RECLAIMING FIDUCIARY LAW FOR THE CITY

Max Schanzenbach* & Nadav Shoked **

Modern law sets "public" local government law apart from "private" business entities law. While seemingly intuitive, this distinction ignores legal history, and, even more troublingly, the contemporary practices of local governments. Due to distressed finances and a political atmosphere favoring privatization, present-day cities routinely engage in sophisticated market transactions typical of private business entities. Current law fails to adequately address this reality. Because cities are deemed "public," courts refrain from applying to their transactions the legal device normally regulating such business activities: fiduciary duties. Major city transactions thus evade meaningful review. This Article addresses this worrisome anomaly by demonstrating that the city's supposed public nature need not interfere with the application of fiduciary duties to it. To the contrary, the Article shows that the fiduciary status of city officials is supported—indeed, necessitated—by American law's own history, structure, and normative logic. The Article also devises the appropriate fiduciary duty of care—or sound management—that courts should therefore apply to city officials. It advocates a Delaware corporate law standard of care, requiring local decision-makers to abide by certain processes of informed decision-making before selling major municipal assets. As primarily a procedural, non-substantive test, such a standard would not constrain the political discretion of local officials, and can readily be applied by courts.

*Seigle Family Professor of Law, Northwestern University Pritzker School of Law.
**Associate Professor of Law, Northwestern University Pritzker School of Law. We thank participants in the 2016 Fiduciary Law Workshop held at Duke University School of Law, as well as participants in faculty workshops at Northwestern University School of Law. We are also grateful to Michelle Anderson, Joey Becker, David Dana, Nestor Davidson, Andrew Gold, Robert Sitkoff, and James Speta, for helpful feedback at various stages of this project. Thanks are also due to the students in the Spring 2016 Local Government Law course at Northwestern, who read and discussed portions of the manuscript. Joe Delich, Matthew Fisher, and Brian Valcarce provided invaluable research assistance.

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Introduction

For a lump-sum payment of $1.157 billion, an entity's officials decided to transfer, for seventy-five years, all rights to income derived from one of the entity's major assets. Almost immediately after the contract was signed, facts began to emerge demonstrating that the entity's conduct in approving and negotiating the deal had been flawed. An independent assessment found that the asset had been undervalued by at least $1 billion. Although the asset was

*Seigle Family Professor of Law, Northwestern University Pritzker School of Law.
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one of the entity's only marketable properties, the entity's finance committee dedicated only a single meeting to the discussion of its sale. The meeting was held the day after an offer was announced, and the offer's details were forwarded to committee members that same morning, with no details to aid in their deliberations. The finance committee heard only one person testify, the entity's chief financial officer, who simply asserted that the offered payment accurately reflected the asset's true value. When asked, he refused to produce figures to substantiate this claim. Nonetheless, the committee approved the deal on the spot. The next day the entity's full decision-making body did the same. A "fairness opinion" was issued by an investment bank, but only a summary was provided and, curiously enough, it did not analyze the price the asset could fetch on the open market. A legal opinion respecting the deal was also requested from the entity's outside counsel, but it was submitted months after the decision-makers had already approved the deal.

Imagine that a person holding an interest in the entity objects to the transaction. Will a court be willing to entertain her challenge and review the decision to sell the asset? The answer is probably obvious to any lawyer with the most cursory acquaintance with the law of business associations or trusts. The asset sold did not belong to the officials personally; they held and sold it on behalf of those owning an interest in the entity—the asset's true owners.[1] This separation of control from ownership creates an inherent risk of conflicted or careless decision making: as non-owners, the officials in control of the asset may not pursue the best deal when selling that asset.[2] They realize little of the gain and bear little of the loss.[3] The law has long acknowledged this "agency problem" and applies a specialized framework to treat it.[4] Namely, the law characterizes the non-owner officials as "fiduciaries," and subjects them to judicially enforced duties meant to assure that their decisions are in the best interests of the real—or "beneficial"—owners.[5]

These fiduciary duties—recently the subject of much sophisticated scholarly attention—[6]are commonly divided into two categories: a duty of

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[1] ADOLPHE BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 5 (1932).

[2] For a classic treatment of the principal-agency costs, see Michael C. Jensen and William H. Meckling, *Theory of the Firm: Management Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

[3] Robert Cooter & Bradley Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1048 (1991).

[4] The common law of agency defines agency as a "[f]iduciary relationship that arises when one person (a "principal") manifests asset to another person (an "agent") that the agent shall act on the principal's behalf…" RESTATEMENT (THIRD) OF AGENCY, § 1.01.

[5] *E.g.*,Cooter & Freedman, *supra* note 3, at 1046; D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1403 (2002).

[6] *E.g.*, Paul B. Miller & Andrew S. Gold, *Fiduciary Governance*, 57 WM. & MARY L. REV. 513 (2015); Larry Ribstein, *Fencing Fiduciary Duties*, 91 B.U. L. REV. 899, 901 (2011); Ethan Leib, *Friends as Fiduciaries*, 86 WASH. U. L. REV. 665 (2009); Margaret Brinig, *Parents, Trusted but not Trustees or (Foster) Parents as Fiduciaries*, 91 B.U. L. REV. 1231 (2011); Julian Valesco, *How Many Fiduciary Duties Are There in Corporate Law?*, 83 S. CAL. L. REV. 1231 (2010); Evan J. Criddle, *Fiduciary Administration: Rethinking Popular Representation in Agency Rulemaking*, 88 TEX. L. REV. 441 (2010); Deborah DeMott,

loyalty and a duty of care.[7] Under the duty of loyalty, the fiduciary must avoid conflicts of interest when dealing with the beneficiary's assets.[8] Under the duty of care, she must exercise sound management.[9] To ensure such sound management a court will generally assess the process the fiduciary employed before transacting in the beneficiary's asset.[10] In the sale described in the opening paragraph, that process appears hasty, uninformed, and well outside the norms of fiduciary behavior for a transaction of such a magnitude.[11]

Yet when a court passed judgment on this deal, it was not asked to engage, nor did it choose to engage, in such fiduciary analysis.[12] The court explicitly stated that it would not inquire into the decision-making process engendering the deal or into the deal's quality.[13] Instead, the litigants and the court contented themselves with arguments solely over whether the entity had the power to enter a deal to sell the asset. Why? How was a whole body of law—fiduciary law—sidestepped in a case seemingly tailor-made for its application? For one single reason: the entity selling the asset was Chicago, a "public" entity—i.e., a city—and not a "private" entity—i.e., a corporation or a trust.[14] And under current law, fiduciary duties are inapposite to public entities.

This disparate legal treatment of public and private entities is grounded in a factual difference between the entities. Cities usually act as an arm of state government, regulating individual behavior and directly providing governmental

Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences, 48 ARIZONA L. REV. 925 (2006); Melanie B. Leslie, *Trusting Trustees: Fiduciary Duties and the Limits of Default Rules*, 94 Geo. L.J. 67 (2005); John H. Langbein, *Questioning the Trust Law Duty of Loyalty* 114 YALE L. J. 929 (2005); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399 (2002); Evan Criddle & Evan Fox-Decent, *The Fiduciary Constitution of Human Rights*, 15 LEGAL THEORY 301 (2009); Gregory Alexander, *A Cognitive Theory of Fiduciary Relationships*, 85 CORNELL L. REV. 767 (2000).

[7] For a description of fiduciary duties in agency relationships, *see* RESTATEMENT (THIRD) OF AGENCY, § 8.01-8.15.

[8] Meinhard v. Salmon, 164 N.E. 545, 546, 548 (N.Y. 1928).

[9] RESTATEMENT (THIRD) OF AGENCY § 8.08 (2006).

[10] *See infra* notes 234-47, and accompanying text.

[11] The facts of the deal are very similar to those in Smith v. Van Gorkom, 488 A.2d 858, 889 (Del. 1985), in which the court found the agents in breach of their duty of care. For a full discussion, *see infra* notes 241-43, and accompanying text.

[12] *See* Independent Voters of Illinois v. Ahmad, 13 N.E.3d 251 (Ill.App. 1 Dist. 2014), Brief for Plaintiffs-Appellants at Independent Voters of Illinois v. Ahmad, 13 N.E.3d 251 (Ill.App. 1 Dist. 2014).

[13] Independent Voters of Illinois v. Ahmad, 13 N.E.3d 251, 265 (Ill.App. 1 Dist. 2014) ("we certainly understand the argument that the concession agreement transferring the City's control of the metered parking system for 75 years should not have been so hastily entered into and that the accompanying Metered Parking System Ordinance should not have been enacted. However, arguments about why the concession was a bad deal for the City do not provide a basis for invalidating the concession agreement and the adopting Ordinance").

[14] The facts of the case as described in the opening paragraph were also derived from OFFICE OF THE INSPECTOR GENERAL, CITY OF CHICAGO, REPORT OF INSPECTOR GENERAL'S FINDINGS AND RECOMMENDATIONS: AN ANALYSIS OF THE LEASE OF CITY'S PARKING METERS (June 2, 2009).

services.[15] Unlike private corporations or trusts, cities are not the creatures of their members—their residents—set to manage the members' property in the most efficient manner.[16] Rather, they are creatures of the state.[17] Accordingly, courts reckon that the relevant legal question when cities act is whether the state empowered them to act: not the question, prevalent in private law, whether their action lived up to any obligations towards members.[18] But the factual distinction between the city and the private entity underlying this disparate legal attitude broke down in the case described above, wherein Chicago sold to an investors' consortium all revenue from its parking-meters for seventy-five years.[19] Chicago was not acting as the state's long-arm: it was not regulating its residents' activities or providing them with services. It was selling an asset to investors. Chicago "transacted" rather than "governed."[20]

Chicago's turn to the market is not unusual. The twenty-first century American city performs private market functions most of which would have been unimaginable for its twentieth-century predecessor.[21] The convergence of the outmigration of key industries, stagnant populations, shrinking federal and state grants, and large pension shortfalls, has generated structural upheavals in local finances.[22] In response, a wave of privatizations, of private-public partnerships, of spin-offs of city assets, and of sophisticated financial dealings, is sweeping the nation's cities.[23] Cities are investing in securities and buying

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[15] *See infra* Part I.B.1.
[16] RESTATEMENT (THIRD) OF TRUSTS § 2 (2003); 18 AM. JUR. 2D *Corporations* § 1.
[17] United States v. Baltimore, 84 U.S. 322, 329 (1872).
[18] *See infra* notes 76-80 and accompanying text.
[19] Chicago Parking Meters System Concession Agreement, J. OF THE PROC. OF THE CITY COUNCIL OF THE CITY OF CHIC., ILL., Dec. 4, 2008, at 50570.
[20] Independent Voters of Illinois v. Ahmad, 13 N.E.3d 251,265 (Ill.App. 1 Dist. 2014). The court approved Chicago's transaction because the deal did not implicate the city's powers as government—it's "police powers." The court agreed that the city was no allowed to relinquish, to a private party, those powers, but it reasoned that in the parking meters deal the city did not transfer, or implicate, them.
[21] DAN MCNICHOL, THE UNITED STATES: THE WORLD'S LARGEST EMERGING P3 MARKET 2 (2013), available at https://www.aig.com/content/dam/aig/america-canada/us/documents/insights/final-p3-aig-whitepaper-brochure.pdf (last visited March 5, 2017) (projecting that the United States will become the largest hub for public private partnerships in dealing with local infrastructure).
[22] The most notorious victim of these upheavals was Detroit, which was forced to file for bankruptcy protection in 2013. *In re* City of Detroit, Mich., No. 13–53846, 2013 WL 4761053, at *1 (Bankr. E.D. Mich. July 25, 2013). Chicago's finances have also been affected: in May 2015, Chicago's debt was dropped to "junk bond" status. *See* Aaron Kuriloff, *Moody's Cuts Chicago's Debt to Junk: Ratings Firm Drops City's Debt Two Notches to Ba1 from Baa2*, WALL STREET J., May 12, 2015.
[23] For an overview, *see* Khalid Razaki et al., *Privatization of Infrastructure Assets*, 12 J. FINAN. & ACC. 25 (2013).

revenue producing venues,[24] while offering their waterworks,[25] airports,[26] bridges,[27] and other infrastructure for sale.[28] This wave should only intensify over the next few years, as the new federal administration has already firmly endorsed such initiatives.[29]

The factual gap between the supposedly public city and the private corporation or trust is closing fast. Yet the legal gap between "public" local government law and "private" entities law has steadfastly, and mindlessly, persisted. Because the city is legally deemed public, its market transactions are not subjected to the fiduciary scrutiny that private law has developed precisely for such deals, leaving city transactions almost wholly unregulated.[30]

It is imperative, therefore, to reclaim fiduciary law for the city. This novel call made in this Article to connect city law and private entities law may appear radical. In actuality, however, it finds ample grounding in local government law's own logic and history. In disparate branches of the law, the supposedly public city is in fact regarded as a private entity. For example, when the city restricts trade, antitrust laws regulating private businesses may intervene, although state actions are exempt from such regulation.[31] Similarly, residents in many jurisdictions can bring a derivative lawsuit on their city's behalf, as if it were a corporation.[32] The law thus conceives of the city as an entity of a dual nature: a public entity that can, in certain circumstances, be treated as private.[33] Most importantly, a long line of forgotten common law decisions from the nineteenth and early twentieth centuries explicitly drew on corporate and trust law to hold that city officials are fiduciaries when transacting

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[24] *E.g.*, Lizette Alvarez, *How Many Mayors Can Puerto Rico Afford? Tradition and Budgets Collide*, July 26, 2016 N.Y. TIMES (reporting on cities that in order to sustain their finances invest in "self-sustaining businesses" such as water parks and golf courses), Jay Koh, *The Myth of Procedure: Derivative Investment Reform in St. Petersburg*, 16 YALE J. REG. 245, 247 (1999) (describing cities' investments in derivatives).

[25] *See* Danielle Ivory, *In American Towns, Private Profits from Public Works*, N.Y. TIMES, Dec. 24, 2016.

[26] *See* Rachel Y. Yang, *Airport Privatization: Issues and Options for Congress*, CONGRESSIONAL RESEARCH SERVICE (2016), available at https://fas.org/sgp/crs/misc/R43545.pdf (last visited March 5, 2017).

[27] *See* Katie Banner, *Wall Street to Cities: Wanna Sell that Bridge?* WALL ST. J., June 11, 2010.

[28] For trends in local government privatization, *see* Austill Stuart & Leonard Gilroy, *Annual Privatization Report: Local Government Privatization*, REASON FOUNDATION (2016), available at http://reason.org/files/apr-2016-local-privatization.pdf (last visited March 5, 2017).

[29] *See* Patrick Sisson, *The Art of the New Deal*, CURBED, Jan. 19, 2017, available at http://www.curbed.com/2017/1/19/14268628/trump-infrastructure-plan-new-deal (last visited March 7, 2017).

[30] *See also* Angie Schmitt, *The Indiana Toll Road and the Dark Side of Privately Financed Highways*, STREETSBLOG USA, Nov. 18, 2014, available at http://usa.streetsblog.org/2014/11/18/the-indiana-toll-road-and-the-dark-side-of-privately-financed-highways/ (last visited March 5, 2017) (noting that the deals cities are currently entering are declining in quality).

[31] *See infra* Part I.C.2.a.

[32] *See infra* Part I.C.2.b.

[33] *See infra* Part I.B-C.

in city assets and making contracts on the city's behalf.[34] These cases, heretofore neglected by lawmakers and commentators, have never been overruled and their reasoning remains normatively compelling today.

To reclaim fiduciary duties for the city, however, unearthing and reinstating city officials' long-dormant status as fiduciaries does not suffice; establishing that status's precise ramifications for those officials is also necessary. Specifically, the legal standard of sound management that city officials must abide by needs to be discerned. The most effective way to achieve that objective is through an exploration of the fields of law that have a long experience with fiduciary standards: corporations law and trust law.[35] A close study of these will indicate that the standard of care most appropriate for the normative circumstances of the city is one testing the quality of decision-making processes.[36] Such a standard will require that officials engage in informed decision-making before entering major transactions. Judicial review to assure that such procedures were abided by will alleviate the agency problem inherent to city officials' relationship with residents. At the same time, as a procedural rather than substantive form of scrutiny, it will not interfere with those officials' democratic standing. Under this standard, courts will not be permitted to question the wisdom of a city's decision to trade: of a local decision to, for example, sell (or refrain from selling) its parking-meters. But courts will be allowed to question the mechanics of the decision-making process for picking the meters' individual buyer. City officials will thus preserve their prerogative as legislatures, to, in words attributed to Justice Marshall, "enact[] stupid laws."[37] In a major transaction, however, city officials will be required to reach that stupid result through a sufficiently rational process.

The Article proceeds as follows. Part I identifies the source of the city's fiduciary duties, demonstrating that private law fiduciary duties can be applied directly to the city. Part I does so by highlighting the corporate law history of the city, and by revealing that even after the rise of the public law perception of the city, late nineteenth-century and early twentieth-century common law courts maintained corporate law fiduciary precepts in local government law whenever cities transacted in public assets. The discussion further illustrates that this dual treatment of the city—a public entity subject to private law precepts when entering the market—has persisted into contemporary times, as exhibited in disparate legal fields, such as antitrust. Yet, Part I's exploration

[34] *See infra* Part I.B.5.

[35] The fiduciary duties for an entity are always developed through comparison to the fiduciary duties prevalent in other entities. *See* Deborah DeMott, *Beyond Metaphor*, 1988 DUKE L.J. 879, 891 ("The evolution of the law of fiduciary obligation illustrates, perhaps more powerfully than most bodies of law, the power of analogy in legal argumentation. Courts considering whether to impose a fiduciary constraint in a novel context rely heavily on comparisons to more conventional contexts in which the constraint does apply. …[T]is pattern's pervasiveness and persistence suggest that it is an inevitable aspect of fiduciary analysis").

[36] *See infra* Part II.C-D.

[37] New York State Board of Elections v. Lopez Torres, 552 U.S. 196, 209 (2008) (quoting Thurgood Marshall) (Stevens, J., concurring).

into current law also finds that courts' meaningful references to fiduciary duties—particularly to the duty of care—in their treatment of city transactions have dwindled for no apparent, and normatively viable, reason. Part II then proceeds to fill this void by giving substance to the city's fiduciary duty of care. After exploring the different duties of care used in private entities law, it imports to the city context the duty of care that currently exists under Delaware corporate law, as it finds this duty to be the most suitable to the city's normative circumstances. It concludes by addressing potential objections to the application of such a fiduciary duty to city officials, answering both substantive and procedural concerns. From this analysis, a clear conclusion emerges: American law should, and easily can, reclaim fiduciary duties for the city.

PART I: THE SOURCE OF CITY OFFICIALS' FIDUCIARY DUTIES

This Article contends that city officials are, at times, fiduciaries. The claim is innovative but also deeply rooted in American law. This Part explains that paradox. It shows that while recent scholarly works that argue that all public officials are fiduciaries indeed break novel doctrinal grounds, local public officials represent a special case. The common law already regards them as fiduciaries, even if this status has been lately forgotten.

To establish this claim, this Part first surveys recent literature in fiduciary law analogizing all public officials to private officials and explains its limitations. It then turns specifically to local officials, whose unique case the literature has not addressed. The evolution of the traditional common law's treatment of cities is traced, highlighting the common law's insistence on the city's private attributes and, accordingly, city officials' legal status as fiduciaries. Finally, this Part highlights the anomaly in current law's neglect of the ramifications of this traditional characterization of city officials as fiduciaries.

A. The Public Source of All Officials' Fiduciary Duties: Recent Works and Their Limits

Fiduciary duties are typically associated with private law.[38] Those controlling trusts, estates, corporations, partnerships, etc., are the quintessential fiduciaries.[39] In a recent spate of highly influential works, however, prominent scholars have put forward the fresh proposition that fiduciary duties are just as relevant to public law. These works are very diverse, yet at their core is the contention that the relationship between public official and citizen mirrors the relationship between corporate or trust official and the corporate or trust beneficiary. Like the corporation's shareholder or trust's beneficiary, the citizen empowers representatives who govern her affairs in

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[38] Frank Easterbrook, *Corporate Control Transactions*, 91 YALE L. J. 698, 702 (1982).
[39] *Id.*

accordance with an agreed-upon constitutional order.[40]

Drawing on writings from the era of the Framing and before,[41] on the text of the Constitution itself,[42] and on state laws and court decisions old as new,[43] scholars have assembled support for the idea that public officials should be treated as fiduciaries. Specifically, they have argued that administrators,[44] judges,[45] federal elected officials,[46] and state elected officials,[47] owe fiduciary duties to the public. These officeholders are thus obliged, commentators argue, to disclose conflicts of interest,[48] refrain from insider trading,[49] abide by strong anti-corruption norms,[50] and more.[51]

The contention that public officials are the equivalents of private law's fiduciaries is hence now a highly-developed argument generating concrete, effective, and far-reaching doctrinal rules. It is not without weaknesses though.[52] The argument is grounded in an analogy,[53] and that analogy is far from perfect. For example, the notion that residence in a nation or state represents a choice analogous to the choice involved in subjecting oneself to a corporate regime by buying the corporation's stock is somewhat far-fetched.[54] Similarly, reliance on use of the term "trust" by the Framers may be attributing to them, anachronistically, the modern concepts of trust law.[55] It may conflate the legal function of the word "trust" as a term imbued with specific doctrinal meaning with the word's function as an abstract, and philosophical, term

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[40] *E.g.*, Sung Hui Kim, *The Last Temptation of Congress*, 98 CORNELL L. REV. 845, 872-73 (2013); Deborah DeMott, *Agency by Analogy*, 70 L. & CONTEMP. PROBS. 157, 166-67 (2007);

[41] Robert Natelson, *Judicial Review of Special Interest Spending*, 11 TEX. REV. L. & POL. 239 (2007); Paul Finn, *Public Trust and Public Accountability*, 3 GRIFFITH L. REV. 224 (1994)

[42] TAMAR FRANKEL, FIDUCIARY LAW 284-87 (2011).

[43] Kim, *supra* note 40, at 877.

[44] Evan Criddle, *Fiduciary Foundations of Administrative Law*, 54 UCLA L. REV. 117 (2006)

[45] Ethan Leib, *A Fiduciary Theory of Judging*, 101 CAL. L. REV. 699, 753 (2013).

[46] Kathleen Clark, *Do We Have Enough Ethics in Government Yet?*, 1996 U. ILL. L. REV. 57, 63 (1996).

[47] Theodore Rave, *Politicians as Fiduciaries*, 126 HARV. L. REV. 671, 713 (2013).

[48] Donna Nagy, *Owning Stock While Making Law*, 48 WAKE FOREST L. REV. 567 (2013).

[49] Donna Nagy, *Insider Trading, Congressional Officials, and Duties of Entrustment*, 91 B.U. L. REV. 1105 (2011).

[50] Clark, *supra* note 46.

[51] *E.g.*, Rave, *supra* note 47 (employing fiduciary duties to police self-serving redistricting).

[52] For a discussion of the risks inherent to the exercise see Ethan J. Leib, *Translating Fiduciary Principles into Public Law*, 126 HARV. L. REV. F. 91 (2013).

[53] Kim, *supra* note 40, at 869-77. On analogies in fiduciary law, *see* DeMott, *supra* note 35, at 891.

[54] Leib, *supra* note 52, at 72.

[55] What we now recognize as fiduciary law was not even mentioned in trust law treatises until 1837 in England, and 1881 here. John Langbein, *Rise of the Management Trust*, TR. & EST., Oct. 2004, at 52. Thus, for example, Natelson who argues for this position concludes that the Framers merely meant to apply to government standards of "decency". Robert Natelson, *The Constitution and the Public Trust*, 52 BUFF. L. REV. 1077, 1178 (2004).

laypeople employ almost daily.[56] Therefore, while the analogy of the public official to the corporate or trust official is possible, it is contestable.

This Article is distinct from all these other works since its focus on one specific subcategory of public officials—local officials—sidesteps this controversy bogging down the literature. Fiduciary duties can be applied to local officials much more easily than to state and federal officials because this move need not draw on an analogy. Unlike the federal or state governments, the city's legal roots are in the laws of the private corporation and trust. As a result, fiduciary duties actually form an inherent part of local government law itself—as will be established next—and need not be imported into it.

B. The Private Law Source of City Officials' Fiduciary Duties: The City as a Private Law Subject in Nineteenth-Century Law

Stripped to its elemental composition, a city is a geographically-contained collection of individually-owned properties which rely on, and are connected by, common properties, all supervised by a representative management body. This management body also provides certain services to the individually-owned properties and their inhabitants. The same can be said of the homeowners association or condominium.[57] What then distinguishes the city from the homeowners association or condominium? For many laypeople and lawmakers today the answer is simple: the former is public, the latter private.[58] But what turns the city public? Why, for legal purposes, is it not, like the similarly constituted, and similarly functioning, homeowners association or condominium, "private"? That question is vital since the distinct label affixed to the city carries legal ramifications, including whether city management is exempt from core obligations applicable to private collective entities, such as traditional fiduciary duties.[59] This section and the one following it thus chronicle American law's ongoing struggles with the question; this section focusing on the original nineteenth-century approach to it, the next turning to developments occurring in the twentieth- and twenty-first centuries.

American local government law was reinvented during the century following Independence, and thus the common law of the city must first be sought in the nineteenth-century.[60] This section dedicated to the law as it emerged from that century begins by reviewing the key transformation in the city's status during that time: from an indubitable subject of private law to a supposedly unquestionable subject of public law. The discussion next detects

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[56] During the American revolutionary era the concept of "trust" was discussed as a component of "republican virtue"—the individual self-restraint and civic regard for the greater good that was thought essential to any democratic regime. *See* GORDON WOOD, THE CREATION OF THE AMERICAN REPUBLIC 118-24 (1969).

[57] On homeowners associations and condominiums, see, for, example, ., JOSEPH SINGER, PROPERTY LAW 586-87 (6th ed. 2014).

[58] *E.g.,* Robert Ellickson, *Cities and Homeowners Associations*, 130 U. PA. L. REV. 1519, 1519 (1982).

[59] On the importance of the public/private distinction, *see, e.g.*, Gerald Frug, *The City as a Legal Concept*, 93 HARV. L. REV. 1059 (1980).

[60] *Id.*, at 1099-1117.

the vestigial aspects of private law that were nonetheless preserved in local government law, specifically respecting city property ownership. It then highlights late nineteenth-century and early twentieth-century jurists' resultant application of private law's fiduciary duties to city officials when transacting in city-owned properties.

1. The City's Origins as a Private Law Subject

The city, the homeowners association or condominium, the corporation, and similar entities are all collective entities—associations. Originally, the common law did not recognize any distinctions among associations. The City of London was not different from the East India Company.[61] Both were "called a corporation or body corporate because the persons are made into a body, and are of capacity to take, grant, & c., by a particular name."[62] All such associational bodies shared a common goal: a group of individuals had chosen to combine their resources in order to promote common interests.[63] That goal inevitably demanded the provision of a degree of protection to association members from outsiders. In a legal regime supplying individuals with little protections from government, such protection—the protection from the King—was to a great extent the raison d'être of all associations.[64] Consequently, the *quo warranto case* of 1683, endorsing King Charles II's move to revoke corporate charters—including, prominently, the Charter of the City of London—is known as "the most important case in English history."[65] It contributed to the Stuarts' ouster five years later in the Glorious Revolution that led to the immediate legislative reversal of the decision.[66]

As the uproar over the *quo warranto case* illustrates, the early common law did not see the city as part of government; quite the opposite. The city like the business enterprise formed part of associational, or corporate, law and its main role—as that of all other associations—was isolating members from government. Against this legal background cities were founded in the New World. After all, few entities better reflect the muddied historical boundaries between business endeavors and local governments than the Virginia Company of London: an association of shareholders set to establish, for the shareholders' profit, new communities in America.[67] Many major colonial

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[61] Blackstone famously grouped together, as "lay corporations" towns, the "trading companies of London," and colleges. 1 WILLIAM BLACKSTONE, COMMENTARIES *469.
[62] *Id.*, at *467.
[63] M. WEBER, THE CITY 133 (D. Martindale trans. 1958).
[64] "[T]he English charters incorporating towns are to be viewed…in the nature of a bill of rights.….They were constitutional charters, which the crown could not encroach upon without violating the freedom of the subject. Most, if not all the leading cases in the books, involving the question of the inviolability of these charters in the English courts, arose between *the prerogative of the crown* and the corporation." People v. Morris, 1835 WL 2510 (N.Y. Sup. Ct. 1835).
[65] J. LEVIN, THE CHARTER CONTROVERSY IN THE CITY OF LONDON 1660-1688, AND ITS CONSEQUENCES 80 (1969).
[66] 1 BLACKSTONE, SUPRA note 61, at *485.
[67] EDMUND MORGAN, AMERICAN SLAVERY, AMERICAN FREEDOM 44-46 (1975).

cities were legally established and governed as corporations chartered by the King: New York received such a charter in 1665,[68] Philadelphia's dates to 1701.[69]

The corporate form separated ownership from management—as it still does today.[70] Like the business corporation owned by many stockholders yet governed by a handful of directors, a chartered English municipality serving many residents was governed by a handful of common councilors (board of directors) and mayor (chief executive).[71] As a legal matter, the city at Independence was an association like any other, sharing the same governance scheme with the business association.[72]

In the ensuing decades, however, a stark division materialized in American associations law: the private/public divide. The corporation came to be perceived as private, the city as public.[73] The emerging core legal difference between the private and public association—most famously elaborated in the Supreme Court's ruling in *Dartmouth College v. Woodward* (1819)—had to do with the power of the state over the association.[74] The "private" association, courts explained, was the embodiment of its members, and hence enjoyed the same protections from the state as did the individuals who had created it and were benefiting from it.[75] Conversely, the "public" association was an instrumentality of the state, not a creature of its members.[76] All powers a public association such as the city enjoyed had to be traced to the state, and could always be limited or taken away by the state.[77] This attitude was given its most enduring expression in the famed 1907 decision in *Hunter v. Pittsburgh*, where the Supreme Court would not entertain a challenge by residents to a state's decision to disband their city and annex it to another.[78] The city owed its existence, and was answerable to, the state, not its residents.[79]

Hunter v. Pittsburgh encapsulated the law's transformation during the preceding century. Even though, as a practical and historical matter, the city

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68 The city's first, Dutch charter dated to 1657. HENDRIK HARTOG, PUBLIC PROPERTY AND PRIVATE POWER 14 (1983).

69 Judith Diamondstone, *Philadelphia's Municipal Corporation*, 90 PA. MAG. HIST. & BIO. 183 (1966).

70 *See generally* BERLE & MEANS, SUPRA note 1, at 5.

71 Pauline Maier, *The Revolutionary Origins of the American Corporation*, 50 Wm. & Mary Q. 51, 61–62 (1993).

72 Another conception of the city was not even imaginable. Even Boston, whose Puritan residents abhorred the corporate model bestowing control on a select few and thus refused to formally incorporate, was treated as a "quasi-corporation." 2 JAMES KENT, COMMENTARIES ON AMERICAN LAW 221.

73 People v. Morris, 1835 WL 2510 (N.Y. Sup. Ct. 1835) ("The distinction between public and private corporations is strongly marked, and, as to all essential purposes, they correspond only in name.")

74 17 U.S. 518.

75 MORTON HORWITZ, THE TRANSFORMATION OF AMERICAN LAW 111-14 (1977).

76 United States v. Baltimore, 84 U.S. 322, 329, 21 L. Ed. 597 (1872).

77 *E.g.*, Saving-Fund v. Philadelphia, 31 Pa. 175, 182 (1858) ("a municipal corporation… may be created and destroyed by the state at pleasure"); Laramie v. Albany, 92 U.S. 307 (1875).

78 207 U.S. 161.

79 New Orleans v. Clark, 95 U.S. 644, 652 (1877).

was a collective entity like any other association, as a legal matter, the members of an American city, unlike the members of other associations, formally no longer "'own[ed]' their municipal corporation, except derivatively as members of a state polity."[80]

2. The City Retains a Private Law Status as Property Owner

The statement just quoted very nicely reflects the conclusion of the post-Independence ideological transformation in attitudes towards the city. As a reflection of the legal reality emerging at the time, however, it is somewhat overblown. Whereas decisions in heavily cited cases, generalized court pronouncements, and scholarly writings forcefully insisted on the separation of the city from its roots in private law, in practice the picture was blurred. Several domains remained in the law wherein the city was continuously treated as a private entity. The earliest and most prominent such domain was property law.

Even as the city was shedding its private legal status, its standing as a property holder was the one element of its original corporate nature that persistently needled nineteenth-century courts and commentators.[81] At least two attributes of city property ownership contributed to the complexity: one normative, the other historical. First, the subjugation of the city to the state as described above was animated by a democratic desire to curb city power.[82] City power was threatening since the city wielded regulatory powers over individuals, a governmental power which private entities lacked.[83] As a property owner, on the other hand, the city enjoyed no special powers that private entities did not share, and hence the risk of abuse, and the accompanying need for separate legal treatment, was somewhat muted.[84] Second, whenever the issue was the city's standing as an owner—as opposed to as a regulator—the city's corporate roots were difficult to ignore.[85] The city owned property because such property was conveyed to the public by residents (e.g., through the doctrine of "dedication"), or because the city acquired it using the residents' pulled resources.[86] While as a government the city's existence could somehow be imagined as mere extension of the state government, as a holder of property such a conception was clearly inadequate.[87] Thus, the law did not remove the city's private guise when its

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[80] HARTOG, SUPRA note 68, at 4.
[81] Murray Seasongood, *Municipal Corporations: Objections to the Governmental or Proprietary Test*, 22 VA. L. REV. 910, 938 (1936)("no satisfactory basis for solving the problem whether the activity falls into one class or other has been evolved. The rules sought to be established are as logical as those governing French irregular verbs").
[82] Frug, *supra* note 59, at 1106
[83] HARTOG, SUPRA note 68, at 17.
[84] 1 DILLON, MUN. CORP. § 26 (5th Ed.).
[85] *E.g.*, Mt. Hope Cemetery v. Boston, 158 Mass. 509, 519 (1893).
[86] *E.g.*, City of Philadelphia v. Fox, 64 Pa. 169, 177 (1870); Bd. of Trs. v. Haven, 11 Ill. 554 (1850).
[87] Tippecanoe Cty. v. Lucas, 93 U.S. 108, 115(1876) ("But property, derived by them from other sources, is often held, by the terms of its grant, for special uses, from which it cannot be diverted by the legislature. In such cases, the property is protected by all the guards

ownership interests in assets were concerned—a key finding for this Article's analysis of the city's obligations as an assets' seller.[88]

The starting point for the muddled doctrine respecting city property ownership—and the direct outcome of the two original difficulties just described—was nineteenth-century courts' insistence that the city was always subject to state powers in its governmental capacity, but not in its proprietary capacity.[89] That is, when holding that the state could overrule city action, and could even abolish city governments (as in *Hunter v. Pittsburgh*), courts noted that the same would not apply when the city exercised its property rights.[90] The courts thus early on acknowledged the duality of the city's nature.

Respecting this dual nature was challenging, however.[91] The neatness of the dividing line between regulating behavior and owning property easily collapsed in practice.[92] Control over resources is always a form of exercising power over others,[93] and the city's position as the sole owner of certain local properties means that it forcefully polices behavior by regulating the uses of those properties.[94] When the city is defining allowable activities in the public park (for example, permitting or prohibiting the consumption of alcohol, or closing it on Sundays) is it acting as the regulator of individual behavior or as an owner setting the contours of its property's uses?[95] When the city sets construction criteria for buildings that will be allowed to connect to its sewage system, is it acting as the regulator of individuals' behavior or as an owner

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against legislative interference possessed by individuals and private corporations for their property. And there would seem to be reasons equally cogent, in abstract justice, against a diversion by the legislature from the purposes of a municipality of property raised for its use by taxation from its inhabitants").

88 Dartmouth College v. Woodward, 17 U.S. at 694-95 (Story, J., concurring).

89 2 J. KENT, COMMENTARIES ON AMERICAN LAW 275-76 (3d ed. 1836) ("Public corporations are such as are created by the government for political purposes, as counties, cities, towns and villages; they are invested with subordinate legislative powers to be exercised for local purposes connected with the public good, and such powers are subject to the control of the legislature of the state. They may also be empowered to take or hold private property for municipal uses, and such property is invested with the security of other private rights").

90 *E.g.*, Detroit Park Comm'rs v. Detroit, 28 Mich. 228, 247 (1873).

91 Dillon believed that the distinction was so "difficult to trace" that it ought to be ignored. DILLON, SUPRA note 84, at § 39.

92 In a related context, the modern Supreme Court has acknowledged the futility of efforts to rely on the distinction. Shortly after holding that a minimum wage law applied to municipal workers interfered with traditional local governmental powers and was thus unconstitutional, National League of Cities v. Usery 426 U.S. 833 (1976), the Court reversed itself and rejected the distinction between governmental and proprietary powers. Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985).

93 Morris Cohen, *Property and Sovereignty*, 13 CORNELL L. REV. 8 (1927).

94 HARTOG, SUPRA note 68, at 7 (arguing that the earlier city ruled through its control over resources). *See also* Nicole Garnett, *Relocating Disorder*, 91 VA. L. REV. 1075 (2005) (arguing that we are seeing a rise in local government policy where officials use "property regulation," rather than "policing" in attempt to control "urban disorder").

95 *E.g.*, ROY ROSENZWEIG & ELIZABETH BLACKMAR, THE PARK AND THE PEOPLE: A HISTORY OF CENTRAL PARK 254-56 (1992).

setting the contours of its property's use?[96] These questions defy categorical answers,[97] and thus statements that as owners cities were immune from state intervention remained mostly dicta.[98] When put to the test, courts did not block states from interfering with local activities—irrespective of those local activities' seemingly proprietary nature.[99] For example, courts allowed states to seize a city's ferry franchise,[100] and to rewrite a contract a city had entered with a railroad servicing its streets.[101] The city's unique, private status when owning property did not, apparently, generate a private law type relationship between the city and the state.[102]

3. City Ownership and the Public Trust Doctrine

The city's unique, private status when owning property did, nonetheless, generate a private-law type relationship between the city and its residents. Acting as a government, the city was not obliged to assure residents the enjoyment of specific services or regulations.[103] But when acting as an owner, it could be required to assure residents the enjoyment of certain assets—since the law conceived the city as holding assets as the residents' trustee.[104]

The "public trust" doctrine originated in the common law's rule that certain resources—navigable waters and the lands submerged under them, and later also highways and streets,[105] were held by the King, not the owners of adjacent lands.[106] But the powers of the government (the King's successor) over these assets depended on the specific government's identity. Nineteenth-

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[96] *E.g.,* THE HARRIS COUNTY FLOOD CONTROL DISTRICT, POLICY, CRITERIA & PROCEDURE MANUAL (2010).
[97] *See* Hugh Spitzer, *Realigning the Governmental/Proprietary Distinction in Municipal Law*, 39 SEATTLE U. L. REV. 173, 175 (2016) (discussing confusion over the governmental/proprietary distinction).
[98] Some states never recognized the distinction. *E.g.,* Carter v. City of Greenville, 175 S.C. 130, 178 (1935).
[99] The Supreme Court could only name two cases applying the doctrine, and even among those two, only one--_Mt. Hope Cemetery v. Boston, 158 Mass. 509 (1893)—actually did so. Worcester v. Worcester Consol., 196 U.S. 539, 551 (1905).
[100] Town of E. Hartford v. Hartford Bridge Co., 51 U.S. 511, 533 (1850).
[101] Worcester v. Worcester Consol., 196 U.S. 539(1905).
[102] The Supreme Court reckoned the distinction's sole resonance was with respect to the city's immunity it torts from negligence claims respecting acts of its agents—and was thus irrelevant to the city's relationship with the state. Trenton v. New Jersey, 262 U.S. 182, 191 (1923).
[103] 18 MCQUILLIN MUN. CORP. § 53:2 (3d ed.) ("As a government [the city] is obligated to serve the local inhabitants, to supply them with municipal needs and conveniences… the only remedy for failure, like the remedy for failure on the part of the nation or state, is public protest at the ballot box"). Naturally, state statutes may place specific service obligations on the city.
[104] Martin v. Waddell, 41 U.S. (16 Pet.) 366, 412-14 (1842).
[105] MOLLY SELVIN, THIS TENDER AND DELICATE BUSINESS: THE PUBLIC TRUST DOCTRINE IN AMERICAN LAW AND ECONOMIC POLICY, 1789-1920 63, 108 (Harold Hyman ed., 1987).
[106] Carol Rose, *The Comedy of the Commons*, 53 U. CHI. L. REV. 711, 727 (1986)

century American courts drew a clear distinction between state governments and city governments. The state as holder of public trust properties had full power to convey them, like any other owner: the properties were "'subject to [the State's] absolute discretion and control'...over which she holds despotic sway…."[107] The city, by contrast, held public trust assets merely as an agent of the residents.[108] Consequently, it only held over them the limited powers of a "trustee."[109] As one court declared "the street…has been given to [the city corporation] as a trust for the use of the public and [thus] it is not authorized to relinquish" exclusive control over it.[110] A legal encyclopedia authored during the century's closing decade authoritatively announced that "Municipal corporations hold the title to streets, alleys, public squares, wharves, etc., in trust for the public; and upon principle, such trust property can no more be disposed of by the corporation than can any other trust property held by an individual."[111]

The public trust doctrine generated duties that the city owed members—not the state. It thus undermined the prevalent notion that the city was now a mere creature of the state, assuring that as the owner of certain properties, the city remained, explicitly, the equivalent of the private trust or corporation.

4. The Rules Governing Cities' Transactions with Public Trust Properties

Although the city could not divest itself of the trust properties or close them to the public, it could manage them to promote the public trust's goals.[112] Effective management might require entering contracts that could enhance the public benefit derived from the properties.[113] But once a contract is thus permissible, what were the duties to which the contracting city was subject? An early New York decision provided the answer—an answer of great importance for this Article's claim, because it was resolutely grounded in the private law of the trust and the corporation.

In 1852, New York City's council resolved to allow a private entity to operate a passenger railway on Broadway. The street itself was, naturally, a public trust asset. But the street was to remain open, so there was no

[107] Phila. & Trenton R.R. Co., 6 Whart. 25 (Pa. 1840).
[108] Milhau v. Sharp, 1853 WL 5741 (N.Y. Gen. Term. 1853)("There is undoubtedly a wide difference in this respect between the acts of the state legislature and of municipal corporations…. The [city] council has no authority under the city charter or any statute, to give away, or make an improvident grant of, the public property…Its disposition of such property… is therefore subject to the common law principles applicable to the grants made by trustees to whom the management of private property is confided").
[109] City of Quincy v. Jones, 76 Ill. 231, 242-43 (1875) ("Holding [the streets] in trust for the public and having no authority to convey or divert them for other uses….").
[110] Milhau v. Sharp, 27 N.Y. 611, 622 (1863)
[111] 1 AMERICAN AND ENGLISH ENCYCLOPEDIA OF LAW 949, 1064 (John Houston Merrill ed. 1891).
[112] *Id.*
[113] Milwaukee v. State, 193 Wis. 423, 453-56 (1927) (grant for harbor improvement does not violate public trust).

questioning the city's power to grant access to the passenger railway. Instead, the plaintiffs contested the details of the specific grant made, arguing that the city was conveying "these privileges for a trifling sum…when the trustees might have obtained a million of dollars for the grant…[and this] was a palpable breach of trust..."[114]

This claim was extraordinary: it required the court to strike down a city decision, duly authorized by state law, merely because it was improvident.[115] Nonetheless, the court, relying on the distinction between the city's role as government and its role as private property holder, accepted the plaintiffs' claim. The judges agreed that "as far as [the city] acts in the exercise of its public political powers" it is vested with almost unfettered discretion. "[W]hether its laws are wise or unwise; whether they are passed from good or bad motives, it is not the province of this court to inquire."[116] But the court proceeded to draw a clear line dividing such acts from others:

> as regards the acts of the corporation in reference to its private property, it stands upon a very different footing. Such property is held for the common benefit of all the corporators [i.e., city residents]. In respect to that, the corporation is charged with high duties. It is the depositary of a trust which it is bound to administer faithfully, honestly and justly. And no one will contend that the body of men, who for the time being, may be its duly authorized representatives, can legally dispose of its property of great value, without any or for a nominal consideration; and if they shall presume to do so, it will be no excuse for such a gross and unwarrantable breach of trust to say that they acted in their legislative capacity; for the very simple reason that they will not act in that capacity. *They will be acting in reference to the private property of the corporation, and, in this respect, will stand upon the same footing as if they were the representatives of a private individual, or of a private corporation*.[117] [italics added]

When it was transacting in public trust assets—as opposed to when it was exercising "political powers"—the city council was the equivalent of the "board of directors" of "banking corporations, and railroad and insurance companies." [118] The court thus subjected the city council to the same obligations governing those bodies. Consequently, the court faulted the city council for accepting an offer that was much worse than other offers presented to it. The council had violated its obligation towards the residents—referred to as "corporators"—in a "gross and unwarrantable" manner. The New York court, thus, clearly delineated two realms of city power: one of public political powers, another of property holding and contracting powers. The court agreed

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[114] Milhau v. Sharp, 1853 WL 5741 (N.Y. 1853)
[115] *Id.*,at *26 (Morris J., dissenting).
[116] *Id.*, at *11.
[117] *Id.*
[118] *Id.*

that the former was not subject to duties from private law; it had no doubt that the latter was.

5. Cities' Fiduciary Duties when Transacting in Public Trust Properties

Once the city's dual public and private nature was thusly acknowledged, courts had to elaborate on the contents of the city's "private" duties and the specifics of their application to city deals. This work was accomplished through two groups of cases: one involving government contracts, the other the sale of services to outsiders.[119] The city's expanding role in the rapidly industrializing nation of the late nineteenth-century created the factual underpinnings of both groups of disputes. [120] The legal underpinnings of their resolution were squarely found in the fiduciary law of trusts and corporations, paralleling, almost perfectly, modern notions of private fiduciary law.

The first group of cases dealt with city contracts. As cities grew in size and economic importance, they increasingly assumed responsibility for the provision of expanded services, for which they often entered contracts.[121] In turn, many contracts raised ethical concerns because the lines between municipal political leadership and local business interests were at the time famously porous. [122] In reaction to this problem courts drew on standard private law fiduciary theories which made contracts voidable if tainted by an agent or trustee's self-dealing.[123] In this vein, for example, courts voided a contract whereby a city hired a council member to provide horses for a Fourth of July procession,[124] and a city's transfer of land to a railroad company on whose board a council member sat.[125] Courts reasoned that upon becoming a member of a city council, a councilor takes on certain fiduciary duties towards the city's residents. Among those duties was a prohibition on engaging in self-dealing transactions.[126] In reaching this rule, courts explicitly held the city to

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[119] A third group of cases prominently alluding to fiduciary notions dealt with municipalities' liabilities for their employees' acts. Courts stressed "[i]t is the duty of the corporation to exercise proper care and prudence in the selection and employment of suitable agents and servants . . . " But such tort these duties did not derive from a corporation's fiduciary duties to its residents (or stockholders). City of Memphis v. Lasser, 28 Tenn. 757, 761 (1849).

[120] On the city at the time, *see, e.g.*, ROBERT FOGLESONG, PLANNING THE CAPITALIST CITY 60 (1986).

[121] *See* MacDonald, American City Government and Administration 67 (rev. ed. 1937) (rapid increase of city services between 1865 and 1890).

[122] The exploitation of city resources for private benefit, supposedly caused by the cross-pollination between municipal and business interests, was the rallying cry of reformers. *E.g.*, LINCOLN STEFFENS, SHAME OF THE CITIES 1-18(1904)

[123] The so-called "sole interest" standard from trust law, famously pronounced in Thorp v. McCullum, 6 Ill. (1 Gilm.) 614, 626 (1844).

[124] Smith v. Albany, 61 N.Y. 444, 445 (1875).

[125] San Diego v. San Diego & Los Angeles R. Co., 44 Cal. 106, 113 (1872)

[126] *Id.*

be the corporation or trust's equivalent.[127] Decisions were based on the leading treatise on agency,[128] and on cases involving trustees.[129]

The second group of cases in which courts used private fiduciary law precepts involved extra-territorial service delivery. As the century progressed, cities began providing their residents with water, gas, light and electricity. Sometimes a city's utility would produce a surplus that the city would sell to non-residents. City residents challenged these acts as ultra vires.[130] By this point local government law was defined by the requirement that the city, as a public entity, pinpoint an authorization in state law for each and every one of its actions. Moreover, as the allegedly corrupt cities of the time were deeply mistrusted by jurists,[131] the rule was further fortified to require that such authorization be explicit. The rule, named "Dillon's Rule" after a famous treatise writer, was that state statutes enabling local acts were to be interpreted narrowly.[132] Therefore, plaintiffs could compellingly claim that relevant state statutes enabling city utility services only authorized cities to provide services to their own residents.

Nonetheless, the many courts that dealt with these resident suits rejected them—by referencing corporate law notions.[133] They explained that Dillon's Rule applied only to the city's governmental powers, not to its proprietary actions.[134] Reverting to the supposedly rejected idea of the city as a business corporation,[135] they referred to the city entering the utilities market as a "business concern or enterprise."[136] Acting as such, it "is governed largely by the same rules that apply to a private corporation."[137] These counted a duty towards its members to exercise "common prudence,"[138] to act in accordance with a theory of "good business."[139] Like any other corporation, decisions about "when to sell and when not to sell must be left as other matters of business are left to [municipal corporations'] sound judgment."[140]

These descriptions smoothly—almost imperceptivity—glided from a

[127] People ex rel. Plugger v. Overyssel, 11 Mich. 222, 226 (1863) (also using the example of a guardian and a ward).
[128] Smith v. Albany, 61 N.Y. 444, 446 (1875)(citing Justice Story's treatise).
[129] Plugger v. Overyssel Tp. Board, 11 Mich. 222, 226 (1863) (citing Dwight v. Blackmar, 2 Mich. 330, 331 (1852)); Smith v. City of Albany, 61 N.Y. 444, 446 (1875) (citing Collier v. Munn, 41 N. Y. 143).
[130] Complaints were also brought by private concerns with whom the city utility competed. *E.g.*, Andrews v. S. Haven, 187 Mich. 294, 299 (1915).
[131] David Barron, *Reclaiming Home Rule*, 116 HARV. L. REV. 2255, 2285 (2003).
[132] DILLON, SUPRA note 84, at §237.
[133] *E.g.*, Milligan v. Miles, 51 Mont. 374 (1916); State v. City of Eau Claire, 40 Wis. 533 (1876); Richards v. City of Portland, 121 Ore. 340 (1927; Larimir County v. Ft. Collins, 68 Colo. 364 (1920); Henderson v. Young, 119 Ky. 224,(1904); Paris Mountain Water Co. v. Greenville, 110 S.C. 36 (1918); Andrews v. S. Haven, 187 Mich. 294(1915).
[134] *E.g.*, Pike's Peak Power Co. v. Colorado Springs, 105 Fed. 1(8th Cir. 1900); Henderson v. Young, 119 Ky. 224 (1904).
[135] Milligan v. Miles City, 51 Mont. 374 (1915).
[136] Andrews v. S. Haven, 187 Mich. 294, 299 (1915).
[137] Larimer Cty. v. Fort Collins, 68 Colo. 364 (1920).
[138] Milligan v. Miles City, 51 Mont. 374 (1915).
[139] Hyre v. Brown, 102 W. Va. 505 (1926).
[140] Corp. of Mt. Jackson v. Nelson, 151 Va. 396, 407-08 (1928).

discussion of corporations to a discussion of cities. Citing cases respecting private corporations,[141] courts concluded that a prudent business would sell surplus product.[142] Indeed, some courts hazarded that prudence actively required cities to sell resources they produced but could not consume.[143] The reasoning was always premised, once more, on the public trust notion: "[the city] holds the property represented by the investment, in trust for its citizens" and thus city officials are subject to "the duty to gain the greatest benefit to the taxpayers."[144]

Like the rulings in the city contracts cases, the rulings in the extra-territorial utility provision cases treated the city as a private entity because it was acting as such. Moreover, these two groups of cases specifically subjected city officials to the fiduciary duties prevailing in corporate and trust law. The prohibition on councilors' self-dealing developed in the city contracts cases echoes the modern "duty of loyalty."[145] The duty to exercise prudence developed in the extra-territorial services cases traces the modern "duty of care."[146] Indeed, one 1870s court's conclusion that due care in city management required that city officials act "as prudent persons ought to allow themselves in the management of their own affairs"[147] reflects a canonical statement of the trust law standard of care.[148]

6. Conclusion: Private Law's Fiduciary Duties in the Traditional Common Law of the City

As is well-established by scholars, although the city's legal status originated in the private law of associations, nineteenth-century law came to view the city as a creature of public law. Yet as this section illustrated, the supposedly public city still shared many substantive characteristics with private entities, and, accordingly, the era's common law recognized those acting on behalf of cities as de jure fiduciaries in certain contexts.[149] Courts distinguished the city's public attributes—on display when the city was governing—from its private attributes—on display when it was owning property. When dealing in city properties, city officials were held accountable to fiduciary standards: a duty of loyalty (to avoid conflicts of interests) and a duty of care (to abide by sound management principles), both derived from the laws of trusts and corporations.

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[141] *E.g.,* Pike's Peak Power Co. v. City of Colorado Springs, 105 Fed. 1(8th Cir. 1900) (citing Union Pac. v. Chicago, 51 F. 309, 321 (8th Cir. 1892)).
[142] Dillon himself acknowledged this city privilege as an exception to his rule. DILLON, SUPRA note 84, at §1300.
[143] Pike's Peak Power Co. v. Colorado Springs, 105 F. 1, 13 (8th Cir. 1900); Milligan v. Miles City, 51 Mont. 374 (1915).
[144] *Id.*
[145] *See supra* note 8.
[146] *See supra* note 9.
[147] Tuggle v. Mayor & Council of Atlanta, 57 Ga. 114, 117 (1876).
[148] Harvard College v. Amory, 26 Mass. 446, 461 (1876).
[149] For another example of city officials held as agents of the public, *see* Green v. Town of Canaan, 29 Conn. 157, 164 (1860) (holding that since the public had already accepted a dedication of a highway, city officials, the public's mere "agents" need not do so).

C. The Private Law Source of City Officials' Fiduciary Duties: The City as a Private Law Subject in Contemporary Law

Nineteenth-century courts unequivocally subjected city market transactions to the same fiduciary scrutiny prevalent in the law of trusts and corporations. But fiduciary duties were not even mentioned by the Illinois court faced, in 2014, with the challenge to the sale of Chicago's parking meters. What transpired in the intervening century? Has the city's banishment from the realm of private law finally been completed? Have the rulings subjecting the city to fiduciary law been overruled? This section addresses these questions, concluding that the doctrine as presented in the preceding section is still good, albeit dormant, law. The discussion will commence by noting the endurance of the public trust doctrine that originally served as the basis for treating the city, when transacting in its assets, as a private corporate entity. The discussion will then highlight two novel and highly consequential doctrines from private associations law—the derivative lawsuit and antitrust—that have been applied during the past century to local governments, despite those entities' supposed public nature. Having established that the law has maintained the dual public/private treatment of the city, the section concludes by directly addressing the modern treatment of private law's fiduciary duties in local government law. It finds that courts have never removed local officials from the specter of the old fiduciary duties created in the nineteenth-century. Courts did, however, by and large neglect to develop—and even resort to—those common law duties, partially because of legislative reforms codifying such duties. Yet, as will be seen, these legislative reforms have been largely incomplete, mostly focusing on conflicts of interest, and not attending to the risk of unsound management, the traditional subject of the fiduciary duty of care.

1. The City and the Public Trust Doctrine Today

As the preceding section established, the nineteenth-century's public trust doctrine served as the beachhead for the application of private law's fiduciary duties to the city even after it had been transformed into a public law entity. This doctrine of the public trust still forms part of American law today, indicating that the grounds for perceiving the city as a private entity, at least in some contexts, remain firm.

The public trust doctrine has persisted as a vital tool through which courts limit cities' ability to transfer lands covered by the trust.[150] Thus, for example, late in the twentieth-century the Illinois Supreme Court clarified that "public streets are held in trust for the use of the public...Streets do not exist and were not created as…revenue-producing property for municipalities."[151] Pertinent modern statutes similarly employ corporate and trust language: "[T]he premises intended for any street, alley, way, common or other public

[150] JOSEPH SINGER, PROPERTY 87 (3rd. ed. 2010). Not all states embrace the doctrine. *See* Fencl v. City of Harpers Ferry, 620 N.W.2d 808, 814 (Iowa, 2000).
[151] Am. Tel. & Tel. Co. v. Vill. of Arlington Heights, 156 Ill. 2d 399, 414 (1993)

use in any city, village or town …. shall be held in the corporate name thereof in trust to and for the uses and purposes set forth or intended."[152] Chicago in its deal, described in the Introduction, to sell the income from its parking-meters, specifically acknowledged as much: "The City agrees, and the Concessionaire acknowledges and accepts, that the City holds and administers the public way in trust under the public trust doctrine..."[153]

Many questions plague the current operation of the public trust doctrine and we will not attempt to resolve them.[154] Our point rather is that courts still—routinely and consistently—rely on the public trust doctrine.[155] That doctrine is grounded in notions of trust emanating from private law. It restricts cities' freedom in transacting with assets as the public is perceived to be those assets' true owner: the traditional, and analytical, grounds for applying to the city fiduciary duties derived from private trust and corporations law.

2. The City and Modern Corporate Law Doctrines

Despite their supposed attachment to the public law notion of the city, modern courts continue to draw the city into the legal ambit of private associations. Especially when the city engages the market, courts have built on the foundation laid by the public trust doctrine to imagine the relationship between city and residents as that characteristic of a private association. At least two key twentieth-century doctrines policing those private associations have been applied to the city, one procedural, the other substantive: the derivative lawsuit and antitrust law.[156] Separately and in tandem, they both thus indicate that modern law has continuously acknowledged, and acted upon, the conception of the city warranting fiduciary duties' application.

a. Derivative Lawsuits

The derivate lawsuit is an intrinsic, and unique, feature of private

[152] 765 ILL. COMP. STAT. 205/3 (West 2010)
[153] Section 3.19 of the Chicago Parking Meters System Concession Agreement, J. OF THE PROC. OF THE CITY COUNCIL OF THE CITY OF CHIC., ILL., Dec. 4, 2008, at 50576.
[154] *E.g.,* Joseph Kearney & Thomas Merrill, *The Origins of the American Public Trust Doctrine*, 71 U. CHI. L. REV. 799, 803 (2004)("A number of serious ambiguities afflict this doctrine. What resources are covered by the doctrine? Does the doctrine rest on federal or state law? Is the doctrine absolute or merely a default rule subject to legislative modification? Does the doctrine permit intergovernmental transfers or transfers to nonprofit corporations? Who has standing to enforce the doctrine?").
[155] Richard Lazarus, *Changing Conceptions of Property and Sovereignty in Natural Resources: Questioning the Public Trust Doctrine,* 71 IOWA L. REV. 631, 643 (1986)(noting that "[s]ince 1970 the public trust doctrine indisputably has had a major impact on litigation" and surveying cases).
[156] Another important field where the city has recently been subjected to private, corporate-like treatment is § 1983 litigation. In Monell v. N.Y., 436 U.S. 658 (1978), the Court, reversing its earlier ruling, held that local governments are "persons" that can be held liable under 42 U.S.C. § 1983. The Supreme Court has also carved a "market participant" exception to the Commerce Clause's prohibition on discrimination against outside business by local governments. White v. Mass. Council of Construction, 460 U.S. 2014 (1983).

entities law—its availability in local government law thus signifies the latter field's continued affinity with the former.[157] In a derivative lawsuit, a third-party, not directly injured by the defendant, is granted standing to sue that defendant for an injury inflicted on an entity in which she holds a beneficial interest.[158] The individual's suit is "derivative" since the plaintiff's rights and thus standing is derived from the entity's. Accordingly, any recovery from the lawsuit will be awarded to the entity, not to the plaintiff.[159] Derivative suits are the primary enforcement mechanisms of fiduciary law in corporations.[160] If the board of directors, in breach of a fiduciary duty, sells a corporate asset at an unreasonably low price, the corporation, thusly wronged, can bring a lawsuit to have the transaction rescinded or seek recovery from the directors for their breach. But those who would typically make litigation decisions on behalf of the wronged corporation are those whose decision is to be challenged. The corporate lawsuit against the agents may thus never be brought. The law solves the problem by enabling in such situations a lawsuit brought not by the corporation itself, but derivatively by its shareholders.[161]

Precisely because the derivative lawsuit is so central to the circumstances of the private association, such a lawsuit cannot be brought on behalf of a government.[162] Government entities, as the Supreme Court explained, are not mere agglomerations of their taxpayers' interests, and thus individual taxpayers have no standing to sue government agents, or those the agents deal with, in the absence of a direct individual injury to them.[163] A government's lawsuit is not the citizens' lawsuit:[164] if officials are not pursuing

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[157] Steven Winter, *The Metaphor of Standing and the Problem of Self–Governance,* 40 STAN. L REV. 1371, 1501 (1988)(explaining that the derivative suit expresses the view that an entity is constituted of its members).

[158] JAMES COX & THOMAS HAZEN, COX & HAZEN ON CORPORATIONS §15.03(2d ed. 2003). Likewise, trust law recognizes a beneficiary's derivative suit. *See, e.g.,* In re Blumenkrantz, 824 N.Y.S.2d 884 (2006) ("The derivative suit is, in effect, a combination of two causes of action[,] one against the trustees for wrongfully refusing to sue and the other against the party who is liable to the trust") However, the trust is not a separate legal entity, and so the beneficiaries of a trust need not resort to the derivative suit when breaches of loyalty or care by a trustee are at issue. Rather, they may proceed directly against a trustee and so our focus in this section is on derivative actions in the corporate context.

[159] COX & HAZEN, SUPRA note 158, at §15.03. The individual plaintiff may recover attorney's fees.

[160] *Id*. Our focus in this section is on the corporate context, since the beneficiaries of a trust need not resort to the derivative suit when breaches of loyalty or care by a trustee are at issue. Seeing that the trust is not a separate legal entity, trust beneficiaries may proceed directly against a trustee.

[161] *E.g.,* Levine v. Smith, 591 A.2d 194, 205 (Del. 1994) (holding that a derivative claim may be brought when "a majority of the board of directors either has a financial interest in the challenged transaction or lacks independence or otherwise failed to exercise due care").

[162] Fairchild v. Hughes, 258 U.S. 126, 129 (1922)("Plaintiff has only the right, possessed by every citizen, to require that the government be administered according to law and that the public moneys be not wasted. Obviously this general right does not entitle a private citizen to institute [a suit] in the Federal courts . . .").

[163] Frothingham v. Mellon, 262 U.S. 447,487 (1923) (stressing that unlike the corporation, not all of the government's funds can be traced to members).

[164] Winter, *supra* note 157, at 1501 (explaining that by rejecting the derivative suit American constitutional law subverts the constitutive model of government).

the lawsuit citizens desire, citizens' recourse is to vote those officials out of office.[165] Hence, with very few exceptions,[166] explicitly created by specific laws,[167]and not premised on an associational view of government,[168] citizens cannot bring a lawsuit on behalf of government.[169]

The line in American law is clear: derivative lawsuits are available in private law, not in public law.[170] Yet still, ever since their induction into American law, many courts have held that such lawsuits can be brought on

[165] Massachusetts v. Mellon, 262 U.S. 447, 488–89, 43 S. Ct. 597, 601, 67 L. Ed. 1078 (1923) ("To do so would be, not to decide a judicial controversy, but to assume a position of authority over the governmental acts of another and coequal department, an authority which plainly we do not possess"); Lujan v. Defs. of Wildlife, 504 U.S. 555 (1992) ("Vindicating the *public* interest (including the public interest in Government observance of the Constitution and laws) is the function of Congress and the Chief Executive" not the courts and individual plaintiffs").

[166] Michael Greve, *The Private Enforcement of Environmental Law*, 65 Tul. L. Rev. 339 (1990) ("While Congress has on occasion put private enforcers to work for public purposes, it has done so rarely, reluctantly, and in recognition of the problematic nature of its undertaking").

[167] The earliest example is the Civil War Era False Claims Act, which authorizes qui tam actions against government contractors suspected of fraud. False Claims Act Amendments, 31 U.S.C. §§ 3729-3733 (1988). For much of the nineteenth century, some tax laws and tariff statutes were enforced by so-called private "informers." LEONARD WHITE, THE FEDERALISTS 415-17 (1948). More prominently, ever since the 1970s, environmental laws have included provisions allowing citizen suits against violators. MICHAEL AXLINE, ENVIRONMENTAL CITIZEN SUITS, at xv (1991). These provisions are now an integral part of virtually every federal environmental statute. *See* George Cleve, *Congressional Power to Confer Broad Citizen Standing in Environmental Cases*, 29 ENVTL. L. REP. 10, 28 (1999). Examples include the Clean Air Act, 42 U.S.C. §§ 7401-7671 (2016), and the Federal Water Pollution Control Act, 33 U.S.C. §§ 1251-1387 (2016).

[168] Citizen lawsuits are premised on the idea of the private attorney general: government desires assistance since it lacks resources to pursue itself the enforcement of all laws. Delaware Valley v. Kurz-Hastings, 813 F. Supp. 1132, 1142 (E.D. Pa. 1993) ("[t]he purpose of citizen suits is to supplement the EPA's enforcement abilities because the EPA lacks sufficient resources to bring all necessary actions"). Statues granting the power to bring citizen suits therefore clarify that the suit is brought on behalf of the citizen, not the public: For example, See Noise Control Act of 1972, 42 U.S.C. § 4911(a) (2006) ("[A]ny person (other than the United States) may commence a civil action on his own behalf...").

[169] *See, e.g.*, Gallagher v. Cont'l Ins. Co., 502 F.2d 827, 829–30 (10th Cir. 1974); Elliott v. Superior Court In & For Solano Cty., 180 Cal. App. 2d 894, 897 (1960) ("It is the general rule that a taxpayer cannot maintain an action in [sic] behalf of the state to enforce a claim or demand inuring to the state itself"); Lyons v. Ryan, 201 Ill. 2d 529, 531-42, 780 N.E.2d 1098, 1100-06 (2002)("the state was the real party in interest, and the authority to bring an action on behalf of the state was derived from the Illinois Constitution. Under our constitution, the authority to initiate litigation has been vested exclusively in the Attorney General"). Even the legislature cannot allow for derivative suits on behalf of the state. Doe v. Dart, 2009 WL 1138093, at *2-3 (N.D. Ill. Apr. 24, 2009). Delaware is the exception, allowing taxpayers to bring derivative suits challenging improper spending on behalf of the state. See Richardson v. Blackburn, 187 A.2d 823, 824 (1963).

[170] Robert Clark, *Vote Buying and Corporate Law*, 29 Case W. Res. L. Rev. 776, 804 (1979) ("But in the political arena, nothing corresponds to the derivative suit as a way to overcome difficulties of collective action; an individual citizen cannot sue 'on behalf of' the polity to remove an incompetent politician or to force him to return embezzled funds").

behalf of local governments.[171] As early as in 1879, the Supreme Court announced that "there is at this day no serious question" that local property owners could sue on behalf of a city to compel another party to return assets obtained from the city illegally.[172] Explaining this standing rule applicable to the local government but not to other governments, Justice Brandeis later stressed the city's affinity with the private corporation and attendant dissimilarity to other governments:

> The interest of a taxpayer of a municipality in the application of its moneys is direct and immediate . . . The reasons which support the extension of the equitable remedy to a single taxpayer in such cases are based upon the peculiar relation of the corporate taxpayer to the corporation, which is not without some resemblance to that subsisting between stockholder and private corporation…But the relation of a taxpayer of the United States to the federal government is very different.[173]

The city, courts have further explained, shares not only a corporate nature with private entities, but also the agency problem that the tool of the derivative lawsuit was set to alleviate in the private context.[174] Some courts, acting on this rationale and further equating the law of the city with corporations law, even condition resident derivative standing on proof that misconduct tainted city leadership's decision not to bring the lawsuit.[175] As one important local government law treatise writer observed, if "our jurisprudence is not so defective" as to leave shareholders remediless when directors refuse to bring a lawsuit benefitting the corporation while harming themselves, "Why should a different rule apply to a municipal corporation?"[176] In holding that a different

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[171] An earlier, and important, procedural move presaged this result. In 1844, reversing an earlier ruling, the Supreme Court held that corporations qualified as persons and thus could sue and be sued in federal courts. Louisville R. Co. v. Letson, 2 How. 497, 558 (1844). In 1869 the principle was automatically and without discussion extended to municipal corporations—apparently deemed interchangeable with other corporations. Cowles v. Mercer County, 7 Wall. 118, 121 (1869).

[172] Crampton v. Zabriskie, 101 U.S. 601, 609 (1879).

[173] Frothingham v. Mellon, 262 U.S. 447,487 (1923).

[174] Crampton v. Zabriskie, 101 U.S. 601, 609 (1879) ("a bill by or on behalf of individual tax-payers should[] be entertained to prevent the misuse of corporate powers"); Gram v. Shoreview, 259 Minn. 145, 149-50 (1960)("… the right of a taxpayer to maintain such suit is based on the same principles as the right of a stockholder in a private corporation to bring an action against the corporation or its officers to protect the corporate assets from the illegal and fraudulent acts of its officers").

[175] McIntyre v. El Paso County, 15 Colo. App. 78 (1900). Mirroring corporate law derivative suits, some courts require that the taxpayer-plaintiff make a demand on the city to bring the lawsuit or produce evidence that such a demand would have been futile: City of Chicago v. Duncan Traffic Equip., 95 Ill. 2d 344, 352-56 (1983); Evans v. Metro. Utilities Dist. of Omaha, 184 Neb. 172, 173-76 (1969); Washington Pub. Trust Advocates v. Spokane, 117 Wash. App. 178, 181-83 (2003); Madison v. Comm. on Water Pollution, 260 Wis. 229, 247 (1951). Not all courts insist on this requirement. *See* Harman v. City and County of San Francisco, 7 Cal. 3d 150 (1972).

[176] 4 JOHN DILLON, COMMENTARIES ON THE LAW OF MUNICIPAL CORPORATIONS §1580

rule should not apply,[177] courts have acknowledged an inevitable procedural incident of the enduring legal notion that the city holds assets as the residents' agent, like in the trust or corporation.[178]

b. Antitrust

Through the law of the derivative suit, as through the even earlier public trust doctrine, modern American courts have set up the city as at times a corporate legal entity, one with obvious parallels to a private corporation. In a more modern branch of law, courts have gone even further: they have flat-out characterized the city as a private business.

American Antitrust law, first legislated as the Sherman Act of 1890,[179] was created as a tool to regulate big business and restrict anti-competitive behavior in the modern capitalist economy.[180] This role has informed antitrust law's distinct attitude towards governments. Reasoning that the Sherman Act's goal was to police private business practices, and not government regulation of economic activities, the Supreme Court decided that the Act does not apply to actions taken by states (the "state action" doctrine).[181] Thus, if raisin producers combine to coordinate a marketing strategy they will be subject to antitrust regulation; if the state adopts a coordinated market strategy for all raisin producers in the state, it will not be subject to antitrust regulation.[182]

Given that cities are, as noted, supposedly public entities that are mere branches of state government, this protection from antitrust's reach was expected to extend to them.[183] Nonetheless, the Supreme Court reckoned otherwise. It opted, once more, to treat cities as private corporations. Like private entities,[184] it ruled, cities are only shielded from antitrust liability if they are acting pursuant to specific state policy—seeing that the state is the one entity enjoying immunity.[185] Thus, for example, a municipal hospital's acquisition of a competing hospital is subject to antitrust regulation,[186] and so

(5th ed. 1911).

177 Not all courts, however, appear to allow for the municipal derivative lawsuit. *E.g.,* Common Cause/Georgia v. Atlanta, 279 Ga. 480, 480-83, 614 S.E.2d 761, 762-64 (2005) (announcing that derivative taxpayer standing is not recognized, but proceeding to dismiss the lawsuit on the merits).

178 The doctrine has been codified in certain states. *E.g.,* ILL. COMP. STAT. ANN. 5/1-5-1 (2016) ("A suit may be brought by any taxpayer, in the name and for the benefit of the municipality, against any person to recover any money or property belonging to the municipality…").

179 15 U.S.C. §§ 1-7(2012).

180 Herbert Hovenkamp, *The Sherman Act and the Classical Theory of Competition,* 74 IOWA L. REV. 1019, 1044 (1989).

181 Parker v. Brown, 317 U.S. 341 (1943).

182 *Id.*

183 William Quinlan, *Do Local Government Lawyers Really Have to Worry About the Antitrust Laws? Part I*, N.Y. ST. B.J., Nov. 1985, at 20, 21.

184 Cal. Retail Liquor Dealers v. Midcal Aluminum, 445 U.S. 97, 105 (1980) (detailing the requirements a private entity's action must meet if it is to be shielded by the state's immunity).

185 Hallie v. Eau Claire, 471 U.S. 34, 38 (1985).

186 F.T.C. v. Phoebe Putney, 133 S. Ct. 1003 (2013).

are a municipal electrical utility's anti-competitive practices.[187] By contrast, a municipal ordinance prohibiting signs' placement near existing ones—thereby protecting the interests of the existing signs' owner—is not subject to antitrust prohibitions because the municipality was employing its state-assigned power to regulate land uses, rather than acting on its own policy judgment.[188]

Irrespective of its reasoning's coherence,[189] the distinction the Court insisted on drawing in these cases again treats the municipality as a corporation whenever it enters the market (for example, the health services market or the utilities market), rather than acting as a traditional government (for example, zoning and designing the built environment).[190]

3. The City and Fiduciary Duties in Contemporary Law

The normative and doctrinal grounds that led nineteenth-century law to apply fiduciary duties to cities, as reviewed in Part I.B., still stand therefore. As illustrated by the discussion of the derivate lawsuit and antitrust, these grounds have even been fortified, seeing that the circumstances in which the city is treated as a private entity have expanded. Accordingly, the law has indeed remained formally committed to the old proposition that city officials are fiduciaries.[191] The actual enforcement of the ensuing fiduciary duties, however, has, as exemplified by the Chicago parking-meters case, declined in its effectiveness. This final section in our discussion of the source of local officials' fiduciary duties presents, and critiques, this current legal attitude.

Modern courts have continued to announce their adherence to the principle that local officials are fiduciaries.[192] "It is well established that a public officer occupies a fiduciary relationship to the political entity on whose behalf he serves,"[193] or "public officers hold[] positions of public trust. They stand in a fiduciary relationship to the people whom they have been elected or appointed to serve."[194] Courts have also explicitly refused to note any difference between the city official and the official of a private association: "In the case of a defendant who occupied a fiduciary position in the private sector, these allegations, if proved, would establish that he had exploited his fiduciary position for his personal benefit. The fiduciary responsibilities of a public

[187] *Lafayette v. Louisiana Power*, 435 U.S. 389 (1978).
[188] City of Columbia v. Omni Outdoor Advert., 499 U.S. 365 (1991).
[189] The relationship between the city's empowerment by the state to zone and the city's decision to prioritize existing signs is not particularly tight—probably not any tighter than that between the municipality's empowerment by the state to provide health services and the its decision to acquire a hospital.
[190] Peter Nascenzi, *FTC v. Phoebe Putney and Municipalities as Nongovernments*, 110 NW. U. L. REV. 963, 986-87 (2016).
[191] Carter v. Greenville, 175 S.C. 130 (1935) ("Of course, all property owned by the city is held in a fiduciary capacity for the use or benefit of its citizens and residents").
[192] 63C AM. JUR. 2D *Public Officers and Employees* § 241 (West 2017); 67 C.J.S., *Officers*, §6, p. 118.
[193] Chicago Park Dist. v. Kenroy, 78 Ill. 2d 555, 564-565 (Ill. 1980).
[194] Driscoll v. Burlington-Bristol, 8 N.J. 433, 474 (1952). *See also* Boston v. Dolan, 298 Mass. 346, 354 (1937); Minneapolis v. Canterbury, 122 Minn. 301 (1913).

officer cannot be less than those of a private individual."[195]

Explicating these responsibilities, the New Jersey Supreme Court stated elsewhere:

> As fiduciaries and trustees of the public weal [local officials] are under an inescapable obligation to serve the public with the highest fidelity. In discharging the duties of their office they are required to display such intelligence and skill as they are capable of, to be diligent and conscientious, to exercise their discretion not arbitrarily but reasonably, and above all to display good faith, honesty and integrity.[196]

This modern court statement mirrors nineteenth-century courts' decisions subjecting local officials to the two fiduciary duties by which private agents must routinely abide: a duty of loyalty ("to display good faith, honesty and integrity") and a duty of care ("be diligent and conscientious"). Yet in practice, based on our searches, all modern cases since the 1920s discussing city officials' fiduciary duties address the duty of loyalty. There has been a dearth of cases interpreting, and enforcing, the local official's other duty, the duty of care: the obligation to not only refrain from corrupt practices but to also act in accordance with principles of sound judgement.[197] Even the New Jersey court, when making the quoted pronouncement requiring officials to display "intelligence" and be "diligent," discussed and applied in detail only the duty to refrain from conflicts of interest.[198]

The causes for the duty of care's neglect by contemporary courts are opaque—as the causes of tacit decisions to refrain from action always are. The neglect is clearly not principled: it represents a movement away from existing principles of law without acknowledgement, let alone explicit justification. One potential explanation for this judicial failure to act on this body of law may be, however, and ironically, the successful entrenchment of its principles through codification.

The late nineteenth-century confluence of the expanded demand for local government action on the one hand and the corruption and incompetence of urban politicians on the other hand engendered, as seen in Part I.B.5, court decisions expounding local officials' fiduciary duties. It also sparked the Progressive Era's reform movement, which famously fostered an

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[195] Cohen v. Keane, 64 Ill. 2d 559, 565–66 (1976). *See also* Marjohn Realty Co. v. Long Beach, 204 N.Y.S. 53 (Sup. Ct. 1924) ("The general principles of law and equity as to transactions and contracts by and with persons sustaining fiduciary relations, of course, apply to municipal officers").

[196] Jersey City v. Hague, 18 N.J. 584, 590 (1955). *See also* Tuscan v. Smith, 130 Me. 36 (1931); Fletcher v. Naumann, 213 Iowa 418 (1931); *In re* Marshall, 363 Pa. 326 (1949); Chicago Park Dist. v. Kenroy, 78 Ill. 2d 555, 564-565 (1980).

[197] The last such case we were able to find is Haesloop v. Charleston, 123 S.C. 272, 282-85 (1923) (equating the city's discretion in considering different elements of the consideration offered for one of its assets to the discretion of a trustee).

[198] Jersey City v. Hague, 18 N.J. 584, 590 (1955).

array of transformations in American local government law.[199] These included the codifications of ethical standards and conflict of interest rules—the traditional purview of the common law duty of loyalty—into municipal ordinances and state statutes.[200]

Such codes were enacted to embody and in some cases amplify common law rules, and thus they did not explicitly displace existing fiduciary law.[201] Courts, at least originally, continued to apply the common law duty of loyalty in cases where statutes did not provide a remedy.[202] But municipal ethics codes provided detailed rules (such as the maximum value of a gift an official could accept) and thus were easier to apply than the common law's standard-based duty of loyalty.[203] The very specific ethical rules governing conflicts of interest and disclosure requirements under which local governments have been operating ever since the early twentieth-century[204] largely supplanted the requirements of the duty of loyalty.[205] Inevitably, in cases where officials act in a conflict of interests, litigation has shifted to concentrate on breaches of statutes or ordinances, rather than the common law.[206]

This understandable focus on codified obligations in corruption cases, the traditional realm of the duty of loyalty, has, less understandably, prompted a similar move in cases of unsound management, the traditional realm of the duty of care.[207] There too courts have analyzed cases in light of existing statutes and ordinances that set, for example, bidding procedures.[208] Courts have accepted challenges to the city' unsound management when the city breached specific statutory obligations applicable to transactions named in the statute,[209]

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[199] *See* Richard Briffault, *Our Localism*, 90 COLUM. L. REV. 1, 9 (1990)(ban on special legislation); HARRY TOULMIN, THE CITY MANAGER 156-68 (1915); Nadav Shoked, *The Reinvention of Ownership*, 28 YALE J. REG. 91 (2011) (zoning); Barron, *supra* note 131 (home rule); Nadav Shoked, *Quasi-Cities*, 93 B.U. L. REV. 1971 (2013) (special districts).

[200] *See* Robert Wiebe, The Search for Order: 1877-1920, at 164-85 (1967).

[201] Smith v. Albany, 61 N.Y. 444, 444 (1875) ("The act … making it unlawful for a member of a common council to become a contractor under a contract authorized by the common council is but declaratory of the common law, and is not to be construed strictly")

[202] Marjohn Realty v. Long Beach, 204 N.Y.S. 53 (Sup. Ct. 1924).

[203] *E.g.*, 50 ILL. COMP. STAT. ANN. 105/3 (2014); CHICAGO MUNICIPAL CODE 2-156-020.

[204] *E.g.*, LA. STAT. ANN. § 42:1112(A) (2014), N.Y. PUB. OFF. LAW § 74 (McKinney 2016), ALA. CODE § 36-25-5 (2015), SAN MARCOS, TEX., CODE OF ETHICS § 2.424(b).

[205] *E.g.*, Daley v. Warren Motors, 114 Ill. 2d 305, 315 (1986).

[206] *E.g.*, Cohen v. Keane, 64 Ill. 2d 559 (1976); Price v. San Marcos, 744 S.W.2d 349, 351 (Tex. App. 1988); Rampey v. State, 415 So. 2d 1184, 1187 (Ala. Crim. App. 1982); Baton Rouge v. Comm'n on Ethics, 94-2480 (La. App. 1 Cir. 5/5/95); United States v. Seminerio, 680 F. Supp. 2d 523, 544 (S.D.N.Y. 2010).

[207] *E.g.*, Silver v. City of Los Angeles, 57 Cal. 2d 39, 41 (1961)(holding that court will void a city sale of public trust land "only in cases involving fraud, collusion, ultra vires, or a failure …to perform a duty specifically enjoined" and will not turn to the common law of trusts).

[208] *E.g.*, Los Angeles Dredging Co. v. Long Beach, 210 Cal. 348 (1930).

[209] *E.g.*, Harman v. San Francisco, 7 Cal. 3d 150 (1972)(accepting a challenge to tcity's sale of streets since it violated charter provisions delineating the city's duties in appraisal and disposition of vacated streets); Ferch v. Hanson, 115 Colo. 366 (1946) (accepting a challenge to a garbage collection contract entered by the city official without the public bidding procedures city ordinances mandated).

while rejecting such challenges brought in the absence of specific statutes.[210]

This judicial tendency to fall back on legislation, satisfactory enough in cases of potential duty of loyalty breaches, can easily leave unaddressed cases of potential duty of care breaches. In contrast to the duty of loyalty, with its clear decree against self-dealing, the common law's flexible duty of care resists translation into statutory prescriptions.[211] Moreover, to the extent legislatures have endeavored to overcome this difficulty, the statutory scheme created simply does not apply to cities. The statutory core of the modern duties of sound management for governments has, ever since the first decades of the twentieth-century, constituted a new body of law—administrative law.[212] Administrative law may dictate procedures for the drafting of government contracts, for the adoption of regulations, and for the handling of public properties.[213] However, state administrative law standards, set up under a state administrative procedures act, do not apply to local governments, as the latter are excluded from state administrative procedure acts' definition of administrative agencies.[214] Thus only individual obligations enacted to apply specifically to very defined local government actions cover local governments.[215] Consequently, statutes and codes cannot perform the role traditionally performed by the fiduciary duty of care in ensuring sound management in all local government private market dealings. The unfortunate neglect of the common law duty of care generates a lacuna—and an inconsistency—in the law.

4. Conclusion: Contemporary Law and the City as a Private Entity

The Chicago parking-meters deal litigation is emblematic of the anomaly of contemporary American law's treatment of the city when it enters

[210] *E.g.*, Silver v. Los Angeles, 57 Cal. 2d 39 (1961).
[211] Some judges have argued as much, criticizing their peers. In *Ferch v. Hansen*, 115 Colo. 366, 381 (1946), the concurring judge agreed with his brethren that the complaint should be accepted, but stressed that a breach of a charter provision was not necessary—the court itself could provide remedy when discretion was abused in the city's transaction.
[212] *See generally* MORTON HORWITZ, THE TRANSFORMATION OF AMERICAN LAW 213-46 (1992).
[213] § 1:1.Definition, 1 ADMIN. L. & PRAC. § 1:1 (3d ed.).
[214] Municipalities are explicitly excluded from the definition of "agency" in many state Administrative Procedure Acts. FLA. STAT. ANN. § 120.52 (2013) ("[t]his definition [agency] does not include a municipality or legal entity created solely by a municipality"); ALA. CODE § 41-22-3 (2010) ("[t]he term [agency] shall not include . . . municipalities"); WYO. STAT. ANN. § 16-3-101 (2008) (defining agency as "except the governing body of a city or town . . . ."); DEL. CODE ANN. tit. 29, § 10102 (2016) ("[a]gency does not include . . . municipalities"). In other states the act itself does not explicitly make exceptions for municipalities in its definition of agency but courts excluded local bodies from its reach. Westchester Cty. v. Rent Guidelines Bd., 71 A.D.2d 655, 656 (N.Y. 1979); Riggins v. Hous. Auth. of Seattle, 87 Wash. 2d 97, 100 (1976).
[215] *E.g.*, 50 ILL. COMP. STAT. ANN. 510/1 (2014) ("The Local Government Professional Services Selection Act" applicable to "contracts for architectural, engineering and land surveying services"); N.Y. GEN. CITY LAW § 3-c (2009)(disallowing informal agreements for fare reduction on omnibus lines).

the market.[216] That case highlights both the continuity with the traditions and logic of the nineteenth-century common law and also the unexplained forgoing of the doctrinal tool those traditions and logic spawned. As the Illinois court ruled, the city of Chicago was not acting as a government—i.e., was not regulating—when it sold the meters' revenue.[217] Rather it was acting as a market actor: a custodian of an asset whose value it was out to maximize. The city itself, in the contract whereby it entered the market, was adamant in having its counterparty acknowledge that the asset transacted in was held by the city as a trustee on behalf of the residents.[218] The court allowed one of these residents to bring a derivative lawsuit, on behalf of the city, against the counterparty which had bought that asset's revenue.[219] Everything was progressing along the logic—and doctrine—of the law of private associations. The next natural move, accordingly, would have been to examine whether in transacting in the public trust asset the trustee—the city—had breached its fiduciary duty towards the member—the resident. But the court did not make that step. Having proceeded along the corporate or trust track—in the fashion required by the attitude of American law towards the city, established in this Part of the Article—it brusquely jettisoned that track at its culmination.

Contemporary law has done much to fortify the standing of the city as a private association: retaining and expanding the public trust doctrine, treating the city as a private corporation for purposes of modern derivative lawsuit and antitrust laws, and continuing to acknowledge the fiduciary status of city officials. Courts have insisted that the latter duties are "more than mere rhetoric,"[220] and that such "obligations are not mere theoretical concepts or idealistic abstractions of no practical force and effect."[221] They have correctly identified the local official's duty as originating in the "common law."[222] But, as the Chicago case illustrated, they have not taken the opportunity to fill the duty of care with meaning. The next Part of this Article thus turns to modern fiduciary law to synthesize from it a modern duty of care that courts can and should apply to cities.

PART II: THE CONTENTS OF CITY OFFICIALS' FIDUCIARY DUTIES

Part I established that under the common law of the city local officials are subject to fiduciary duties. But the fiduciary analysis is only half-finished. Once a fiduciary status is established, the contents of the fiduciary's duties must be discerned. As the Supreme Court once explained, identifying a fiduciary relationship "only begins analysis; it gives direction to further inquiry...What obligations does he owe as a fiduciary?...what are the

[216] Indep. Voters of Illinois v. Ahmad, 13 N.E.3d 251 (Ill. App. 2014).
[217] *See supra* note 20.
[218] *See supra* note 153.
[219] The court never even mentioned, let alone questioned, the grounds for allowing the plaintiff, a taxpayer, to bring the lawsuit on the city's behalf.
[220] Boston v. Dolan, 298 Mass. 346, 354 (1937).
[221] Jersey City v. Hague, 18 N.J. 584, 591 (1955).
[222] *Id.*

consequences of his deviation from duty?"[223] While, as just seen, courts confronting cases in local government law have ceased to ask these questions, a rich body of law addresses them in modern cases involving private entities. This Part analyzes these modern cases and suggests ways in which answers developed there can be used to devise the contents of city officials' fiduciary duties.

In modern private law the contents of the fiduciary duty imposed on an individual fiduciary are adjusted in light of a careful appreciation for the context of the particular fiduciary relationship.[224] As we have seen, the early courts that routinely applied fiduciary duties to cities inter-changeably analogized the city to the trust and the corporation. While grouping the two legal institutions—trust and corporation—together may have appeared intuitive to those nineteenth-century courts, given that both institutions separate ownership from management, current law recognizes markedly different fiduciary duties for the two institutions, due to each's distinct institutional realities. Therefore, the specific contents of the modern city official's desired fiduciary duty can only be figured out through a determination whether in its pertinent institutional realities the city is closer to the trust or to the corporation.

This Part will thus first present the disparate duties of care used in trusts and corporations. It will then examine the reasoning behind this legal discrepancy—explaining that the duty's costs and benefits vary in accordance with each entity's institutional setting and thus current law maintains for each a duty of different rigor. Next, drawing on this analysis of the trust's and corporation's contrasting institutional attributes, the city's institutional attributes will be examined to project the costs and benefits of a duty of care applied to it. Based on this exercise we will proceed to discern the strength of the duty of care appropriate for the circumstances of the city, finding that the contemporary standard most suitable is one focused on a review of the process leading up to large transactions. Having fleshed out the city's fiduciary standard, the discussion concludes with an overview of the procedures for its enforcement.

A. The Distinct Duties of Care in Trust Law and Corporate Law

Modern law, from which the contents of city officials' fiduciary duty of care is to be drawn, applies differing duties of care in the trust and corporate contexts. In trust law, the duty of care presents a very meaningful restraint, at least as a matter of default law. By contrast, courts apply much lower fiduciary standards in corporate law, with the so-called business judgment rule insulating a great deal of activity from judicial review.[225]

The approach in trust law, as stated for example in the Uniform Trust

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[223] SEC v. Chenery Corp., 318 U.S. 80, 85-86 (1947).

[224] DeMott, *supra* note 35, at 881 ("The evolution of fiduciary obligation . . . owed much to the situation-specificity and flexibility that were Equity's hallmarks. . . ").

[225] For a fulsome discussion of these differences, *see* Robert Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621, 656-57 (2004).

Code, holds that trustees must "administer the trust as a prudent person would."[226] Prudence encompasses *all* aspects of trust administration, including making investment decisions, distributions, and fulfilling the trust's general purposes.[227] Prudence is defined as "reasonable care, skill, and caution."[228] The standard covering trustee behavior is thus negligence,[229] and no trustee action is shielded from review.[230]

Corporate law has opted for a much lower standard than this negligence standard prevalent in trust law. The corporate duty of care is circumscribed by the "business judgment rule," which significantly limits its reach.[231] The rule's definition is contested,[232] and at least two versions can be found. Some jurisdictions view the business judgment rule as screening all uninterested business decisions from the judicially-enforced duty of care, leaving corporations subject solely to a duty of loyalty (the "abstention" version of the business judgment rule).[233] Under the second view, commonly associated with Delaware's courts, and also reflected in the widely-adopted Model Business Corporation Act (MBCA),[234] the business judgment rule does not wholly immunize non-conflicted decisions from review. Rather, it applies a bad faith, gross negligence, or recklessness, standard that focuses not on the substance of a decision, but on the decision-making process.[235] This

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[226] UNIFORM TRUST CODE § 804 (2000).
[227] *Id.*
[228] *Id.*
[229] Jesse DUKMINIER ET AL., WILLS, TRUSTS, AND ESTATES 610 (9th ed. 2013). For some trustee functions, an even more detailed standard of behavior is specifically articulated. For example, when investing the trust's assets, the trustee must abide by the "prudent investor rule," which mandates employing "an overall investment strategy having risk and return objectives reasonably suited to the trust" and "diversify the investments of the trust." Max Schanzenbach & Robert Sitkoff, *The Prudent Investor Rule and Market Risk*, J. EMP. LEGAL STUD. (forthcoming 2017).
[230] Even if the trust instrument specifies that certain or all decisions shall be made in her "sole and absolute" discretion, trustee actions are still subject to prudence review. UNIFORM TRUST CODE § 814(a) (2000, rev. 2004); RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. c (2003).
[231] As one commentator put it, the business judgement rule "enables courts to easily screen out non-meritorious challenges to the actions of directors and executives." Douglas Branson, *The Rule That Isn't a Rule—The Business Judgment Rule*, 36 VAL. U. L. REV. 631, 637–38 (2002).
[232] *See, e.g.*, Franklin Gevurtz, *The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?*, 67 S. CAL. L. REV. 287, 287-88 (1994)("a problem occurs when courts and writers attempt to inject specific content into this general proposition—immediately, a lack of consensus emerges as to what the rule really is").
[233] *See* Stephen Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004). The abstention approach has been taken by courts in Illinois, New York, and Texas. *See* Kamin v. American Express, 383 N.Y.S.2d 807 (Sup.Ct. 1976); Shlensky v. Wrigley, 237 N.E.2d 776 (Ill.App. 1968); Grearhart Indus. v. Smith Int'l, 741 F.2d 707 (5th Cir. 1984) (surveying Texas case law).
[234] *See* Corporate Laws Committee of the ABA, The 2016 Revision of the Model Business Corporation Act 1 (2016)(reporting that the model act has been adopted in a majority of the states).
[235] Stone v. Ritter, 911 A.2d 362, 369 (Del. 2006) (identifying "gross negligence" as the level of conduct that would "giv[e] rise to a violation of the fiduciary duty of care"); Lyman

Delaware/MBCA version of the business judgment rule, like the abstention version, is premised on the notion that judicial second-guessing of a board's decision is ill-advised. Yet this version of the rule stipulates that such a notion must presuppose an actual decision made by the board. An actual decision, in turn, must be the product of a rational process.[236] Therefore, while the review of the substance of the board's decisions is circumspect even under the Delaware/MBCA version of the business judgment rule, a court adhering to it may review *how* rationally those decisions are arrived at.[237]

Naturally, the degree of diligence required for a rational decision-making process is determined by the specific decision's nature.[238] The more unusual the legal and financial aspects of the decision and the greater the magnitude of the deal it pertains to, the more important process, including external advice, becomes.[239] Most ordinary business decisions require little such process or advice, and hence the Delaware/MBCA standard in practice only subjects large, unusual decisions to judicial review.[240]

Not surprisingly, therefore, the leading cases in the field involve the sale of the corporation—perhaps the most extraordinary decision a corporate board can make. In the famous case of *Smith v. Van Gorkom*,[241] a corporate board approved a sale of the corporation after a two-hour meeting, relying "solely upon" the oral presentations of three board members, an internal study of the merger, a legal opinion, and the board's experience.[242] The Delaware Supreme Court found that by not considering all material information reasonably available this board had violated its duty of care.[243] Similar (though not identical) language is found in the MBCA, which directs a director to gather information "with a care that a person in a like position would reasonably believe appropriate under the circumstances."[244]

Johnson, *Unsettledness in Delaware Corporate Law*, 38 DEL. J. CORP. L. 405, 423-431 (2013) (suggesting the business judgement rule directs the courts to "not weigh in on the substantive soundness of director decisions.")

[236] WILLIAM ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION at 263 (2nd ed. 2007) ("The business judgment rule protects boards that have made *decisions*….[T]he relatively few cases that actually impose liability on directors for breach of the duty of care are not cases in which a decision proved disastrously wrong but cases…in which directors simply failed to do anything [reasonable] under circumstances….").

[237] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (requiring the board to make a decision on an "informed" basis). *In re* Citigroup Inc. Shareholder Derivative Litig., 964 A.2d 106, 122, (Del. Ch. 2009) (explaining that directors; duty of care "can never appropriately be judicially determined by reference to *the content of the board decision* that leads to a corporate loss, apart from consideration of the good faith or rationality of the process employed").

[238] Stahl v. Apple Bancorp, Inc., 5790 A.2d 1115 (Del.Ch.1990).

[239] McMullin v. Beran, 765 A.2d 910, (Del. 2000).

[240] Norman Veasey, *Seeking a Safe Harbor from Judicial Scrutiny of Directors' Business Decisions*, 37 BUS. LAW. 1247, 1250-51 (1982).

[241] 488 A.2d 858 (Del.1985).

[242] *Id.*, at 866.

[243] *Id.*, at 872-73, 893.

[244] MBCA § 8.30(b). If the board fails this standard, liability can be imposed for, inter alia, bad faith actions, failure to exercise oversight over an extended period, and uniformed

Other influential cases have further clarified the corporate board's care duties when selling the corporation. In a line of important cases, the Delaware court developed so-called *Revlon* duties.[245] *Revlon* duties provide that, after the corporate board decides to sell the corporation, the discretion afforded to its decision-making process decreases considerably. The board bears the burden of demonstrating good faith in the sale. Although the business judgment rule insulates from judicial review the decision whether to sell, once the sale process commences, the board operates under a judicially-enforceable duty to attain the best deal possible for shareholders.[246] Similar liability outside the merger context remains possible, even if it is not particularly likely.[247]

The Delaware/MBCA understanding of the business judgment rule thus retains a meaningful role for the duty of care in corporate law—unlike the abstention version of the rule adopted in some other jurisdictions. Still, since the care duty it draws is mostly process-focused, even under this understanding the duty's role in corporate law is much more confined than in trust law.

B. The Reasons for the Distinct Duties of Care in Trust Law and Corporate Law

This contrast between the harshness of the duty of care enforced on a trust and of that enforced on a corporation is born of the different circumstances animating each of the contexts. Due to such different circumstances, the duty of care portends different costs and benefits in each of the two distinct settings. Understanding the interplay between these institutions' settings and the duty's costs and benefits is necessary for later determining the appropriate duty of care for the institution of the city.

1. Varying Costs of the Duty of Care

Since it mandates judicial review, the fiduciary duty of care inevitably carries costs. These take the form of the risk of judicial error (a court mistakenly ruling that an agent's decision was unreasonable), which, in turn has a chilling effect on agents (who, fearful of such a potential judicial error, refrain from adopting a reasonable decision).[248] The magnitude of these costs of judicial error and its chilling effect vary in accordance with the nature of the entity whose decisions are reviewed.

The corporate entity is designed to encourage entrepreneurship and

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actions. MBCA § 8.31(b). The *Van Gorkom* standard may be higher, seemingly requiring the gathering of all material information reasonably available.

[245] Revlon v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1985).

[246] *Id.*, at 180; *See also* Paramount Communications v. QVC Network, 637 A.2d 34 (Del. 1994).

[247] In *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27 (Del. 2006) the court analyzed the board's decisions respecting the compensation and termination of an executive, ultimately finding no liability but noting that the board's passivity came close to a "bad faith" action. *Id.*, at 67.

[248] For a discussion of the literature, *see* Andrew Gold, *A Decision Theory Approach to the Business Judgment Rule*, 66 U. MD. L. REV. 398, 445 (2007).

risk-taking.[249] Courts, which lack business acumen,[250] are prone to err if asked to strictly review—in hindsight—the decisions of such an entity.[251] Even more importantly, the frequency of such errors will bias corporate boards toward inaction or at least generate a tendency to prefer a conservative course of action—undermining the rationale underlying the private corporation.[252] The corporation as a legal form was created precisely in order to enable the assumption of risk.[253]

By contrast, the paradigmatic private trust is a portfolio of assets to be managed, not by an entrepreneur, but by a professional investor taking close account of the risk tolerance of the trust beneficiaries and the preset goals of the trust.[254] In a trust, risk is to be managed and calibrated considering beneficiary circumstances and defined goals, not generally enabled. The likelihood of judicial error in reviewing actions adopted to pursue such a defined mission is somewhat decreased,[255] and thus so are the costs of strict judicial review under a fiduciary duty of care.

2. Varying Benefits of the Duty of Care

Not only the duty of care's costs, but also its benefits, vary between the corporation and the trust. Judicial intervention is less beneficial if there are other tools that can treat the problem courts seek to address. The duty of care addresses, in both the corporation and the trust, an agency problem.[256] But in the corporate context, at least three alternative mechanisms—private ordering, corporate structure, and external markets—provide tools that alleviate the agency problem, thereby reducing the potential benefits of the problem's

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[249] Kenneth Davis, *Once More, the Business Judgment Rule*, 2000 WIS. L. REV. 573, 582 ("corporate law recognizes that successful business leadership often entails risk-taking, innovation, and experimentation, qualities inimical to insistence on routine procedures and standardized practices").

[250] Daniel Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1288 (1982) ("Courts (and shareholders) do not possess the experience, expertise, or information necessary to make complicated business decisions.").

[251] Joy v. North, 692 F.2d 880, 886 (2d Cir. 1982)("[C]ourts recognize that after-the-fact litigation is a most imperfect device to evaluate corporate business decisions"). *See also* Jeffrey Rachlinski, *Heuristics and Biases in the Courts*, 79 OREGON L. REV. 61, 79-81 (2000) (collecting cases of hindsight bias).

[252] *E.g.*, William Allen, *Realigning the Standard of Review of Director Due Care with Delaware Public Policy*, 96 NW. U. L. REV. 449, 455 (2002) ("A standard of review that imposes liability on a board of directors for making an 'unreasonable' (as opposed to an 'irrational') decision could result in discouraging riskier yet socially desirable economic decisions, because an ordinary negligence standard of care will tend to make directors unduly risk averse").

[253] *E.g.*, Joy v. North, 692 F.2d 880, 886 (2d Cir. 1982).

[254] *See* John Langbein, *The Contractarian Basis of the Law of Trusts*,105 YALE L.J. 625, 638 (1995) ("[T]he prototypical modern trustee is the fee-paid professional, whose business is to enter into and carry out trust agreements").

[255] Trustee behavior can be undesirably chilled, but only in very specific circumstances. *See* Max Schanzenbach & Robert Sitkoff, *Did Reform of Prudent Trust Investment Laws Change Trust Portfolio Allocation?* 50 J. L. & ECON. 681, 681-688 (2007).

[256] *See supra* notes 2-5, 9, and accompanying text.

judicial regulation. The trust form, conversely, largely lacks these three substitutes for judicial monitoring, and consequently the duty of care promises greater benefits there.

First, the corporate form provides ample opportunity for "private ordering."[257] The corporation is a "nexus of contracts" between its members, and in drafting those contracts that create and mold the corporation, members can craft for themselves the protections from their agents that they desire.[258] Such contractual protections include shareholder voting agreements, incentive pay for managers and other terms in managers' employment agreements, share repurchase agreements, and the like.[259] Second, the corporate structure itself awards members two powerful tools to control agents: voice and exit.[260] Shareholders can vote against directors failing at their jobs.[261] Alternatively, unhappy shareholders can simply exit the firm by selling their shares, possibly to an activist investor who is acquiring sufficient control to replace ineffectual directors.[262] Third, the market both imposes an external restraint on corporate agents and limits members' vulnerability to the risks those agents generate.[263] A mismanaged corporation will not be able to raise capital or profitably sell its products on the market, increasing the likelihood of bankruptcy or takeover—a threatening prospect for managers concerned with maintaining their jobs and reputations.[264] Moreover, such a corporation, if traded in capital markets, will see its share prices decline, providing an important performance metric for shareholders.[265] The capital market also allows shareholders to protect themselves from the corporation's mismanagement by owning diversified

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[257] For the classic exposition in the legal literature, *see* FRANK EASTERBROOK & DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991).

[258] *See, e.g.*, Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. OF FINANCIAL ECONOMICS 305 (1976) (describing the argument).

[259] Jonathan Macey, *Fiduciary Duties as Residual Claims*, 84 CORNELL L. REV. 1266 (1998). For a discussion of the costs and benefits of executive compensation, *see* Kevin Murphy, *Executive Compensation*, *in* 3B HANDBOOK OF LABOR ECONOMICS 2485 (Orley Ashenfelter ed. 1999); Lucian Bebchuk, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751 (2002).

[260] For the canonical treatment of this issue in corporate law, *see generally* ALBERT HISRSCHMAN, EXIT, VOICE, AND LOYALTY (1970).

[261] Delaware courts view voting as a key component of firm governance. Blasius Indus., Inc. v. Atlas Copr., 564 A.2d 651, 659 (Del.Ch. 1988). The extent to which the shareholder franchise is really exercised to remove underperforming directors is limited. *See* STEPHEN BAINBRIDGE, CORPORATION LAW AND ECONOMICS § 1.5, at 26-38.

[262] Exit is more meaningful when shares are widely traded. This has led some courts to impose higher fiduciary standards in closely held corporations. *See* Wilkes v. Springside Nursing Home, 353 N.E.2d 657 (Mass. 1976).

[263] Kenneth Andrews, *Corporate Governance Eludes the Legal Mind*, 37 U. MIAMI L. REV. 213, 215 (1983).

[264] *See, e.g.*, Henry Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965). *See also* Lucian Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973 (2002); Symposium, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5 (1983).

[265] Kowal v. MCI Comm'ns Corp., 16 F.3d 1271, 1276 n.1 (D.C. Cir. 1994) ("[I]n an efficient securities market all publicly available information regarding a company's prospects has been reflected in its shares' price" (citation omitted)).

portfolios, thereby reducing their exposure to the risk of any one corporation's poor management decisions.[266]

These non-judicial protections are either absent or greatly diminished in the trust setting. Often the trust beneficiary is not a party to the trust instrument and thus cannot negotiate contractual protections.[267] In most instances, she does not vote to appoint the trustee ("voice") nor can she freely sell her trust interest ("exit").[268] Indeed, trusts are frequently created precisely to remove any such powers from the beneficiary who may be incapacitated or improvident with funds.[269] Finally, since trust interests are not traded, the market does little to regulate the trust's managers and the beneficiary cannot freely spread trust assets among other investments to reduce her risks.[270]

Given the relative weakness of non-judicial mechanisms for addressing the agency problem in the trust context, the benefits of a judicial duty of care treating that problem are greater there than in the corporate setting. At the same time, as seen, the costs of judicial intervention in trusts' management are lower. In accordance, as Part II.A. showed, courts have set a duty of care for trust law that is much more interventionist than its counterpart set for corporations.

C. The City and the Trust Law/Corporate Law Divide

Where should city officials—who, as Part I established, are, like their trust and corporate counterparts, fiduciaries—fall on this spectrum of fiduciary duties? Does the agency problem in the municipal context require relatively aggressive judicial regulation, as in trusts, or does it call for a highly attenuated and deferential approach, as in corporations? To answer this question, we ascertain the duty's costs and benefits in the context of the city, comparing them to those associated with those two other institutions just reviewed.

1. Costs of the Duty of Care Applied to the City

How costly would judicial error and its attendant chilling effect on city officials be if those officials' actions were reviewed by courts? American law charges the city with the provision of some of the most vital public services. Education, policing, and land use regulation are local responsibilities.[271] In

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[266] *See, e.g.*, WILLIAM BRATRON, CORPORATE FINANCE 120 (5th ed. 2003).
[267] Some—though limited—private ordering may be available in trusts. Exculpatory provisions, opt-outs of diversification rules, and constraints or expansions of trustee power are common. *See* Sitkoff, *supra* note 225, at 644-645.
[268] *See* RICHARD POSNER, ECONOMIC ANALYSIS OF LAW § 18.7, at 523-24 (6th ed. 2003).
[269] Adam Hirsch, *Spendthrift Trusts and Public Policy*, 73 WASH. U. L.Q. 1, 44 (1995).
[270] Sitkoff, *supra* note 225, at 675.
[271] ROBERT LINEBERRY, EQUALITY AND URBAN POLICY: THE DISTRIBUTION OF MUNICIPAL PUBLIC SERVICES 10 (1977) ("The services performed by municipalities are those most vital to the preservation of life (police, fire, sanitation, public health), liberty (police, courts, prosecutors), property (zoning, planning, taxing), and public enlightenment (schools, libraries)").

addition, local governments manage transportation, public spaces, public health, and more.[272] Local officials are thus tasked with actively designing and overseeing the management of a complicated entity that produces a diverse set of complex public goods. True, local government law restricts the city's power to initiate policy and to act on business impulses.[273] It does not prioritize officials' freedom of action quite as much as in the corporate world.[274] Still, even if limited, the city's freedom of action in the provision of key public services is unquestionably important for economic, political, and social reasons.[275] American law, always dedicated to values of localism, does not imagine the city as a passive, supervisory, trust-like regime.[276] Potential judicial error in overturning city policies, and the consequent chilling effect on city initiative, hence present a serious risk in the city context, even if not of quite the same magnitude as in the corporate context.

2. Benefits of the Duty of Care Applied to the City

To assess the benefits of the duty of care, we evaluate the presence and potency of the non-judicial substitutes for that duty—contractual ordering, voice and exit, and the external market. Unlike in trusts, these substitutes operate to mitigate the agency problem inherent to city action, but they cannot allay it as effectively as they allay the corporation's agency problem.

In theory the city, like the corporation from which it evolved, can be imagined as a contractual arrangement that can accordingly generate contractual safeguards reducing agency costs—the first substitute for the judicial duty of care. Cities' charters can restrict officials' powers,[277] set governance structures and procedures,[278] and empower residents to require voter approval for certain city decisions.[279] Yet while such requirements are reminiscent of corporate contractual provisions expanding shareholder voting

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272 Keith Aoki et. al., *(in)visible Cities*, 10 OR. REV. INT'L L. 453, 459 (2008).
273 Most prominently, as noted in Part I, cities must find a basis for all their activities in state law. For a famous discussion of resultant city powerlessness, *see* Frug, *supra* note 59, at 1062-67.
274 Ellickson, *supra* note 58, at 1575-78 (1982) (acknowledging and normatively justifying this attitude).
275 *See, e.g.*, HANNAH ARENDT, ON REVOLUTION 269-73 (2006) (discussing local politics as the key to realizing true citizen participation); RICHARD SENNETT, THE USES OF DISORDER: PERSONAL IDENTITY AND CITY LIFE 163-71, 190-93 (1970) (describing local politics as necessary for community building); Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 418-23 (1956) (arguing that greater local control over the provision of government services generates a more efficient allocation of public goods).
276 The most well-known celebration of American law and politics dedication to active, local government is 1 ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 74-76 (F. Bowen ed., 1863).
277 *E.g.*, DES MOINES, IOWA, CODE OF ORDINANCES, art. III, § 2-170 (2016) (defining the powers of the mayor), § 2-201 (defining the powers of the city manager).
278 *E.g.*, *Id.* art. V, § 276 (setting procurement procedures)
279 *E.g.*, SEATTLE, WASHINGTON, CHARTER, art. IV., § 1-H (2016) (setting procedures for residents to demand a referendum to approve a city ordinance); *see also* Heider v. City of Seattle, 100 Wash. 2d 874, (1984) (limiting the power).

rights in areas of special concern, the analogy to the corporate setting is imprecise. As Part I.B.1. stressed, in current American law cities are first and foremost creatures of the state—not contractual creations of their residents. Therefore, unlike the incorporators of a corporation, the incorporators of a city are not free to design the management regime that they desire.[280] State statutes strictly confine the options: some cities cannot adopt a charter,[281] and almost all others must choose from a menu of governance forms the state dictates.[282] Such mandatory charters cannot faithfully reflect residents' subjective preferences and thus are not the perfect equivalents of the freely drafted corporate charter offering an internal, voluntary substitute for the external, judicially-imposed duty of care.

The second substitute for the judicial duty of care, voice and exit, is much more clearly available in the city context. Residents, unlike trust beneficiaries, and like corporate shareholders, elect the officials governing their affairs and can replace them on a regular basis. Indeed, due to their small-size and the civic spirit they engender, cities are often celebrated as the best arenas for democratic participation and popular control of government.[283] City residents can also regulate their officials by leaving the city if they are unhappy with those officials.[284] Here again, they enjoy a power—exit—shared with the corporate shareholder who can sell her stock but not with the trust beneficiary who cannot alienate her interest. Still, exit is costlier for a resident as compared to a corporate shareholder.[285] Leaving a city is not as easy as selling a share. It may involve a socially and financially expensive move, a home sale, or a change of jobs.[286]

The analysis respecting the final substitute for the judicial duty of care, external markets, is similar: unlike in trusts, markets do aid in solving the agency problem in cities, but not as effectively as they do so in corporations. First, like the corporation and unlike the trust, the city turns to capital markets

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[280] *E.g.*, 65 ILL. COMP. STAT. ANN. 5/2-5/6 (2014)(dictating the organization of municipalities and the powers and standing of their officials).
[281] *E.g.*, WASH. CONST. art. XI, § 10 (permitting only cities with ten thousand inhabitants or more than to frame a charter for their own government).
[282] *E.g.*, IOWA CODE ANN. § 372.1 (2015) (defining the permissible forms of city government) and DES MOINES, IOWA, CODE OF ORDINANCES, art. I, § 2-32 (picking one of those forms for Des Moines); *Id.* art. II, § 2-61 (explaining that the council will only possess power "not inconsistent with statutes applicable to cities organized under the council-manager-ward form…conferred by law upon councils or cities organized under the general laws of the state"). Hartig v. City of Seattle, 53 Wash. 432, 436, (1909) (permitting the city to hold a referendum to approve a council decision only because state laws empowered such referendum requirements).
[283] *See, e.g.*, ARENDT, SUPRA note 275, at 283; Robert Dahl, *The City in the Future of Democracy*, 61 AM. POL. SCI. REV. 953, 967 (1967).
[284] Tiebout, *supra* note 275.
[285] ALBERT BRETON, COMPETITIVE GOVERNMENTS 192 (1996) ("Given limited citizen mobility, markets may not effectively discipline government actors to produce public goods that match citizens' preferences").
[286] Richard Briffault, *Our Localism: Part II-Localism and Legal Theory*, 90 COLUM. L. REV. 346, 420 (1990).

to raise debt.[287] In deciding whether to lend money to an individual city, investors rely on a grade awarded to that city by rating agencies.[288] These grades are highly sensitive to the city's economic standing, and also explicitly consider the city's quality of "governance."[289] Mismanaged cities' access to credit will thus be curtailed, restricting careless officials' ability to invest in local amenities and curry favor with voters.[290] Second, city officials also face some competitive market pressures because residents and businesses choose where to locate. These decisions affect city tax revenues and the market values of local properties,[291] supplying residents with metrics to evaluate officials' performance.[292] This mechanism is far from perfect: unlike corporations, cities are not actively traded, and housing prices are determined by many factors—not solely the quality of the relevant city's management.[293] Still less helpful in the city's context is the last market mechanism attenuating the agency problem in the corporate context—members' ability to diversify their holdings to limit their exposure to the entity's mismanagement. For most families, homes are a significant and undiversified investment.[294] Social and human capital investments are also often tied to the individual's city of residence, magnifying the risk irresponsible city management poses to residents' interests.[295]

D. The Duty of Care for the City

The balance of the costs and benefits of a duty of care applied to the city, as just exposed, does not fully mirror either their balance in the trust or in the corporate settings. It is somewhere in between. Several factors, however, move the city closer to the corporation in this regard. City officials' freedom of action is an important normative value that will be threatened by too intrusive a duty of care. In addition, the presence of two of the three regulatory mechanisms capable of replacing that judicial duty—voice/exit and the external market—renders the duty somewhat less indispensable.

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[287] In 2014 alone, municipalities issued debt bonds to the tune of $314.9 billion. SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, US MUNICIPAL CREDIT REPORT, Fourth Quarter and Full Year 2014 (Feb. 2015), available at http://www.sifma.org/research/item.aspx?id=8589952951 (last visited Feb. 23, 2017).

[288] For an overview of the market for municipal debt, *see* Nadav Shoked, 102 *Debt Limits' End*, IOWA L. REV. 101, 108-14 (2017).

[289] MOODY'S U.S. PUBLIC FINANCE GROUP, GUIDE TO MOODY'S U.S. MUNICIPAL RATINGS 12, available at https://www.gfoatspringinstitute.org/wp-content/uploads/2016/04/Guide-to-Moodys-US-Municipal-Ratings-and-Rating-Process.pdf (last visited March 4, 2017).

[290] Jonathan Rodden, *Market Discipline and U.S. Federalism, in* WHEN STATES GO BROKE 123, 133 (Peter Conti-Brown ed. 2012).

[291] Tiebout, *supra* note 275, at 420.

[292] S*ee, e.g.*, WILLIAM A. FISCHEL, THE HOMEVOTER HYPOTHESIS 4 (2001).

[293] *See, e.g.*, LEE ANNE FENNEL, THE UNBOUNDED HOME: PROPERTY VALUES BEYOND PROPERTY LINES 38 (2009).

[294] EDWARD N. WOLFF, TOP HEAVY 26-27 (2002).

[295] William A. Fischel, *Voting, Risk Aversion, and the NIMBY Syndrome,* 7 GEO. MASON L. REV. 881, 885 (1999) ("The exposure to risk that homeowners face is analogous to having nearly all of one's retirement wealth invested in the stock of a single, undiversified company with only one huge plant").

The city's nature, hence, is markedly different from the trust's, and the latter's duty of care is unsuitable. A negligence review of all the agent's decisions is appropriate for a regime, like the trust, grounded in the idea of an agent managing assets in compliance with predefined goals and of true owners who have little say.[296] That is not the city regime, which encourages some imaginative city action and assumes some resident agency. The city regime is more reminiscent of the corporate form, which embraces a lenient standard of care to enable directors' freedom of action and assumes some non-judicial shareholder monitoring of those actions.

Still, the city is not the corporation's normative equivalent, and therefore the most lenient judicial approach to regulation that some recognize for the corporate setting—the abstention version of the business judgment rule—is inappropriate for the city. Cities are not imagined as profit-seeking enterprises,[297] and thus fears of depressing their levels of business initiative through judicial regulation, while very relevant, are not as portentous as for corporations. Similarly, though some non-judicial constraints are present, the effectiveness of these mechanisms that may replace the duty of care for corporations is limited in the city context: contractual arrangements are mostly unavailable, exit is expensive, the market for residents is not particularly effective, and the financial market is not a source of diversification.

In conclusion, the city has many of the attributes of a corporation (unsurprisingly, since, as highlighted in Part I.B.1., the two share a history). However, judicial intervention is not as costly in the city as in the corporate setting, and market substitutes for fiduciary duties are not as readily available as they are there. Thus, instead of a full abstention doctrine, the law should opt for the less extreme version of the lenient corporate duty of care: the process-oriented Delaware/MBCA version. This standard, as seen in Part II.A., will require that when entering major deals city officials undertake a sufficiently rational process, including informed investigation, meaningful deliberations, and consultation with experts.

E. The Delaware/MBCA Corporate Duty of Care Applied to the City: Normative and Procedural Concerns

As just established, importing the Delaware/MBCA duty of care into local government law is in line with the normative logic of private entities' fiduciary law. Yet perhaps there are special normative reasons, unique to the nature of local governments, to refrain from doing so. Parts I.B. and I.C. highlighted the city's private law origins and characteristics—but as part of its dual nature as a private *and* public law unit. The public aspects of the city's nature raise normative concerns alien to the corporate context. Specifically,

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[296] Andrews, *supra* note 263, at 215 ("The exercise of ethical leadership in organizations requires values and skills in intricate combinations that cannot be prescribed by black letter law").

[297] *E.g.*, Olesen v. Hurley, 2004 S.D. 136; Robin Malloy, *The Political Economy of Co-Financing America's Urban Renaissance*, 40 VAND. L. REV. 67, 121 (1987). *See also* FRANK MICHELMAN & TERRENCE SANDALO, GOVERNMENT IN URBAN AREAS 155-97 (1970) (arguing that local governments must separate themselves from "private" markets).

judicial review of a public unit's decisions may be perceived as undermining basic tenets of separation of powers and the supremacy of the democratic process.[298]

This section explains that the application of the Delaware/MBCA duty of care to cities does not contradict these modern conceptions respecting courts' role and the power of local governments; indeed, it promotes them. The discussion's focus thus is on the manner in which courts will engage, through the suggested duty of care, the actions of elected local officials. First, it identifies the instances where courts will be able to intervene in local decisions to enforce the duty, showing that these will not expand the opportunities for judicial interference in political decisions. Second, the discussion singles out the defendants in these lawsuits and the remedies potentially imposed on them, concluding that the duty poses no threat to elected officials' powers.

1. Cases Litigated

The introduction of a new—or rather, retrieved—basis for challenging local action generates a risk of increased litigation.[299] Such expanded recourse to legal action threatens to shift the locus of local decision-making away from local officials—who draw on both expertise and democratic legitimacy—and onto inexpert and unaccountable courts. This troubling prospect is premised on the assumption that a duty of care applied to cities will open boundless, and new, possibilities for residents to second-guess local leadership through legal action. This intuitive assumption is, however, wrong—for two reasons.

First, the Delaware/MBCA duty of care, as expounded in the corporate setting, does not proffer an open-ended invitation for shareholder challenges to any decision made by management. Instead, as noted throughout Part II.A., the Delaware/MBCA standard strikes a compromise which leaves most management decisions outside of courts. Day-to-day, routine decisions are never reviewable. Only unusual decisions, respecting which significant process engaged by the decision-makers is necessary and delegation inappropriate, are reviewable. Thus, whether in its current corporate settings or in the city settings suggested here, the duty of care has bite almost solely in the sale of major assets.[300] In other words, under a Delaware/MBCA duty of care applied to a city, a contract with a supplier for the repair of parking-meters will not be reviewable; a contract to sell all income from the meters will be.

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298 *See* JOHN HART ELY, DEMOCRACY AND DISTRUST 75–77 (1980) (discussing the limited rule of courts in regulating the political-process); State v. City of Panama City Beach, 529 So. 2d 250 (Fla. 1988) ("[T]he function of this Court is not to decide whether the proposed [local] financing is wise or even fiscally sound").

299 *See* Kenneth Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 STAN. L. REV. 927, 937 (1983) (discussing this concern in the corporate context).

300 It is possible to review actions that are not a sale. *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27 (Del. 2006) involved a nine-figure severance package, but such cases are few, and, even though the *Disney* court criticized much of the board conduct, the board ultimately prevailed.

Furthermore, even for the latter, reviewable, type of deals, the Delaware/MBCA duty does not permit a review of the original decision to sell the asset. Under the *Revlon* line of cases, discussed in Part II.A., the duty only subjects to review the subsequent choice of a specific buyer. This limitation minimizes the risk of judicial interference in political affairs. Unlike the original decision to sell a major pubic asset, the choice of a buyer for that asset is not an act demanding policy analysis and political tradeoffs. Quite the opposite: it is a decision with one predetermined goal—to obtain the highest return possible.[301] A review to assure that decisions so straightforward in their rationale were adopted in accordance with certain procedural practices accords with the normal role of courts—it offers little occasion for judicial overreaching into the realm of politics or policy.

Second, due to current legal realities prevailing in local government law, any such occasion will not be newly afforded by the duty of care promoted here anyway. For the past few decades, courts have dramatically relaxed standing rules for lawsuits against local governments.[302] Coupled with a local government's need to pinpoint a specific state law empowering each of its actions,[303] this procedural move has subjected practically all local government decisions to legal challenge. The slightest local decisions—the dedication of a bike lane[304] or the placement of a bike share docking-station,[305] for example—have therefore been challenged in courts. Local decisions—including Chicago's parking meters deal itself—are already being litigated. The addition of a cause of action based on a duty of care could not generate new litigation.[306] It will merely channel some existing litigation challenging local action towards exploration of a question that is more normatively pertinent.

2. Defendants and Remedies

Even if it is unlikely to engender new legal challenges, a revitalized cause of action, such as the duty of care suggested here, could still radiate an undesirable deterrent effect on political decision-making, if it expands the universe of potential defendants or remedies that can be attained. A duty of

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[301] Some therefore argue that such city sales should not be analyzed alongside privatization deals (whose logic and contested political upside is improvement of services): Julie Roin, *Privatization and the Sale of Tax Revenues*, 95 MINN. L. REV. 1965 (2011).
[302] *See* Nadav Shoked, *The New Local*, 100 VA. L. REV. 1323, 1326, fn.6-7 (2014).
[303] *See supra* Part I.B.1.
[304] Seniors for Safety v. N.Y.C., 101 A.D.3d 1029, 1032 (N.Y. App. Div. 2012); Coalition for Adequate Review v. San Francisco, No. 505509, 2007 WL 5368710, at 2 (Cal. Super. Ct. June 18, 2007).
[305] Mitch Smith, *Condo Residents Go to Court over Divvy Bike Sharing Station*, CHI. TRIB., Aug. 22, 2013.
[306] If taxpayer lawsuits are not allowed, another group of potential plaintiffs consists of other fiduciaries of the city—other council members, for example. In corporate law, some state statutes accord co-directors standing in such cases. *See, e.g.*, N.Y. BUS. CORP. LAW § 720 (McKinney 2012). Some argue that they should enjoy standing regardless, based on equity. PRINCIPLES OF CORPORATE LAW § 7.02(c). A few courts have expressed willingness to adopt this position. Cuker v. Mikalauskas, 692 A.2d 1042, 1049 (Pa. 1997); Francis v. United Jersey Bank, 87 N.J. 15, 34 (1981).

care imposed on officials would appear to place them under the threat of monetary damages liability for breaches, a threat that would deter some from assuming office and others from adopting inventive decisions if in office.[307] However, in actuality, the duty of care cannot expose city officials to such threats of liability. The ensuing discussion explains why, and, in so doing, describes the remedies that could be sought in city transaction-related duty of care litigation.

Under existing local government law, immunity extends over local legislators' decisions, so they can never be held liable for them.[308] The duty of care suggested here cannot, therefore, present a personal risk to lawmakers—and thus to their political independence. This state of affairs is not, as a practical matter, different from that prevalent in corporate law. Delaware's laws permit articles of incorporation to guarantee indemnification to corporate directors for damages liability for duty of care violations.[309] Almost all Delaware corporations now have such indemnification provisions,[310] and similar indemnification is allowed under the MBCA.[311] The practical result of such provisions is that corporate directors are personally insulated from duty of care liability.[312]

As in litigation in corporate law, defendants in challenges to city transactions reached in violation of a duty of care will thus not be the officials violating the duty—as they are legally shielded by immunity—but rather the counter-parties to the violating transaction. The most common remedy currently sought against such parties in corporate law cases is an injunction against, or rescission of, the transaction.[313] A proposed contract that would breach a fiduciary duty can be enjoined or modified by a court.[314] An already signed one can be voided or rescinded in certain circumstances.[315] Thus

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[307] Julian Velasco, *A Defense of the Corporate Law Duty of Care*, 40 J. CORP. L. 647, 655 (2015) (discussing the risk in the corporate context).
[308] OSBORNE REYNOLDS, LOCAL GOVERNMENT LAW 815-16 (3rd ed. 2009).
[309] DELAWARE GENERAL CORPORATE LAW § 102(b)(7) (2012).
[310] *See* Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 EMORY L.J. 1155, 1160-51 (1990) (finding the 90% of public corporations enacted indemnification provisions).
[311] § 2.02(b) (5).
[312] Margaret Blair & Lynn Stout, Trust, *Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1790-91 (2001) ("a director is more likely to be hit by lightening after leaving her board meeting than she is to pay damages").
[313] RESTATEMENT (SECOND) OF CONTRACTS § 193 (1981) (explaining that a "promise by a fiduciary to violate his fiduciary duty or a promise that tends to induce such a violation is unenforceable on grounds of public policy").
[314] *See , e.g.*, Omnicare, v. NCS Healthcare, Inc., 818 A.2d 914, 936 (Del. 2003) (citing the Restatement of Contracts and refusing to enforce merger agreement that did not contain adequate safeguards allowing board to consider other offers).
[315] Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 371 (Del. 1993), (empowering the court to fashion any "appropriate" remedy including "rescissory damages" in a duty of care claim); Smith v. Van Gorkom, 488 A.2d 858, 889 (Del. 1985) (stating that the failure of the board to exercise business judgment in a merger constitutes a "voidable" act though one that in theory could be ratified by shareholders). *See also In re* Lukens Inc. Shareholders Litig., 757 A.2d 720, 737 (Del. Ch. 1999); *In re* Wheelabrator Technologies, 663 A.2d 1194, 1196 (Del. Ch. 1995).

Delaware courts often void specific provisions in merger agreements or even the merger agreement itself.[316] Courts are willing to disregard the resultant injury to the counter-party's reliance interests if she had reason to know that the fiduciary was "on thin ice."[317] Sophisticated counterparties are usually deemed to understand the legal environment in which they act, and will therefore generally have such reason to know that the entity with whom they transact may have acted in breach of care duties.[318] Such informed counter-parties may even be liable for restitution if the sale contract has been executed and cannot be unwound.[319] In extreme cases—when the court finds that the third-party not only knew of the breach, but actually colluded in it—the counter-party may additionally be charged with damages for the full extent of the entity's loss.[320]

The manner in which these procedural rules could operate in the city context can be gauged through their application to the Chicago parking-meters example introduced earlier. There, a recognition of the duty of care suggested here would have resulted in a claim against the consortium that had acquired the meters' revenue, for the sale's rescission. City officials—the mayor, aldermen, members of the administration—would not have been defendants: immunity would have shielded them.[321] Had the court been persuaded that the process these officials engaged before entering the contract with the specific, chosen buyer was faulty it could have enjoined the deal or even voided it if completed. The court may have been willing to inflict this cost on the third-party buyer since a government's decision-making process is made in an open,

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[316] For example, in *Paramount v. QVC*, 637 A.2d 34 (Del. 1994), the Delaware Supreme Court held a no-shop provision invalid because it forbade the directors from considering competing offers, which was necessary for them to fulfill their fiduciary duties.

[317] ACE Ltd. v. Capital Re Corp., 747 A.2d 95, 104 (Del. 1999).

[318] *Id.*, at 106. Indeed, many cases do not even discuss whether the other party had knowledge of the breach, apparently just presuming such knowledge. *See* Omnicare, v. NCS Healthcare, Inc., 818 A.2d 914, 936 (Del. 2003); Paramount v. QVC, 637 A.2d 34 (Del. 1994).

[319] *In re* Celera Corp. Shareholder Litig., 2012 WL 1020471, at *28 (Del.Ch. Mar. 23, 2012), *aff'd in part, rev'd in part on other grounds*, 59 A.3d 418 (Del.2012); In re BioClinica, Inc. Shareholder Litig., [2013 BL 285851], 2013 WL 5631233, at *11 (Del. Ch. Oct. 16, 2013) (holding that an adder and abettor could be liable for conduct or which the board had been exculpated); Arnold v. Soc'y for Sav. Bancorp, Inc., 1995 WL 376919, at *8, *affrm'd* Arnold v. Soc'y for Sav. Bancorp, Inc., 678 A.2d 533 (Del.1996) (permitting a claim against an acquirer for aiding and abetting the breach of the duty of care that resulted in misleading disclosures even though there was an exculpatory provision regarding care); Penn Mart Realty Co. v. Becker, 298 A.2d 349 (Del.Ch.1972) (sustaining a complaint against a broker and the third-party purchaser of corporate shares in a friendly tender offer for aiding and abetting the breach of fiduciary duty).

[320] RBC Capital Mkts., v. Jervis, 129 A.3d 816, 862 (Del. 2015) ("If the third party knows that the board is breaching its duty of care and participates in the breach by misleading the board or creating the informational vacuum, then the third party can be liable for aiding and abetting").

[321] Local administrators enjoy immunity whenever their acts are "discretionary"—acts to which the worker is free to exercise judgment in determining the manner in which the work is performed. The negotiations surrounding a transaction are a clear example of such acts. REYNOLDS, SUPRA note 308, at 816-18.

public process, and thus actual knowledge on the part of the purchaser here—as in other such deals—is highly likely.[322]

As this example highlights, thanks to the procedures used for its implementation, the duty of care suggested in this Article would close a troubling regulatory gap in local government law, without menacing local officials in whose political freedom that body of law is rightly invested.

Conclusion

In late 2012, the City of Rialto, California, became one of the first in the nation to outsource its water and sewage systems to a private equity firm.[323] The concession agreement gave the firm, for thirty years, the right to operate, manage, maintain, and collect revenue from, the city's water and sewer facilities. In return, and in addition to a cash payment, the firm had to upgrade the aging and underfunded system.[324] The deal was the culmination of a three-year-long process, that included multiple votes—some of them disapproving—by Rialto's city council.[325] The endeavor was so lengthy and fraught because the city went through a procurement process requiring competitive proposals for each of the two different contractual structures considered (a concession agreement approach and a qualified management agreement approach). Both approaches and all proposals were then compared with the aid of outside counsel. Community members were invited to voice their concerns at different points along the way, before the deal's completion.[326]

This process leading to Rialto's deal materializes as the antithesis of the process leading to Chicago's parking-meters deal that opened this Article. Rialto deal's aftermath is similarly the inverse of Chicago's. More than four years after its closing, the deal has been hailed as one of the very few successful private takeovers of municipal infrastructure: Rialto's water system is upgraded, residents had a say in all the rate increases introduced since (one was even delayed), and all the city utility's employees kept their jobs, with better pay.[327]

If this happy outcome is to become the norm rather than the outlier,[328] Rialto's decision-making process—an informed, deliberative, and rational affair—must first become the norm. Fortunately, Rialto's officials chose this

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[322] Courts have accordingly already been ordering restitution in derivative taxpayer lawsuits against counter-parties to city deals. Chicago Park Dist. v. Kenroy, 78 Ill. 2d 555, 564-565 (1980).

[323] Randall Jensen, *Southern California City Enters into P3 for its Water and Sewer Systems*, THE BOND BUYER, Dec.6, 2012.

[324] *Id.*

[325] *Id.*

[326] The city offered a description of its decision-making process in the National Conference for Public-Private Partnerships of 2014. The presentation, titled a "Tale of Two Cities" is available at www.ncppp.org/wp-content/uploads/2014/07/Rialto-and-Allentown1.pptx (last visited March 2, 2017).

[327] Ivory, *supra* note 25.

[328] *Id.* (discussing the poor track record of local sales of waterworks to private investors).

elaborate and thoughtful process. Unfortunately, Chicago's officials and the officials of many—probably most—cities chose, and are choosing, a very different process.[329] The quality of decision-making processes when cities enter the market today by and large hinges on these choices officials make.[330] This Article showed that this need not be the case. Through its fiduciary duty of care, the common law can be used to assure that officials do not have the option of avoiding procedures of sound management when transacting in city assets. That duty can, and should, be reclaimed for cities. While for Chicago, as its current mayor admitted, there may be no going back to the parking regime that preceded its ill-advised deal,[331] for cities everywhere, there should be no going back to the process responsible for that ill-advised deal.

[329] *Id.*
[330] Accordingly, In November 2015 Chicago's officials chose to adopt an ordinance mandating certain procedures that must be abided by before the city transacts in assets. MUNICIPAL CODE OF CHICAGO, ILLINOIS § § 2-164-010—2-164-100 (2016).
[331] Mick Dumke, *How Mayor Emanuel Locked the Parking Meter Deal in Place*, CHICAGO READER, June 6, 2013.