The primary rationale for creating public authorities today remains their ability to issue debt without seeking a public referendum.<sup>61</sup> A 2001 study estimated that public authorities issue 75% of all state debt and 66% of all city and county debt.<sup>62</sup> They are now second only to the federal government in the amount of debt they issue.<sup>63</sup> As illustrated in states such as New York, where public authorities issue approximately 90% of the public debt,<sup>64</sup> there does not seem to be an end in sight.<sup>65</sup> New York is not alone. States are borrowing at increased rates and are now regularly borrowing to fill budget gaps.<sup>66</sup> In 2003, Claire Cohen, vice chairman at Fitch rating agency commented that “everything has been bonded that could

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60. *Public Authority Reform*, *supra* note 3, at 8-9 (quoting Office of the State Comptroller, Study No. 4, *Public Authorities in New York State: A Financial Study*, Comptroller’s Study for the 1967 Constitutional Convention 2 (June 1967)).

61. See MAXWELL, *supra* note 23; see also A. JAMES HEINS, CONSTITUTIONAL RESTRICTIONS AGAINST STATE DEBT V (1963) (“Since 1900 . . . states have developed means of borrowing for public improvements that escape constitutional bans. . . . This development has been so complete that most states are now able to borrow funds in any amount for nearly any purpose.”).

62. Briffault, *supra* note 6, at 925 (citing VALENTE, *supra* note 6, at 647).

63. U.S. Census Bureau, *State and Local Government Finances by Level of Government and by State: 2001-02* (Dec. 9, 2005), available at [http://www.census.gov/govs/estimate/0200ussl\\_1.html](http://www.census.gov/govs/estimate/0200ussl_1.html).

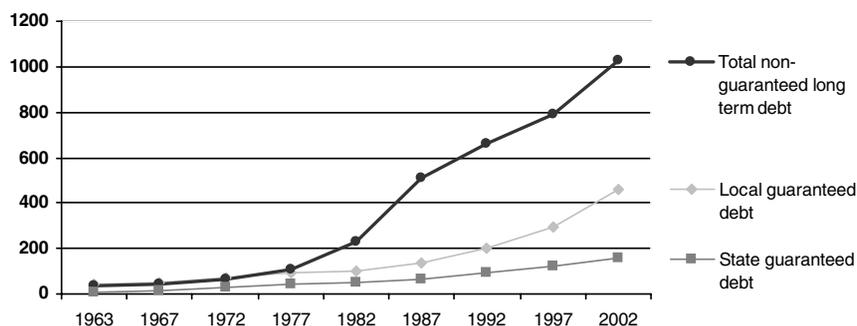
64. Office of the State Comptroller Alan G. Hevesi. *2004-05 Budget Analysis, Review of the Executive Budget* 55 (Feb. 2004), available at <http://www.osc.state.ny.us/reports/budget/2004/execbudget04.pdf> [hereinafter *NYS Budget Analysis*]; see also Briffault, *supra* note 6, at 918 (“Today, most state and local borrowing does not involve general obligation debt, but instead uses non-debt debts that avoid the pledge of full faith and credit and thus escape the constitutional debt limitations.”).

65. Office of the State Comptroller Alan G. Hevesi. *2005-06 Budget Analysis, Review of the Executive Budget* 61 (Feb. 2005), available at <http://www.osc.state.ny.us/reports/budget/2005/statebudgetreport22305.pdf> (noting, for example, New York State’s 2005-2006 executive budget providing \$2.9 billion in new appropriations to eleven public authorities, including \$348 million to one authority solely to make debt service payments on bonds).

66. Diane Kittower, *Deals of the Year*, GOVERNING MAGAZINE, Apr. 2004, at 55 (stating that 2003 “was marked by an unusual phenomenon in public finance: A lot of states . . . were ‘trying to borrow to cover their deficit’ and doing more of it than . . . ever . . . .”) (citation omitted); see also Briffault, *supra* note 6, at 925.

be.”<sup>67</sup> As seen in Figure Two, public authorities have taken on more and more debt and for the first time surpassed \$1 trillion in outstanding debt.<sup>68</sup>

FIGURE TWO: LONG-TERM STATE AND LOCAL DEBT AT THE END OF THE TWENTIETH / EARLY TWENTY-FIRST CENTURY<sup>69</sup>  
(IN BILLIONS)



In addition to rising debt, public authorities do not seem to have solved many of the corruption woes that hinder general-purpose governments.<sup>70</sup> Allegations of abuse and corruption plague public authorities with no less and sometimes even more frequency than other government entities.<sup>71</sup> Numerous public authorities

67. Kittower, *supra* note 66, at 55 (quoting Claire Cohen); *see also* Briffault, *supra* note 6, at 925.

68. U.S. Census Bureau, *State and Local Government Finances: 2002* (June 17, 2004), available at <http://www.census.gov/govs/www/estimate02.html>.

69. U.S. Census Bureau, *State and Local Government Finances*, vol. 4, no. 5, tbl. 13 (1987); U.S. Census Bureau, *State and Local Government Finances*, vol. 4, no. 5, tbl. 13 (1982); U.S. Census Bureau, *supra* note 68; U.S. Census Bureau, *State and Local Government Finances: 1997* (Jan. 29, 2001), available at <http://www.census.gov/govs/www/estimate97.html>; U.S. Census Bureau, *State and Local Government Finances: 1992* (Jan. 29, 2001), available at <http://www.census.gov/govs/www/estimate92.html>.

70. *See Public Authority Reform*, *supra* note 3, at 29 (“A review of past practices by authorities reveals a history of unethical and, at times, illegal activities.”).

71. *Public Authority Reform*, *supra* note 3, at 29 (stating that with the increase of public authorities “allegations of impropriety . . . corrupt practices also surface[ ]. Investigations . . . [and] audit[s] . . . uncover[ ] cases of bribery, nepotism, bid-rigging, misuse of funds and financial mismanagement — costing the State tens of millions of dollars and resulting in the indictments of dozens of authority employees.”).

have been faulted in recent decades<sup>72</sup> and many have been faulted more than once.<sup>73</sup> Despite the uncontrolled rise in debt and the existence of corruption, cities and states routinely create new public authorities to evade the referendum requirement.<sup>74</sup>

### 3. Corporate Structure of Public Authorities

The rationale for creating public authorities is rarely admitted to be an evasion of the referendum requirement. Rather, public authorities are justified on the grounds that their businesslike form increases efficiency, expertise and independence. At the heart of that form is a board of directors and a hierarchy of administrative officers.<sup>75</sup> With the board and officers, public authorities take on a quasi-public status<sup>76</sup> and are not bound by many of the restrictions applicable to typical public agencies such as civil service, environmental, land use and procurement laws and regulations.<sup>77</sup> They are also subjected to little oversight and have the power to determine their own policies and budgets.<sup>78</sup> Many public authority

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72. See HENRIQUES, *supra* note 2, at 42-52; MITCHELL, *supra* note 7, at 116-20; SMITH, *supra* note 2, at 33-37.

73. *Public Authority Reform*, *supra* note 3, at 24-38.

74. See Briffault, *supra* note 6, at 922 (stating that the use of public authorities to circumvent debt limitations in 2001 was common in 33 states) (citation omitted).

75. In most public authorities the board is not elected and is appointed by the governor. See, e.g., MICH. COMP. LAWS SERV. §§ 803.411, 803.412(2); V.T.C.A., GOV. CODE §§ 1232, 1232.052.

76. Compare *Hess v. Port Authority Trans-Hudson Corp.*, 513 U.S. 30, 52 (1994) (holding that public authority was a private entity not entitled to state immunity); *Int'l Soc'y for Krishna Consciousness, Inc. v. Lee*, 505 U.S. 672, 680 (1992) (finding Port Authority of New York and New Jersey, a public authority, to be a private entity operating an airport); *Ball v. James*, 451 U.S. 355, 371 (1981) (upholding unequal voting power for the board of directors of a special district because it provided electricity, a function typically provided by private companies), with *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 392 (1995) (holding that Amtrak was a public agency because it was created by Congress and members appointed by the president); *Hadley v. Junior Coll. Dist.*, 397 U.S. 50, 53 (1970) (requiring one person one vote for election to community college district because it "exercised general governmental powers").

77. See FOSTER, *supra* note 2, at 10. Public authorities are also often not held to the same United States constitutional standards as cities and states. See, e.g., *Int'l Soc'y for Krishna Consciousness*, 505 U.S. at 672 (applying a lower standard to a challenge that the Port Authority of New York and New Jersey violated the First Amendment); *Ball*, 451 U.S. 355 (applying lower standard of one person, one vote under the Equal Protection Clause).

78. See also BOLLENS, *supra* note 4, at 34; FOSTER, *supra* note 2, at 10.

budgets are not included in state budgets at all or, at best, are only attached separately, as addenda.<sup>79</sup> Because they are free from many oversight and accountability measures, public authorities are often empowered to perform tasks other government entities would not, or could not, perform due to various social and political pressures.<sup>80</sup>

As public entities, public authorities are authorized to issue tax-exempt bonds.<sup>81</sup> As private entities, they do not issue their bonds on behalf of the state and need not seek public approval via a referendum.<sup>82</sup> Their bonds are not officially guaranteed by the state's full faith and credit,<sup>83</sup> and are therefore not subject to state limitations.<sup>84</sup> Public authorities initially issued mostly revenue bonds. Most public authorities today do not have the revenue capacity through fees or rent payments to make principle and interest payments on their bonds. States create public authorities to issue bonds not connected with a public service, but rather to fill budget

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79. See, e.g., Daniel W. Hynes, Illinois State Comptroller, *Bonded Indebtedness and Long Term Obligations, Fiscal Year 2003* (Apr. 2004), available at <ftp://163.191.177.34/ioc-pdf/FY03AnnualBondReport.pdf>; Michael J. Masch, Pennsylvania Secretary Office of the Budget & Harvey C. Eckert, Deputy Secretary, *Comprehensive Annual Financial Report For the Fiscal Year Ended June 30, 2003* 167-68 (Apr. 27, 2004), available at <http://www.budget.state.pa.us/budget/lib/budget/2002-2003/cafr/2003CAFROfficialWeb.pdf>.

80. See FOSTER, *supra* note 2, at 10; see generally *Public Authority Reform*, *supra* note 3, at 7.

81. See generally SMITH, *supra* note 2, at 1 ("One of the more striking manifestations of this reflection is the increasing prescription by local officials of large doses of what the London *Economist* has referred to as 'the wonder-drug authoritycin,' — the public-authority device.") (citation omitted).

82. Occasionally, public authorities are authorized to tax or make special assessments for the purpose of paying service on outstanding bonds, creating further debt. See BOLLENS, *supra* note 4, at 149 (citation omitted).

83. Bonds that are guaranteed by the state are backed by the state's full faith and credit and will be paid out of any revenue source from the state.

84. See *Employers Ins. Co. of Nev.*, 21 P.3d 628; *Dykes*, 411 S.E. 2d 1; *Dep't of Ecology v. State Fin. Comm.*, 804 P.2d 1241 (Wash. 1991); *Dieck*, 477 N.W.2d 613; *Schulz*, 84 N.Y.2d at 244 (holding the purpose of public authorities is to "protect the State from liability and enable public projects to be carried on free from restrictions otherwise applicable"; public authorities' financial obligations "are — by constitutional mandate — not legal liabilities of the [s]tate.") (citations omitted); *Train Unlimited Corp.*, 362 N.W. 2d 489; *Mun. Building Auth. v. Lowder*, 711 P.2d 273; (upholding creation of public authority to issue bonds for exact project that voters denied via referendum).

gaps.<sup>85</sup> Because the state cannot make direct payments on the bonds, unless the bonds were submitted to and approved by referendum, public authorities enter into complex agreements with the state to circumvent the referendum requirement and allow the state to pay for the bond “indirectly” from the state coffers. These agreements take various forms, including leasebacks, contractual services debt, appropriation back debt and personal income tax (PIT) and sales tax bonds.<sup>86</sup>

A typical leaseback bond works as follows.<sup>87</sup> In 1991 New York State “sold” Attica State Prison and a piece of Interstate 287 to the Urban Development Corporation (the UDC), a state-created public authority, for \$242 million.<sup>88</sup> The UDC issued \$242 million in bonds without a referendum and forwarded the capital directly to the state to balance a shortfall in the state budget. But the state still needed the prison and the UDC was not designed to run a prison, yet it needed funds to pay the debt service on the bonds. The state, therefore, leased the prison back from the UDC.<sup>89</sup> The lease payments were the same amount as the debt service obligation and were used to make payments on the bonds. While the state balanced the budget for that year, the bonds are still being paid for and will cost the taxpayers over \$750 million.<sup>90</sup> “The *Journal of Com-*

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85. See, e.g., New York State Comptroller, DA’s Public Authority Administrative Data File (Mar. 31, 2005), available at <http://www.osc.state.ny.us/pubauth/data/FACFIN/DASNY.htm> (stating that the Dormitory Authority in fiscal year ended March 31, 2003 issued \$800 million in personal income tax (PIT) bonds and had over \$8 billion in outstanding leaseback bonds, compared to \$1.1 billion in outstanding revenue bonds).

86. Upon the issuance of a PIT bond, the proceeds from the bonds are transferred to the state and the state allocates a percentage of the personal income tax from the state general fund to pay the authority on the bond payments. New York State Personal Income Tax Revenue Bond, Debt Outstanding by Issuer and Series for Fiscal Year 2005-06, (June 30, 2005), available at <http://www.budget.state.ny.us/investor/bond/NYSPITDebtOutstanding.pdf>.

87. Donald Axelrod “sarcastically observed that it would take the ‘wizardry of the legendary Rube Goldberg merely to chart [lease backs] on paper.’” MITCHELL, *supra* note 7, at 86 (citation omitted).

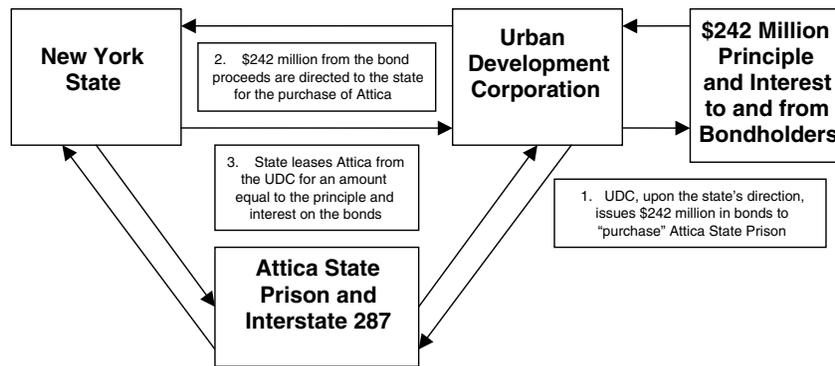
88. Senator Daniel Patrick Moynihan, *Introduction to The Federal Budget and the States: Fiscal Year 1997* 12 (John F. Kennedy Sch. of Gov’t, Working Paper, Sept. 30, 1998), available at [http://www.ksg.harvard.edu/taubmancenter/pdfs/fisc/complete\\_97.pdf](http://www.ksg.harvard.edu/taubmancenter/pdfs/fisc/complete_97.pdf).

89. See *id.* There was no question as to whether UDC was going to “privatize” or operate the prison, as it does not maintain this personnel.

90. *Id.* at 12.

*merce* likened the transaction to ‘selling your arm to your head to raise money for a new pair of shoes.’”<sup>91</sup>

FIGURE THREE: NEW YORK STATE AND UDC LEASE BACK OF ATTICA STATE PRISON



Another often cited reason for the creation of public authorities is that they provide corporate-like expertise by being limited to one or two services, such as housing, development or transportation.<sup>92</sup> By providing only one service, public authorities are, in theory, able to develop a specific area of expertise.<sup>93</sup> The experts are believed to efficiently operate public functions and know better than the public the proper means of attaining public goals.<sup>94</sup>

#### B. Existing Critiques of Public Authorities

Despite an increase in the number of public authorities, the services they render and the debt they issue, public authorities remain a fairly unstudied matter.<sup>95</sup> The studies to date are primarily

91. *Id.* at 13 (quoting William E. Simon, *Where New York Went Wrong*, JOURNAL OF COMMERCE, May 8, 1985, at 6A. The lease back is regularly used in all areas of the country. Reaching the leaseback pinnacle are cities like Troy, New York, which rents its city hall from a public authority. See MITCHELL, *supra* note 7, at 79.

92. See Frug, *supra* note 2, at 1781-82; see Bafron, *supra* note 2, at 2300.

93. See also BOLLENS, *supra* note 4, at 68 (“An overwhelming majority of these districts are legally limited to supplying a single service”).

94. See generally ROBERT A. DAHL, ON DEMOCRACY 45, 69 (1998).

95. See AXELROD, *supra* note 12, at 13-21; BOLLENS, *supra* note 4, at 1, 44; FOSTER, *supra* note 2, at 4; MITCHELL, *supra* note 7, at 19 (citations omitted); SMITH, *supra* note

focused on the ability of public authorities to evade many of the good governance checks applicable to public agencies such as oversight and accountability.<sup>96</sup> The studies do not examine the effects of applying typical private corporate oversight and accountability measures to public authorities.<sup>97</sup>

The recommendations for reform parallel the critiques by calling for some form of public oversight and accountability. The recommendations only minimally focus on the private corporate structure and whether it is producing the alleged effects of increasing efficiency and expertise. Former New York State Comptroller Arthur Levitt's reform proposal is a typical example. He recommended that public authorities be subjected to the same accountability and oversight applied to state executive agencies and that their budgets be reviewed by the state budget director.<sup>98</sup> Another typical example is a 2004 bill proposed in New York that would increase oversight and accountability, but that would not alter the fundamental private corporate structure of public authorities.<sup>99</sup> The current reforms maintain the idea that one public authority is necessary for each public service in order to develop corporate-like

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2, at 5; *Public Authority Reform*, *supra* note 3, at 4 (quoting that in "1990, when the Commission on Government Integrity issued its 'Preliminary Report on Authorities and Other Public Corporations,' it noted: 'At present, so far as Commission staff has been able to determine, no one has even an approximate count of how many of these organizations exist, where they are, much less an accounting of what they do.'") (citation omitted).

96. See, e.g., Axelrod, *supra* note 12, at 92-117, 310-19; BOLLENS, *supra* note 4, at 88-92, 247-63; BOLLENS & SCHMANDT, *supra* note 12, at 444; BURNS, *supra* note 4, 11-13; FOSTER, *supra* note 2, at 218-33; HENRIQUES, *supra* note 2, 105-29; POCK, *supra* note 12, at 99-104, 138-51; STEPHENS & WIKSTROM, *supra* note 12, at 136-37; Jones, *supra* note 12, at 545; *Public Authority Reform*, *supra* note 3, at 39-41 (listing government funded reports warning about public authority finance); *Advisory Comm'n 1974*, *supra* note 12, at 80-99; *Advisory Comm'n 1969*, *supra* note 12, at 5, 87-89; *Advisory Comm'n 1964*, *supra* note 12, at 64-84; *California State Assembly Res. 500*, *supra* note 12.

97. See generally Frates, *supra* note 13, at 99.

98. *Public Authority Reform*, *supra* note 3, at 40. It should be noted that in March 1972 when Levitt made these comments, the combined direct and indirect state debt in New York was \$5.8 billion. In 2004, New York direct and indirect state debt exceeded \$45 billion. *Id.* at 39 (citation omitted).

99. James M. Odato, *Bill targets influence on authorities; Albany latest reform proposal would open up processes of contract awarding, borrowing*, THE TIMES UNION, May 22, 2004, at B3.

expertise, despite a lack of information or a standard of review to test this claim.<sup>100</sup> As one author noted despairingly:

The unfortunate conclusion seems to be that there is no significant way to evaluate in a comparative sense the relative efficiency of the authority-device and the performance of such functions in the more conventional government department.<sup>101</sup>

In the next section, I propose one such evaluation.

### III. PUBLIC AUTHORITIES AND PRIVATE REFORMS

The private sector has established standards to evaluate the corporate structure in the private realm. Instead of looking to external public accountability and oversight mechanisms to mitigate the ailments stemming from public authorities, in this section, I look at public authorities' private corporate structure to see if it provides them with the same level of efficiency and expertise as it does in the private sector. The use of private corporate standards to evaluate public authorities is not a comment on the adequacy of the private corporate standards. Rather, because public authorities do not have standards to review their private corporate structure, private corporate standards offer one approach to developing a standard of evaluation.

There is no single management or monitoring system universally used to gauge private corporate governance. Publicly traded corporations<sup>102</sup> are scrutinized and evaluated by numerous groups

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100. The New York State Comptroller has encountered great difficulty in discovering the number of public authorities in New York State. Telephone Interview with Margaret Sherman and Kim Fine, New York State Office of the State Comptroller Alan Hevesi (July 1, 2004) (noting the comptroller initially published a report with 640 public authorities, following the release of the report, the comptroller found more authorities and some authorities telephoned to inform the comptroller that they were not on the list; the list on July 1, 2004 was at 708); *see also* MITCHELL, *supra* note 7, at 19 (finding that empirical data on public authorities is difficult to find) (citations omitted); SMITH, *supra* note 2, at 4-7 (noting the "anonymity" of public authorities); *Public Authority Reform*, *supra* note 3, at 5.

101. SMITH, *supra* note 2, at 92.

102. For purposes of this article "publicly traded corporation" is used interchangeably with "private corporation" and "company" and means a company registered under section 12 of the Securities Exchange Act of 1934 [hereinafter Exchange Act] or the filing of reports pursuant to section 15(d) of the Exchange Act.

such as investors, government entities and shareholders. Publicly traded corporations are also evaluated according to numerous standards, financial and otherwise.<sup>103</sup> Below I review public authorities based on three of these standards to provide a snapshot of how the private corporate structure operates in public authorities when reviewed under private corporate standards. The three standards are based on: (1) corporate responsibility to and from shareholders; (2) market forces restricting, evaluating and disclosing information on corporations; and (3) board of directors' responsibilities to and from the corporation. First, I ask, do public authorities operate in anyone's interests the way private corporations work in shareholders' interest? Second, I ask, what standards or mechanisms serve to evaluate and disclose whether or not public authorities are successfully meeting that interest in a manner similar to the way the market operates in the private sector? Third, I ask, what organizational form steers public authorities the way boards of directors do in private corporations? This section concludes that when tested against these private corporate norms, public authorities do not provide more efficiency or expertise in the delivery of public services.

#### A. Shareholders

A corporation operates first and foremost in the interest of its shareholders.<sup>104</sup> Public authorities, however, do not have shareholders in the same sense that private corporations have them. This section explores in whose interest public authorities operate and whether that interest is represented in a manner analogous to the interest of shareholders in a private corporation.

##### 1. Shareholder Interest and Enforcement

Shareholders have a stake in the corporation through their voluntary investment, which is freely transferable.<sup>105</sup> Increasing share-

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103. See David Monsma & John Buckley, *Non-Financial Corporate Performance: The Material Edges of Social and Environmental Disclosure*, 11 U. BA. J. ENVIRON. L. 151, 173 (2004) (citation omitted).

104. COMMITTEE ON CORPORATE LAWS, CORPORATE DIRECTOR'S GUIDEBOOK 5 (4th ed. 2004) [hereinafter DIRECTOR'S GUIDEBOOK] (stating that the goal of private corporations is to "create and increase shareholder value").

105. See WILLIAM MEADE FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5082 (perm. ed., rev. vol. 2003); FRANKLIN A. GEVURTZ, CORPORATIONS LAW

holder investment or accomplishing the “economic objectives” of the corporation is the corporation’s “primary consideration.”<sup>106</sup>

Shareholders protect their interest with their voting power.<sup>107</sup> Shareholder approval is required for some proposals and all elections to the board of directors.<sup>108</sup> Depending on the corporation, shareholders must approve certain items and removal of directors may be possible with or without cause.<sup>109</sup> Shareholders may withhold their vote to express disapproval,<sup>110</sup> and they may be entitled to place proposals on the ballot.<sup>111</sup> While not binding, shareholder proposals can have an impact on investors and can potentially change the direction of the company.<sup>112</sup>

Shareholders are not empowered to manage the corporation,<sup>113</sup> but under some circumstances they are able to enforce or compel corporate action through a “derivative action.”<sup>114</sup> A derivative action “is based upon a primary right of the corporation, but is asserted on [the corporation’s] behalf by the stockholder because

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§ 7.1.1 (2000); ALAN R. PALMITER, CORPORATIONS, EXAMPLES AND EXPLANATIONS 4 (4th ed. 2003).

106. DIRECTOR’S GUIDEBOOK, *supra* note 104, at 6-7 (citing Model Business Corporations Act § 7.28 (3d ed. 2002) [hereinafter Model Act]); *see* PALMITER, *supra* note 105, at 4, 187.

107. *See* JAMES D. COX & THOMAS LEE HAZEN, ON CORPORATIONS §§ 13.12-13.24 (2d ed. 2003); GEVURTZ, *supra* note 105, § 3.1.3(a).

108. *See* GEVURTZ, *supra* note 105, § 3.1.3(a); Model Act, *supra* note 106, § 7.28.

109. *See* COX & HAZEN, *supra* note 107, at § 9.13; Model Act, *supra* note 106, § 8.08.

110. *See, e.g.*, Institutional Shareholder Services, *A New Corporate Governance World: From Confrontation to Constructive Dialogue*, 2004 Postseason Report 5 (2004) [hereinafter *ISS Report*], available at <http://www.issproxy.com/pdf/2004ISSPSR.pdf> (noting that a 42% withhold vote at Disney resulted in Michael Eisner resigning as chairman and later as CEO).

111. *See* ROBERT CHARLES CLARK, CORPORATE LAW § 9.3 (1986); GEVURTZ, *supra* note 105, § 3.2.3; *see, e.g.*, *ISS Report*, *supra* note 110, at 26, 31 (noting that U.S. Bankcorps received shareholder proposal to limit compensation and disclosure of retirement benefits and that Pepsi Americas and Coca-Cola Enterprises both received shareholder proposals on recycling in 2004).

112. *See* GEVURTZ, *supra* note 105, § 3.2.3; *see, e.g.*, *ISS Report*, *supra* note 110, at 8 (noting that Merck & Co., after seeing five years of shareholder majority votes to declassify the board, in 2004 took such an action).

113. *See* COX & HAZEN, *supra* note 107, § 13.01; GEVURTZ, *supra* note 105, § 3.1.3(a); PALMITER, *supra* note 105, at 4.

114. *See* COX & HAZEN, *supra* note 107, §§ 15.01-15.22; GEVURTZ, *supra* note 105, § 4.3.

of the corporation's failure, deliberate or otherwise, to act."<sup>115</sup> A director or officer may be held personally liable for injuries to the corporation and the shareholders if the director or officer knew or should have known that violations of the law were occurring, took no steps to prevent or remedy the violations and such inaction resulted in shareholder losses.<sup>116</sup> The derivative action is also one of the primary methods for enforcing the duty of care and loyalty.<sup>117</sup>

## 2. Duty of Care and Loyalty Owed to Shareholder/ Interested Party

Shareholders' interest in a corporation is protected by the "duty of care" and "duty of loyalty."<sup>118</sup> Shareholders are unique in that while they have an interest in the corporation, they only minimally participate in governance.<sup>119</sup> The duty of care secures shareholders' interest by requiring directors and officers<sup>120</sup> to act "with the care that a person in a like position would reasonably believe appropriate under similar circumstances."<sup>121</sup> At a minimum the duty of care requires directors to attend and participate in board meetings, read the necessary documents, acquire a rudimentary understanding of the business, stay informed and monitor officers to

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115. BLACK'S LAW DICTIONARY 443-44 (6th ed. 1990) (citation omitted); see COX & HAZEN, *supra* note 107, § 15.01; GEVURTZ, *supra* note 105, § 4.3.1; Model Act, *supra* note 106, § 7.41.

116. See COX & HAZEN, *supra* note 107, § 15.21; GEVURTZ, *supra* note 105, §§ 4.3, 4.4. Directors are granted some insulation from suit by the "business judgment rule," stating that absent fraud, illegality, gross negligence, or conflict of interest, a court will defer to the board's decision. DIRECTOR'S GUIDEBOOK, *supra* note 104, at 11 (quoting the Model Act, *supra* note 106).

117. See GEVURTZ, *supra* note 105, § 4.3.1(a).

118. For a discussion of the duty of care and duty of loyalty, see CLARK, *supra* note 111, sections 3.4, 3.5, 4.1, 4.2; COX & HAZEN, *supra* note 107, sections 10.01-10.19; GEVURTZ, *supra* note 105, sections 4.1, 4.2.

119. See COX & HAZEN, *supra* note 107, §§ 10.01, 13.01; GEVURTZ, *supra* note 106, § 3.1.3(a); PALMITER, *supra* note 105, at 4.

120. See GEVURTZ, *supra* note 105, at 273 ("directors and officers have a fiduciary duty to the corporations" including a duty of care and loyalty). Officers are generally held to the same standard of duty of care and loyalty as directors. See Model Act, *supra* note 106, §§ 8.30, 8.40, 8.42 (setting forth the good faith and reasonable person standard for directors and officers).

121. DIRECTOR'S GUIDEBOOK, *supra* note 104, at 11; see COX & HAZEN, *supra* note 107, § 10.01.

promote the ultimate objectives of the corporation.<sup>122</sup> Shareholders are also entitled to regular reports, and notice of, and the right to attend the annual meeting.<sup>123</sup> The duty of loyalty requires directors and officers to act in good faith and “in a manner . . . reasonably believe[d] to be in the best interest of the corporation.”<sup>124</sup> Conflicts of interest and self-dealing, such as buying and selling to the corporation, are prohibited by the duty of loyalty.<sup>125</sup>

Without an identifiable shareholder, there is no need for an equivalent duty of care and loyalty, as there is no one to whom to owe a duty.<sup>126</sup> Public authority boards are not bound by the duty of care and loyalty that restrict private boards.<sup>127</sup> They are not compelled to attend and participate in board meetings, read the necessary documents, acquire a rudimentary understanding of the business, or take on any other private corporate board responsibilities required by the duty of care and loyalty.

Private corporate boards of directors have been criticized for failing to closely oversee the corporation and for opening it up to abuse. The United States Senate subcommittee described the relationship between Enron’s board of directors and the corporation’s collapse as follows:

[T]he Subcommittee identified more than a dozen red flags that should have caused the Enron Board to ask hard questions, examine Enron policies, and consider changing course. Those red flags were not heeded. In

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122. See COX & HAZEN, *supra* note 107, § 10.01 (requiring familiarity with corporation and its investments); GEVURTZ, *supra* note 105, § 4.1 (stating the duty of care requires attention to and monitoring of corporation).

123. See COX & HAZEN, *supra* note 107, §§ 13.13, 13.14; GEVURTZ, *supra* note 105, § 3.1.

124. See COX & HAZEN, *supra* note 107, § 10.11; GEVURTZ, *supra* note 105, § 4.2.

125. See GEVURTZ, *supra* note 105, §§ 4.2.1, 4.2.2.

126. The duty of care and loyalty are necessary to protect the shareholders’ interest because corporations separate shareholders from the decision making process. See PALMITER, *supra* note 105, at 186.

127. The “duty of care” applied to public authorities is that applied in negligent tort cases and is the same standard that applies to private corporations. It involves a physical injury, such as slipping on the subway stairs, and not one stemming from the protection of an interest or investment. See, e.g., *Harding-Wright v. D.C. Water & Sewer Auth.*, 350 F. Supp.2d 102 (D.D.C. 2005); *In re New York City Asbestos Litig.*, 786 N.Y.S.2d 26 (1st Dep’t 2004); *Asbury v. Port Auth. Transit of Allegheny County*, 863 A.2d 84 (Pa. Cmwlth. Ct. 2004).

too many instances, by going along with questionable practices and relying on management and auditor representations, the Enron Board failed to provide the prudent oversight and checks and balances that its fiduciary obligations required and a company like Enron needed. By failing to provide sufficient oversight and restraint to stop management excess, the Enron Board contributed to the company's collapse and bears a share of the responsibility for it.<sup>128</sup>

Like private corporate boards, public authority boards are open to this criticism. Without some standards of care and loyalty, public authority boards' primary function is to appoint a manager or executive director to run the day-to-day operations. The board of directors need not provide oversight after it chooses an executive director, and it does not hire or suggest policy or financial courses of action.<sup>129</sup>

### 3. Accountability

Shareholders are not personally liable to outsiders for corporate obligations,<sup>130</sup> except in a "piercing of the corporate veil." Creditors can hold shareholders personally liable under some circumstances, including when:

the business is a closely held corporation; the plaintiff is an involuntary (tort) creditor; the defendant is a corporate shareholder . . . ; [shareholders, directors or officers] failed to follow corporate formalities; [shareholders, directors or officers] commingled business assets . . . ; [shareholders, directors or officers] did not adequately capitalize the business; the defendant actively participated in the business; [or shareholders, directors or officers] deceived creditors.<sup>131</sup>

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128. See generally STAFF OF S. COMM. ON INVESTIGATIONS, 107TH CONG., REPORT ON THE ROLE OF THE BOARD OF THE DIRECTORS IN ENRON'S COLLAPSE (Comm. Print 2002).

129. *Public Authority Reform*, *supra* note 3, at 22-23 (quoting Richard L. Brodsky, Chair, 2003 Legislative Update from the New York State Assembly Committee on Corporations, Authorities and Commissions (Jan. 9, 2004)).

130. See COX & HAZEN, *supra* note 107, § 7.07; PALMITER, *supra* note 105, at 4.

131. PALMITER, *supra* note 105, at 540-46; see COX & HAZEN, *supra* note 107, §§ 7.09-7.11; GEVURTZ, *supra* note 105, § 1.5.

There is no identifiable group that can be held liable for public authorities' actions through a piercing of the corporate veil. The public may be most susceptible to a piercing the corporate veil in public authorities because it is ultimately liable for public authority debt whether through leaseback agreements or the tacit agreement that states and cities will not allow public authorities to default. While the public has much of the liability, it has none of the shareholder enforcement mechanisms.<sup>132</sup> Public authorities do not have a shareholder that can protect the shareholders' interest by enforcing standards of duty of care and loyalty.<sup>133</sup> This failure results in fewer checks than private corporate shareholders, who can ensure that the corporation is performing in their best interest.<sup>134</sup>

#### 4. Hypothetical Shareholders in a Public Authority

There is no group that has an interest in public authorities, holds some power of enforcement over them, is owed a duty of care by their officers and directors, and has limited accountability for their actions. There are hypothetical candidates based on the characteristics of shareholders described above. While each of the candidates has some features in common with shareholders, none of them has fully taken on the shareholders' role.

There are at least five groups that could assert some interest and enforcement in public authorities: bondholders and underwriters, the public, elected and appointing officials, private developers, and public authority officers. Each group's interest, however, is either minimally represented or the group is limited in its ability to compel the public authority to protect its interest.

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132. Board members are not liable for public authorities. *See, e.g.*, CONN. GEN. STAT. ANN. §§ 15-120(g)–15-120(o).

133. *See generally* MITCHELL, *supra* note 7, at 86-99.

134. Ira M. Millstein, *A Self-correcting Course for Governance in* PRAC. L. INST., FIRST ANNUAL DIRECTORS' INSTITUTE ON CORPORATE GOVERNANCE 13 (Sept. 2003) (stating that the general idea of the corporate structure is that "[t]he board checks the managers, shareholders check the board, and lawyers and accountants have a professional responsibility to the corporation and its shareholders, not to management").

a. Bondholders and underwriters<sup>135</sup>

While public authorities do not have investors similar to shareholders, the closest similarity may be holders of public authority bonds and underwriters. Like shareholders, bondholders and underwriters make a voluntary investment in public authorities. Bondholders and underwriters differ from shareholders, however, in that they are not investing in the public authority as an entity. Bondholders and underwriters purchase the bonds as a means of lending money or providing capital to the authority.<sup>136</sup> For example, in 2004 when the Los Angeles Metropolitan Transit Authority (LAMTA) refunded and reissued bonds to finance the development of its twenty-six-story Union Station Gateway Headquarters it agreed that Goldman, Sachs & Company would be the underwriter. In underwriting the bonds Goldman, Sachs did not acquire an ownership in the LAMTA or become intricately tied to the financial undertaking of the LAMTA in the same way it would in a private corporation. While the shareholders' interest ebbs and flows with the corporation's performance, bondholders and underwriters, like Goldman, Sachs, have a fixed interest not tied to performance of the public authority. This separation between investment and performance provides little incentive for bondholders and underwriters to ensure positive development of the authority, as their return is set.<sup>137</sup>

The existence of bondholders and underwriters in the private sector for private corporate bonds undermines the likelihood that bondholders and underwriters would act as shareholders in public authorities. Private corporations, like public entities, can and do issue bonds. Bondholders and underwriters of private corporate bonds do not obtain a shareholder interest in the private corporate, just as they do not in public authorities. Bondholders and underwriters cannot vote for the public authority board of directors or for

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135. An underwriter generally buys the bonds from the city or state and resells them at an increased price, usually between 2-4%, to bondholders. Doig & Mitchell, *supra* note 7, at 70. "It has been estimated that the nation's major underwriting firms make nearly \$3 billion per year solely off government corporation debt." *Id.* at 70. *See generally* SMITH, *supra* note 2, at 4.

136. *See* MITCHELL, *supra* note 7, at 71.

137. The rare exception to this is if a public authority completely fails and defaults.

“shareholder” proposals to alter the corporation.<sup>138</sup> They also have no power to compel a public authority either through a derivative or personal action to protect their interest.<sup>139</sup>

Nor is it a very comfortable thought that individual and often massive private bondholders or underwriters (usually financial institutions) are the group in whose interest public authorities work when performing public functions. The performance of a public function has little, if any, overlap with the strong performance of bonds.<sup>140</sup> For example, it is hard to imagine that Goldman, Sachs, headquartered in New York, could have any more interest in the functioning of transportation in Los Angeles County than the average citizen, resident or employee in Los Angeles County. It is also not clear how working in the interest of Goldman, Sachs could make transportation in Los Angeles County more efficient, as the smooth performance of the LAMTA will not affect bond payments to bondholders, who are paid through a sales tax revenue agreement. It is also not clear how working in the interest of a bondholder could improve the service provided by a public authority, such as transportation.

#### b. The public

There are several segments of the public that could have an interest in public authorities: for example, the tax paying public, as

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138. It is, however, common to find large bondholders and underwriters appointed to public authority boards of directors. *See, e.g.*, New York State Dormitory Authority, <http://www.dasny.org/dasny/board/board.php> (last visited Apr. 8, 2005) (sitting members include former Price Waterhouse and Citibank employees); Michigan State Building Authority, [http://www.michigan.gov/dmb/0,1607,7-150-36161\\_36164--,00.html](http://www.michigan.gov/dmb/0,1607,7-150-36161_36164--,00.html) (last visited Apr. 5, 2006) (sitting chair is President and CEO of Capital National Bank); Texas Public Finance Authority, <http://www.tpfa.state.tx.us/> (last visited Apr. 8, 2005) (sitting member is from Ellis-Reisbord Financial Group, Inc.).

139. *See, e.g.*, *Local Gov. Assist. Corp. v. Sales Tax Asset Receivable Corp.*, 2 N.Y.3d 524, 539-44 (2004) (holding that bondholders cannot stop public authority from issuing more bonds).

140. It is not unheard of to have public authorities make decisions based on their bondholders. *See* AXELROD, *supra* note 12, at 141-62 (going through the billions of dollars bond underwriters and holders make from public authority bonds); SMITH, *supra* note 2, at 24 (“The general dissemination of information . . . which distorts and twists the facts in the interest of sensationism, would necessarily erode investor confidence in authority operations. This could result in an unwarranted decline in the market price of their outstanding bonds and consequent loss to their bondholders.” (quoting Robert Moses) (citation omitted)).

it finances public authorities; “customers” or the user fee-paying public, as they pay for and receive services the authorities render;<sup>141</sup> potential customers, as public authorities seek to attract them; residents in the public authorities’ jurisdiction, as they may be directly impacted by public authorities’ projects; employees of the public authorities, as the positive functioning of the authorities directly effects their livelihood; or the public at large within the city, county or state.

Each of these segments of the public has significantly less voting power, enforcement rights and political power than private shareholder investors in private corporations. Unlike shareholders, none of these public groups have a voluntary or a freely transferable investment in public authorities. In most cases, the public has little choice but to use public authority services. Even in situations where the public may choose not to use public authority services, it must still pay taxes to pay for the public authorities and the services they render.<sup>142</sup>

The public also holds little enforcement power. The public’s minimal enforcement is in electing public officials who may appoint the board of directors to public authorities. The public has no direct authority over the board of directors and does not vote for board members or public authority proposals.<sup>143</sup> Most of the public is unfamiliar with public authorities and what they do,<sup>144</sup> much less who the board members are and what functions they perform.<sup>145</sup> In many ways, avoiding public participation is the reason

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141. The United States Supreme Court has noted that the “relationship between [the public and public authorities is] . . . that between consumers and a business enterprise from which they buy.” *Ball*, 451 U.S. at 370.

142. See generally *Schulz*, 84 N.Y.2d 231; *Mun. Bldg. Auth.*, 711 P.2d 273.

143. See *supra* note 43 (citing typical examples establishing board appointments).

144. See generally BOLLENS, *supra* note 4, at 30.

145. See *Kessler v. Grand Central Dist. Mgmt Ass’n, Inc.*, 158 F.3d 92 (2d Cir. 1998) (Weinstein, J., dissenting) (stating that if general purpose governments are permitted to carve “up . . . civic services and functions into a multitude of ‘specializations,’ each one subject to privatization, immuniz[ing] the municipality from the strictures of one person, one vote . . . there is a significant risk that a substantial portion of this country’s urban population will be effectively prevented from controlling much of local government”); BURNS, *supra* note 4, at 13; MITCHELL, *supra* note 7, at 86-99 (noting lack of organization and governance and complex finances contributing to confusion as to public authorities’ functions) (citations omitted).

public authorities are created.<sup>146</sup> While the public often pays for public authority bonds,<sup>147</sup> taxpayers have been consistently denied access to compel public authorities to perform in their interest.<sup>148</sup> Holding otherwise, courts have said, would limit the independence of public authorities.<sup>149</sup> As the New York State Comptroller lamented in 2004:

New Yorkers pay for public authorities in the form of rates, tolls or fees, and our taxes offset authority-related tax exemptions and pay the debt service on authority-issued debt. Yet, New Yorkers are denied the traditional consumer avenues of protest. In most cases, New Yorkers have no choice but to use authority facilities and they do not have direct control over how their tax dollars might be used in response to authority decisions. These corporations have no stockholder meetings or proxy votes—the people of New York must rely on their government to keep these entities in check.<sup>150</sup>

The public receives the same public services, but incurs an increased financial burden in the form of increased taxes or service fees when public authority bonds are issued instead of general obligation bonds.<sup>151</sup> For example, in 2004, New York City proposed to create the Hudson Yards Infrastructure Corporation (HYIC), a public authority, to oversee the redevelopment of part of Manhattan's far West Side. In the best-case scenario with the project paying for

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146. Questions concerning one person, one vote do not arise in appointed boards. *See Ball*, 451 U.S. 355 (upholding unequal voting power for the board of directors of a special district).

147. State governments almost unanimously do not list public authority debt that the state and the taxpayers are legally bound to pay. *See infra* note 177-79 and accompanying text.

148. *See, e.g., Campbell*, 276 Ga. 714; *Carr-Gottstein Props.*, 899 P.2d 136; *In re Anzai*, 936 P.2d 637; *Train Unlimited Corp.*, 362 N.W. 2d 489; *Wilson*, 884 S.W.2d 641; *Schulz*, 84 N.Y.2d 231; *Mun. Bldg. Auth.*, 711 P.2d 273; *Dykes*, 411 S.E.2d 1.

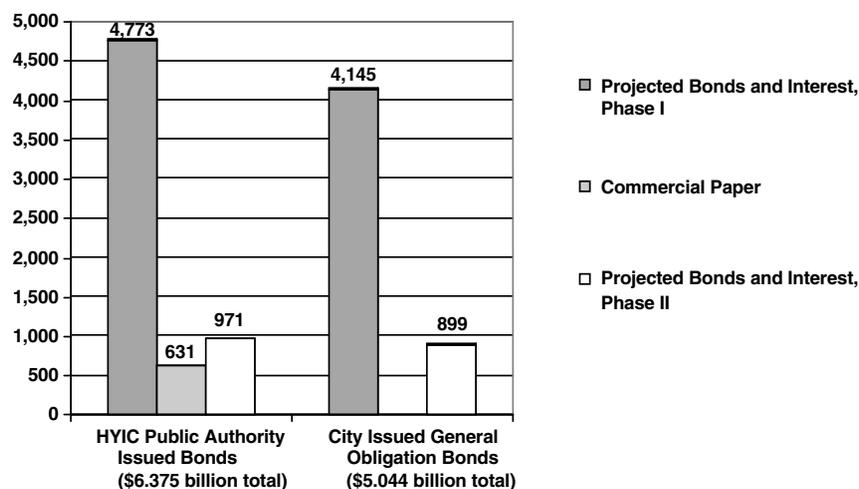
149. *See, e.g., Schulz*, 84 N.Y.2d 231.

150. *Public Authority Reform*, *supra* note 3, at 5.

151. *See* MAXWELL, *supra* note 23, at 7 (stating that non-guaranteed bonds carry a .5-6% interest rate higher than general obligation bonds); SMITH, *supra* note 2, at 28-29 (noting studies finding public authority bonds to be 1/8 to 1% point and 1/2 to 1% point higher than general obligation bonds) (citations omitted); Briffault, *supra* note 6, at 926 (citing RATCHFORD, *supra* note 24, at 514); *see generally*, BURNS, *supra* note 4, at 15 (citation omitted).

itself,<sup>152</sup> tax payers would pay an additional \$1.3 billion because of higher rates applicable to public authority bonds.<sup>153</sup> The public authority bonds rated “BBB” would have a .5% interest rate higher than the city’s general obligation bonds rated “A.”<sup>154</sup> If the city, rather than the public authority, had issued the bonds, the city and its taxpayers would have saved \$1.3 billion, 26% of the cost, paid mostly to bondholders.<sup>155</sup> It is hard to see how this additional \$1.3 billion benefits the taxpayer.<sup>156</sup>

FIGURE FOUR: COMPARISON OF HUDSON YARDS PUBLIC AUTHORITY AND GENERAL OBLIGATION BONDS IN MILLIONS



### c. Elected and appointed officials

Elected officials have a political interest in the effectiveness of public authorities that is not necessarily tied to the successful per-

152. The effects of not being able to pay the debt service obligations on the bonds would be financially disaster for the city, as it would have to pay the bonds, redirecting funds from other services.

153. See New York City Independent Budget Office, Fiscal Brief, *West Side Financing's Complex \$1.3 Billion Story* 1, 7 (Aug. 2004), <http://www.nyc.gov/html/records/pdf/govpub/1217westsidefinancefb.pdf>.

154. See *id.* at 7.

155. See *id.* at 6.

156. See *id.* at 1.

formance of public authorities, because elected officials can disassociate themselves from public authorities when they wish.<sup>157</sup> They can shift accountability to public authorities and thereby deflect criticism by claiming that public authorities are independent entities not within their control.

Public authorities do not appear to be working in the financial interest of government officials, as corporations do in the interest of shareholders. The continued issuance of public authority bonds restricts general-purpose governments by limiting their ability to borrow in potential time of need.<sup>158</sup> While many public authorities provide vital services, they take revenue or compete for revenue with general-purpose governments. Public authorities may also hamper government officials' creative process in balancing the budget. Public authorities provide elected officials with an easy mechanism to avoid fiscal prudence in balancing the budget. They allow politicians to avoid making difficult decisions and creating innovative efficiencies.

Public authorities have been abused for the personal benefit of government officials.<sup>159</sup> Fraud and corruption, however, are neither legal nor acceptable practices. When public authorities are used in this manner they fundamentally differ from corporations working in the interest of shareholders, who benefit legally from the corporation.

Elected officials possess the closest thing to shareholder voting power. They are almost always responsible for appointing board members to public authorities.<sup>160</sup> They are not, however, the equivalent of shareholders. Once appointed to a public authority,

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157. See, e.g., Anthony Flint, *Romney Taps Aide for Pike Board Grabauskas Will Succeed Mihos*, THE BOSTON GLOBE, Aug. 19, 2004, at B1 (detailing the battle between Massachusetts Governor Mitt Romney and the Massachusetts Turnpike Authority over costs overruns on the Big Dig).

158. See also *Public Authority Reform*, *supra* note 3, at 9-10 (noting that because of one public authorities' mismanagement all government entities were subjected to higher costs) (citation omitted).

159. See AXELROD, *supra* note 12, at 92-117 (setting forth numerous examples of public authority abuse); HENRIQUES, *supra* note 2, at 1-19, 105-29 (same); MITCHELL, *supra* note 7, at 112-23 (same); *Public Authority Reform*, *supra* note 3, at 25-38 (setting forth numerous contracts where government officials indirectly benefited from public authority contracts).

160. See, e.g., MILLSTEIN, *supra* note 134 (setting forth several of the appointments for public authorities' boards).

elected officials have little, if any, power to remove board members. If elected officials held the power to vote annually for the entire board of directors, like shareholders, public authorities would essentially become fully controlled by elected officials. Public authorities would be no different than typical general-purpose government agencies, where the heads are removable at will and the agencies ultimately serve the will of the elected official. Elected officials can, however, create and dissolve public authorities by statute.

d. Private developers<sup>161</sup>

Developers generally advocate for the creation of public authorities because public authorities remove projects from the public arena, secure capital quickly for infrastructure and avoid the political and public process.<sup>162</sup> Public authorities have been accused of funneling their funds to developers to facilitate developers' projects.<sup>163</sup> To the extent that developers can make personal gains from public authorities, they are similar to shareholders. The use of public funds solely in the interest of private developers, however, verges on misappropriation that does not exist when private corporations work in shareholders' financial interests.

Private developers do not have voting rights or a direct financial investment in public authorities. They have enforcement mechanisms only to the extent that they have an enforceable contract with a public authority.

e. Public authority officers

Operation of public authorities in their own interest can occur on several levels. There is the corrupt authority working to benefit its own board or officers,<sup>164</sup> and the public authority working to perpetuate its own existence. Public authorities can exist continually because many of them do not have termination clauses. They have broadly defined objectives.<sup>165</sup> While some public authorities

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161. Included in this category are contractors.

162. See also MITCHELL, *supra* note 7, at 103.

163. See *id.* at 116-17.

164. See, e.g., *Public Authority Reform*, *supra* note 3, at 25-37.

165. See *Public Authority Reform*, *supra* note 3, at 7-8 (noting twenty-two public authorities created between 1921 and 1953 that are still operating today).

automatically dissolve when a particular event occurs, many authorities are charged with making the determination as to whether the event has occurred. It is unclear how the existence of numerous public authorities improves efficiency. Many authorities have overlapping functions and jurisdictions, which is not a model for corporate efficiency.<sup>166</sup> As one author noted “the prime evil of the [sole source provider] is that it grossly decentralizes administration.”<sup>167</sup>

*B. What Are the Market Forces to Gauge the Success of Private Corporations and Public Authorities?*

The stock market serves the dual function of reporting and critiquing corporations. The market projects the current and long term viability of a company, providing investors, shareholders and corporate administrators with indicia of how the corporation is performing. If a corporation is not performing well, it will be reflected in the company's stock price and will be known by those interested, who can then make informed decisions. Whether a corporation enjoys market success is partially based on the corporation's bottom line. The market may devalue a corporation's stock price, if the corporation's finances are weak and earnings drop or expenses increase.

When a corporation is underperforming in the market, it may be a target for a takeover. “More than any other corporate regulating device, a hostile takeover exposes management to shareholder control.”<sup>168</sup> In a hostile takeover, shareholders or outside investors seek to seize control of the corporation by circumventing and replacing management. Federal law requires shareholders to receive the highest legally delivered price in a hostile takeover through disclosure and substantive requirements.<sup>169</sup> In this role, the market serves as a watchdog protecting shareholders' interests and provid-

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166. See GRIFFITH, *supra* note 31, at 298.

167. SMITH, *supra* note 2, at 38 (quoting Kirk H. Porter, 22 *National Municipal Review* 547 (Nov. 1933)).

168. PALMITER, *supra* note 105, at 637; see COX & HAZEN, *supra* note 107, §12.06.

169. Exchange Act §§ 13(d), 14(e); see GEVURTZ, *supra* note 105, § 7.3.2.

ing incentives to corporate administrators to act in the corporation's best interest.<sup>170</sup>

Private corporations are also driven by market competition. Competition is often thought to promote efficiency through a struggle for market share.<sup>171</sup> The more efficient a corporation and the more marketable its products, the larger its market share will be, driving competition out of business and improving its economic growth. Private corporations are often researched and reported on by research analysts. The analysts' reports are used to determine the market value of a corporation and its long-term viability.<sup>172</sup>

There is no market force to evaluate public authorities or to restrain them through market competition and discipline. Public authorities do not have stocks or a stock market to rate and report on their performance. Knowledge of public authorities and their long-term viability is limited to three isolated sources.

The first source is public authorities' annual budgets, which are not readily available or accessible. The second source is state budgets, which are often unwieldy and do not include public authority debt.<sup>173</sup> The third source is the bond market, which has been criticized for failing to provide an enforceable external check as it "will ignore even serious internal [public authority] problems unless and until the problem raises questions about the ability of an authority to repay its bonds."<sup>174</sup> If one public authority has poorly rated bonds, the state can replace the public authority with a new

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170. *But see* Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms)*, 146 U. PA. L. REV. 101, 130-46 (1997) (noting that officers often only report good news).

171. *See generally* DAHL, *supra* note 94, at 167 ("Historical experience shows pretty conclusively that a system in which countless economic decisions are made by innumerable independent but competing actors, each acting from rather narrow self-regarding interests and guided by the information supplied by markets, produces goods and services much more efficiently than any known alternative. What is more, it does so with a regularity and orderliness that is truly astonishing.")

172. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 § 501(c)(1) (2002) [hereinafter Act].

173. *See, e.g.*, Illinois State Budget Book Fiscal Year 2007, *available at* <http://www.state.il.us/budget/FY07%20Budget%20Book.pdf> (July 1, 2006) (Illinois' state budget for fiscal year 2007 is 478 pages); Governor's Budget Recommendations — Fiscal Year 2006-07 (Feb. 2006), *available at* [http://www.ebudget.state.fl.us/reports/governors\\_bill\\_2006.pdf](http://www.ebudget.state.fl.us/reports/governors_bill_2006.pdf) (Florida's state budget is 346 pages).

174. HENRIQUES, *supra* note 2, at 14.

one.<sup>175</sup> In addition, the public has easy access to the stock market through numerous media outlets, but has little access to or general knowledge of the bond market. For example, it is doubtful whether the majority of the population knows what the significance of an “A” rated bond or an upgraded “AAA” bond is or where to locate this information. Without some indication as to how public authorities are performing, like the stock market in the private sector, there is little information to determine whether they are improving on their distribution of public services.<sup>176</sup>

Public authorities have little or no market discipline and can issue debt without the risks associated with borrowing in the private sector.<sup>177</sup> “There is no market test of the[ir] efficiency . . . . They can bury their overhead in their capitalization, so there really is no ‘bottom line.’”<sup>178</sup> While poorly performing private corporations lose value and enter bankruptcy, poorly performing public authorities continue to operate. The suggestion is not that public authorities are acting unethically or illegally. Rather, it indicates that the failure to have some market discipline allows financial practices widely condemned in the private sector to occur in the public sector.

Public authorities are also not subject to corporate takeovers. Corporate boards of directors have an impetus to perform well, as the corporation may be subject to a takeover. Public authorities are not subject to the same market controls that would allow a hostile takeover of a poorly performing public authority.<sup>179</sup>

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175. Following the Urban Development Corporation’s 1975 default on its bonds, the State of New York renamed the public authority and it continued to operate. N.Y. UNCONSOL. LAW § 5 (Consol. 2006).

176. See HENRIQUES, *supra* note 2, at 13 (quoting interview with Dr. Annmarie H. Walsh) (“The tax-exempt bond market is not concerned with efficiency — just with yields and revenue flow.”).

177. See Leavitt & Morris, *supra* note 77, at 156; see also HENRIQUES, *supra* note 2, at 4, 13 (“[T]he ease of borrowing has sometimes tempted local governments to borrow to cover deficiencies in their ordinary budgets, if not directly through bond issues, then indirectly through short-term loans which have to be funded later through bond issues.”).

178. HENRIQUES, *supra* note 2, at 13 (quoting interview with Dr. Annmarie H. Walsh).

179. One exception to this lies in elected officials’ attempt to assert control over public authorities. See MITCHELL, *supra* note 7, at 91, 94, 95; see, e.g., *Watson v. Pennsylvania Turnpike Comm.*, 386 Pa. 117 (1956); *Commonwealth ex re. Hanson v. Reitz*,

Unlike private corporations, public authorities are not restricted by market competition. They often have a complete monopoly on services. Consumers and taxpayers have no choice but to draw on public authorities' services regardless of performance or cost. Where competition in the private sector results in better products by compelling corporations to perform at a higher levels, the absence of competition among public authorities provides no motivation to improve on the provision of public services.<sup>180</sup> Without competition, public authorities often spend more than necessary. For example, public authority projects cost more than if the project were completed through general-purpose governments because of higher interest rates.<sup>181</sup> Public authority agreements, like the lease back, are generally not consistent with the market value of the leased property, but are rather based on principal and interest payments.<sup>182</sup>

Without some motivation to economize, public authorities often duplicate services.<sup>183</sup> There are thousands of public authorities with fragmented services.

The bewildering maze of separate and often conflicting statutory provisions presently applicable to districts is a

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403 Pa. 435 (1961). *See generally supra* notes 75-94 and accompanying text (setting forth claim that public authorities produce more efficiency, expertise and independence); *see also* MITCHELL, *supra* note 7, at 104-11 (questioning the competence of public authorities).

180. While the market competition among cities has been defended, the equivalent competition does not exist in public authorities because they, unlike the cities, are sole service providers having little explicit overlap for competition. *See, e.g.*, Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956) (justifying increased municipal power because it increases competition and allows residents to vote by moving).

181. *See also* FOSTER, *supra* note 2, at 148-88 (concluding that providing services with special districts costs more than providing them through general purpose governments).

182. *See* Briffault, *supra* note 6, at 920 ("In most contemporary lease-financings the state or local 'rent' payment is based not on the market value of the lease but on the private firm's or public authority's debt service requirements.").

183. *See generally* KLINENBERG, *supra* note 49, at 142-43 (describing one of five key government failures that led to the death of hundreds in the 1995 Chicago heat wave, Klinenberg states "The lack of an effective system for organizing and coordinating the service programs of different city, county, state, and federal agencies, result[ed] in a complex but decoupled political structure that reproduces important functions and has no clear lines of accountability"); Frug, *supra* note 2, at 1783.

permanent bar to any efforts to adapt district organization to the needs of growing communities. Not only do statutory complexities prevent consolidations or dissolution of unnecessary or obsolete districts, much more important they also inhibit districts which are currently functioning well from making any organizational changes in response to future community needs.<sup>184</sup>

Private corporations adequately function in an isolated world separated from other corporations and often benefit from this isolation by providing the market competition discussed above. Public authorities are not competing with each other, have overlapping jurisdictions and, yet, rarely converse with each other. There is no forum for public authorities to discuss their projects or to consolidate services in an efficient manner. Public authorities rarely assess their goals and objectives in relation to other government agencies or develop master plans in conjunction with each other. Not only does this result in an inefficient system in which overlapping responsibilities are over performed, wastefully performed or neglected, but it also results in an inexpert system in which sole service providers have little, if any, knowledge of related services.<sup>185</sup> A mass transit authority, for example, may have no discussion with a highway authority — both performing means of transportation, but not communicating with each other.<sup>186</sup>

While private sector corporations are subjected to market forces that evaluate, oversee and report on them, public authorities operate in a standardless vacuum without a method to gauge their progress.<sup>187</sup> The absence of market forces puts public authorities at a disadvantage because they are not provided with a standard on which to base success or to strive for improvement. If there is no equivalent to market forces, how should the success of public au-

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184. *California State Assembly Res. 500, supra* note 12, at 40.

185. *See SMITH, supra* note 2, at 167-72; *see generally* MITCHELL, *supra* note 7, at 86-99 (stating that lack of organization and governance and complex finances result in indifference to public authorities).

186. *See also* Frug, *supra* note 2, at 1784, 1787 (finding that public authorities are a more expensive way to accomplish a task).

187. *See generally* FOSTER, *supra* note 2, at 10 (“As independent entities, districts have sovereignty over their administrative and financial affairs and enjoy substantial freedom from oversight by their parent government.”).

thorities be gauged, and what provides them with a motivation for improvement?

*C. Board of Directors and Officers: How are Private Corporations and Public Authorities Organized?*

Private corporations and public authorities are organized around a board of directors and a hierarchy of officers.<sup>188</sup> Corporate boards of directors are responsible for overseeing the corporation and running the business and affairs of the corporation, while the officers run the day-to-day operations.<sup>189</sup>

Similar to private corporations, public authorities are organized around a board of directors and a hierarchy of officers. Like private corporate boards, public authority boards are ultimately responsible for overseeing the authority and their officers responsible for running the day-to-day operations. Public authority and private corporation boards have little else in common. As set forth below, public authority boards are subjected to significantly less regulation, safeguards and oversight than their private sector counterparts and have avoided all major private corporate governance reforms.

1. Board Membership

A majority of board members must be “independent” individuals, having “no material relationship with the company . . . directly or as a partner, shareholder or officer of an organization that has a relationship with the company.”<sup>190</sup> An independent director cannot be an employee, have an immediate family member as an executive officer or have a family member who is paid \$100,000 or more from the corporation until three years after the employment

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188. See American Bar Association, *Report of the American Bar Association Task Force on Corporate Responsibility*, 59 BUS. LAW. 145, 147 (Nov. 2003); see also *supra* notes 117-24 and accompanying text (setting forth director’s and officer’s duty of care and loyalty).

189. See GEVURTZ, *supra* note 105, at 3.1.2(b); DIRECTOR’S GUIDEBOOK, *supra* note 104, at 6 (citation omitted); Model Act, *supra* note 106, § 8.01.

190. NYSE, Corporate Governance Rules, § 303A, 2(a) (Nov. 4, 2003) [hereinafter NYSE Rules]; see Cox & Hazen, *supra* note 107, § 9.02A(1)(A) (supp. 2005) (citing NYSE Rules).

ends.<sup>191</sup> Nor can an independent director be affiliated, employed or have an immediate family member affiliated or employment with an auditor until three years after the employment ends.<sup>192</sup> While a majority of boards are staggered or classified, more shareholders are demanding that their boards be declassified, requiring yearly elections.<sup>193</sup>

Public authority boards rarely, if ever, have restrictions limiting board membership to “independent” directors. Family members, public authority officers, individuals doing business with public authorities and campaign contributors to appointing officials’ candidacies are often found on the more libertine boards of public authorities, but would be prohibited from serving on private corporate boards.<sup>194</sup> In addition, it is not uncommon to find a public authority board member sitting on more than one public authority board, even when the authorities have competing interests.<sup>195</sup> While some states have conflict of interest laws that may or may not apply to public authorities,<sup>196</sup> no state has established wholesale re-

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191. NYSE Rules § 303A, 2(a-b)i-iii, 6, 7; *see also* Act §§ 301, 407 (failure to have a “financial expert” on the committee must be disclosed in the regular reports with an explanation as to why); *see* COX & HAZEN, *supra* note 107, § 9.02A(1)(A) (supp. 2006).

192. NYSE Rules § 303A, 2(b)iii; *see* COX & HAZEN, *supra* note 107, § 9.02A(1)(A) (supp. 2005).

193. *See* Security Holder Director Nominations, Exchange Act Release No. 34-48626 (Oct. 14, 2003), *available at* <http://www.sec.gov/rules/proposed/34-48626.htm> (proposing rule to allow shareholder access to the proxy ballot under specific circumstances).

194. The Massachusetts Bay Transportation Authority (MBTA) provides a typical example of public authority board membership. When Barry Locke became the Massachusetts secretary of transportation, he ousted the then top executive of the MBTA, and inserted himself in the position. Six months later the MBTA was given more autonomy and Locke had himself appointed the MBTA chairman and general manager, all while still serving as the secretary of transportation. As one writer described it, Locke was “the MBTA’s boss, its boss’s boss, and its boss’s boss’s boss.” HENRIQUES, *supra* note 2, at 38. Locke was eventually ousted and indicted for taking bribes once he assumed the power. HENRIQUES, *supra* note 2, at 38-42. The current Massachusetts secretary of transportation is also the chairman of the MBTA board of directors. *See* Massachusetts Bay Transportation Authority, *From the Secretary*, <http://www.mbta.com/insidethet/secretary.asp> (last visited Apr. 22, 2006). The general manager is a separate individual.

195. *See Public Authority Reform*, *supra* note 3, at 21 (“[s]everal of the State’s public authorities are governed by boards whose members are involved in the affairs of more than one public authority.”).

196. Public authorities are often excluded from these laws because of their private nature. *See, e.g.*, *Mass. Bay Transp. Auth. Retirement Bd. v. State Ethics Comm’n*, 414 Mass. 582 (1993).

strictions like the private sector that limit who may serve on public authority boards.

Election to public authority boards also differs greatly from the private sector.<sup>197</sup> The appointed members are usually business-oriented people<sup>198</sup> and are called directors, commissioners or trustees, who serve from two to eight years with staggered or overlapping appointments. Public authority members are appointed by a single public official or a small group of public officials and are not elected by a larger group of shareholder investors. In addition, public authority board members usually sit for longer terms than their private corporate counterparts, who often require reelection every year or every other year.

## 2. Committees

Private corporations are required to establish three specific oversight committees. First, corporations must establish an “audit committee” comprised of three financially literate independent directors.<sup>199</sup> The audit committee is responsible for overseeing the financial statements, Securities and Exchange Commission (SEC) compliance, independence of the internal and external audits, qualifications of the auditors and audit committee reports.<sup>200</sup> The audit committee reviews the financial status with management and independent auditors<sup>201</sup> and establishes procedures for financial whistleblowing.<sup>202</sup> Second, corporations must form a “nominating/corporate governance committee” to identify individuals to be

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197. *Public Authority Reform*, *supra* note 3, at 21 (“Due to their corporate nature, authorities are governed by boards of directors whose members can be appointed by the Governor, some on the recommendation of members of the Legislature or local officials.”); *see, e.g.*, New York State Dormitory Authority, <http://www.dasny.org/dasny/board/board.php> (last visited Apr. 8, 2005); Michigan State Building Authority, [http://www.michigan.gov/dmb/0,1607,7-150-9152\\_23400-63623—,00.html](http://www.michigan.gov/dmb/0,1607,7-150-9152_23400-63623—,00.html) (last visited Apr. 8, 2005); Texas Public Finance Authority, <http://www.tpfa.state.tx.us/> (last visited Apr. 8, 2005).

198. *See* Leavitt & Morris, *supra* note 77, at 157.

199. COX & HAZEN, *supra* note 107, at § 9.02A(1)(B) (supp. 2006) (citations omitted).

200. NYSE Rules § 303A, 7(b-c); Rule 10A-3(b)(2-5); *see* COX & HAZEN, *supra* note 107, § 9.02A(1)(B) (supp. 2006).

201. NYSE Rules § 303A, 7(c) (iii); *see* COX & HAZEN, *supra* note 107, § 9.02A(1)(B) (supp. 2005).

202. Act § 301.

board members and to oversee the board and management.<sup>203</sup> Third, they must establish a “compensation committee” to determine CEO compensation, evaluation, and goals.<sup>204</sup>

Public authorities are not required to establish an auditing committee. They have no requirement to designate specific individuals to perform financial oversight, direct fiscal compliance or oversee external audits. In addition, there is no requirement prohibiting public authorities from having ties to the auditing company. In the wake of Enron, WorldCom and others, the Sarbanes-Oxley Act of 2002 (the Act)<sup>205</sup> was enacted and the New York Stock Exchange Rules (the NYSE Rules) were amended to limit financial abuses, protect shareholder investments and designate individuals to be accountable and responsible for important corporate functions. While public authorities are not immune from similar problems, they are not required to designate similar committees.

Public authorities are also not required to establish a nominating/corporate governance committee. Board nominations to public authorities, if not established by statute, are left to the will of the appointing official. As a result, many boards are filled with loyal, yet inexperienced politicians — the body politic that public authorities were created to avoid.<sup>206</sup> The experts who were initially expected to serve as members of the boards end up being in the minority. In fact, few, if any, experts actually sit on boards.<sup>207</sup> Public authorities are not required to establish a separate compensa-

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203. NYSE Rules § 303A, 4(a-b); see COX & HAZEN, *supra* note 107, § 9.02A(1)(C) (supp. 2005).

204. NYSE Rules § 303A, 5(a-b); see COX & HAZEN, *supra* note 107, § 9.02A(1)(D) (supp. 2005) (citing NYSE Rule 4350 (b)(1)(2)).

205. Act § 501(c)(1).

206. See Frug, *supra* note 2, at 1818 (finding public authorities to be full of politicians and not experts); *Public Authority Reform*, *supra* note 3, at 29 (“Questions have repeatedly been raised about the qualifications and compensation of appointed authority executives.”).

207. See, e.g., Metropolitan Transit Authority of Harris County, Texas, <http://www.hou-metro.harris.tx.us/about/board.asp> (last visited Apr. 8, 2005) (transportation authority servicing the Houston area has only one planner and mostly business and finance professionals on the board); Southwest Ohio Regional Transit Authority, <http://www.sorta.com/aboutMetro/sortaboard.html> (last visited Apr. 8, 2005) (transportation authority servicing the Cincinnati region has two transportation experts and the remaining members with expertise in anything from selling medical devices to estate planning to education).

tion committee. They need not formally establish goals and objectives or regularly evaluate CEOs. With no committee to establish goals and evaluate performance, public authority officers are not given a clear idea of the authority's goals and objectives and do not have the same level of motivation as officers in private corporations.

### 3. Reporting

The federal government requires publicly traded corporations to file annual and quarterly reports. The reports include a balance sheet, earning statement, value of assets, off-balance sheet transactions, corrections in accounting and liabilities.<sup>208</sup> The reports are available to the public on the SEC's website, and are to be made available to the shareholders.<sup>209</sup> Each officer signing a report certifies that he was responsible for establishing the procedure to produce the report, has evaluated the report and has disclosed all deficiencies and any fraud.<sup>210</sup> In addition, each corporation's CEO certifies to the New York Stock Exchange that he is not aware of any violation of corporate governance standards.<sup>211</sup> CEOs and CFOs forfeit bonuses and stock gains to the corporation if the corporation has to restate its financial status as a result of misconduct.<sup>212</sup> A CEO or CFO can be fined up to five million dollars and sentenced to twenty years in prison for certifying a false report.<sup>213</sup>

In contrast to private corporations, public authorities need not perform annual or quarterly reports like private corporations. New York State provides a typical example of the financial reporting required for public authorities. There, public authorities do not sub-

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208. The SEC governs the form and substance of the reports required by the Securities Act of 1933 and the Exchange Act. *See* 17 C.F.R. §§ 229, 240.13a-1, 240.15d-13 (2003); Act § 401; *see also* Act § 409; Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports, Exchange Act Release No. 33-8128.

209. *See* COX & HAZEN, *supra* note 107, § 9.02A(3) (supp. 2005) (citation omitted).

210. Act §§ 302, 501; 17 C.F.R. § 242 (2003).

211. NYSE Rules § 303A, 12(a).

212. Michael R. McAlevey, *Alston & Bird Securities Law Advisory*, in PRACTICING LAW INSTITUTE, UNDERSTANDING THE SARBANES-OXLEY ACT OF 2002 218 (Aug. 27, 2002).

213. Act § 1350; *see also* Monsma & Buckley, *supra* note 103, at 177 (2004) (noting that the Code of Federal Regulations makes it illegal "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading") (citing 17 C.F.R. § 240.10b-5(b)).

mit their budgets for legislative review or adoption, and the legislative and executive branches play little, if any, role in forming public authority budgets. "As separate corporations governed by appointed boards of directors each public authority adopts its own budget."<sup>214</sup> Just as they are not required to file reports, public authorities are not required to have an officer certify the accuracy of reports. Unlike private corporations, public authority officers do not certify that they have reviewed the report and do not face criminal and monetary sanctions for falsifying reports.<sup>215</sup> Without a reporting and certification requirement, public authorities are not mandated to review their performance, publish that review and make appropriate alterations.<sup>216</sup>

#### 4. Auditing

Private corporations are responsible for performing and certifying internal audits.<sup>217</sup> Internal auditors must disclose critical accounting policies and financial information to external auditors. The external auditors, overseen by the federal Public Company Accounting Oversight Board (PCAOB) and the corporation's audit committee,<sup>218</sup> are required to state that a corporation's financial statements fairly represent its financial position and that the corporation has adequate financial controls and procedures.<sup>219</sup> External auditors may not provide additional services to the corporation such as bookkeeping and accounting.<sup>220</sup> External audits are reviewed and approved by a second partner from the audit firm.<sup>221</sup> Anyone interfering with an audit or destroying audit work papers before five years may be subject to a fine and a twenty-five year

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214. *NYS Budget Analysis*, *supra* note 64, at 55.

215. For example, there have been no criminal indictments, or discussion of indictments, for Metropolitan Transportation Authority officials, who allegedly kept two financial books, allowing it to move over \$500 million off the books. See Joshua Robin, *MTA Agrees to Disclose Accounting Practices*, *NEWSDAY*, Jan. 14, 2004, at A15. This would be illegal for public authorities.

216. See MITCHELL, *supra* note 7, at 19.

217. NYSE Rules § 303A, 7(d).

218. Act §§ 101-05, 107-08 (PCAOB sets auditing and ethical standards and reviews accounting firms to assess compliance, any violation of professional accounting standards may be sanctionable).

219. Act §§ 102-04, 107-08.

220. Act § 201.

221. Act § 103.

prison sentence; and any violation of audit disclosure can carry criminal and civil penalties of up to twenty-five million dollars for corporations and up to five million dollars and twenty years in prison for individuals.<sup>222</sup> The SEC also reviews a corporation's financial records at least once every three years.<sup>223</sup>

Unlike private corporations, public authorities are not required to perform internal or external audits. While many public authorities do perform annual audits, those audits do not contain the same level of detail as private corporations' audits do. Moreover, public authority audits do not have the typical private corporate governance safeguards such as disclosure of critical accounting policies, checks and balances between the external and internal auditors, oversight of the external auditors by an external agency like the PCAOB, a certified statement that the authority's financial statements fairly represent its financial position, independence of external auditors, review of external audits by a second auditor in the firm and punishment for interfering with an audit or destroying audit work papers before five years.

Public authority audits are not widely available on a single web site like private corporate audits are on the SEC's website.<sup>224</sup> Some public authorities do make audits available on their websites, but those audits are sporadic and are located only on the public authority's webpage.<sup>225</sup> Public authorities also do not have an SEC equivalent to review their audits once every three years. If they do not perform audits, public authorities cannot state whether they are delivering public services more efficiently.

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222. Act § 303.

223. Valerie Caproni, *Sarbanes-Oxley Act of 2002 – CEO/CFO Certifications, Corporate Responsibility and Accounting Reform*, in PRACTICING LAW INSTITUTE, UNDERSTANDING THE SARBANES-OXLEY ACT OF 2002 417 (Aug. 27, 2002); see McAlevy, *supra* note 212, at 222.

224. While some public authorities do have external agency oversight, that oversight is limited and is not uniformly applied. For example, only eleven of New York State's over 700 public authorities are subject to limited oversight by the Public Authority Control Board (PACB). Moreover, members to the PACB are appointed by the governor, the same individual who appoints the majority of members to the eleven public authorities. See New York State Office of the State Comptroller, What is the Public Authorities Control Board?, <http://www.osc.state.ny.us/pubauth/whatisboard.htm> (last visited Apr. 5, 2005).

225. See, e.g., Michigan State Building Authority, [http://www.michigan.gov/dmb/0,1607,7-150-9152\\_23400—,00.html](http://www.michigan.gov/dmb/0,1607,7-150-9152_23400—,00.html) (Mar. 23, 2005).

## 5. Additional Considerations

Additional restrictions in the Sarbanes-Oxley Act of 2002 and New York Stock Exchange, Corporate Governance Rules include regular evaluation of senior management;<sup>226</sup> adoption and disclosure of “corporate governance guidelines” such as director qualification standards, responsibilities, access to management, compensation, continuing education and management succession;<sup>227</sup> and oversight by the SEC to bar officers and directors for “unfitness.”<sup>228</sup>

The boards of public authorities are not mandated to evaluate senior management. Nor are they required to adopt and disclose corporate governance guidelines. “Unfit” board members cannot be barred from further public authority service by an external agency such as the SEC. Even though passive boards were considered to be one of the major problems with pre-Enron boards,<sup>229</sup> public authorities continue to be confronted with this problem without an equivalent to the NYSE Rules and Act to mitigate it.

### *D. Summary of Private Corporate Analysis*

When tested against private corporate regulations, public authorities appear seriously deficient. Their use of private corporate structures does not produce a more efficient, expert and independent body. In fact, they have drawn only selectively on the private corporate structure, leaving many of the core components that promote efficiency, expertise and independence behind. In particular, public authorities are not required to operate in the interest of a definitive body like shareholders, nor are they subjected to market forces designed to gauge and check whether they are successfully operating in the shareholders’ interest. The failure to adopt these two critical structural features results in an operation in which public authorities have neither an ultimate goal (i.e. increasing share-

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226. NYSE Rules § 303A, 3; DIRECTOR’S GUIDEBOOK, *supra* note 104, at 10 (citing the Model Act, *supra* note 106).

227. NYSE Rules § 303A, 9-10; Act § 406.

228. Act §§ 305, 1105.

229. See MILLSTEIN, *supra* note 134, at 14.

holder investment) nor a standard with which to judge attainment of that goal (i.e. market forces).<sup>230</sup>

The organizational structure adopted by public authorities is built primarily around the board of directors and a hierarchy of officers. At best, that structure serves as a social crutch providing general-purpose governments with an easy method to balance budgets quickly, resulting in poor finances and high debt.<sup>231</sup> Money that would have been allocated to programs or less taxes is spent unnecessarily on higher interest rates to bondholders. Moreover, the political appointments and favors that public authorities were originally designed to avoid permeate public authority boards and functions. At worst, public authorities are ripe for mismanagement, abuse and corruption.

The comparative analysis above indicates that based on one set of private corporate standards, public authorities do not improve efficiency and expertise in the delivery of public services. The absence of equivalents for the functions served by shareholders and market forces — critical components of the private corporate enterprise — signifies the absence of key regulatory features associated with the private corporate structure. In addition, the antiquated, pre-reform organization of the board of directors promotes inefficient and inexperienced bodies. As a result, private corporations are more heavily regulated than the thousands of public authorities that affect many of the basic functions of everyday life. Without these checks, public authorities have little of the private sector oversight and motivation to ensure a businesslike delivery of public services.

#### IV. BEYOND PRIVATE REFORMS: DEMOCRATIZING THE DISTRIBUTION OF PUBLIC SERVICES

*“[P]ure democracy has neither the imagination, nor the energy, nor the disciplined mentality to create major improvements.”*<sup>232</sup>

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230. See generally *id.* at 13.

231. See BOLLENS, *supra* note 4, at 256 (noting that local governments have become less effective through the use of public authorities by “bypassing them or stripping them of particular functions”).

232. Raymond Moley, *Forward* to ROBERT MOSES, *PUBLIC WORKS: A DANGEROUS TRADE* xi (1970).

In the last section, I concluded that public authorities could not legitimately claim to be more businesslike. The private corporate comparison revealed that public authorities are rife with the mismanagement and corruption they were designed to address and debt management is out of control. In this final section, I push the boundaries in thinking about the kind of structures that can and should provide public services. The principal aim of the proposal is to broaden our thinking about the distribution of public services.

Public authorities were, after all, an experiment and there is no reason to stop experimenting. To accept the proposition that public authorities are more efficient and expert solely because of their private corporate structure is to accept a rationalization for them that hampers creative thinking about how to distribute public services. This continued rationalization hampers creative thinking about service distribution. For starters, there is little basis for accepting the suggestion that the private corporate structure was the only option at the inception of public authorities. Challenging that option can open up new and innovative methods of thinking about service distribution.

As a point of departure for this exploration, I revisit the three questions used in Part III and restate them as normative questions. Instead of asking who are the shareholders in public authorities, I ask, whose interest should be represented in the distribution of public services. Instead of asking what are the market forces that evaluate public authorities, I ask, how we should evaluate the delivery of public services. Finally, instead of asking how public authorities are organized, I ask, how the distribution of public services should be organized. The answers to these questions lead me to posit that a regional service organization designed to set policy and fund services to be carried out by entities like public authorities or cities under the organization's guidance would increase democracy, oversight, communication, dispute resolution, monitoring systems and efficiency. The organization could tap into existing resources at public authorities, but public authorities are to perform under the direction and oversight of the regional government, as set forth below. Different from most calls for regional forms of government or cooperation, which are rooted in the inequalities among local

jurisdictions,<sup>233</sup> this proposal is rooted in the inefficiencies resulting from public authorities as highlighted by the private corporate analysis.

A. *Whose Interest Should Be Represented?*

The comparative analysis above highlights the failure to identify a discernable constituency in whose interest public authorities provide public services. This failure has several consequences. First, the ultimate goal of providing public services varies from one public authority to another. As a result, public authorities provide a chaos of services that are provided individually and that overlap geographically and functionally. Second, the lack of a discernable constituency leads to a failure to connect decision making and enforcement power with those who benefit from the services. Third, it fails to provide a standard of performance and motivation. Fourth, it makes oversight and accountability impossible, as there is no tangible body designated to scrutinize the delivery of services. Moreover, because the lines of communication between each public authority and its body politic are irrelevant from one public authority to another, as the jurisdiction and the relevant parties for each public service change, it is often unclear whether one's home or work is in a particular public authority's jurisdiction.

To connect the provision of public services with the body receiving those services, public authorities could have the goal of providing efficient, expert and independent services to a discernable body — a body politic.<sup>234</sup> The provision of public services should be completed in relation to and consistent with the interest of this body politic.

Defining a body politic can begin with simplifying the geographical boundaries. One solution is to define a single regional geographic area within which public services would be provided based on need. The area could be clearly marked and periodically changed. This form of regionalism would shift the focus of public

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233. See *infra* note 239 for a partial list of articles discussing regional forms of government based on local issues.

234. See CHARLES TAYLOR, *SOURCES OF THE SELF* 19-23 (1992) (defining the body politic as those people for who the public good is performed).

services to a definitive body based on the general welfare of the region.

Having the provision of public services apply to a single regional area could accomplish several goals.<sup>235</sup> First, it would simplify and clearly define the body politic by a geographical area. This would provide the people receiving the services with a clear understanding of who is responsible for providing the services. It would also provide the organization providing services with a more defined goal. Second, a single regional jurisdiction would respond directly to distributive inequalities in a particular region. It would import the general benefits associated with regional forms of government, including a more equal distribution of public services, as the body politic would be defined relative to the region.<sup>236</sup> Third, a single regional jurisdiction could open communication among political entities. “[T]here is no institution in the country that allows a region’s cities to meet together and forge a common policy that is binding on all of them.”<sup>237</sup> Public authorities also do not regularly

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235. Regional governments are not a new phenomenon in the United States. See Frug, *supra* note 2, at 1770 (stating “[e]very large city in America . . . is itself a form of regional government” because of the annexation and expansion of cities over the last 110 years) (citing JACKSON, *supra* note 32, at 444), and come in various forms including “new regionalism.” See Frug, *supra* note 2, at 1786-87; see, e.g., H.V. Savitch & Ronald K. Vogel, *Paths to New Regionalism*, 32 ST. & LOC. GOV’T REV. 158, 159-63 (2000) (stating that governance “conveys the notion that existing institutions can be harnessed in new ways, that cooperation can be carried out on a fluid and voluntary basis among localities, and that people can best regulate themselves through horizontally linked organizations”); Sheryll D. Cashin, *Localism, Self-Interest, and the Tyranny of the Favored Quarter: Addressing the Barriers to New Regionalism*, 88 GEO. L.J. 1985, 1989 n.11 (2000) (stating that new regionalism “focus[es] primarily on achieving regional cooperation and limited-purpose regional government, rather than on creating regional governments that supplant fragmented local governments”).

236. For the general benefits of regional forms of government see Frug, *supra* note 2, at 1820-22 (finding that cities are inadequately funded and regional governments would provide equality in school funding, affordable housing, economic development and environmental concerns); see generally CITY MAKING, *supra* note 17, at 113-64 (analyzing the “geography of community” in terms of the separation and inequality of region inhabitants); COMM. ON IMPROVING THE FUTURE OF U.S. CITIES THROUGH IMPROVED METRO. AREA GOVERNANCE, NAT’L RESEARCH COUNCIL, GOVERNANCE AND OPPORTUNITY IN METROPOLITAN AMERICA (Alan Altshuler, William Morrill, Harold Wolman & Faith Mitchell eds., 1999) (setting forth how regional government can address the socioeconomic disparity in inner-cities); DAVID RUSK, INSIDE GAME/OUTSIDE GAME: WINNING STRATEGIES FOR SAVING URBAN AMERICA 324-30 (1999) (emphasizing importance of housing desegregation); Cashin, *supra* note 15, at 1989 n.11.

237. Frug, *supra* note 2, at 1799.

communicate with each other, which further decreases efficiency and expertise. Public authorities at best fail to address the inequalities and disparities among municipalities and at worst exacerbate them.<sup>238</sup> A single jurisdiction could reduce intergovernmental rivalries and competition in the provision of public services, and focus energies on productive measures.<sup>239</sup> A regional organization could also serve as a place to remedy the inequalities among jurisdictions by serving as an intermediary in the distribution of public services.<sup>240</sup> Fourth, decisions based on a regional area would be more comprehensive, as information from numerous and diverse areas would be represented. The area could develop a comprehensive regional plan for a more efficient, equal and consistent review of public services.

In addition to having multiple geographical jurisdictions, public authorities fracture public services in irrational organizational units. As sole service providers, thousands of public authorities per-

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238. See generally Frug, *supra* note 2, at 1781, 1820 n.200, 1821 (finding most major problems faced by cities can be traced to regional inequalities); sources cited, *supra* note 250 (discussing municipal inequalities).

239. See NEAL R. PIERCE, CITISTATES: HOW URBAN AMERICA CAN PROSPER IN A COMPETITIVE WORLD 316-22 (1993) (finding that regional governments are more efficient and economically smart); see also H.V. Savitch, David Collins, Daniel Sanders & John P. Markham, *Ties That Bind: Central Cities, Suburbs, and the New Metropolitan Region*, 7 ECON. DEV. Q. 341, 341-52 (1993); Richard Voith, *City and Suburban Growth: Substitutes or Complements?*, BUS. REV.: FED. RES. BANK OF PHILA., Sept.-Oct. 1992, at 21, 21-31; see generally JOHN STUART MILL, CONSIDERATIONS ON REPRESENTATIVE GOVERNMENT Ch. 15 (1861) (New York: Harper & Brothers, 1867) (noting differing local issues instantly become non-local); Gerald Neuman, *Territorial Discrimination, Equal Protection and Self-Determination*, 135 U. PA. L. REV. 261 (1987). For a discussion on municipal isolationism based on the desire to control property taxes see GARY J. MILLER, THE POLITICAL ORIGINS OF THE LAKEWOOD PLAN IN CITIES BY CONTRACT (1981) (discussing the incorporation of Lakewood, California).

240. The competition between municipalities for property tax and the negative socioeconomic and environmental ramifications it has is well documented and includes anti-school age children policies, promotion of sprawl and divestment of cities. See, e.g., ANDRES DUANY ET AL., SUBURBAN NATION: THE RISE OF SPRAWL AND THE DECLINE OF THE AMERICAN DREAM (2000); ROBERT FISHMAN, BOURGEOIS UTOPIAS: THE RISE AND FALL OF SUBURBIA 3-4, 15-16 (1987); Rosalind Greenstein & Wim Wiewel, *Introduction to URBAN-SUBURBAN INTERDEPENDENCIES* 1-5 (Rosalind Greenstein & Wim Wiewel eds., 2000); HALL, *supra* note 51, at 292-93; JAMES HOWARD KUNSTLER, THE GEOGRAPHY OF NOWHERE: THE RISE AND DECLINE OF AMERICA'S MAN-MADE LANDSCAPE (1993); LEWIS MUMFORD, THE CITY IN HISTORY (1961); Frug, *supra* note 2, at 1777-78, 1823-26; see also Campaign for Fiscal Equity v. State, 100 N.Y.2d 893 (2003); Sheff v. O'Neill, 238 Conn. 1 (1996) (holding Connecticut's distribution of school funding unconstitutional).

form thousands of individual tasks, making for an excessively complex use of resources.<sup>241</sup> Even related issues are sectioned into different public authorities. For example, transportation can be split into subways, airports, highways and sidewalks independent of each other, even though they are intricately related.<sup>242</sup> The sheer number of public authorities also makes it difficult for one public authority to know what other authorities are doing, even when their services are related.<sup>243</sup> As one commentator noted,

When you set up a function in a single authority, that single authority knows it was designated by God to do a certain job – and its work is the most important task in the world. Nothing can stand in the way of what the authority is planning to accomplish. They don't care if they bankrupt the town – they're going to get their job done because that's the only job they have to do.<sup>244</sup>

For public services to be performed in a defined body politic's interest, that body should have a clear idea of what public services are provided within a region and by whom. Instead of individualizing public services, one entity could be authorized and empowered to set and execute the public services for the region. For example, if a region called for new transportation policies, the regional organization would be empowered to set and orchestrate all related transportation services, including roads, mass transit, highways, buses, zoning, bicycles, pedestrians, property tax and any other related service. Moreover, it would be responsible for allocating funds to cities or public authorities to carry out its goals.

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241. See generally Reynolds, *supra* note 15, at 113-14 (citations omitted); Richard Voith, *The Determinants of Metropolitan Development Patterns: What are the Roles of Preferences, Prices and Public Choices*, in URBAN-SUBURBAN INTERDEPENDENCIES, *supra* note 240 at 50, 78); Cashin, *supra* note 15, at 2000-01.

242. For a discussion of how various forms of transportation effect one another see DANIEL LAZARE, AMERICA'S UNDECLARED WAR: WHAT'S KILLING OUR CITIES AND HOW WE CAN STOP IT 273-96 (2001); CALTHORPE & FULTON, *supra* note 15, at 68-72, 214-22; PETER CALTHORPE, THE NEXT AMERICAN METROPOLIS: ECOLOGY, COMMUNITY, AND THE AMERICAN DREAM (1993); MARTIN WACHS & JENNIFER DILL, REGIONALISM IN TRANSPORTATION AND AIR QUALITY: HISTORY, INTERPRETATION, AND INSIGHT FOR REGIONAL GOVERNANCE, in GOVERNANCE AND OPPORTUNITY IN METROPOLITAN AMERICA, *supra* note 236, at 296-97 (setting forth support for regional transportation in the 1920s).

243. See also Frug, *supra* note 2, at 1787 (stating that a sole service provision can disrupt local governments and is inconsistent with regional plans).

244. SMITH, *supra* note 2, at 38 (citation omitted).

Unifying services would benefit the body politic by enabling it to set clear, consistent goals and redirect energies from wasteful competition. Unification of services would also provide for a more complete and efficient provision of public services, as solutions would be more comprehensive. It would simplify projects that normally would require several public authorities by setting forth lines of communication, providing uniform procedures for services and financing, and streamlining the regulatory process. Unification of the policy in providing public services under a regional body would empower the body politic by giving it control over services that are currently being performed by public authorities. Finally, unifying services would provide a more comprehensive and equitable distribution of public services. Having a unified regional service organization would limit undesired effects by requiring some consistency or cohesiveness in the distribution of public services.

Within the regional body politic there are at least three general groups that have or represent different interests in the distribution of public services. These groups include the public, city governments and the private sector. Each of these segments could play a role in providing oversight over the provisioning of public services. Each segment has a distinct interest in the distribution of public services. The public, possibly the most disenfranchised under the current system, is comprised of individuals who are direct recipients and financial supporters of public services, which are publicly funded. At the most fundamental level, their interest lies in receiving and paying for the services. The public has several components, including residents, property owners, workers, commuters, customers of the unified services (for example, mass transit riders, vehicle owners, bike riders, pedestrians, homeless in shelters, etc.) and employees of the organization delivering the services. City governments consist of municipalities, as city entities, in the region. Their interest in the provision of public services lies in their historical representation of and their close connection with their constituency. The private sector also has a distinct interest in the delivery of services. The private sector consists of corporations and partnerships. Its interest is tied to its financial support for the services (taxes) and its need to ensure that the services are available to support its endeavors. The power each group possesses to influence

and evaluate the distribution of public services and the way it could exercise that power are discussed in the next two sections.

*B. How Should We Gauge Success?*

As discussed in the comparative analysis above, the failure of public authorities to develop a method to gauge whether or not they are efficiently and expertly providing public services creates little effective pressure to improve. As the body politic has three parts — city government, private business and public individuals — each could participate in evaluating the regional provision of public services.<sup>245</sup> They could participate in a manner that builds their unique perspectives and strengths into the organization that would be charged with checking on the distribution of public services. The following proposals are only one attempt to maximize the abilities of each part of the body politic to evaluate and secure the successful delivery of public services.

The city government component of the body politic could participate by setting the broad substantive agenda or goals for the organization overseeing and setting regional services.<sup>246</sup> In this role, mayors or city representatives could join together to negotiate, discuss and identify the general substantive areas that the regional unified service organization should address. Once the organization sets the agenda it would then be carried out by public authorities or cities pursuant to the organization's oversight.

Requiring cities to come together to set the agenda would accomplish several goals. It would allow cities to protect their interest in the provision of public services by giving them control over ser-

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245. See DAHL, *supra* note 94, at 37, 95 (“that the only government which can fully satisfy all the exigencies of the social state is one in which the whole people participate; that any participation, even in the smallest public function, is useful; that the participation should everywhere be as great as the general degree of improvement of the community will allow and that nothing less can be ultimately desirable than the admission of all to share in the sovereign power of the state”) (quoting MILL, *supra* note 239, at 55); HERBERT J. STORING, *WHAT THE ANTI-FEDERALISTS WERE FOR* 15-47 (1981) (stating the republican argument that participation in the law begets voluntary attachment to the laws); ALEXIS DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* 62-72 (Richard D. Heffner edited, 1984); see also GRIFFITH, *supra* note 31, at 67 (“The cure for the ills of democracy is more democracy.”) (quoting, but not citing, environmentalist Edward Abbey).

246. See generally DAHL, *supra* note 94, at 38 (finding the setting of the agenda to be a major aspect of democratic rule).

vices currently performed by public authorities. Services that were once provided by cities have been shifted to independent public authorities, which often perform those services without consulting the cities.<sup>247</sup> This proposal would reinvigorate and reintroduce the cities into the process of providing public services. In setting the regional agenda, the cities would not only have a voice in regional matters currently performed by public authorities, but they would also have a voice in matters currently performed by each city irrespective of other cities. Under this proposal, cities would be permitted to address matters they currently cannot address, such as zoning regulations abutting their borders. Zoning is currently determined by each city individually, even though it has a significant regional impact.<sup>248</sup>

Having city governments set the regional agenda would integrate a tool to evaluate the provision of public services that is currently lacking in public authorities. The agenda would develop from an informed group negotiating and developing a plan on behalf of the region. The joining of city governments to set the agenda for the region would provide a forum to voice issues, work out disputes and talk about inequalities. Cities would have an opportunity to economize and reduce the duplication and overlap of functions by working together instead of in competition. They could coordinate public services to ensure quality.

The regional agenda would be generated at the local level where the issues are most acutely felt and are often ignored by public authorities. Cities are in the best position to evaluate the level of services in their area.<sup>249</sup> They have the best access to information and a tangible understanding of what public services are needed.<sup>250</sup> In *Democracy in America*, Alexis De Tocqueville described the con-

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247. See, e.g., *Schweker*, 858 A.2d at 75 (holding that the city cannot stop the state from reapportioning public authority revenue away from city); Frug, *supra* note 2, at 1814.

248. For a discussion of municipal extraterritorial impacts see Briffault, *supra* note 15; David Becker, *Municipal Boundaries and Zoning: Controlling Regional Land Development*, 1966 WASH. U. L.Q. 1 (1966).

249. See generally MILL, *supra* note 239, at ch. 15 ("I need not dwell on the deficiencies of the central authority in detailed knowledge of local persons and things.").

250. See Frug, *supra* note 2, at 1809. For a defense of municipal power see CITY MAKING, *supra* note 17, at 15-70, 165-79, 219-23; Gerald E. Frug, *The City as a Legal Concept*, 93 HARV. L. REV. 1059, 1062-67 (1980); Tiebout, *supra* note 187, at 418-20 (justi-

nection between individuals and local governments as essential and the very basis of liberty.<sup>251</sup> It allows people, he stated, to participate in government, taking pride in government decisions and addressing issues through the process of solving issues, rather than having them dictated by a far off government.<sup>252</sup>

The private business component of the body politic could participate by providing financial oversight such as performing audits and reviewing bonds. The audits could monitor the financial efficiency and equitable distribution of services. The audits could also evaluate the execution of the regional organization's goals by public authorities and cities. The private segment would be responsible for posting the findings of the audits and bond reviews in an easily accessible and readable format in newspapers with comparisons to prior years and projections, including at least a list of the current, new and expanded services, the amount of money each taxpayer should expect to pay, outstanding debt, debt burden per capita, revenues and expenditures. A more complete audit could be cited and made available on a designated website similar to the SEC's website. The private business component could make related recommendations on measures for cost cutting and improving services.

Financial auditing and reviewing of bonds by the private segment of the body politic would help gauge the success of delivering public services. These functions would tap directly into expert functions already performed in the private sector and apply that expertise to an area where it could be most effective. Financial auditing and reviewing by the private sector would also provide transparency and comprehensibility that are now badly lacking in the provision of public services.<sup>253</sup> Reviews by the private segment would provide the regional organization with a clear indication as to how it is performing and an opportunity to cure deficiencies. Separating auditing from setting the agenda would partially control outside influence and favoritism. In addition, having the private sector per-

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forming increased municipal power because it increases competition and allows residents to vote by moving).

251. TOCQUEVILLE, *supra* note 245, at 62-72.

252. *Id.* at 62-72.

253. For the benefits of transparency and comprehensibility in a democracy see DAHL, *supra* note 94, at 38.

form the audit and review would increase accountability and provide investors with more security. This would revive the general integrity of government bonds and keep bond interest rates at a minimum. The institutional form that the auditing function would take is addressed in the next section.

One of the most troubling aspects of public authorities is the lack of connection between the public segment of the body politic and the provision of public services. The public regularly uses and relies on public services, yet, it has little or no voice in determining how the services are distributed or are performing. It also has little ability to evaluate public authorities.

The public component of the body politic could oversee the provision of public services through direct representation on the organization responsible for adopting, modifying and distributing work from the government component's agenda. The organization would consider the city government segment's agenda and private business segment's audits and assign tasks and funds to various entities to carry out the agenda and audits' recommendations. The organization itself would not be empowered with staff or resources to actually carry out the functions, but rather would determine the proper entity by which those functions should be carried out. In addition, it would determine the proper allocation and collection of funds to finance the projects.<sup>254</sup> It could be the central placement for and distribution of all regional funds, including a percentage of local property and sales taxes. The public component could be represented on the organization by proportional representation.<sup>255</sup> Moreover, there could be a high number of members on the organization to more closely represent the body politic.

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254. The shifting of taxes to the regional organization would increase the public's control over these funds, as the funds are currently controlled by public authorities or municipal jurisdictions beyond individual city borders, meaning one city has no access to funds in another city.

255. See also DAHL, *supra* note 94, at 131 (“[T]he most common electoral system is one deliberately designed to produce a close correspondence between the proportion of the total votes cast for a party in elections and proportion of seats . . . this is usually known as a system of *proportional representation*.”). “First-past-the-post” or “plurality” voting is used for the United States House of Representatives and allows a single candidate from a given district with the most votes to win. It “may greatly increase the proportion of seats won by the party with the largest number of votes” and fortifies the two-party system. As opposed to proportional representation, where the number of votes directly

Regional control of funds would increase the public's control over bonds and taxes currently issued and spent by public authorities beyond the public's control. First, it would drastically increase the power of the public. Each time a public authority is created, the public is disenfranchised — the more public authorities, the less voting power and representation the public has. Situating voting power with the public segment would insert a necessary element of fair representation and public participation. Regional control of funds would increase the public's control over bonds and taxes currently issued and spent by public authorities, beyond the public's control. Second, it would build in an evaluation based on a popular, regional constituency. Similar to a hostile takeover, if public services were not being provided efficiently, adequately or equally, the public segment would have the authority to change leadership and alter the course of how public services were delivered. Third, situating power with the public would promote the flow of information by requiring "candidates" to air competing views.<sup>256</sup> Fourth, with public control over the election, the regional unified service organization would be given a sense of legitimacy lacking in public authorities.<sup>257</sup>

*C. How Should the Distribution of Public Services Be Organized?*

In turning to the last question raised by the private corporate analysis, this section proposes a structure for setting the agenda, auditing, distributing of funds and providing public services. The previous two subsections began to develop the framework for a regional unified service organization that responds to the functional and geographic needs and interests of a body politic. The body politic consists of three parts where local governments set the agenda, private businesses audit and the public votes for the people who effectuates the agenda. As seen in Figure Five, all three segments make up the organization responsible for overseeing the distribution of public services.

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corresponds to the number of representatives. "For example, a party with 53 percent of the votes will win 53 percent of the seats." DAHL, *supra* note 94, at 130-39.

256. See DAHL, *supra* note 94, at 37.

257. See DAHL, *supra* note 94, at 125-26 (stating the importance of informed consensus and legitimacy in a democracy).

FIGURE FIVE: BASIC SET-UP OF REGIONAL ORGANIZATION  
TO SET AND OVERSEE PUBLIC SERVICES



In setting the agenda, the city governments could be organized around a single council within the organization. The council could be comprised of local mayors or mayoral appointees with equal representation on the council. The council would be charged with discussing, setting and forwarding the goals and agenda to be taken up by the public component of the organization. The council would adopt an agenda based on the participating jurisdictions and their concerns for equality, efficiency and expertise in the provision of public services. The council could meet regularly and be presided over by a rotating chair from one of the participating jurisdictions. At the meetings, each participating jurisdiction could have an equal opportunity to raise issues to be incorporated on the regional organization's agenda.

The council should be thought of as an idea generator and not a gatekeeper. It should be a place for reflection and discourse on the issues that face the region. Ideas can be further filtered once they are sent to the public segment in the organization. One option in setting the agenda would be a straight vote by the members of the council, requiring a minimal threshold of jurisdictions to approve a matter. Alternatively, the vote could be weighted by population by requiring approval from members representing a

minimum percentage of the population. Another option would combine the first two options to require a combination of a minimal threshold of jurisdictions *and* population to approve matters for the agenda. For example, if thirty cities containing four million people were within the region and approval of matters for the agenda required forty percent by both jurisdiction and population, then the council could place an item on the organization's agenda by an affirmative vote of twelve cities, as long as the population from those twelve cities amounted to at least 1.6 million people.

Beginning the distribution of public services with an agenda set by the council could provide several benefits. First, local governments would have an element of control over aspects of public services they currently do not have. "If properly conceived, regionalism can redefine the current mix of local power and local powerlessness rather than simply reduce the first in order to increase the second."<sup>258</sup> The formation of a council would bring cities back into the decision making process concerning the provision of public services and give them a new voice in regional concerns. Second, the council would provide cities with a forum to negotiate and rectify inequalities.<sup>259</sup> The council could play a key role as an efficient mediator, allowing cities to engage in debate and dispute resolution where there previously was none.<sup>260</sup> Third, consolidating regional decision making and services under the council would increase the efficiency of public services by reducing unnecessary competition and overlapping services. It would avoid parsing out specific services between public authorities, municipalities and county and state governments, and ensures some consideration for related services.<sup>261</sup> Fourth, requiring a minimum percentage vote

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258. See Frug, *supra* note 2, at 1790.

259. See also Frug, *supra* note 2, at 1791 (stating that the sole purpose of a redesigned regional body is to "serve as a vehicle for intercity negotiations designed to forge a regional perspective on metropolitan issues").

260. See generally Reynolds, *supra* note 15, at 93-98.

261. Disputes of local and state power have been fought out in numerous cases, adding regional to the mix may only further complicate matters. See, e.g., *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528 (1985) (carving out areas of state immunity against federal power); *Johnson v. Bradley*, 4 Cal. 4th 389 (1992) (applying a judicially adjudicated state versus city balancing test); *Town of Telluride v. Lot Thirty-Four Venture*, 3 P.3d 30 (Col. 2000) (weighing state versus local interest to determine if they conflict).

by both jurisdiction and population would account for both geographical and popular concerns. Finally, forming an agenda by debate and discourse among knowledgeable government entities would provide some measure of accountability. It would ensure some specificity, discussion and consensus before the regional unified service organization fully adopted the issue.

The private business segment of the body politic could be organized around a committee similar to the private corporate auditing committee. The committee could be part of the regional organization and assembled around a group of independent auditors. For example, the city government council above or the local comptrollers from cities within the region could assemble a list of certified auditors having independent director qualities set forth by the NYSE Rules and the Sarbanes-Oxley Act.<sup>262</sup> From this list, a rotating group of auditors could be randomly selected to perform regular audits and bond reviews for the provision of public services. The auditors could be subject to many of the corporate governance practices set forth in the NYSE Rules and the Sarbanes-Oxley Act in relation to internal and external audits, including certifying audits, restricting conflicts with the organization and imposing penalties for falsification.

Having the private business segment independently perform the auditing and reviewing function would accomplish several goals. First, it would improve the delivery of public services by increasing independent oversight and accountability. Having a separate body perform audits and then widely distributing the audits would allow for a more dispassionate critique by separating oversight from decision making. Second, it would provide an indication as to how well public services are being distributed and would open up the process of providing public services. Third, it would provide the private portion of the body politic with some measure of participation and involvement.

In many ways the public segment of the body politic has been the most disenfranchised from the delivery of public services.<sup>263</sup> As

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262. See *supra* notes 190-93 and accompanying text (setting forth qualities of independent directors).

263. See also BURNS, *supra* note 4 (criticizing public authorities for being undemocratic); Frug, *supra* note 2, at 1781-88 (same).

discussed above, the public segment could be directly represented on the organization through representatives charged with making final approval of and affecting the agenda through the assignment of tasks, collecting and raising of funds and distributing of funds. The elected members would not only effectuate the agenda, but would also review and take action on the audits. The public part would elect members to the organization by a region-wide proportional,<sup>264</sup> cumulative,<sup>265</sup> or single transferable vote.<sup>266</sup> Voting for the elected members, for example, by cumulative voting could be set up where each voter receives as many votes as there are open seats. Each voter could place as many votes as he or she holds and for whichever candidate he or she chooses. For example, if thirty cities with a population of four million were participating in the regional organization, the organization could be made up of two hundred people (one for every twenty thousand people). Each of these members could be elected regionally. While a two hundred member body is large, the body is charged with approving and effectuating ideas, and not the generating and narrowing of those ideas, which is completed by the city government council.

Alternatively, the members could be elected by a cumulative voting system based on per capita utilization of public services. This system could assign one vote to each of the various parts of the public, including residents of the region, property owners in the region, workers in the region, commuters to the region, customers of the unified services (mass transit riders, vehicle owners, bike riders, pedestrians, homeless in shelters, etc.) and employees of the organization. Each person could then vote his cumulative votes for

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264. For a discussion of proportional voting see DAHL, *supra* note 94, at 103-13, 130-41; Jonathan W. Still, *Political Equality and Election Systems*, 91 ETHICS 375, 382-85 (1981).

265. For a discussion of cumulative voting see Lani Guinier, *No Two Seats: The Elusive Quest for Political Equality*, 77 U. VA. L. REV. 1413 (1991).

266. Single transferable voting (STV) is used in a handful of countries including, Ireland and Australia for election to the Senate. See generally DAHL, *supra* note 94, at 190 ("STV insures that the seats in the multimember districts will be won by the most highly ranked candidates and produces an approximately proportional distribution of seats among the political parties."). Election under STV requires candidates to receive in excess of a designated amount of votes set by a variety of systems including the Droop Quota (votes / seats + 1) + 1. It provides several benefits including, election without parties, a more accurate reflection of the population than the two-party system, allows more choice in candidates and protection of minority votes.

the members of his choosing. By connecting votes to usage, this proposal would connect participation to utilization of public services. Instead of maximizing by income or contribution, it would maximize use and potential use.

To ensure equal representation and expertise in the decision making process, there could be minimum qualifications to serve as a member on the organization. The organization could designate expert roles like infrastructure, transportation, water or finance.

This proposal would increase oversight and accountability by providing a check to ensure some responsiveness to the public's concerns in the provision of public services. It would provide some motivation to provide public services efficiently through a measure of accountability. A proportional or cumulative vote with qualifications would also allow for additional parties and diverse regional views to be represented in the organization.<sup>267</sup> Proportional or cumulative voting would result in more debate and negotiation as, in theory, more parties and interests would be represented, requiring agreements and consensus to be worked out prior to approval.<sup>268</sup> It would give the public more choice and opportunity to have compatible representation<sup>269</sup> and would increase voter turnout, which is low in sole service-provider elections.<sup>270</sup>

Once elected to the organization, members could agree to approve an agenda item, take a course of action or distribute funds through various voting methods. One method could account for both population and jurisdictional affiliation.<sup>271</sup> For example, approval of measures by the members could be based on a simply majority vote but require a minimum number of members from each

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267. See Frug, *supra* note 2, at 1807 (noting that a similar system may allow new third parties to thrive).

268. See generally ERIC DAMIAN KELLY, *MANAGING COMMUNITY GROWTH: POLICIES, TECHNIQUES AND IMPACTS* 8-11 (1994) ("In heavily populated and growing areas . . . virtually all local governments are likely to be involved in their own separate planning and land use decisions.").

269. See DAHL, *supra* note 94, at 135-36; see generally CITY MAKING, *supra* note 17, at 85-88 (proposing a regional legislature where members are popularly elected from cities across the region).

270. See Reynolds, *supra* note 15, at 140 n.187 (citing BURNS, *supra* note 4, at 112-13).

271. See, e.g., Frug, *supra* note 2, at 1797-1806 (proposing a "Qualified Majority Voting" for a regional government) (citations omitted).

city based on residency to approve an action. Similarly, taking an action could require a majority by jurisdictional affiliation and by population. If the organization consisted of two hundred members, it could require one hundred and one of the members to affirm an action, so long as a majority of the jurisdictions also approved.

## V. CONCLUSION

Public authorities have clandestinely become an accepted part of American politics. States and cities regularly create new authorities, and almost every major public project today is preceded by the creation of a public authority. Despite their prevalence, public authorities have avoided criticism. The public rarely knows about them, elected politicians have little oversight over them and the media rarely reports on them. Meanwhile, the amount of debt they issue continues to be unchecked.

The continued use of public authorities rests heavily on the theory that they increase efficiency and expertise by providing public services in a “businesslike” fashion because they are designed around a private corporate model. The public sector has not developed standards to test whether this justification is valid. Public authorities continue to be created and issue debt in the absence of information to determine whether the private corporate structure in public authorities actually improves the distribution of public services.

While the public sector does not have standards to evaluate the private corporate structure, the private sector does. This article set out to test public authorities’ private corporate structure based on the private sector’s standards. That evaluation revealed that public authorities lack many of the private sector safeguards. In particular, public authorities operate without an ultimate goal (i.e. increasing shareholder investment) and without a standard with which to judge attainment of that goal (i.e. market forces). Without this direction, public authorities generate uncontrolled debt, waste resources, fracture the provision of public services and lack coordination. The analysis showed evidence that public authorities are inefficient, often resulting in poor finances and increased taxes;

and at worst, it showed that they are ripe for graft, favors, abuse and corruption.

Once it became clear that the private corporate model as applied in public authorities was not increasing efficiency and expertise in the provision of public services, the question became how to reform the delivery of public services. This article suggested a new method of thinking about service distribution and the institutions that perform them by asking questions generated from the private corporate perspective. It reconsidered in whose interest public services should be provided, how success of those services should be evaluated and what structure the organization providing the services should take. When these questions were applied to the provision of public services, one answer was an empowering of different sectors of the public to oversee, provide and be accountable for the provision of public services that affect them.

The proposal, a unified regional overseer and setter of policy for public services, seeks to broaden our thinking about the current state of democracy in the provision of public services. When we go to the polls we expect to vote for those who govern. The reality is that much of state and local government and much of tax owed and debt issued is not impacted by the electorate, as they are dictated by public authorities. One of the principal aims of these proposals is to return some form of democracy to the process. The proposals are only one of many possible options. At this point, the only option that seems unjustified is the continued use of public authorities as presently constituted.

