

**BETWEEN PUBLIC AND PRIVATE ENTERPRISE:
THE LAW AND ECONOMICS OF SPECIAL-PURPOSE GOVERNMENTS**

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Abstract

Of the 90,000 “governmental units” counted in the most recent United States Census of Governments, only about 40,000 are “general-purpose” governments such as municipalities and counties. The other 50,000 are “special-purpose” governments that typically undertake only a single activity, such as water supply or fire protection. With the exception of school districts – which constitute only 12,000 of the 50,000 – special-purpose governments have been largely ignored by the academic literature in law and the social sciences. Yet these overlooked entities have been expanding far more rapidly than any other form of government at the federal, state, or local level.

The nation’s increasing reliance on special-purpose governments raises two conspicuous issues regarding the boundaries between organizational types. The first issue is the stark gap between special-purpose governments and general-purpose governments. While there are tens of thousands of each type, there is virtually nothing in between – that is, there are almost no governments that provide, say, two or three distinct services. The second boundary issue is the contrasting absence of any clear line, in terms of either services or structure, between special-purpose governments and private-law organizations such as cooperatives and condominiums.

This peculiar pattern of boundaries between organizational forms raises, in turn, further basic questions. What, for example, does it mean for an organization to be a “government”? And should the law of special-purpose governments be revised to resemble more closely that which governs private-sector entities by, for instance, adopting uniform enabling statutes that remove limits on permissible purposes or allow formation as of right? Or should the law of special-purpose governments be revised to resemble more closely that applied to general-purpose governments by, for example, extending to them the doctrine of one-person-one-vote? This article addresses these issues, and a variety of others, in an analytic framework that draws heavily on public choice theory and organizational economics. The article concludes by outlining a reformed general statutory structure for special-purpose governments.

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I. INTRODUCTION

The term “government” generally brings to mind an organization that provides a broad array of services to the residents of a given jurisdiction, and that regulates many other services that it does not provide by itself. But that description fits only a minority – about 40,000 – of the 90,000 “governmental units” counted in the United States by the most recent Census of Governments.¹ Those “general-purpose” governments are principally counties, municipalities, and townships. The other 50,000 governments, labeled “special-purpose governments” by the Census, typically undertake only a single activity, such as water supply or fire protection.

Special-purpose governments – also called “special districts,” “special-purpose districts,” “special assessment districts,” or “local districts” – are important and understudied. They are overwhelmingly the source of growth in the number of governments in the United States. Since 1952, the number of general-purpose governments has held steady at around 40,000. Over the same period, by contrast, the number of special-purpose governments (other than school districts) has more than tripled, from 12,000 to 38,000.² The associated growth in revenues of special-purpose governments is even more striking. As shown in Table 1, over the latter half of the 20th century local government revenue grew at more than twice the rate of federal government revenue and is now roughly two-thirds the size of federal revenue.³ And by far the most rapidly growing component of local government revenue is that of special-purpose governments, whose aggregate revenue increased, in real terms, by a multiple of more than twenty, which is six times the growth rate of federal revenue and almost twice the growth rate of state revenue.

¹ See 2012 CENSUS OF GOVERNMENTS, tbl. 1, <http://www.census.gov/govs/cog/>.

² While the number of school districts has fallen dramatically — from over 100,000 in 1942 to around 13,000 today — this seems largely a consequence of consolidation, and not (as confirmed by Table 1 below) an indication that the level of services provided by SPGs generally (that is, including schools) might be growing more slowly. See, e.g., WILLIAM A. FISCHER, MAKING THE GRADE: THE ECONOMIC EVOLUTION OF AMERICAN SCHOOL DISTRICTS 67-118 (2009) (discussing various theories for the consolidation of school districts); William Duncombe & John Yinger, *Does School District Consolidation Cut Costs?*, 2 EDUC., FIN. & POL’Y 341 (2007) (noting that “consolidation is widely regarded as a way for school districts to cut costs”); see also [Part III.A.1], *infra* (discussing consolidation).

³ See also Michael Schuyler, *A Short History of Government Taxing and Spending in the United States*, TAX FOUNDATION, Feb. 19, 2014, <http://taxfoundation.org/article/short-history-government-taxing-and-spending-united-states>. About 40% of local government revenue in recent years has come from SPGs (as opposed to counties or municipalities). See CENSUS OF GOVERNMENTS, *State & Local Government Finance*, http://www.census.gov/govs/local/historical_data_2012.html.

Table 1: Growth in Governmental Revenue 1957-2012 (in 2012 Dollars)

Type of Government	Revenue in 1957 (\$B)	Revenue in 2012 (\$B)	Growth, 1957-2012
Federal	\$551	\$2450	350%
State	\$156	\$1897	1120%
Total Local	\$183	\$1619	790%
Counties	\$36	\$382	950%
Municipalities	\$76	\$525	590%
Townships	\$8	\$51	550%
Special Districts	\$9	\$206	2100%
School Districts	\$56	\$494	780%

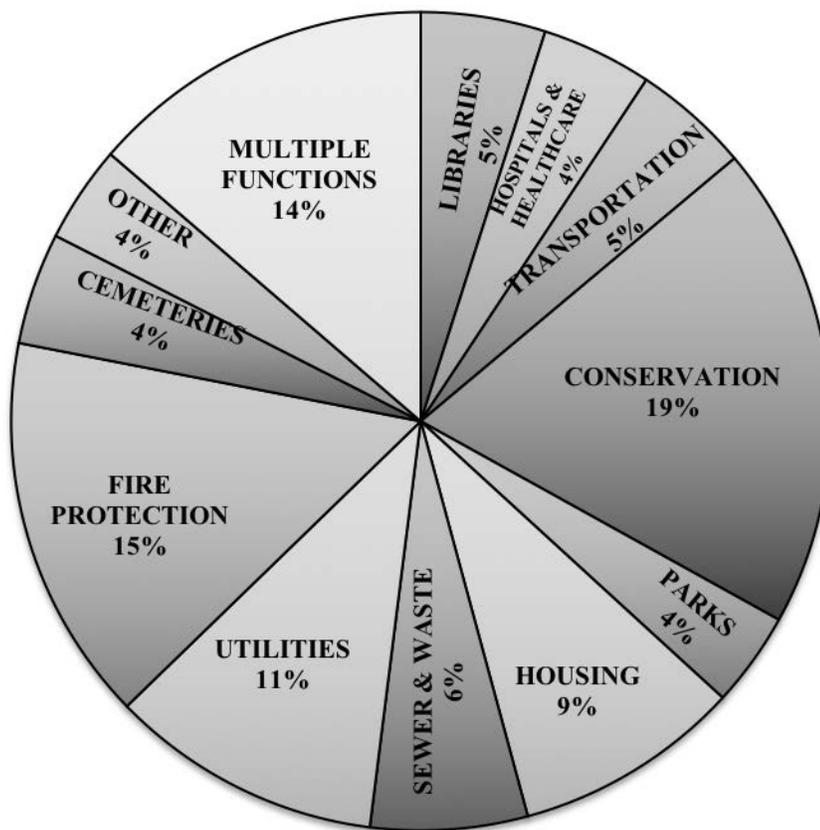
* This data is assembled from the State & Local Government Finance portion of the Census of Governments.

The services provided by special-purpose governments (“SPGs”) overlap almost completely those provided by general-purpose governments (“GPGs”). Thus, SPGs frequently provide such typically municipal services as drinking water, sewage, fire protection, trash collection, roads, parks, jails, libraries,⁴ and hospitals.⁵ Conversely, it is difficult to find any service provided by an SPG that is not also provided somewhere by GPGs. Table 2 offers a general overview of the proportion of SPGs that provide each of several broad categories of service.

⁴ See, e.g., OKLA. STAT. ANN. tit. 65, ch. 9 (2017).

⁵ See, e.g., ARIZ. REV. STAT. ANN. tit. 48, ch. 5 (2015); CENSUS, INDIVIDUAL STATE DESCRIPTIONS: 2012 (2013), available at <http://www2.census.gov/govs/cog/2012isd.pdf>.

Table 2. The Distribution of Special District Functions in 2012



* This data is assembled using the Census of Governments FactFinder tool. In particular, it is based on the Table "Special District Governments by Function and State: 2012."

At the same time, SPGs often bear a strong resemblance to privately-owned organizations, and particularly to organizations of a residential character like condominiums and consumer cooperatives. Indeed, the allocation of services, costs, and control in an SPG providing irrigation or electricity to a rural community is generally quite similar to that of a cooperative providing the same service. But cooperatives are, under American law, quite distinctly private, nongovernmental organizations, fully owned by their members.

The broad similarity between SPGs and private organizations has been noted before.⁶ A leading local government casebook describes special-purpose districts as "quasi-proprietary

⁶ The most insightful analysis in the legal literature of the thin boundary between public and private organizations is Robert Ellickson, *Cities and Homeowners Associations*, 130 U. PA. L. REV. 1519 (1982). The organizations on which Ellickson focuses his analysis are multi-purpose, as opposed to the single-purpose organizations that are the focus here. The lenses through which we and he examine the

firms.”⁷ And the Supreme Court, in the course of deciding whether special-purpose districts should be subject to the constitutional requirement of one-person-one-vote (the answer was no), described them as “essentially business enterprises, created by and chiefly benefiting a specific group of landowners.”⁸

And yet, despite a few high-profile comments on the similarity between business corporations and local governments, the full import of this connection has never been explored. There is a rich literature in economics and political science on the structure and theory of local government.⁹ And there is a rich literature on the law of local government, focusing particularly on the relationship between state and local governments as a form of federalism, or on the relationship between SPGs and GPGs.¹⁰ But there is little scholarship that examines SPGs from the distinct perspective of private organizational law, including the law governing business corporations, cooperative corporations, and nonprofit corporations.

Viewing SPGs in that context, and using the tools developed to study the law and economics of private enterprise, offers at least three important advantages. The first is historical clarity. The nineteenth century produced, from the undifferentiated primordial soup of individually chartered corporations, a standard set of statutorily-enabled specialized corporate forms, including the business (joint-stock) corporation, the cooperative corporation, the nonprofit corporation, and the municipal corporation. Today, most states have separate general enabling statute for each of these four types of corporation.¹¹ Yet, while a large fraction of the early individually-chartered corporations had much of the character of modern SPGs, a general statutory form for SPGs did not emerge. Instead, SPGs have typically come to be governed by a disparate and confusing patchwork of state statutes, each of which typically applies only to SPGs formed for some particular purpose (like street lighting or fire protection). This difference in contemporary law is explained by the distinct historical origins of the SPG: as we show, modern SPGs and the statutes that enable them principally derive not from the many early SPG-like corporations in the original states, but from later efforts to solve property and resource problems in the American West. Uncovering this and other historical and contemporary relationships — and lack thereof — among the various types of corporation sheds new light on the origins and evolution of SPGs and their place in the larger organizational taxonomy.

The second advantage is analytical. We offer reasons for some important and widespread legal trends in local government law that have so far defied easy explanation. Most prominently, we explore the stark division between single-purpose and general-purpose governments: there are many of each, but little between them. In fact, the gap between special- and general-purpose

relationship between private and public enterprise are very similar, however, and our analysis essentially builds on his. See particularly Section [] *infra*.

⁷ Richard Briffault & Laurie Reynolds, *Cases And Materials On State And Local Government Law* 124 (6th ed. 2001).

⁸ *Ball v. James*, 451 U.S. 355, 368 (1981).

⁹ A seminal contribution to this literature which has had a large influence in economics and political science is Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

¹⁰ See, e.g., Richard Briffault, *Our Localism: Part I—The Structure of Local Government Law* 90 COLUM. L. REV. 1 (1990).

¹¹ Including, importantly, municipal corporations. See BRIFFAULT & REYNOLDS, *supra* note 7, at 166 (“Most states provide for the incorporation of new municipalities by general law.”).

governments is so striking that we refer to “*single-purpose governments*” and “*special-purpose governments*” interchangeably. (Happily, the acronym “SPG” remains the same.) Drawing on the literature of public choice and organizational economics, we argue that the seemingly high costs of democratic decision-making within governmental entities place strong constraints on organizational structure. In particular, those decision-making costs are best mitigated by employing one or the other of two polar organizational strategies: providing a single service to a relatively homogeneous population (an SPG), or alternatively providing a broad array of services to a more heterogeneous population (a GPG).

The third advantage of our approach is that it enables us to explore legal reforms. The laws that govern SPGs have not kept pace with the growth and economic importance of that organizational form. Not only does this body of law remain highly fragmented, with most states offering different statutes for different types of SPGs, but many of these statutes are oddly incomplete, lacking provisions, for example, concerning expansion, contraction, merger, or dissolution of the entities involved. In light of this unfocused patchwork of law, we ask whether it is time for SPGs to follow the path toward simplification and rationalization taken by other types of corporate entities. In particular, we examine the potential for more uniform, functional, and complete statutory law to govern SPGs. More boldly, we suggest that incorporation of an SPG—which often requires discretionary approval by a higher state authority—might be freed of prior restraint and made available “as of right” to any persons who comply with the statutory requirements, for any purpose not otherwise contrary to law. This shift from incorporation as a privilege to incorporation as a right has already been made for the basic standard forms of nongovernmental corporations – joint stock, cooperative, and nonprofit. SPGs are, arguably, sufficiently similar to those forms to be given the same liberty of formation.

These insights matter for local government law. One of the great debates in this field over the last twenty years has been the ongoing contest between “regionalism” and “localism.”¹² On one side are the intellectual descendants of Charles Tiebout, who argue broadly that fragmentation and decentralization can yield more efficient delivery of local governmental services.¹³ On the other side are those who emphasize the downside of decentralization. For them, special-purpose districts are unaccountable, inefficient, and opportunistic. In particular, critics claim that SPGs impose costs on the larger communities in which they operate by letting discrete local populations carve away service provision on an *à la carte* basis, thereby sacrificing economies of scale and frustrating efforts to undertake redistribution at the local level.¹⁴ While we do not seek here to resolve this broad debate, we do seek to add perspective to it by providing a clearer view of the organizational structures that are realistically available to deal with the

¹² See, e.g., Richard Briffault, *The Local Government Boundary Problem in Metropolitan Areas*, 48 STAN. L. REV. 1115 (1996); Richard Briffault, *The Rise of Sublocal Structures in Urban Governance*, 82 MINN. L. REV. 503 (1997); Gerald E. Frug, *Beyond Regional Government*, 115 HARV. L. REV. 1763 (2002); Laurie Reynolds, *Intergovernmental Cooperation, Metropolitan Equity, and the New Regionalism*, 78 WASH. L. REV. 93 (2003).

¹³ See Clayton P. Gillette, *Regionalization and Interlocal Bargains*, 76 N.Y.U. L. REV. 190 (2001).

¹⁴ See Reynolds, *supra* note 12, at 94 (“This increasing stratification between city and suburb may be the intended result of state laws pertaining to local government formation, which allow affluent, homogeneous enclaves to form their own government and thus prevent the redistribution of resources that occurs when wealthy and poor pay property taxes to the same general purpose municipality.”).

issues involved, of the relative costs and benefits of those structures, and of the potential for reform of the law that governs those structures.

II. SINGLE-PURPOSE GOVERNMENTS IN CONTEXT

Despite their ubiquity and rapid growth, SPGs generally occupy little space in the public (or scholarly) consciousness. Consequently, before proceeding to a systematic analysis, we provide some context by offering brief descriptions of several functioning SPGs.

A. Some Illustrative Examples

The three particular examples that we describe here were chosen to give some sense of the wide variation across SPGs in size, structure, and services. These organizations can, of course, only in the very loosest sense be taken as “typical” of the nation’s 50,000 SPGs.

Calleguas Municipal Water District. The Calleguas Municipal Water District (“Calleguas”) is a water wholesaler organized under California’s Municipal Water District Act of 1911.¹⁵ Calleguas was founded in 1953 in response to recurrent droughts in the Ventura County area. The District currently supplies water to around three-quarters (approximately 630,000) of the residents of Ventura County, situated an hour north of Los Angeles on the Pacific Coast. Calleguas’s gross revenue for fiscal year 2015-2016 was \$117,964,050 and its total operating expenses were \$106,024,890.¹⁶ Calleguas has an elected board of directors comprised of five members, each representing one of the district’s five geographical divisions. The five divisions are of approximately equal population, and are readjusted after each national census. Elections to the Calleguas Board of Directors are held by the County of Ventura and coincide with general elections. Members are elected to four-year terms, with either two or three members up for election every two years.¹⁷ Voter turnout for Calleguas’s director elections was 50.3% in 2016, 17.6% in 2014, and 51.7% in 2012.¹⁸ Members of Calleguas’s Board of Directors set general policy, make financial decisions, and hire a district counsel, auditor, and general manager to run the day-to-day operations of the District. These three officials report directly to the Board of Directors. The Board of Directors typically holds between six and eight meetings per month, and directors are paid \$200 per meeting.

Calleguas, like most special districts in California, is subject to oversight by its county local agency formation commission (LAFCO). LAFCOs are independent county agencies organized and governed pursuant to a state statute adopted in 2000.¹⁹ LAFCOs are charged with

¹⁵ See CAL. WATER CODE div. 20 (West 2017).

¹⁶ CALLEGUAS MUN. WATER DIST., FY 16/17 ADOPTED BUDGET (2016), *available at* <http://www.calleguas.com/images/docs-financial/budget-cover.pdf>.

¹⁷ Telephone Interview by Emily Barreca, Research Assistant, Yale Law School, with Susan Mulligan, Gen. Manager, Calleg

uas Mun. Water Dist. (Feb. 14, 2017).

¹⁸ *Election Results*, COUNTY OF VENTURA, <http://recorder.countyofventura.org/elections/election-resultscanvass-of-the-vote/prior-election-vote-totals>. The drop in voter turnout in 2014 is attributable to the fact that it was an off-year election, as total county-wide voter turnout experienced a similar drop.

¹⁹ See Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000, CAL. GOV’T CODE tit. 5 div. 3 (West 2010).

regulating “orderly development” within their county jurisdiction.²⁰ The primary authority of LAFCOs rests in their power to review and approve (a) the formation of new special districts, (b) the consolidation, merger, and dissolution of existing districts, and (c) the annexation and detachment of territory to and/or from cities and most special districts.²¹ It appears that the Ventura County LAFCO has in fact played a minimal role in overseeing the operations of the District, which has rarely changed its boundaries.²²

Enfield Fire Department District 1. This district (“Enfield”) serves only 20,000 people spread over 16 square miles near Middletown, Connecticut.²³ It employs nine full-time firefighters, who are supplemented by about fifty volunteers.²⁴ The district is governed by nine commissioners who serve staggered three-year terms.²⁵ The annual elections are not put on the general ballot, but are held in person at the fire station. Generally, only “a couple hundred” people turn out for an election, and typically they are the friends and family of the candidates. Although turnout is low, elections are challenged fairly regularly, and it is not unusual to have six or seven candidates for the three open seats in any given year. Commissioners do not exercise significant control over the day-to-day operations of the District. Apparently seats on the Commission are desirable in part as resume-builders for prospective city council candidates.

Connecticut fire districts receive no revenue from service charges. Enfield instead issues general obligation bonds that are backed and paid for with property taxes and that must be approved by both the Commission and the members of the District. The District has also succeeded in obtaining federal grants to buy or upgrade equipment. Grants of this sort to the District under various FEMA programs totaled over \$650,000 between 2006 and 2015.²⁶ Although Connecticut fire districts are subject to standard open-records laws and must provide annual reports to the town clerk of the town(s) they serve, they are not subject to specific oversight by a state agency.

Samaritan Healthcare. Washington State has 54 active public hospital districts, most of which service rural communities.²⁷ Samaritan Healthcare is a midsize district with a fifty-bed hospital. It is one of five hospital districts that serve, collectively, 95,000 people in Grant County.²⁸ The district’s facilities include a hospital, a federally-qualified health center,²⁹ and

²⁰ *Frequently Asked Questions*, VENTURA LAFCO, <http://www.ventura.lafco.ca.gov/faqs/> (last visited Feb. 23, 2017).

²¹ *Id.*

²² Telephone Interview, *supra* note **Error! Bookmark not defined.**

²³ ENFIELD FIRE DEPARTMENT, DISTRICT 1, <http://enfieldfire.org/cms/>.

²⁴ *Members*, ENFIELD FIRE DEPARTMENT, DISTRICT 1, <http://enfieldfire.org/cms/index.php/aboutusmembers>.

²⁵ Telephone Interview with Edward Richards, Chief, Enfield Fire Dep’t, Dist. 1 (Mar. 30, 2017).

²⁶ [Cite]

²⁷ Telephone Interview by Ariel Dobkin, Research Assistant, Yale Law School, with Ben Lindekugel, Exec. Dir., Washington State Hospital Ass’n (Feb. 21, 2017). Rural hospital districts are defined as those that encompass no city of more than 50,000 people. *Id.*

²⁸ Telephone Interview by Ariel Dobkin, Research Assistant, Yale Law School, with Theresa Sullivan, Chief Exec. Officer, Samaritan Healthcare (Mar. 13, 2017). In 2016, Samaritan had 2,906 hospital admissions; 19,847 Emergency department visits; and 19,723 primary care visits to the clinic. E-mail from Theresa Sullivan, Chief Exec. Officer, Samaritan Healthcare, to Ariel Dobkin, Research Assistant, Yale Law School (Mar. 13, 2017, 7:56 PM).

several specialized rural health clinics.³⁰ Samaritan's board of directors, all of whose members are elected for six-year terms,³¹ consists of two at-large commissioners and three who represent specific district subdivisions.

The district's net operating revenue in 2016 was \$74,700,000.³² Although only about \$2 million of that revenue comes from taxes,³³ the entire entity is treated as taxpayer-funded and subject to state regulations that would not apply to private hospitals. For example, while the district engages an independent audit firm to validate its financial statements, the state performs its own audit, which serves in large part to review compliance with state regulations.³⁴

We now turn to what it is that these and other SPGs have in common, and what – if anything – distinguishes them from private or other governmental organizations.

B. Defining the Modern Single-Purpose Government

The absence of a clear borderline between governmental and nongovernmental organizations is reflected in the absence, in both law and the social sciences, of a workable -- much less commonly-accepted -- definition of what it means for an organization to be a "government." This definition problem³⁵ came to prominence in the legal literature around 1980

²⁹ The Samaritan Clinic is a health clinic located in Moses Lake, WA, offering primary care and a limited range of non-emergency specialist services. See *Samaritan Clinic*, SAMARITAN HEALTHCARE, <https://www.samaritanhealthcare.com/services/samaritan-clinic.aspx>.

³⁰ Telephone Interview with Theresa Sullivan, *supra* note **Error! Bookmark not defined.**

³¹ Telephone Interview with Ben Lindekugel, *supra* note **Error! Bookmark not defined.** Rural hospital districts are defined as those that encompass no city of more than 50,000 people. *Id.*

³² E-mail from Theresa Sullivan, Chief Exec. Officer, Samaritan Healthcare, to Ariel Dobkin, Research Assistant, Yale Law School (Mar. 13, 2017, 7:56 PM).

³³ *Id.*

³⁴ For example, the district cannot give back pay, since it is viewed as gifting of public funds. So the district must agree up front to payments and cannot change its decision afterward. An outside audit would not look at this, but the state does. *Id.*

³⁵ The Census of Governments ostensibly counts entities as governments if they possess three characteristics: "existence as an organized entity," "governmental character," and "substantial autonomy." See CENSUS, *supra* note 5, at v. The first of these criteria, however, is met by all legal entities, private or public, while the third criterion, which is met when "an entity has considerable fiscal and administrative independence," *id.* at vi, makes no distinction between sub-governments on one hand and proprietary subsidiaries on the other. That leaves us with the circular-sounding "governmental character" criterion, which (the Census continues) is met "when officers of the entity are popularly elected or are appointed by public officials" and when the organization has a "high degree of responsibility to the public, demonstrated by requirements for public reporting or for accessibility of records to public inspection." *Id.* But this definition also fails to establish a clear line between public and private enterprise. The "popularly elected" criterion, for instance, might seem to exclude an irrigation district – of which there are many – whose voting members are limited to owners of agricultural land and are allocated votes according to the number of acres they have in production. On the other hand, this criterion might be thought to include a publicly-traded business corporation with thousands of voting shareholders. Likewise, the "appointed by public officials" criterion might be read to classify a state-owned steel company as a "government." And the disclosure criterion also fails to discriminate appropriately given, for example, the extensive disclosure requirements imposed upon business corporations whose stock is widely traded.

as part of a debate over the existence -- posited by members of the Critical Legal Studies movement -- of an overly rigid distinction between “public” and “private” institutions in American law. Robert Ellickson’s classic contribution to that debate -- his article on “Cities and Homeowners’ Associations” -- demonstrated clearly that there is no consistent distinction at all, in terms of either structure or function, between organizations commonly classified as public or governmental on one hand and, on the other hand, those organizations commonly classified as private.³⁶ Rather, it is only in terms of the procedures for the initial formation of organizations that there appears any regularity in the distinction between public and private organizations, or governmental and nongovernmental organizations, and that distinction is, in practice, often more formal than consequential.

To illustrate these points, we begin by offering the following partial definition of a “government.”

Partial Definition: A *government* is (1) a legal entity³⁷ that is (2) associated with a defined geographic territory (3) to whose residents or property owners the entity has the authority to provide one or more services whose costs (4) the entity can allocate among, and charge to, the territory’s residents or property owners regardless of whether they have, as individuals, requested or consented to receive and pay for the services involved.

A *special-purpose government* is then a government that is organized to provide only a single service, whereas a *general-purpose government* has, and exercises, authority to provide multiple services that it chooses from a large and generally open-ended set. The “authority” to act as a government, whether special or general purpose, is generally granted by a higher level of government, with the exception of sovereign governments (in the U.S., the national and state governments), which draw their authority from constitutional sources.³⁸ Because we will be dealing here with local governments, we can largely avoid these broader questions of sovereignty.

Our partial definition does not specify how the persons who control the government are chosen. It therefore includes both *democratic* governments -- that is, governments whose management is chosen by voting among the residents or property owners of the government’s associated territory --and *nondemocratic* governments whose leaders are chosen in some other fashion. The managers of nondemocratic SPGs are typically appointed by a higher unit of government, such as a municipality or the state. Organizations in the latter category are often (though not always) referred to as “authorities,” such as Boston’s Massachusetts Bay Transportation Authority and the Port Authority of New York and New Jersey. In our view, authorities are best thought of as either subsidiaries of higher-level governments or joint ventures between two or more other governments. Importantly, authorities lack the autonomy of democratic SPGs. While the Census figures lump together both democratic and nondemocratic SPGs, democratic entities apparently constitute the majority of the 50,000 SPGs reported by the

³⁶ Robert Ellickson, *Cities and Homeowners’ Associations*, 130 U. PA. L. REV. 1519 (1982).

³⁷ As to what constitutes a legal entity for our purposes, see Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387 (2000).

³⁸ See Jack Goldsmith & Daryl Levinson, *Law for States: International Law, Constitutional Law, Public Law*, 122 HARV. L. REV. 1791, 1852 (2009); see also BRUCE ACKERMAN, *WE THE PEOPLE I: FOUNDATIONS* (1993).

Census.³⁹ For that reason, and for simplicity and clarity of both analysis and proposed reforms, we will largely confine our discussion to democratic SPGs.

While we are dealing with definitions, we note that the terminology used in this area varies in occasionally subtle and often overlapping or inconsistent ways. The special-purpose governments we study are sometimes referred to as ‘districts,’ ‘authorities,’ ‘boards,’ or ‘commissions.’ Terms like ‘tax district,’ ‘zoning district,’ ‘business improvement district,’ and ‘regional district’ also carry specific and sometimes delicate connotations. We use the term “single-purpose government” inclusively and loosely, focusing on the broadest features of local governments that provide only a single service. While this may elide what others view as important distinctions between these forms, we hope it captures the great bulk of the organizational forest without cutting out or keeping in too many of the wrong trees.

Before proceeding further with definitions, however, we need to examine governmental services.

C. Governmental Services

What do the various services provided by SPGs have in common? To a large extent, SPGs provide the same services that are provided by general-purpose local governments, such as municipalities and counties — that is, they provide the services of governments generally. And what kinds of services are those? The typical answer is that governments provide public goods⁴⁰ — that is, goods that are (at least for residents of the government’s associated territory) non-rivalrous and non-excludable.

But a substantial fraction of governmental services are not public goods in the economic sense, since they commonly fail to meet at least one, and frequently both, of the criteria that define a public good. First, the cost of providing governmental services is rarely independent of the number of people served — that is, these services are not strictly (or even nearly) non-rivalrous. The more residents there are in a government’s territory, the more it must spend on roads, schools, sewers, fire trucks, police officers, and courts. Second, residents of a government’s territory can usually be excluded from consuming the government’s services if they fail to pay for those services. To be sure, there are many governmental services, such as the construction and maintenance of local roads, from which exclusion is often impractical. But there is little difficulty in excluding nonpaying residents from the use of governmentally provided schools, transportation, utilities, museums, courts, fire protection, or even police protection.

Instead, as one of us argues at greater length elsewhere,⁴¹ the attribute that seems most generally and importantly to distinguish services provided by governments from services provided by private entities is monopoly — or, more precisely, substantial market power vis-à-vis the residents of the government’s associated territory. This market power has several sources.

³⁹ The enabling statutes that provide for the creation of SPGs generally authorize, but do not require, elected boards.

⁴⁰ See, e.g., James M. Buchanan & Richard E. Wagner, *An Efficiency Basis for Federal Fiscal Equalization*, NAT’L BUREAU ECON. RES., at 143 (1970) (“we shall assume in our basic models that state-local governments provide public goods efficiently...”).

⁴¹ Henry Hansmann, *Government as Enterprise* (Working Paper, 2018).

First, some services exhibit economies of scale that render a single provider of services the least-cost mode of production, a situation usually described as a natural monopoly.⁴² Sewage systems are a simple example: building two or more parallel systems of competing sewage pipes in a town would involve the costly duplication of fixed and sunk costs.

In addition, monopolies are often created by higher-level governments, and then assigned to lower-level governments, to reduce the impact of one or another market failure. One example is regulation designed to limit externalities, including zoning and other land-use controls, as well as stoplights and speed limits. These services address coordination problems that are best met with a single solution. Dispute resolution mechanisms such as courts are analogous, at least outside contractual settings in which the parties can be left free to specify themselves the forum and the law that will govern subsequent disputes.

D. Governments as Monopoly Control

The logic of using a democratic government to provide territorially monopolistic services is straightforward. The residents served by the government control the government, and can use that control to prevent the government from exploiting its monopoly position by, for example, charging prices for its services that are far above the cost of production. This is precisely the economic role typically played by (private) cooperatives, including -- for example -- the numerous and often very large cooperatives found in utilities (electricity, gas, water, telephone service), agricultural marketing, wholesaling, and franchising (in the many cases in which franchisees collectively own the franchisor to which they are effectively locked in).⁴³ In these and other situations, cooperatives arise where a monopoly is unavoidable, but exploitation of customers can largely be avoided by making the customers, collectively, the owners of the monopolistic firm.

Viewed in this light, democratic governments are effectively territorial cooperatives, and perform the same consumer protection function as cooperatives in general.

There are, to be sure, other limits to the monopoly power of a local government. As Tiebout famously observed, if the cost of moving from one government's territory to another is negligible, and if governments seek to attract new residents, we might expect a competitive market for governmental services.⁴⁴ The world, however, appears far from meeting the strong assumptions of Tiebout's model. The costs of moving can be large; they entail not just finding new employment, housing, and schools, but new social relationships as well. And local governments often seem (quite rationally) more interested in keeping new residents out than in attracting them.⁴⁵ The result is that exit -- the opportunity to move out of a territory -- provides only a modest limit to the market power of suppliers of locally monopolistic services. Thus, residents of a territory depend not just on exit, as per Tiebout, but also heavily on voice --

⁴² For a definition, see William J. Baumol, *On the Proper Cost Tests for Natural Monopoly in a Multiproduct Industry*, 67 AM. ECON. REV. 809, 810 (1977) (describing a natural monopoly as an "industry in which multi-firm production is more costly than production by a monopoly").

⁴³ [# cite HH]

⁴⁴ Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

⁴⁵ See, e.g., Robert C. Ellickson, *Suburban Growth Controls: An Economic and Legal Analysis*, 86 YALE L.J. 385, 399-403 (describing the exclusionary effects of municipal growth controls).

essentially, control through the electoral process – to protect them from exploitation.⁴⁶ By assuming away the costs of moving from one government's territory to another, Tiebout effectively assumes away the principal function of governments.

E. Formation of Governments

The partial definition of “government” offered above encompasses various types of organizations that are conventionally considered private rather than governmental, such as housing cooperatives and condominiums and even landlord-owned rental apartment buildings.

In exploring the difference between governmental and nongovernmental organizations, it is helpful to consider a service that is provided by both. Because the organization of multi-unit housing appears strongly affected by special rules of taxation,⁴⁷ we instead take as an example local electricity distribution. This service has the character of a natural monopoly because of the large fixed costs it involves and the attendant inefficiency of constructing two parallel distribution systems. As a result, we find local electricity distribution organized almost exclusively in some manner designed to mitigate the consequences of monopoly. Moving down the scale from the most “private” to the most “public” of those forms of organization, they are: (1) investor-owned and subject to governmental rate regulation; (2) customer-owned through a consumer cooperative (and generally free of rate regulation); (3) owned and operated by a special district (SPG); or (4) owned and operated by a municipality or other GPG. Although organizations in category (2) are conventionally considered nongovernmental (private), while organizations in category (3) are conventionally considered governmental (public), the practical differences between them are modest.

The principal difference lies in formation. As we discuss in more detail below, an SPG is typically formed at the initiative of a group of local residents who develop a proposal for the nature of the service to be provided and the territory to be served. The residents draft a petition and, if they obtain the statutory minimum number of signatures from among the residents of the territory (usually well under 50%), they conduct a vote on the proposal among all residents of the designated territory. If that vote meets the statutory minimum (usually 50% or more) and any other statutory conditions (like the approval of a designated state official), the district comes into existence and commences operation. All residents of the designated territory become members of the special district whether they voted in favor of it or not. In particular, they become liable for assessments levied by the district to cover the costs of supplying the service. In the case of electricity distribution, these costs may include initial assessments to cover the capital expenses of constructing the distribution system, and then user fees charged according to the amount of electricity consumed. Residents who decline to use the service can avoid the user fees, but remain liable for assessments to cover their share of capital costs.

Formation of a cooperative is also likely to begin with a proposed service to be provided and a proposed territory to be served, followed by the solicitation of residents. But approval in this case means a pledge to become a member of the cooperative if it is formed, which is likely

⁴⁶ For the classic statement on the contrast between these types of response, see ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY* (1970).

⁴⁷ See Henry Hansmann, *Condominium and Cooperative Housing: Transactional Efficiency, Tax Subsidies, and Tenure Choice*, 20 J. LEGAL STUD. 25-71 (1991); HENRY HANSMANN, *THE OWNERSHIP OF ENTERPRISE* 168-81 (1996).

to be conditioned upon receipt of such pledges by a given fraction of the residents of the designated territory. The cooperative will be collectively owned and operated by the residents who have chosen to become members. But residents of the territory who do not wish to join need not become members and are not subject to any assessments if they do not use the service.

Formation of these two forms of organization differs, then, in whether residents of the territory are compelled to join the organization – and to pay a share of its costs – once it is formed. In the case of a service such as electricity, where charges are based principally on metered use and can thus largely be avoided by declining the service, there is little difference between these arrangements. A resident of the territory can avoid using and paying for the service if they want, but if they choose to consume the service they must obtain it from (and pay the fees to) the SPG or the cooperative, whichever it is.

This difference between cooperatives and special-purpose governments is particularly important for shared physical improvements such as street lighting and sidewalks. If a qualified majority of the owners of houses facing a given street wish to form a special district to install sidewalks along the street, they can force all of the residents fronting on the street to both accept the sidewalks and pay the assessed share of the cost. That is, an SPG can force residents to consume and finance the service it provides, and not just – as in the electricity distribution example – accept the availability of the service. While a private cooperative might also be established to provide sidewalks to a given group of residents, it could not force unwilling residents to pay for the sidewalks, nor force unwilling residents to install – or even accept – sidewalks on their own property.

In short, SPGs – like governments in general – serve importantly to solve the problem of the commons. By creating an SPG to provide a service, everyone in the territory is required to pay their pro rata share of the cost of the service; holdouts and free riders are largely eliminated. Thus the difference in formation mechanisms between SPGs and cooperatives is fundamental. Once formed, an SPG may well be structured and operate little differently from a typical cooperative. To complete the partial definition of a government offered above, we must therefore add a 5th element: when a government is formed for a given territory, all residents of that territory must become members.

III. THE GAP BETWEEN SINGLE-PURPOSE AND GENERAL-PURPOSE GOVERNMENTS

Despite the broad overlap in the services they provide, there is a striking divide between single-purpose governments and general-purpose governments.

The corporation statutes under which municipalities operate place few limits on the type of services they may provide.⁴⁸ The typical municipality takes full advantage of that opportunity

⁴⁸ See, e.g., IDAHO CODE ANN. § 50-301 (West 2016) (“Cities governed by this act . . . exercise all powers and perform all functions of local self-government in city affairs as are not specifically prohibited by or in conflict with the general laws or the constitution of the state of Idaho.”); OR. REV. STAT. ANN. § 221-410(1) (West 2016) (“Except as limited by express provision or necessary implication of general law, a city may take all action necessary or convenient for the government of its local affairs.”); S. C. CODE ANN. § 5-7-30 (2016) (“Each municipality of the State, in addition to the powers conferred to its specific form of government, may enact regulations, resolutions, and ordinances, not inconsistent with the Constitution and general law of this State . . .”).

by providing a large range of services, often including police and fire protection, the construction and maintenance of roads and bridges, mass transit, zoning and land-use regulation, primary and secondary education, trash collection, and utilities such as water, gas, and electricity.

SPGs, on the other hand, almost universally provide only a single service, such as agricultural irrigation or fire protection. It is rare to find an SPG that provides two services, much less three or four. Of the SPGs listed in the Census, more than 86% are categorized as providing only a single service.⁴⁹ And even those districts that nominally provide more than one service (e.g., erosion management and water conservation) often might as easily be described as providing a single unified service (e.g., water management). Indeed, most districts that the Census categorizes as multi-service seem to provide a bundle of connected water-related services.⁵⁰ Large districts that provide more than one distinct service do indeed exist — one such district, providing both irrigation water and electricity, was at the center of controversy before the Supreme Court in *Ball v. James*,⁵¹ which we discuss below⁵² — but they are rare, and seem to have started out as single-purpose entities and subsequently fallen victim to mission creep.⁵³

Almost as a rule, then, local governments in the United States provide either a single service or, alternatively, a broad and largely unbounded range of services. This divide exists despite the fact that the services provided by SPGs in one locality are often the same as those provided by municipalities in another locality, and vice versa. And the divide appears despite the absence of any *legal* reason why several services cannot be provided by the same district. The statutes that enable special districts often explicitly allow combinations. Tennessee’s Utility Districts statute, for example, provides that the districts “may provide water service, sewer, garbage collection and disposal, street lighting, parks and recreational facilities, gas supply, fire and police protection, transit, transmission of industrial chemicals or natural gas by pipeline, and community antenna television facilities, *or combinations*” of these services.⁵⁴ But the Census and other data sources list no such joint services in the state, and the Tennessee officials we spoke with identified none in practice.

⁴⁹ Special District Governments by Function and State: 2012 – United States – States, AM. FACTFINDER, <http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmk>; see CENSUS, *supra* note 5; see also BRIFFAULT & REYNOLDS, *supra* note **Error! Bookmark not defined.**, at 486 (“In nearly all instances . . . these government units exist for one reason only — to provide a single regional service.” <http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmk>).

⁵⁰ See PORTER ET AL., *supra* note **Error! Bookmark not defined.**, at 3.

⁵¹ 451 U.S. 355, 371 (1981).

⁵² Discussion *infra* Section IV.B.

⁵³ See BRIFFAULT & REYNOLDS, *supra* note **Error! Bookmark not defined.**, at 487 (“In all cases, they were created in response to one identifiable problem that was indisputably regional in scope. . . . Starting out as something akin to a single-purpose regional special district, these entities gradually acquired new regulatory responsibilities.”).

⁵⁴ TENN. CODE ANN. § 7-82-202 (West) (emphasis added).

Why does this near-complete divide exist, with roughly 40,000 general-purpose governments and 50,000 single-purpose governments, but virtually nothing in between? The question has hardly been raised before, much less answered.⁵⁵

We offer three related functional explanations.

A. The Costs of Collective Decision-Making

Our first explanation for the divide between single- and general-purpose governments involves the costs of collective decision-making:

Both private firms and governments can benefit when their owners or members have homogenous interests. Many private firms are owned and controlled by a large number of persons. The publicly-traded business corporation is the most familiar example, but extremely large producer and consumer cooperatives – collectively owned, respectively, by the firm’s suppliers or consumers – are also quite common in advanced economies. It is extremely rare, however, to find successful firms that are jointly owned by a large number of persons with interests in the firm that are even mildly heterogeneous.⁵⁶

Voting rights in widely-held business corporations, for example, are generally tied to possession of shares of a single class of common stock that, for most purposes, leaves the shareholders all equally interested only in a single, simple, and clear measure of the firm’s performance – namely, the firm’s earnings per share. The result is that shareholders are affected identically (in proportion to their ownership) by decisions the firm makes. The same is true of cooperatives. The – sometimes huge – U.S. farmer cooperatives that market a large fraction of the nation’s staple crops, from corn and wheat to cranberries and Concord grapes, generally focus their activities on a single crop. If they market other crops as well, profits for the different crops are generally accounted for separately to avoid the potential for cross-subsidies, and hence for conflict among the members concerning the allocation of profits.⁵⁷ Firms in fact often sacrifice substantial economies in other aspects of their organization for the sake of having a homogeneous class of owners.⁵⁸ Evidently the use of voting to make decisions among a heterogeneous group of owners is extremely costly..

More particularly, heterogeneous ownership can create conflict, inefficient decisions, and exploitation of one group by another; homogenous ownership can help avoid this. To see this clearly, consider, for example, an SPG established to provide irrigation to farmers in a semi-rural community consisting of a small town surrounded by farms. If assessments levied by the district are made proportional to the number of acres a farmer has in production, and votes in the SPG are allocated in the same way, the farmers’ interests in the management of the SPG are likely to be quite homogeneous. All will want water distributed at the lowest cost per gallon possible. And

⁵⁵ Briffault and Reynolds suggest specialization as an important factor: “Having a specialized, single purpose focus, moreover, enables the directors of the district to maintain a high level of expertise, knowledge, and enthusiasm about their mandate.” BRIFFAULT & REYNOLDS, *supra* note **Error! Bookmark not defined.**, at 487. But, while this consideration may play a role, it seems implausible as a general explanation because, among other things, one sees no such discontinuous divide between single-product and multi-product enterprise among standard investor-owned business firms.

⁵⁶ See HENRY HANSMANN, *THE OWNERSHIP OF ENTERPRISE* 39-43 (1996).

⁵⁷ See HANSMANN, *supra*, at 120-48.

⁵⁸ Employee-owned firms offer some particularly strong examples. See HANSMANN, *supra*, at 66-119.

since all farmers will be charged roughly according to the amount of water they use (as proxied by acres in production), and all will want roughly the same amount of water per acre, the farmer-members of the SPG will all be in rough agreement on the aggregate amount of water that needs to be supplied. Simple majority voting should yield the per-acre, and hence aggregate, amount of water preferred by the median voter, which is likely to be close to the average demand, which in turn is likely to be a good approximation to the efficient level of total water distribution.

In short, where an SPG provides only one service, there is a reasonable chance that voting rights and assessments can be allocated among members of the SPG in a fashion that largely harmonizes their interests, with no more than one important dimension of performance on which members differ and which must therefore be settled by voting.⁵⁹ And, in such circumstances, voting is likely to lead to a reasonably efficient and stable outcome.

But now suppose that the SPG also distributes electricity to the same territory. And suppose that the per capita demand for electricity is much higher among the urban population – which needs electricity for light and power for homes, shops, offices, and industry -- than per capita demand is among farmers. The efficient levels of both services will be more difficult to achieve. For example, suppose that such a combined water and electricity district were created with votes allocated per acre of land in agricultural production, as with the hypothetical district described above in which the only service rendered was water. If so, the aggregate number of votes held by the farmer-members of the district would far exceed those held by the urban residents. It would thus be in the interest of the farmers as a group to exploit their voting control to impose on the district's members very high assessments for electricity -- perhaps in the form of exorbitant rates per kilowatt hour consumed – and using the resulting net returns from electricity distribution to cross-subsidize the use of water for irrigation by levying assessments for water far below the cost of the water to the district. The expected result would then be too little consumption of electricity, too much consumption of water for irrigation, and a large transfer of wealth from urban to rural members of the district. (There is nothing fanciful about this example: Indeed, an extreme version of it is the focus of the Supreme Court's decision in *Ball v. James*,⁶⁰ which we discuss below.)

If, alternatively, voting rights in such a two-service district were allocated among its members according to the number of kilowatt-hours each member consumed, we would expect the opposite result: urban members would control the district, and would have both the incentive and the opportunity to charge exorbitant rates for water usage and to use the resulting profits to subsidize the rates levied for electricity usage, distorting consumption of both water and electricity and transferring substantial wealth from rural to urban members of the district.

In fact, there exists no simple solution to the problem of allocating voting rights in such a two-service district.⁶¹ The problem remains, for example, even if the district establishes a

⁵⁹ Moreover, as our example suggests, preferences along that one dimension are likely to be “single-peaked” and hence to yield one, and only one, stable voting equilibrium. *See* [cite].

⁶⁰ 451 U.S. 355 (1981).

⁶¹ Indeed, when the choice involves more than one dimension, voting may not only lead to inefficient choices concerning the values for the various dimensions, but also to choices that are unstable in the sense that there will always be another set of choices, involving a different combination of values for those variables, that will defeat the initial choices by majority vote. This gives rise to the potential for cycling

separate user fee for each of its two services – for example, a charge for electricity usage according to kilowatt hours consumed, together with a charge for water usage according to number of acres in production. Regardless of how voting rights are allocated in such a district, one of the two groups of members – urban or rural – will (excluding the unlikely case of a tie) have the majority of votes, and will therefore be in a position to set service charges that exploit the group that has only a minority of the votes. The fundamental problem lies in decision-making by voting where there is more than one important dimension to the available alternatives. In such circumstances, there may well be no allocation of votes that assures efficient choices.⁶²

In addition, whether the ultimate outcome is efficient or not, the process of arriving at that outcome might itself be quite costly. Persons who are voting on issues involving multiple dimensions have an incentive to inform themselves, not just about their own preferences, but also the preferences of other members of the electorate, and they have an incentive as well to engage in strategic bargaining and coalition-building with other members. Such costs are largely obviated when voting is confined to a single dimension.

The advantages of homogenous membership may go far in explaining the large number of SPGs that provide only a single service. But what about the large number of general-purpose governments that provide many services? A plausible theory is that, in effect, GPGs offer a solution to the cost of collective decision-making that is the polar opposite of that offered by SPGs. When many services are provided by a single GPG, the supply of individual services is not voted upon one by one, but rather is typically determined by general administrators who are chosen in broadly spaced general elections. In this situation, residents who have an unusually strong preference concerning one individual service out of many are unlikely to be sufficiently numerous to form a coalition that will control the government, and then use that control to cross-subsidize services that disproportionately benefit that coalition. At the same time, virtually all residents share a common interest in having their municipal services — whatever they may be — provided with competence, at low cost, and without corruption. Rather than fight over the division of the pie, residents might well choose to enlarge the overall pie simply by having the municipality -- and all of its various services – managed by officials who are relatively competent and disinterested.

among different choices, with resulting uncertainty and transaction costs. Such cycling, to be sure, might not be a serious concern for services that, like many governmental services, involve substantial fixed costs. But the closely related problem of agenda control – in which the persons choosing the order in which alternatives are voted on can manipulate the voting process to yield nearly any end result they want – may be more serious. The crucial contribution is Richard D. McKelvey, *Intransitivities in Multidimensional Voting Models and Some Implications for Agenda Control*, 12 J. ECON. THEORY 472 (1976). See also Gary W. Cox & Kenneth A. Shepsle, *Majority Cycling and Agenda Manipulation: Richard McKelvey's Contributions and Legacy*, in POSITIVE CHANGES IN POLITICAL SCIENCE: THE LEGACY OF RICHARD D. MCKELVEY'S MOST INFLUENTIAL WRITINGS (John Aldrich & James E. Alt, eds., 2007); but see Keith T. Poole & R. Steven Daniels, *Ideology, Party, and Voting in the U.S. Congress, 1959–1980*, 79 AM. POL. SCI. REV. 373, 376 n.3 (1985) (noting xxx).

⁶² The median voter theorem — the theoretical prediction that a majority voting system will select the policy preferred by the median voter — works only with a number of very strong assumptions. Perhaps the strongest of these assumptions is that the policy options — and thus the voters' preferences — can be spread out along a 'one-dimensional' policy space: A line from, say, more spending to less spending, or liberal to conservative. [Cite.]

Indeed, this logic seems reflected in the gradual but continuing spread, over the last century, of the city manager system, under which members of the city council are chosen in nonpartisan at-large elections, and in turn hire a nonpartisan technocrat as city manager, much as in a business corporation. The same logic may help explain the secular decline of political parties in American municipal government.⁶³ The plurality voting system that is almost universally employed in American elections encourages the formation of two parties that bundle current issues along a single common dimension (such as left-right or progressive-conservative).⁶⁴ And such a severe reduction in the dimensionality of politics may be easier to accomplish at the national level, where politics takes on a relatively abstract character, than it is at the municipal level, where governmental services directly impact the lives of voters in concrete and perhaps quite disparate ways.

If, as just argued, adding further services to the tasks undertaken by a given GPG tends to diminish the potential for the formation of strong factions whose members all favor one subset of municipal services over another, that tendency seems likely to be strongest where no one service takes up a great deal more of the municipal budget than do other services, and hence becomes the dominant focus when residents are choosing how to vote in municipal elections. We suggest below that this is an important reason why primary and secondary education, which generally are by far the most costly services provided by local governments,⁶⁵ are often organized separately as SPGs rather than included among the services provided by GPGs.

Following the same reasoning, the addition of another service to those already being undertaken by a given GPG should – if that service is not in itself disproportionately important to the municipality’s electorate – reduce the average cost of collective decision-making across all of the GPG’s services. This continuing downward trend would provide a reason why, for a given territory at the municipal level, there is only one GPG even though there may be many SPGs.

Suppose, for example, that a given territory were to be served by two GPGs, the first of which provided 12 services to residents of the territory while the second provided an additional 18 services, all of which were different from the 12 provided by the first GPG. By the reasoning just offered, it would then follow that, by merging the two GPGs into a single GPG that provides all 30 services, the average costs of collective decision-making for those services as a group could be reduced. And if, as argued here, the costs of collective decision-making are quite high in democratic governments, this would explain in turn why economies of scope in the number of services provided would continue to grow as additional services were provided by a single GPG.

More precisely, the reasoning provided here suggests that – holding everything else constant – the per-service costs of collective decision-making increase rapidly as the number of services provided goes from 1 to 2, and perhaps beyond that to 3, 4, or even more. Those costs then reach a peak—say, for example, when the number of services is 4 – after which the per-service costs of collective decision-making decrease as further services are added to those that the government already provides, and continue to decrease, though perhaps only marginally, as the number of services increases. In short, if the costs of collective decision-making resulting

⁶³ See David Schleicher, *Why Is There No Partisan Competition in City Council Elections: The Role of Election Law*, 14 J. L. & POL. 419 (2007).

⁶⁴ [citation]

⁶⁵ [citation]

from governmental provision of an additional service would be minimized either by organizing it as a stand-alone SPG or by adding it to the multiple services already provided by the local GPG. Which of those two extremes is chosen for any given service will then depend upon the particular characteristics of the service involved, as discussed in the next section.

Considerations of collective choice may also lend perspective to one of the most frequently castigated features of SPGs: their low electoral turnout.⁶⁶ That low turnout (which, as illustrated by our three examples below, is by no means universal) may have their roots in apathy or ignorance, but our analysis suggests that less worrisome considerations may have greater explanatory power. If, owing to the low dimensionality of the issues presented by an SPG, voting produces a stable and predictable median voter result without much regard to the number of residents who vote, most voters can abstain from voting without fear that much is at stake, either for them or for the district as a whole.

B. Specialization and Coordination

Our discussion of the costs of aggregating preferences through voting offers reasons for the great empty divide between SPGs and GPGs. It remains to explain which services are provided by SPGs and which by GPGs -- or why all governmental services are not provided just by SPGs, or just by GPGs. Why are both of these polar approaches to governmental services often employed in the same locality?

One consideration may be the inherent multidimensionality of the service itself. Choices regarding the provision of irrigation water to a reasonably uniform agricultural zone may be relatively easy to reduce to a single dominant dimension, while provision of police services to a mid-sized city may not be.⁶⁷ For the latter type of service, an SPG may offer few advantages in comparison with a GPG, while presenting some relatively important disadvantages regarding the broad tradeoff between specialization and coordination.⁶⁸ While specialization has obvious

⁶⁶ See NANCY BURNS, *THE FORMATION OF AMERICAN LOCAL GOVERNMENTS: PRIVATE VALUES IN PUBLIC INSTITUTIONS* 12; see, e.g., *supra* text accompanying notes 28, 38. *But cf.* Elisabeth M. Currie, Ben Walter Honadle & Lawrence P. DeBoer, *Exploring the Growth of Special District Governments: Results of a Minnesota Survey*, 21 *HAMLIN J. PUB. L. & POL'Y* 67, 82 (1999) (noting that in a presidential election year forty-seven percent of Minnesota SPGs reported having turnout rates of between fifty and seventy-five percent).

⁶⁷ See Noah M. Kazis, *Special Districts, Sovereignty, and the Structure of Local Police Services*, 48 *URB. LAW.* 417, 418-19 (2016) (arguing that SPGs rarely provide police services because SPGs are mere "administrative appendages of the state," as opposed to municipalities which "share in the state's sovereignty" and therefore may legitimately employ the state's "monopoly on legitimate violence").

⁶⁸ This trade-off has been the focus of economic analysis for some time, particularly in the context of the business enterprise. See R.H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937); ALFRED D. CHANDLER, JR., *STRATEGY AND STRUCTURE: CHAPTERS IN THE HISTORY OF THE INDUSTRIAL ENTERPRISE* (1962); OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (1975); Gary S. Becker & Kevin M. Murphy, *The Division of Labor, Coordination Costs, and Knowledge*, 107 *Q.J. ECON.* 1137 (1992); see also Jacques Cremer, *A Partial Theory of the Optimal Organization of a Bureaucracy*, 11 *BELL J. ECON.* 683 (1980); Oliver Hart & John Moore, *On the Design of Hierarchies: Coordination Versus Specialization* (Nat'l Bureau of Econ. Research, Working Paper No. 7388, 1999). This literature focuses principally on business firms; there is little application to

benefits — the general benefits of comparative advantage — those benefits are constrained by the costs of coordinating between activities.⁶⁹ An urban police force, for example, may perform much more effectively if its services are closely coordinated with fire protection, family services, courts and jails, public transportation, schools, traffic control, road maintenance, public parks, and homeless shelters. In such circumstances, horizontal integration of policing with many or all of these other services into a single GPG under unified control may offer coordination economies that would be unavailable if the police were organized as a separate and autonomous SPG.

The tradeoff between specialization and coordination can also help explain when and why we see those rare two- and three-purpose governments. These districts often combine services with the same or similar final outputs: irrigation and wastewater management, for example, or water storage and water supply. These are services for which the specialized expertise of a single administrative coordinator — dealing, in all cases, with the provision of water and a network for delivering, removing, and storing it — may exceed in value the costs of having such a coordinator. But a district that pays the fixed cost of building an irrigation network, and develops expertise in water management, will have few coordination benefits to offer a district that runs a cemetery or removes trash. It should come as no surprise that we do not see such districts.

C. Legal Feedback

We have focused here on some strong practical considerations that seem to lie behind the stark division of local governments into either SPGs or GPGs. But those practical considerations are, in turn, both reflected in, and reinforced by, legal doctrine. The practical divide between SPGs and GPGs has facilitated the evolution of legal doctrine that treats those two forms of government quite differently. And the difference in legal regimes, in turn, has tended to further deepen the divide between the two types of government, providing further incentives that help guide the choice of form for any given service. The most important area where this occurs concerns voting rights, to which we turn next.

IV. VOTING RIGHTS

The Supreme Court has distinguished between local governments that must adhere to the constitutional rule of one-person-one-vote and those that do not through the “special-purpose district” exception.⁷⁰ This doctrine first emerged in *Salyer Land Company v. Tulare Lake Basin*

governments. See David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 Yale L.J. 955, 986-87 (2004) (“There is, to our knowledge, almost no formal literature on this topic.”).

⁶⁹ As put by David Weisbach and Jacob Nussim, *supra* note 68, at 986, “[t]oo much specialization means that coordination of the specialized activities becomes difficult.” Weisbach and Nussim give the simple example of pediatricians, who are in a sense specialized (they treat children and not adults), but who do not ordinarily specialize in particular childhood diseases. That additional specialization might have some benefits — the hyper-specialized pediatrician might be the most talented and in-demand expert on a particular illness — but would also have attendant costs for the medical field: the “greater expenses in coordinating their care with other pediatricians.” *Id.* At some point, coordination costs will outweigh specialization benefits.

⁷⁰ See Grant M. Hayden, *The False Promise of One Person, One Vote*, 102 MICH. L. REV. 213, 254 (2003).

Water Storage District, in which the Supreme Court upheld the constitutionality of a portion of the California Water Code that permitted only landowners — as opposed to all residents — to vote in elections for the board of directors of local water districts, and that allocated votes only to landowners on the basis of the assessed valuation of their land.⁷¹

A. Rationalizing an SPG Exception to One-Person-One-Vote

A decade earlier, in *Reynolds v. Sims*, the Court had held famously that the districts used for electing state legislatures had to be roughly equal in population: “[A]n individual’s right to vote for state legislators is unconstitutionally impaired,” the Court said, “when its weight is in a substantial fashion diluted when compared with votes of citizens living in other parts of the State.”⁷² Alabama, the state whose voters challenged the apportionment system in *Reynolds*, had districts with populations as much as fourteen times the population of others.

In subsequent cases, the Court extended the *Reynolds* rule to counties and other forms of local government.⁷³ But *Salyer Land* was the first time the Court considered a question that it had expressly reserved in these earlier cases: whether a special-purpose government that performed “functions affecting definable groups of constituents more than other constituents” could “be apportioned in ways which give greater influence to the citizens most affected by the organization’s functions”⁷⁴ — that is, whether such a district must conform to the rule of one-person-one-vote.

The *Salyer Land* Court held that the California Water Code did not violate the Equal Protection Clause. Justice Rehnquist’s majority opinion offered two reasons for this conclusion. The first was that the district had a “disproportionate effect” on landowners: “All of the costs of district projects are assessed against land by assessors in proportion to the benefits received.”⁷⁵ The second was that the district, while “vested with some typical governmental powers,” had “relatively limited authority”: “Its primary purpose, indeed the reason for its existence, is to provide for the acquisition, storage, and distribution of water for farming in the Tulare Lake Basin.”⁷⁶

As many scholars have observed, these two criteria — ‘disproportionate effect’ and ‘limited authority’ — leave much to be desired. In particular, as Richard Briffault has pointed out, the “disproportionate effect” standard, as formulated by the Court, can be circular. For example, a district that limits participation to landowners may still have a disproportionate effect on residents as *consumers*. The Court simply avoided engaging with this possibility by limiting the “effects” under consideration to the financial assessments levied to finance district activities. But this smuggles in the very conclusion that the “disproportionate effect” analysis is supposed to help determine — namely, whether such districts are best thought of as proprietary or more

⁷¹ *Salyer Land Co. v. Tulare Lake Basin Water Storage Dist.*, 410 U.S. 719, 725 (1973).

⁷² *Reynolds v. Sims*, 377 U.S. 533, 568 (1964).

⁷³ *Hadley v. Junior Coll. Dist. of Metro. Kansas City, Mo.*, 397 U.S. 50 (1970); *Avery v. Midland Cty., Tex.*, 390 U.S. 474 (1968).

⁷⁴ *Avery v. Midland Cnty., Tex.*, 390 U.S. 474, 483-84 (1968).

⁷⁵ *Salyer Land*, 410 U.S. at 729.

⁷⁶ *Id.* at 728.

fully democratic.⁷⁷ Intriguingly, Rehnquist's own opinion seemed to hint at this problem by noting that the effects of the district could extend far beyond its property-owning members: "food shoppers in far-away metropolitan areas are to some extent likewise 'affected' by the activities of the district."⁷⁸ It was perhaps the apparent hopelessness of such an analysis — more than the analytical power of the Court's own attempt at a "disproportionate effect" distinction — that seemed to dictate the result. And, though the Court's opinion does not acknowledge the point directly, its decision was presumably guided in substantial part by the realization that, if the rule of one-person-one-vote were imposed upon the district in question, it would have to abandon the water services it was formed to provide -- services that, for all the Court says, were conspicuously fair and efficient overall.

As it is, the Court's "limited purpose" rationale seems to perform the primary analytical work in its opinion. In applying such a standard, however, any court would seem to face an intractable line-drawing problem: There is, as Briffault points out, "no natural or functional distinction" between general welfare services — the provision of which would require one-person-one-vote — and, say, water services.⁷⁹ The line between limited and general is, as Briffault observes, difficult to draw.⁸⁰

And yet we have lived with the *Salyer* standard for more than forty years. How? The key reason, we believe, is that the sharp divide in fact between single-purpose governments and general-purpose governments has allowed the law to function with a vague standard like "limited purpose" without creating ambiguity with respect to the treatment of any given organization. Even if no principled distinction can be drawn between services that are "limited" and those that are "not limited," courts are in practice rarely faced with the need to apply that distinction in a conceptually coherent fashion. The fact that the majority of local governments have only one purpose effectively provides those governments with a safe harbor against the application of *Reynolds'* rule of one-person-one-vote.⁸¹ Other than school districts (which we discuss later), we know of no single-purpose districts that have been held subject to the rule of *Reynolds*. Whether or not *Salyer* intended this result, modern law has tracked the strong distinction in practice between single-purpose and general-purpose governments — and, in turn, has provided

⁷⁷ Richard Briffault, *Who Rules At Home?: One Person / One Vote and Local Governments*, 60 U. CHI. L. REV. 339, 371 (1993).

⁷⁸ *Salyer Land*, 410 U.S. at 730-31.

⁷⁹ Briffault, *supra* note 77, at 375.

⁸⁰ *See id.* at 343.

⁸¹ This test — in its modern incarnation, sometimes framed as a question of whether the entity exercises "general governmental powers" — has been developed in the lower courts. *See, e.g., Day v. Robinwood W. Cmty. Improvement Dist.*, 693 F. Supp. 2d 996, 1004 (E.D. Mo. 2010) ("It does not matter that the organization of the District's governing body more closely resembles that of a corporation than the traditional municipal government model; as the Supreme Court stated in *Hadley*, the relevant question is whether the elected official will exercise "general governmental powers" over a specific area, and that is certainly the case here."); *Cunningham v. Municipality of Metro. Seattle*, 751 F. Supp. 885, 889 (W.D. Wash. 1990) (striking down limited vote where the local government had general powers, and noting that "[t]he broad purpose of [the district in question], according to the statute, is to 'provide for the people . . . the means of obtaining essential services not adequately provided by existing agencies of local government.'"); *Chesser v. Buchanan*, 568 P.2d 39, 41 (Colo. 1977) (upholding limited vote in a tunnel district).

an incentive for districts to steer clear of the doctrinally uncertain territory between the two poles, thus reinforcing the distinction between them.

This is not to say that there are no hard cases. But the hardest cases are not ones in which a court must decide whether providing water is fundamentally different from providing fire protection. Rather, the hardest cases involve the rare instances in which a district provides more than one distinct service but does not – in contrast to a typical municipality -- provide a numerous and open-ended set of largely unrelated services. This is precisely what made the Court’s second major brush with special-district voting — the case of *Ball v. James*⁸²— a narrowly decided and unsatisfying decision.

B. A Problematic Extension of the Exception

The special district at issue in *Ball* (the “District”), like that in *Salyer*, was originally organized to provide water for irrigation to farms within its boundaries, and to this end to provide and maintain the necessary facilities for water storage, delivery, and conservation. Assessments to pay for the District’s operations, and votes for the District’s management, were – also as in *Salyer* – confined to persons owning land located within the District (indeed, confined to persons owning at least one acre of land⁸³), but unlike in *Salyer* were apportioned among those landowners according to the number of acres owned.

The District at issue in *Ball*, however, unlike that in *Salyer*, subsequently expanded the services it provided to include the distribution of electricity. The primary motivation for this expansion was not that combining irrigation and electricity distribution offered economies of scope that could reduce the cost of both services if they were managed jointly. (That is, the two services could not, in the circumstances involved, be considered so interdependent as to constitute, in effect, two different aspects of a larger single activity.) Rather, the motivation for combining the two services was simply and expressly to use profits from the electricity business to help cover the cost of the District’s irrigation activities.

In fact, the District in *Ball* was just like the hypothetical electricity and irrigation district that we discussed above in Section III.A, in which the farmers who consume the irrigation water use their voting control over the organization to set prices for water and for electricity that result in a subsidy from the consumers of electricity to the consumers of irrigation water. Indeed, the District in *Ball* is a particularly egregious instance of the problems illustrated by that hypothetical. Although the Court characterized the electricity operation as “incidental” to the agricultural irrigation operations of the District,⁸⁴ nearly all – 98% -- of the District’s aggregate revenue came from charges for electricity.⁸⁵ In fact, the District encompassed, and provided electricity to, nearly half the population of the state of Arizona, including the entire city of

⁸² 451 U.S. 355 (1981).

⁸³ *Id.* at 359-60. After the District Court’s ruling in *Ball*, the Arizona legislature altered the relevant statute to entitle landowners owning less than one acre to fractional votes. *See James v. Ball*, 613 F.2d 180, 181 nn.2-3 (9th Cir. 1979). There is no indication in the Supreme Court’s opinion, however, that the Court considered this change important for its decision. *See Ball*, 451 U.S. at 359 n.2. Nor is there reason why it should be. The basic conflict in the case is not between small and large farmers, but between farmers in general and urban residents.

⁸⁴ *Ball*, 451 U.S. at 369.

⁸⁵ *Id.* at 370 n.19.

Phoenix – all without allocating any votes in the District’s operations on the basis of electricity usage. Nevertheless, the Court, in a 5-4 decision that provoked a strong dissenting opinion from the minority, held that the District’s voting scheme was consistent with the principle of one-person-one-vote and hence constitutional.⁸⁶

Paradoxically, the Court’s opinion in *Ball* makes the cross-subsidy an argument *in favor of* allocating votes only according to owned acreage.⁸⁷ In so doing, the Court turns the rationale for governmental ownership precisely on its head. The reason for governmental provision of electricity should be to avoid monopolistic exploitation of consumers, not to make it easier. As we noted above, the provision of electricity in the United States is typically undertaken through one of four organizational forms: a privately-owned company subject to governmental rate regulation; a consumer cooperative; an SPG whose voting members are consumers of electricity produced; or a GPG. All of these forms are designed to avoid monopolistic exploitation of electricity consumers. The two-purpose District in *Ball*, in contrast, was designed without any such protection for consumers. It was not owned or otherwise controlled by its consumers, and, evidently under the theory that the District was governmental, charges for its electricity services were exempted from public rate regulation.⁸⁸ Indeed, the organizational form of the District was chosen expressly for the *purpose* of exploiting electricity consumers, effectively taxing them to subsidize consumers of irrigation water.

⁸⁶ Although not widely discussed in the literature, *Ball v. James* received a generally unfavorable reception. See, e.g., Lisa M. Card, *One Person, No Vote? A Participatory Analysis of Voting Rights in Special Purpose Districts*, 27 T. JEFFERSON L. REV. 57, 60 (2004) (objecting to the outcome in *Ball* and arguing that SPGs are “essential forums for participation”); Melvyn R. Durchslag, Salyer, *Ball*, and *Holt: Reappraising the Right To Vote in Terms of Political “Interest” and Vote Dilution*, 33 CASE W. L. REV. 1, 48 (1982) (arguing that the Court in *Ball* was wrong to focus on the distinction between “governmental” and “nongovernmental” organizations, and should have inquired into the difference in interests between voting and nonvoting members of the district); Frank I. Michelman, *Conceptions of Democracy in American Constitutional Argument: Voting Rights*, 41 FLA. L. REV. 443, 468 (1989) (disagreeing with the Court’s conclusion that the district in *Ball* was non-governmental); *The Supreme Court, 1980 Term-- Voting in Special Purpose Districts: Ball v. James*, 95 HARV. L. REV. 181, 190 (1981) (objecting to *Ball* on participatory grounds and arguing that voting is valuable because it “gives individuals the opportunity to participate in and influence the process by which [] outcomes are determined”); Michael E. Tabor, Note, *From One Person, One Vote to One Acre, One Vote—Another Retrenchment of the Right to Vote in Special District Elections—Ball v. James*, 31 DEPAUL L. REV. 177, 191, 196, 198 (1981) (disagreeing with *Ball* on legal and participatory grounds, and suggesting that SPG voting schemes should receive “intermediate scrutiny”). But see William H. Riker, *Democracy and Representation: A Reconciliation of Ball v. James and Reynolds v. Sims*, 1 SUP. CT. ECON. REV. 39 (1982) (supporting the decision on participatory grounds and arguing that the difference between governmental and nongovernmental organizations is that one person-one vote affects the policies of the latter, but not the former); Karen Malm Weaver, *Constitutional Law—Fourteenth Amendment—Equal Protection—Ball v. James*, 31 EMORY L.J. 201 (1982) (disagreeing with the Court’s formal distinctions in *Ball*, but agreeing that *Reynolds* voting “need not permeate every level of state government”); Jeffrey L. Snyder, Note, *Ball v. James and the Rational Basis Test: An Exception to the One Person-One Vote Rule*, 31 AM. U. L. REV. 721, 746, 752 (1982) (agreeing with the Court and suggesting that federalism values underlay the decision).

⁸⁷ *Ball*, 451 U.S. at 369.

⁸⁸ See *id.* at 379 (White, J., dissenting).

In fact, the District in *Ball* raised very much the same problem as did the voting districts at issue in *Reynolds* and its immediate progeny in the early one-person-one-vote line of cases – namely, the increasing empowerment, in state government, of rural voters relative to urban voters through the effect of urbanization on pre-existing allocations of voting rights. The District in *Ball* was originally formed in the late 19th century when the territory it encompassed was largely rural. Only with the subsequent growth of Phoenix did the District become overwhelmingly urban.⁸⁹

The Supreme Court’s majority opinion in *Ball* essentially treats the issue involved as a choice between, on one hand, the District’s current voting rule, with votes allocated according to land ownership, and, on the other hand, a rule of one-person-one-vote for all residents of the District. But the latter rule would simply create the reverse problem, giving voting control over the District to urban residents and hence empowering them to set rate structures for electricity and irrigation water that would exploit the District’s rural residents. In fact, as discussed above,⁹⁰ there exists no administrable voting rule that would yield fair and efficient decisions in a two-purpose district like that in *Ball*. Rather, redesign of the organization would be required. The most obvious approach would be to separate electricity distribution and the supply of irrigation water into two separate and independent districts, with voting rights in each allocated according to consumption of their respective services. Such a reorganization, with its consequent removal of the cross-subsidy, might force reduction or elimination of the supply of irrigation water. But, if so, that would in fact be an advantage of the reorganization. It is neither fair nor efficient to tax urban residents for the sake of maintaining water services whose value is below their cost.

To conclude that *Ball v. James* is wrongly decided does not require that all avoidable cross-subsidies in the provision of governmental services need be considered contrary to the general welfare, much less unconstitutional. School districts provide an example that we discuss below. But, as the dissenting opinion in *Ball* emphasizes,⁹¹ voting arrangements that facilitate such cross-subsidies should require some showing of a compelling state interest if they are to be consistent with the principles supporting the jurisprudence of one-person-one-vote.

V. HISTORICAL EVOLUTION

The preceding discussion explored some of the functional explanations for the modern divide between single- and general-purpose governments. This Part turns to history: where, when, and why did SPGs emerge? We make three basic points. First, the modern SPG shares a nineteenth-century heritage similar to that of other modern corporate forms. Second, the immediate impetus for the modern SPG was an assortment of property and governance problems in the American West — problems that other private or public organizational vehicles were not well adapted to solve. Third, since the late nineteenth century, SPGs have evolved in ways that broadly resemble the evolution of other types of incorporated entities. Most notably, the statutes that govern SPGs exhibit increasing breadth, flexibility, and uniformity.

A. Types of Corporations in Early America

⁸⁹ See *James v. Ball*, 613 F.2d at 183

⁹⁰ See discussion *supra* Section III.F.

⁹¹ *Ball*, 451 U.S. at 379-80 (White, J., dissenting).

At the time of American independence, Anglo-American law did not differentiate clearly among the structures and purposes of individual corporations. The term “corporation” was used broadly to refer to business (joint stock) corporations, guilds, eleemosynary (charitable) corporations, mutual corporations, cooperative corporations, and municipal corporations. One important reason for this was that the government – generally the state legislature, through private acts -- granted charters on an individual basis, which left both the government and the incorporating parties substantial freedom to tailor the organization’s charter.

During the course of the nineteenth century, the number of corporations in the United States swelled enormously, and corporations began to be categorized into distinct types, with each type governed by a separate state-level statute.⁹² This development occurred first for business corporations early in the nineteenth century. Then, beginning later in the 19th century, additional corporation statutes were adopted to enable the formation of, and to regulate, respectively, mutual corporations, cooperative corporations, nonprofit corporations, and municipal corporations.⁹³

General enabling statutes for incorporating special-purpose governments, however, were not adopted in the 19th century. This is in some respects surprising. At least until the mid-nineteenth century, incorporation for what we now think of as *business* (investor-owned and profit-seeking) purposes was not the norm, even when a corporation was formed as a joint-stock company.⁹⁴ Of the corporate charters granted in America between 1781 and 1800, more than 75 percent were for public infrastructure projects like canals, bridges, turnpikes, and docks.⁹⁵ Many corporate charters contained an explicit charge to serve the public, and it was commonly accepted that the state often conferred special charters not for the private benefit of businessmen but to “further the general welfare.”⁹⁶ Indeed, the same pattern characterizes the incorporation boom in to the first half of the 19th century, when roughly one third of the (still numerically

⁹² See Henry Hansmann & Mariana Pargendler, *The Evolution of Shareholder Voting Rights: Separation of Ownership and Consumption*, 123 YALE L.J. 948, 957-85 (2014) (describing this history).

⁹³ The first major general incorporation act was the New York Act of 1811, which provided for incorporation as of right for certain manufacturing industries. 1811 N.Y. Laws 151; see also Henry N. Butler, *Nineteenth-Century Jurisdictional Competition in the Granting of Corporate Privileges*, 14 J. Legal Stud. 129, 143-46 (1985) (discussing the development of general incorporation laws for businesses in the mid-19th century). The first general incorporation act for cooperatives was enacted by Michigan in 1865, and by 1912 eleven states had similar laws. Kimberly A. Zeuli & Robert Cropp, *Chapter 3: Cooperative History, Trends, and Laws in the United States*, in COOPERATIVES: PRINCIPLES AND PRACTICES IN THE 21ST CENTURY 15-26, 17 (4th ed. 2004), <http://www.learningstore.uwex.edu/pdf/A1457.pdf>. The first mutual general incorporation law was enacted by Maryland in 1843. SEYMOUR DEXTER, A TREATISE ON CO-OPERATIVE SAVINGS AND LOAN ASSOCIATIONS 65 (1891). The first nonprofit general incorporation acts were enacted far earlier, in the late 1700s. James J. Fishman, *The Development of Nonprofit Corporation Law and an Agenda for Reform*, 34 EMORY L.J. 617, 632 (1985).

⁹⁴ See David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 207 (1990).

⁹⁵ See P. M. Vasudev, *Corporate Law and Its Efficiency: A Review of History*, 50 AM. J. LEGAL HIST. 237, 243 (2010).

⁹⁶ See Millon, *supra* note 94.

dominant) legislatively chartered joint stock companies were formed to undertake activities, like roadbuilding, that would today be undertaken by government.⁹⁷

These kinds of corporations — turnpikes, bridges, canals, and the like — were essentially special-purpose governments formed on a voluntary rather than a compulsory basis.⁹⁸ Their members (shareholders) usually consisted of their consumers. To take a typical example, the state legislature would — at the request of a group of citizens from the communities involved — pass a special statute creating, and setting forth the charter of, a joint stock company whose purpose was to build and operate a turnpike connecting two towns. Shares of stock in the corporation would be sold to persons who stood to benefit from the turnpike, such as farmers along its route and merchants in the towns it connected. The shares were not purchased as a means of earning a profit. Rather, shareholders understood from the beginning that — though the company had the right to charge tolls for the use of its turnpike — those tolls would never be set high enough to make a profit, much less the monopoly profit that the turnpike could potentially obtain. Shares were purchased, not for dividends, but as a means of making an essentially voluntary contribution to help cover the fixed costs of a service that, in the hands of profit-seeking investors, would face the local community as a monopoly. In keeping with this understanding, the charters of these companies commonly provided for capped or regressive shareholder voting that radically limited the number of votes that could be obtained by buying additional stock, and effectively prevented any individual, or small group of individuals, from obtaining control of the company. The result was to assure that the majority of votes would remain in the hands of local residents who held few shares and stood to benefit more from low tolls than from high dividends.⁹⁹

In short, through the middle of the 19th century the majority of corporate charters granted by state legislatures were for the formation of joint stock companies that were not intended to operate as profit-seeking business firms, as are modern joint stock (“business”) corporations, but rather were intended to be consumer-controlled (as in a modern cooperative corporation) with initial capital in large part donated (as in a modern nonprofit corporation), all for the sake of building public infrastructure of an inherently monopolistic character (like those provided by a modern municipal corporation).

Given this extensive experience with corporations that were in effect SPGs, why were the states so slow in enacting general enabling statutes for the formation of SPGs, thereby achieving a closer match of form and function and solving the collective action problem without reliance on financing through what were effectively donations? The most plausible answer is rooted in a change in the scope of American local government over the course of the 19th century. In the early decades of the Republic — from its founding to the middle of the 19th century — local

⁹⁷ JAMES WILLARD HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970* 17 (1970); William C. Kessler, *Incorporation in New England: A Statistical Study, 1800-1875*, 8 *J. Econ. Hist.* 43, 47 (1948) (finding that thirty-six percent of specially-chartered companies in New England from 1800-1843 were “public utilities”).

⁹⁸ See Hansmann & Pargendler, *supra* note 92.

⁹⁹ See Hansmann & Pargendler, *supra* note 92.

government was slow to develop and act. The reasons have not been well explored, but seem to include difficulty in reconciling conflicting local interests.¹⁰⁰

The second half of the 19th century then brought a “municipal explosion,” with a rapid expansion of general-purpose local governments.¹⁰¹ The result is that the types of public infrastructure provided in the first half of the 19th century by legislatively chartered joint stock companies were, in the latter half of the century, generally undertaken by the rapidly developing network of GPGs at the state, county, municipal, and township levels. (The distinction between municipalities and townships, where it exists at all, is vague and varies from state to state. From this point on, therefore, we will use the term “municipality” to comprise townships as well.)

By 1875, almost every state in the U.S. had an enabling law for business corporations. Most of the statutes, however, did not provide for formation of the types of organizations that we would now characterize as SPGs.¹⁰² Throughout the nineteenth century, special charters continued to serve as the principal means for creating the latter organizations.¹⁰³

B. The Birth of SPG Incorporation Statutes

Indeed, the first statutes enabling the formation of SPGs were not enacted in the Eastern states, despite those states’ extensive experience with “voluntary” SPGs nominally formed as joint stock corporations. Rather, the first general incorporation statutes for any type of special district appeared, in the latter part of the 19th century, in the American West. These early statutes focused on the formation of SPGs to serve the water needs of the rapidly expanding frontier population, including irrigation, drainage, and flood control. In contrast to the East, where plentiful rainfall made irrigation largely unnecessary, and where the common law of water rights adopted from England was well-suited to the terrain, the West often required water management that covered extensive territory, required large-scale investments, and involved substantial – and contentious – rearrangement of property rights.¹⁰⁴

¹⁰⁰ See, e.g., ERNEST S. GRIFFITH, *HISTORY OF AMERICAN CITY GOVERNMENT: THE COLONIAL PERIOD* 259-61 (1938) (explaining that as communities grew, they faced tension between retaining local, individualized control, and accepting the efficiencies accorded by incorporated city governments); Seth Low, *An American View of Municipal Government in the United States*, in 1 JAMES BRYCE, *THE AMERICAN COMMONWEALTH* 589-91 (Liberty Press 1995) (3d ed. 1914) (describing the pressure to transition to incorporated municipalities in terms of the financial flexibility the corporate form provided).

¹⁰¹ JON C. TEAFORD, *THE MUNICIPAL REVOLUTION IN AMERICA* (1975).

¹⁰² See Susan Pace Hamill, *From Special Privilege to General Utility: A Continuation of Willard Hurst’s Study of Corporations*, 49 AM. U. L. REV. 81, 1016 (1999).

¹⁰³ See *id.* at 88.

¹⁰⁴ See ELLEN HANAK ET AL., *MANAGING CALIFORNIA’S WATER: FROM CONFLICT TO RECONCILIATION* 26 (2011), http://www.ppic.org/content/pubs/report/R_211EHR.pdf; Richard H. Peterson, *The Failure to Reclaim: California State Swamp Land Policy and the Sacramento Valley, 1850-1866*, 56 S. CAL. Q. 45, 45 (1974). As the U.S. Supreme Court noted in an early decision upholding special-district control over water use, “climatic conditions in some sections so differ from those in others that the doctrine of the common law may be of advantage in one instance, and entirely unsuited to conditions in another.” Justice Sutherland went on to hypothesize that “this diversity of conditions . . . gave rise to more or less confusion” in common-law decisions on resource rights. *Cal. Or. Power Co. v. Beaver Portland Cement Co.*, 295 U.S. 142, 153 (1935).

The California legislature responded to these needs in 1868 with a statute that “allowed landowners to join together and levy property assessments to fund construction of land reclamation and flood control projects.”¹⁰⁵ This statute — which we believe to be the first general incorporation statute for special districts in the United States — brought the formation of hundreds of reclamation districts in California.¹⁰⁶ That success led in turn to the enactment, in 1887, of California’s prominent and influential Wright Act, which permitted the formation of irrigation districts with, among other powers, the authority to exercise the right of eminent domain¹⁰⁷ and the ability to finance projects by selling bonds.¹⁰⁸

C. From Local to National, and Specific to General

The Wright Act was conspicuously successful in spurring the construction of new irrigation networks,¹⁰⁹ and other states and territories soon began to follow California’s lead.¹¹⁰ In Washington territory (soon to be Washington state), for example, 1888 legislation authorized the construction of dikes to benefit farmers in Skagit County. In 1889, the first legislature of the new state of Washington passed legislation that took the idea of special purpose governments beyond water control, allowing the formation of road districts as well.¹¹¹

Yet more types of SPG soon followed. California continued to be a trendsetter: In 1899, it passed a statute governing the creation and management of sewer districts.¹¹² Illinois — which today has the largest absolute number of special districts in the country¹¹³ — was also an early adopter of such statutes, passing a law allowing for the formation of water districts in 1899 and sanitary districts in 1907.¹¹⁴ Early sanitary districts — responding to the sanitation pressures of

¹⁰⁵ HANAK ET AL., *supra* note 104, at 25.

¹⁰⁶ *Id.* It is possible that earlier regulations allowed for the decentralized formation of districts in Utah Territory (not yet a state) in 1865. *See* DONALD WORSTER, *RIVERS OF EMPIRE* 79 (1985). Relatively little is known about this effort.

¹⁰⁷ MICHAEL DI LEO & ELEANOR SMITH, *TWO CALIFORNIAS: THE MYTHS AND REALITIES OF A STATE DIVIDED AGAINST ITSELF* 117 (1983).

¹⁰⁸ *See* California Senate Local Government Committee, *What’s So Special About Special Districts? A Citizen’s Guide to Special Districts in California* 4 (4th ed. 2010), [http://clerk.calaverasgov.us/Portals/clerk/Docs/Elections/WHATS_SO_SPECIAL_](http://clerk.calaverasgov.us/Portals/clerk/Docs/Elections/WHATS_SO_SPECIAL_ABOUT_SPECIAL_DISTRICTS.pdf)

[ABOUT_SPECIAL_DISTRICTS.pdf](http://www.waterplan.water.ca.gov/docs/cwpu2005/vol4/vol4-background-californiawaterchronology.pdf); *see also* Water Education Foundation, *A California Water Chronology*, <http://www.waterplan.water.ca.gov/docs/cwpu2005/vol4/vol4-background-californiawaterchronology.pdf>.

¹⁰⁹ Wells A. Hutchins, *Irrigation Districts: Their Organization, Operation and Financing*, U.S. DEPT. OF AGRICULTURE, TECHNICAL BULL. NO. 254 at 12 (1931) (“The original purpose of the irrigation district was the construction of irrigation works. Although the Wright Act gave the alternative power of purchasing irrigation systems, nevertheless it was the need for new development that results during the first few years in the formation of districts predominantly for the construction of new works.”).

¹¹⁰ *See* Henley, *supra* note **Error! Bookmark not defined.**, at 380 (“The legislation did not lack the tribute of emulation. Sixteen other western states have enacted irrigation district laws closely modeled upon the Wright Act.”).

¹¹¹ Municipal Research and Services Center of Washington, *Special Purpose Districts in Washington State* 5 (2003), <http://www.mrsc.org/publications/spd.pdf>.

¹¹² *See* CENSUS, *supra* note 5, at 30.

¹¹³ *See id.*

¹¹⁴ *See id.* at 86, 89.

urbanization in the early twentieth century — cropped up elsewhere; Tennessee passed one of the first such statutes in 1901.¹¹⁵ That same year, New Hampshire passed a statute allowing for the creation of “Village Districts.”¹¹⁶ (To the best of our knowledge this was the first example of a single statute that enabled the incorporation of SPGs providing any of several different types of service.) By the early 1930s, well over half the states had statutes providing for the creation of at least one type of special district.¹¹⁷

The states created still more incorporation statutes in the middle of the twentieth century, when the rise of the suburbs — fueled by advances in communication and transportation — shifted some service provision away from urban population centers.¹¹⁸ The ex-urbanites and new suburbanites continued to demand urban-level services outside the city, which led to new laws and new districts. While these new suburban communities could have incorporated new general-purpose governments, or have been annexed by existing ones, many opted instead for services from special-purpose governments.¹¹⁹

As the number and type of these special districts proliferated rapidly, many of these new mid-century statutes — like the early New Hampshire statute mentioned above — stopped limiting their reach to one particular type of service. In 1935, for instance, Alabama passed a statute that allowed for the formation — with a uniform set of standard procedures — of districts that offered “water, sewerage, telephone, gas or electric heat, light, or power services, commodities or facilities.”¹²⁰ In 1937, Tennessee passed a statute that covered “utility districts,” a category that could include “water service, sewer, garbage collection and disposal, street lighting, parks and recreational facilities, gas supply, fire and police protection, transit, transmission of industrial chemicals or natural gas by pipeline, and community antenna television facilities, or combinations.”¹²¹ And in 1947, Vermont expanded its definition of “fire districts” (governed by an earlier limited statute) to include “sewers and sewage treatment works; sidewalks; public parks; water works, water companies and all equipment and real estate used in connection therewith including reservoirs and dams; and for lighting purposes” — all of which would be made available “as the fire district may vote.”¹²² Other states followed suit.¹²³

¹¹⁵ TENN. CODE ANN. § 7-81-101 (West).

¹¹⁶ N.H. REV. STAT. § 52:1.

¹¹⁷ This is based on the authors’ count.

¹¹⁸ See KATHRYN A. FOSTER, *THE POLITICAL ECONOMY OF SPECIAL-PURPOSE GOVERNMENT* 15 (1997).

¹¹⁹ See *id.* at 16.

¹²⁰ ALA. CODE § 39-7-1 (1935).

¹²¹ See Utility District Act of 1937, T.C.A. § 7-82-101.

¹²² 20 VT. STAT. ANN. § 2601 (West)

¹²³ See, e.g., NEB. REV. STAT. § 31-727 (1949) (“A majority of the owners . . . may form a sanitary and improvement district for the purposes of installing electric service lines and conduits, a sewer system, a water system, an emergency management warning system, a system of sidewalks, public roads, streets, and highways, public waterways, docks, or wharfs, and related appurtenances, contracting for water for fire protection and for resale to residents of the district, contracting for police protection and security services, contracting for access to the facilities and use of the services of the library system of one or more neighboring cities or villages, and contracting for gas and for electricity for street lighting for the public streets and highways within such proposed district, constructing and contracting for the construction of dikes and levees for flood protection for the district, and acquiring, improving, and

The history of special-purpose governments has, in fact, been a story of relaxing constraints — from statutes that provide for only a single narrow type of service to more general statutes that enable the formation of SPGs providing any of a broad range of services.¹²⁴ Today, almost half of all states have special district incorporation statutes that cut across service types.¹²⁵ These states, notably, do not include many of the earliest enthusiastic adopters — like California and Illinois — which have no such general statutes. This suggests that reliance on the original patchwork approach, with a special statute for each type of SPG, may be largely a product of path dependence, in which early innovation reduces the incentive to adopt a newer and more efficient approach later on.

Indeed, even the most general of the state enabling statutes for SPGs embody restrictions on the purposes for which SPGs can be formed, or impose different organizational and operational requirements on SPGs according to the purposes they serve, or give to a state official or agency discretion to deny incorporation to individual special districts. In these important respects they differ from modern statutes governing the formation of business corporations, as well as modern statutes governing cooperative corporations¹²⁶ and nonprofit corporations.¹²⁷ This leads us to ask whether further rationalization of the law of SPGs is called for, providing greater generality, uniformity, and/or liberality in its treatment of this rapidly growing class of organizations.

To gain a clearer sense of what might be involved, we sketch out below the basic elements of a single general statute, to be enacted at the state level, that provides for the formation of a democratic SPG for any lawful purpose, as of right and without need for prior approval by agents of the state. Before setting out the provisions of that statute, however, we discuss several potential objections to the analysis we have offered so far.

operating public parks, playgrounds, and recreational facilities.”); UTAH CODE ANN. § 17B-1-202 (1957) (West) (outlining more than twenty different service types that can be formed).

¹²⁴ See, e.g., Henley, *supra* note **Error! Bookmark not defined.**, at 377-78 (“A chronological survey of general district acts shows a definite movement from narrow to wide declarations of purpose. So in 1868, when reclamation districts were first authorized, they were permitted the single function of reducing swamps and tidelands to use. . . . It was not until 1921, with the passage of the Municipal Utility District Act and the Public Utility District Act that use was made of a public agency, not incorporated as a city, which could nevertheless perform a wide variety of services for its inhabitants.”)

¹²⁵ This is based on the authors’ count.

¹²⁶ See, e.g., CAL. CORP. CODE § 12201 (West 2016) (“Subject to any other provision of law of this state applying to the particular class of corporation or line of activity, a [cooperative] corporation may be formed . . . for any lawful purpose provided that it shall be organized and shall conduct its business primarily for the mutual benefit of its members as patrons of the corporation.”); N.D. CENT. CODE ANN. § 10-15-02 (West 2017) (“Cooperatives may be organized under this chapter for any lawful purpose except banking and insurance.”); N.Y. COOP. CORP. LAW § 14 (McKinney 2016) (endowing cooperatives with various general powers).

¹²⁷ See, e.g., N.J. STAT. ANN. § 15A:2-1 (West 2017) (“A [nonprofit] corporation may be organized under this act for any lawful purpose other than for pecuniary profit.”); 15 PA. CONS. STAT. § 5301 (West 2017) (allowing the formation of nonprofits for “any lawful purpose” except insurance and reinsurance).

VI. IS THERE REALLY A GAP BETWEEN SPGs AND GPGs?

We have argued that practical organizational exigencies have led to a sharp division in the forms taken by local government, with single-purpose governments on one side of that divide and general-purpose governments on the other. This division, we have suggested, both requires and permits a body of organizational law for SPGs that is distinct from the law governing GPGs, without regard to the particular services provided by the two types of government. There are, however, several types of local government that may appear to be a poor fit for these claims. We address them here, as exceptions that prove the rule.

A. Misleading “Multi-Purpose” Districts

The Census of Governments data presented in Table 2 indicate that 14% of non-school special districts pursue “multiple functions.” Though that fraction is itself small, it appears to overstate substantially the number of special districts that provide more than a single service. Census personnel tell us that, in fact, most “multipurpose” districts are sewer and water districts¹²⁸, which could appropriately be characterized as a single service (water delivery and disposal). Demand for the two components of that service are likely to be highly correlated for individual members of a district, as are the costs of providing those services. This means that, for practical purposes, there is only one dimension to the combined services, and thus they can be provided by a single district without creating additional conflicts of interest among the members of that district (unlike, conspicuously, the combination of electricity supply with the supply of irrigation water).

B. Community Development Districts

This is not to say that there are no special districts that truly provide multiple services and that appear to be viable notwithstanding. The most important, arguably, are the residential community development districts that evidently account for the bulk of the districts classified in Table 2 as serving “Other” functions.¹²⁹ These organizations are common ownership communities similar to condominiums and homeowner associations. Typically, all homeowners whose property lies within designated boundaries are members of an association, which is a legal entity that is governed by a board of directors elected by the homeowners. The association maintains, regulates, and may own property that is used in common by the members, and may also regulate the members’ use of their private property. Costs incurred by the association are commonly covered by assessments on the homeowners that are proportional to the value of the homeowner’s property, and voting rights are proportional to assessments. The association typically has the statutory authority – which it uses – to pursue simultaneously a variety of clearly distinct functions. For example, the 1980 Florida statute provides that a community development district can provide all – but *only* – the following services and facilities:¹³⁰

Water management and control

Water supply, sewerage, and wastewater management

Bridges and culverts

¹²⁸ Telephone Interview with Matthew P. Clarke, [XXX], Census Bureau (Oct. 8, 2006).

¹²⁹ *Id.*

¹³⁰ FLA. STAT. § 190.012 (West 2017).

- District roads and street lights
- Public transportation and parking
- Investigation and remediation of environmental contamination
- Conservation areas, parks and recreational facilities
- Fire prevention and control
- School buildings and related structures
- Security, but not the exercise of any police power
- Waste collection & disposal
- Mosquito control

Such a development district might seem directly in conflict with our assertion that, owing principally to governance costs, one generally does not – and should not expect to – see limited-purpose governments providing more than a single service. But development districts differ markedly from most other forms of local government in their process of formation. The typical development district is created by a single property developer who initially owns all of the property within the district. The developer builds the district’s housing and other amenities – roads, parks, and even schools – while maintaining sole control over the property. The development is generally planned from the beginning to appeal to a highly homogeneous class of homeowners. And everybody who becomes a homeowner in the district does so by affirmative choice, knowing what the entire community will be like. Indeed, the powers given to the homeowners’ association are commonly intended to provide reassurance to the purchasers of homes that they will be in a position – via their voting control over the association -- to assure that the community will remain highly homogeneous.

In effect, development districts deal with the costs of collective decision-making, not just by homogenizing the characteristics of the facilities and services that they offer, but also by constructing an electorate with homogeneous preferences. This approach is feasible, however, only for governments that are formed before there are any residents of the associated territory – which is to say that are formed in the manner that a business corporation or a cooperative is formed.

C. Business Improvement Districts

Another potential exception to the sharp distinction between SPGs and GPGs is presented by business improvement districts (BIDs), which have become popular in large cities in recent decades. BIDs commonly supplement municipal services, often with the goal of keeping designated sections of the city’s commercial sector safe and attractive (by, for example, deploying guards, picking up litter, removing graffiti, and regulating signage).

Like SPGs, BIDs are limited-purpose organizations that do not have general legislative or governmental powers. But, like general-purpose governments, BIDs often provide several different services simultaneously, many of which are traditional municipal services that are also sometimes provided by individual SPGs, like installing street lighting and collecting trash.

For several reasons, however, BIDs are not as distinctive from other SBGs as they might initially appear. First, the number of services actually provided by the representative BID is a

matter of characterization. Those services are often complementary, and the benefits of the services that the BIDs provide often seem to be similarly distributed. According to one study, the sole service that most BIDs provided was marketing, and half of BID managers (according to the same survey) saw that as their primary role. Lobbying and policy advocacy are also relatively common BID purposes. Viewed in this light, many of the other services commonly provided by BIDs — such as street-cleaning, security, garbage collection, and graffiti removal — have a similar character. Broadly viewed, these services are all designed to improve public relations for a relatively compact cluster of businesses. And these services are likely to be valued in a relatively predictable and homogenous fashion by the commercial property owners who are the typical members of a BID. Thus, the benefits we ascribe to voting in one dimension may largely be enjoyed by BIDs. When considered alongside the fact that relatively few BIDs provide the same consumer services typically offered by SPGs — water provision, sewage lines, and so forth — BIDs seem more like providers of a single bundle of closely related local collective goods (which is to say, more like SPGs) than like GPGs.

Second, and relatedly, BIDs are almost always located in large cities. As of 1999, the median size of the jurisdictions in which BIDs were located was 104,000, and a quarter of BIDs were located in cities with more than 700,000 people. (For perspective, the average local jurisdiction in the United States has only 6,200 people, and the median jurisdiction is probably smaller.) A likely explanation is that, in large cities, there are enough commercial firms to lead to some geographic sorting among them, with the result that preferences for special services are more unified in any given (say) four block square section of a big city than in a similar -sized section of a medium or small city. In New York, for example, Times Square, Williamsburg, and Chelsea are all reasonably homogeneous neighborhoods within themselves, but differ enormously from each other. For local services that can be provided at reasonable cost on a scale much smaller than that of the city as a whole, BIDs can, through appropriate choice of their boundaries, homogenize both demand and supply and thus align the two more closely.

Third, BIDs are often governed by a board whose members are in whole or in greater part appointed -- commonly by the municipality in which they are located -- rather than elected by members of the district.¹³¹ In our classification such BIDs are therefore authorities, in contrast to the democratic SPGs that constitute our principal focus. Moreover, even in those BIDs governed by boards that are elected in major part by owners of property in the district (which is the usual voting constituency in BIDs), the municipality containing the district seems often to retain strong rights to intervene in its affairs, making those BIDs, to a degree, subordinate units of a general-purpose government rather than distinct and relatively autonomous special-purpose governments that run the risk of being captured by unrepresentative groups of constituents.

D. Authorities

We will not explore in detail here the structure and functions of local authorities (or -- in our terminology -- authoritarian SPGs). Rather, we will generally treat them simply as subsidiaries of GPGs or -- where the authority's territory overlaps with the territories of more than one GPG -- as joint ventures among those GPGs. We do not want to suggest by this, however, that

¹³¹ *E.g.*, KAN. STAT. ANN. § 12-1788 (West 2017); MONT. CODE ANN. § 7-12-1121 (West 2017); N.M. STAT. AN. § 3-63-11 (West 2017); TEX. LOC. GOV'T CODE ANN. § 372.008 (West 2017); WIS. STAT. § 66.1109 (West 2017).

authorities are unaffected by the problems faced by democratic SPGs in providing more than a single service. Authorities also tend to be single-purpose. In part this may simply reflect efficiencies in delegation; it may be easier to judge the efficiency with which a subordinate agency operates if it is confined to a single service. But multi-service authorities perhaps also face some of the same problems of collective decision-making that, we have suggested, are in large part responsible for the deep divide between SPGs and GPGs that are democratic. Just because the members of an authority's board are appointed rather than elected does not mean that they are not subject to pressures from the constituencies they serve, whether through the higher officials who appoint them or through direct lobbying. As a consequence, there may be savings in the cost of decision-making from having authorities, like democratic SPGs, pursue a single purpose rather than several.

E. County Governments

All but two of the 50 states are divided into counties, each of which has its own government. A county generally contains within its territory a number of municipalities and is essentially an intermediate level of GPG between municipalities and the state government. Although the structure, functions, and financing of counties – like all forms of local government – differ from state to state, they generally follow a common pattern. Unlike GPGs, counties generally do not provide a broad and open-ended array of services. Rather, they generally provide only a few services, commonly including courts, recording of births and marriages, road maintenance, airports, and health care assistance for the poor. Yet they are generally democratic.¹³² Thus counties seem to constitute an intermediate class of democratic local governments that provide a small number of largely unrelated purposes – a class that, we have argued, generally does not exist, and should not be expected to.

Counties are, however, much more consonant with our general description and analysis of local governments if we take into account the counties' special role, organization, and financing. By and large, counties are not autonomous governments, but rather appendages of the state that carry out, locally and under state government direction, programs adopted and administered by the state. Consistently with this role, counties generally derive more than half of their income from state (and even federal) grants.¹³³ Moreover, the corporate governance of counties is often structured along the lines of the city manager model – which is to say, along the lines of private business and non-business corporations. One form of this approach is to place the authority to manage the county's affairs in the hands of a three-person board of commissioners who are elected at large and who, in turn, hire a professional manager to be the county's chief executive officer.¹³⁴

In short, the costs of collective decision-making in counties are constrained from above by state control and from below by a muted form of electoral representation that puts county commissioners in a role that arguably makes them as much trustees as politicians.

F. School Districts

¹³² KATHRYN MURPHY, NAT'L ASS'N CTYS., COUNTY STRUCTURE: A STATE BY STATE REPORT 7 (2009), <http://www.ipfw.edu/dotAsset/98216b7d-e66c-4da6-a78b-1871b6c1f439.pdf>.

¹³³ [AED Memo 18?]

¹³⁴ MURPHY, *supra* note 132, at 7; Jonathan L. Marshfield, *Improving Amendment*, 69 ARK. L. REV. 477, 503-04 (2016).

School districts meet our definition of SPGs. They operate, however, with powers and limitations that set them apart from SPGs that offer services other than schooling.

First, we must ask why education – and particularly the primary and secondary education that is commonly provided by local governments – is provided by governments at all. The answer seems not to lie in externalities: primary and secondary education are overwhelmingly private goods. More convincing reasons involve market power, finance, and redistribution.

As for market power, most communities are too small to support two or more competing sets of schools. The most dramatic evidence of this is that the number of school districts nationwide declined from over 109,000 in 1942 to 13,000 in 2012¹³⁵. The fact that, as shown in Table 2, total expenditures by school districts simultaneously increased at least eightfold in real terms shows clearly – in case there might be any doubt – that this reduction in the number of school districts was driven by economies of scale rather than by withdrawal from governmental provision of education.

In addition to market power, there is the problem of paying for primary and secondary education. If that education were financed privately, families would often need to borrow to pay tuition. And, because the human capital accumulated by elementary school students cannot practicably be used as collateral for commercial debt, many families would be unable to borrow anywhere near enough to pay for the appropriate amount of education. And, even if families could obtain the needed credit, they would frequently find themselves facing a productivity-stifling debt overhang far larger than that which has already developed through borrowing for higher education.

Both of these basic problems – monopoly and financing -- are greatly mitigated by governmental provision of primary and secondary schooling. Only the market power problem is solved, however, through the organization of schools as conventional democratic SPGs. A particular advantage of SPGs is that, by levying assessments that are proportional to members' use of a single service, they can match demand and supply for the service more closely than can a GPG. But using such benefit-based assessments in a school district leaves the core problem of finance unresolved. As a consequence, state law generally mandates that primary and secondary education, however organized, be financed entirely by general taxation (usually ad valorem property taxes) without supplementation from user fees or other demand-based charges.¹³⁶ The result is that school districts accomplish substantial redistribution among district residents, from rich to poor and from families with no children to families with many children. And, to be sure that the net losers from this redistribution do not prevent it from happening, states generally require local communities to provide free education for all children in the community.¹³⁷

But mandating that education be provided locally and financed with general taxes does not assure that an efficient level of education is provided even within any given school district, and it leaves untouched all disparities across districts in the quality of education they offer. It is not surprising, then, that administration and finance of primary and secondary education has been moving from local districts to the states, and even in part to the national government. Indeed, in many states a substantial and growing fraction of the cost of primary and secondary

¹³⁵ See *supra* note 2.

¹³⁶

¹³⁷

education, especially in relatively poor districts, is now covered directly by the state itself. These subsidies have materially reduced the variation in quality among schools within a given state to a degree that would be unachievable with fully independent and self-financed school districts.

We will not explore here the reasons why, as an historical matter, primary and secondary education came to be widely provided in the United States through independent school districts. Regardless of the historical path, school districts today are regulated and financed in a fashion that makes them quite different from other types of SPG. We therefore exclude them from our proposal below for a unified general enabling statute for SPGs.

We note, however, one respect in which providing education through SPGs rather than GPGs is consonant with our emphasis on the costs of collective decision-making in organizing governments. As Table 1 confirms, the revenues of school districts alone are roughly equal to the total revenues of municipalities. This means that, if primary and secondary education were provided not by SPGs but by municipalities, they would on average account for half the municipal budget. We argued above that municipalities cope with the costs of collective decision-making by offering a bundle of different services over which preferences are more uniform than they would be over any particular service. If that is correct, then adding education to the municipality's bundle of services would unbalance it, creating the risk that disputes about education policy would infect decision-making about all other municipal services as well.

VII. ARE SPGS TOO EASILY ABUSED?

SPGs have been criticised for facilitating unfairness and inefficiency, and it is sometimes argued that they are so subject to abuse that their formation in general should be strongly limited.

A. Racial and Ethnic Discrimination

Although specific examples seem difficult to find, SPGs can be used to enhance racial segregation and to impede provision of services to minority communities, even within existing municipalities.¹³⁸ This can be accomplished by creating districts with boundaries that exclude neighborhoods with a dense minority population, hence leaving the minority community to (1) go without the type of service provided by the district, or (2) create or join another district with a smaller tax base and perhaps an inefficiently small scale of operation, or (3) obtain the service from the municipality, whose quantity and quality of production may well decline as service districts are used to carve away its more prosperous and politically powerful neighborhoods.¹³⁹

¹³⁸ See, e.g., PAUL R. DIMOND ET AL., A DILEMMA OF LOCAL GOVERNMENT 29-31 (1978) (arguing that special districts can enable discrimination because of the “conjunction of residential segregation with the geographic aspect of many public services,” but also that strict antidiscrimination laws can prevent such problems). *But cf.* NANCY BURNS, THE FORMATION OF AMERICAN LOCAL GOVERNMENTS 81-83 (1994) (noting that significantly fewer SPGs were formed in areas with high African-American populations in the 1950s, but finding little empirical evidence for a relationship between SPG formation and race from the 1960s through the 1980s); KATHRYN FOSTER, THE POLITICAL ECONOMY OF SPECIAL PURPOSE GOVERNMENT 41-43, 134-35 (1997) (acknowledging the “metropolitan ecology” hypothesis that special districts are a form of fragmentation used to further racial discrimination, but finding little empirical support for the hypothesis).

¹³⁹ [cites]

These are serious concerns. Rather than impeding the formation of SPGs in general, however, the more direct and less costly approach to such discrimination is to regulate the criteria by which the boundaries of SPGs can be chosen, and provide effective means of challenging those boundaries. We set out tentative criteria of this type below.

B. Wealth Discrimination

A similar complaint has been made with respect to wealth discrimination, in which SPGs are used to provide generous levels of various services to rich enclaves.¹⁴⁰ This problem is similar to the problem of racial segregation, but has a few more complications. It is not clearly unjust, by American ethical standards, to allow the rich to purchase for themselves more goods and services than can be purchased by less prosperous citizens. But special service districts for the rich are far less attractive if they come at the expense of imposing higher costs on other neighborhoods because of lack of economies of scale. Again, the problem is arguably best managed, not by creating obstacles to the formation of SPGs in general, but rather by regulating their boundaries.

C. Redistribution

Related to the preceding problems is the limit that the availability of SPG formation puts on the use of governmental service provision as a mechanism for redistribution. An important advantage of SPGs in general is that they can be used to subdivide provision of a service into geographic districts within which demand for the service is relatively homogeneous.¹⁴¹ But this market segmentation undercuts the ability to cross-subsidize less well-off communities by providing them with better services than the assessments made upon them would otherwise finance.

It is not obvious, however, that redistribution through the supply of local services can often be very effective with or without SPGs. A subsidy for local governmental services is likely to be capitalized in real estate prices and rents, creating a one-time transfer to current property owners and tenants in the subsidized neighborhoods. Those increased real estate prices will then face future acquirers of property in the neighborhood, canceling out the value of the subsidy -- and perhaps making the neighborhoods receiving the subsidized services too costly for many of its former and prospective residents.¹⁴²

As suggested above in our discussion of school districts, effective redistribution generally requires the participation of higher levels of government whose policies affect much larger territories than do most municipalities or service districts.

D. Borrowing Limits

¹⁴⁰ See FOSTER, *supra* note 138, at 41-43, 134-35 (reaching similar conclusions concerning possible wealth discrimination).

¹⁴¹ See Reynolds, *supra* note 12, at 99-100 (arguing that local government fragmentation “vastly limits the opportunities and incentives for redistribution of wealth at the regional level, and contributes to the preservation of inequalities within the region.”).

¹⁴² See CLAYTON P. GILLETTE, LOCAL DISTRIBUTION AND DEMOCRACY: INTEREST GROUPS AND THE COURTS 8 (2011) (noting that when a locality decides to employ redistributive policies, the accompanying increase in the cost of living in that locality—particularly for those subsidizing the redistribution—can lead to an exodus of residents and a “downward financial spiral”).

Many states regulate the amount of debt that a municipality may incur, evidently in an effort to deter the politicians of the moment from spending their way to popularity at the expense of future citizens. SPGs generally have authority to incur debt on their own and are not subject to the debt limits of municipalities whose territory overlaps with theirs. Consequently, residents of a municipality can escape that government's debt limits by using SPGs to provide some services that the municipality would otherwise provide.¹⁴³ This is a good thing or a bad thing depending upon how one feels about the wisdom of strict limits on municipal debt. If it is considered a bad thing, however, the best way to deal with it seems – as with the other concerns addressed here – not to impede the formation of SPGs in general, but rather to extend the limits on local government debt to include overlapping SPGs as well.

E. Excessive Aid to Developers

Finally, SPGs are sometimes faulted for providing excessive aid to developers in creating planned communities.¹⁴⁴ The principal concern seems to be that a developer will, before selling homes in the community, form one or more SPGs to provide services to the community, and have those SPGs issue debt to finance the construction and initial operation of the facilities used to provide the services. The problem here may go beyond evasion of municipal borrowing limits. By using SPGs, developers can issue tax-exempt municipal bonds and thus reduce, at public expense, their cost of financing the facilities they sell, and increase their profits proportionately. Critics have also suggested that developers use SPGs to conceal the aggregate amount of debt that the developer will pass on to purchasers of homes in planned communities.¹⁴⁵

But, like the other potential abuses discussed here, the best solution to these problems – if they are in fact serious problems – is to put appropriate limits on the ability of SPGs to issue tax-exempt bonds, and to require that developers disclose clearly the amount of debt that purchasers of homes in the community will assume, and the charges that will be necessary to service that debt.

VIII. ARE GOVERNMENTS SELECTED FOR EFFICIENCY?

We have been implicitly assuming that the forms taken by local governments in the United States are, viewed broadly, responsive to the costs and benefits of alternative organizational forms. In particular, we have assumed that local governments take forms that are responsive to the competing costs of monopoly and collective decision-making. One purpose of this essay is to test that assumption by examining how well it helps us organize our understanding of existing institutions. But that exercise would not be promising or convincing if it were obvious that factors other than organizational efficiency dominate the evolution of governmental structures.

¹⁴³ ANNMARIE HAUCK WALSH, *THE PUBLIC'S BUSINESS* (1980) (arguing that SPGs are primarily financing devices used to avoid debt limits). *But cf.* FOSTER, *supra* note 138, at 135 (noting that “[d]ebt limits are not associated with higher numbers of debt-dependent (nontaxing) districts).

¹⁴⁴ *See, e.g.*, BURNS, *supra* note 138, at 26-28 (providing examples of developer-created SPGs); VIRGINIA M. PERRENOD, *SPECIAL DISTRICTS, SPECIAL PURPOSES: FRINGE GOVERNMENTS AND URBAN PROBLEMS IN THE HOUSTON AREA* (1984) (criticizing Houston-area SPGs during the 1970s as being created primarily as financing devices for developers).

¹⁴⁵ PERRENOD, *supra* note 144, at ___.

Such factors are not evident, however. Although the historical evolution of the statutory framework for SPGs has clearly been slow, it has followed roughly the same path – at widely varying speeds – in most or all of the 50 states, despite the lack of any central organizing force. Tiebout-type competition may play a role in encouraging and dispersing efficient governmental forms, dulled a bit by the local market power that, we argue, is the stimulus for governmental organization in the first place. We suspect that conscious imitation and logic have played a greater role, however. And it is of course imitation and logic that we are invoking here to influence the future evolution of SPGs ourselves.

In this regard it is striking that the United States is nearly alone among developed countries in making extensive use of SPGs. In Europe, only Switzerland employs the form generally. This might be interpreted as an indictment of the efficiency of SPGs: if they are so effective, why are they largely a U.S. phenomenon? We will not explore this question in depth here. But we suspect that part of the answer lies, not just in the American tradition of minimal government that is strongly citizen-controlled, but also in the fact that local government in the United States became systematically organized, in fact and in law, only in the latter half of the 19th century,¹⁴⁶ and that much of the country's territory – particularly in the West – was not only unincorporated but without strong traditions of local government,¹⁴⁷ and consequently ripe for experimentation by the various states into which it was divided.

In any event, to appreciate the proposal for statutory reform that occupies the rest of this article, one needn't believe that there is some systematic mechanism that guides the evolution of governmental forms toward efficiency. Indeed, one can have it just the other way, and take our proposal as an effort to correct some inefficiencies that have accumulated in the American law of local governments.

IX. RATIONALIZING THE ORGANIZATIONAL LAW FRAMEWORK

In addressing the potential for reforming the organizational law of SPGs, we will restrict ourselves to democratic SPGs, as we largely have in the preceding sections. To be precise, we will define a “democratic SPG” as an SPG in which a majority of the board of directors is elected by the members of the SPG, and where the members eligible to vote are comprised of all residents and/or property owners in the SPG's territory who are subject to assessments to cover the costs of the SPG's activities. Nondemocratic SPGs, which we lump together under the name “authorities,” are sufficiently different from democratic SPGs in important respects as to call for separate statutory treatment (though this is not to deny that important elements of a general statutory regime for democratic SPGs might be appropriate for authorities as well). All subsequent references to “SPGs,” therefore, will be intended to refer only to democratic SPGs.

A. A Unified Statute

The original enabling acts for SPGs, which obviated the need for getting a special legislative charter, were adopted piecemeal, with a separate statute for each particular type of SPG. For example, as we have seen, the first of these statutes was adopted in California, and was

¹⁴⁶ CHARLES R. ADRIAN & ERNEST S. GRIFFITH, *A HISTORY OF AMERICAN CITY GOVERNMENT: THE FORMATION OF TRADITIONS, 1775-1870*, at 29, 39 (1976).

¹⁴⁷ See DAVID K. HAMILTON, *MEASURING THE EFFECTIVENESS OF REGIONAL GOVERNING SYSTEMS* 17 (2013).

limited to irrigation districts. As California found more uses for SPGs, it proceeded to adopt a new specialized statute for each individual use. These statutes imposed different requirements on different types of SPG. The cumulative result of this approach is an extensive patchwork of enactments that are not just inconsistent but confusing. For example, in California, water replenishment districts are governed by a board comprised by five elected directors¹⁴⁸; levee districts have three elected directors¹⁴⁹; and water conservation districts can have three, five, or seven directors, based on how the district is split into electoral divisions.¹⁵⁰ A recent count of the enabling laws in California found 206 statutes enabling 55 varieties of special districts that provide 30 different types of service.¹⁵¹

California is an extreme example, but it is by no means atypical. The law governing SPGs in most states has evolved similarly, with the result that most SPGs are governed by a specific state statute that is limited to a specific type of service and varies in some way or other from the enabling statutes governing other types of SPGs. This is in strong contrast to the legal framework governing business corporations, which (generally) does not vary from industry to industry within a state, and which is also broadly consistent even across states.

One important reason for this difference is that the laws governing SPGs are not subject to the same competitive pressures as the laws governing business corporations. Under the prevailing U.S. choice of law doctrine—the “internal affairs rule” – a business firm is free to incorporate in any state that it chooses, and thus have its structure and conduct governed by the corporation law of that state, without regard to whether many, or even any, of the firm’s shareholders, activities, assets, or personnel are located in the state. The resulting competition and selection effects have led most large and many small business corporations to be governed by the same body of corporation law – that of Delaware – and has resulted as well in relatively homogeneous corporation law across the other states of the union.¹⁵²

Not so with the laws that govern SPGs. In contrast to business corporations, SPGs appear universally to be – and seemingly must be -- incorporated in the state in which they are located.¹⁵³ Thus, while it is relatively easy for a business to incorporate elsewhere in response to a less-than-desirable legal environment, it is enormously harder for dissatisfied residents of a sewer district to alter the law that governs their organization. This helps explain why the expansion of SPG legislation has produced an idiosyncratic patchwork that is resistant to rationalization.

¹⁴⁸ CAL. WATER CODE § 60130 (West 20;16).

¹⁴⁹ CAL. WATER CODE § 70070 (West 2016).

¹⁵⁰ CAL. WATER CODE § 74200 (West 2016).

¹⁵¹ See FOSTER, *supra* note 118, at 11.

¹⁵² The dynamic involved is arguably a bit more complicated. Freedom of choice among jurisdictions for incorporation may actually have resulted in greater differentiation between the law of Delaware and that of other states than would otherwise have appeared. See Ronald Gilson, Henry Hansmann, and Mariana Pargendler, *Delaware Corporate Law as Complement, Not Competitor* (Working Paper, 2015).

¹⁵³ This requirement is implicit rather than explicit in the state statutes governing SPGs. Many state SPG statutes require that those who propose to create an SPG submit an application or other required documentation to the municipal government or county government in which the SPG is to be located, thus implicitly requiring that SPGs incorporate in the state in which they are located. See, e.g., ARIZ. STAT. § 48-261; CONN. GEN. STAT. ANN. § 7-325; KY. REV. STAT. ANN. § 65.160.

To be sure, there has long been serious debate about the efficiency and fairness of the state business corporation statutes that have emerged from the regulatory competition induced by the liberal choice of law doctrine applied to them. But, whether that competition is a race for the top or for the bottom (or not a race at all¹⁵⁴), it has not induced states to adopt different business corporation statutes for firms operating in different industries, with the important exception of the banking and insurance industries.¹⁵⁵ Rather, every state has a business corporation statute that, though providing for variation from default terms, does not alter its terms or their permissible variations depending on the kinds of products or services produced by a firm. The same is generally true for the rash of new forms that have emerged as alternatives for forming proprietary businesses, including importantly the limited liability company and the statutory business trust.

Are there any reasons for taking a different approach to incorporation statutes for SPGs – as most states have in fact done – by having separate statutes for SPGs providing different services? In the abstract, we might expect to see a tradeoff between the particularized benefits of individualized statutes and the general administrative costs of having many statutes— with the latter including the resulting awkwardness and complexity for citizens, judges, and the managers of the districts themselves. Substantial evidence that this trade-off runs in favor of generality can be found, not just in logic, but in the choice of many states, among those that have recently reformed their SPG incorporation laws, to adopt a single statute governing all SPGs regardless of purpose. Colorado’s statute, for example, specifies a single procedural mechanism for creating a district and puts almost no restrictions on the services provided by those districts.¹⁵⁶ South Carolina has adopted a single statute providing that “public health, electric lighting districts, water supply districts, fire protection districts, and sewer districts may be established pursuant to this section.”¹⁵⁷ In 1989, the Florida Legislature passed the Uniform Special District Accountability Act, which provides the general requirements for all types of special districts.¹⁵⁸ Utah’s current statute — the result of a series of enactments over two decades, and one of the most comprehensive and recently updated of the group — offers a unified procedure for forming SPGs providing any of more than 20 different types of services, including airports, cemeteries, fire protection, paramedics, law enforcement, libraries, parks, sewers, and streets.¹⁵⁹ And many

¹⁵⁴ See, e.g., Gilson et. al., *supra*.

¹⁵⁵ Corporations operating in these two industries have probably come to be governed by special corporation statutes because important aspects of those statutes— such as their regulation of financial reserves – serve an important consumer protection function as well as shareholder and general creditor protection functions.

¹⁵⁶ 2007 Colo. Legis. Serv. 283 (H.B. 07-1219) (West) (codified at COLO REV. STAT. ANN § 32-19-109 (West 2016)).

¹⁵⁷ S.C. CODE ANN. § 6-11-10 (West 1976).

¹⁵⁸ 1989 Fla. Sess. Law Serv. 89-169 (West) (codified at FLA. STAT. § 189 (2016)); *see also* FLORIDA DEPARTMENT OF ECONOMIC OPPORTUNITY, FLORIDA SPECIAL DISTRICT HANDBOOK 14 (2014), <http://floridajobs.org/docs/default-source/2015-community-development/community-assistance/sdap/sdhandbook.pdf>.

¹⁵⁹ UTAH CODE ANN. § 17B-1-202 (West). This section was originally enacted in 2007, *see* 2007 Utah Laws ch. 329, but has been amended several times since then, *see, e.g.*, 2016 Utah Laws 2016, ch. 371, § 10; 2014 Utah Laws ch. 377, § 6; 2012 Utah Laws 2012, ch. 97, § 1; 2010 Utah Laws ch. 159, § 1. *See generally* e-mail from LeGrand Bitter, Exec. Dir. Utah Assoc. of Special Districts, to author (Oct. 4,

states that haven't yet unified and standardized their SPG statutes report that it would be useful.¹⁶⁰ As a recent Missouri report put it, the state's districts "have the dubious distinction" of performing "20 different functions . . . under 28 different statutory authorizations."¹⁶¹ The trend toward a single general enabling statute that provides a uniform but flexible framework for the formation of all types of SPGs suggests strongly that this is the most effective approach to their formation and governance, as it seems to be for other types of legal entities from partnerships to nonprofits to joint stock companies. This is not to say that the optimal content for a general SPG enabling act is obvious down to all its details. The law of SPGs has clearly been a field in which the various states have acted effectively as the clichéd laboratories of democracy, leading to the gradual evolution of a large class of governmental entities largely without precedent, not just in common-law countries, but throughout the world.¹⁶² That experimentation should be encouraged to continue. As Judge Posner put it in a recent Seventh Circuit opinion: if courts invalidate creative new ways of structuring public governance, then "we will never learn from experiments in the governance of public institutions."¹⁶³ And there is clearly still much to be learned.

At this point in the development of SPGs, however, it seems likely that experimentation with the legal framework will be most effective if it takes place across states rather than within states. If, for example, a given state adopts one form of governance for fire districts and another form of governance for mosquito abatement districts, it will be difficult to establish criteria for comparing the success of the two types of district, and it will be difficult to know the extent to which any observable difference in performance is rooted in difference of organizational forms. If, on the other hand, two neighboring states each adopt a single form of governance for all of their SPGs, but the forms adopted differ in some meaningful way, the consequences of that difference can be examined by comparing SPGs providing the same service – say fire control – in the two different states. And in fact such a comparison can be made simultaneously with respect to all of the services that are provided by SPGs in both of the states.

The following sections of this Article explore the principal issues that must be addressed in any general statute for SPGs. We hope to illuminate the advantages and disadvantages of alternative ways of addressing these issues, and more generally to provide a clearer perspective on the feasibility of a single general enabling act for (democratic) SPGs. We avoid details and

2013, 1:11 EST) (on file with author) ("Over the past 20 years, the state of Utah has recodified sections of the code dealing with districts. Part of this process has been the simplifications and standardization of state statutes dealing with districts.").

¹⁶⁰ E-mail from Karen Horn, Vermont League of Towns and Cities, to author (Oct. 7, 2013, 10:52 EST) (on file with author) ("We have far too many statutes on the books.").

¹⁶¹ Missouri Municipal League, *Manual for Newly Elected Officials 5* (2007), available at <http://saintmarymo.com/SaintMaryMO/NEO.may.07.pdf>; See also Idaho Legislative Services Office, *Special Districts in Idaho* (2014), available at

<http://legislature.idaho.gov/audit/locgovreports/specialdistrictreport2014.pdf>

¹⁶² The United Kingdom has many special-purpose districts. In general, however, they are not democratic but rather analogous to what we have called here "authorities." [Cite materials on English districts.] Among the civil-law countries, Switzerland comes (by far) the closest to the United States in providing for democratic SPGs, though their formation and governance are more rigid and limited than is typical in the United States. [Is the latter true? Exactly what do the Swiss districts look like?]

¹⁶³ *Pittman v. Chicago Bd. of Educ.*, 64 F.3d 1098, 1103 (7th Cir. 1995).

we generally do not offer specific statutory language. Rather, we focus principally on what we consider the most basic structural elements of a general statute, and in particular on those that seem most difficult or contentious. We also, naturally, focus on those issues that are best illuminated by the economic analysis of the role and structure of SPGs that we offered at the beginning of the Article.

The last of the basic statutory issues we address below is one that would generally come at the beginning of an enabling act: namely, whether organizations can be formed under the statute as of right, simply by following a set of statutorily prescribed procedures, or whether, in addition, permission to form the organization must be granted by a state official or agency with the authority to exercise some degree of discretion. The reason for postponing this issue is that formation of governments as of right is not only a contentious issue, but one that interacts with the other provisions of a statute. Simply put, the better that a statute limits undesirable activity by the organizations formed under it, the more liberty that can be granted to form those organizations.

B. Permissible Purposes

Every state in the U.S. allows the formation of business corporations for “any lawful purpose,” where “lawful” effectively means only non-criminal. States do not have separate business corporation statutes for electronics manufacturers and furniture retailers.¹⁶⁴ These “any lawful purpose” clauses emerged over the course of the nineteenth century — sometimes out of statutes that once restricted incorporation to manufacturing firms¹⁶⁵ — and are simultaneously a source of flexibility and of standardization in modern corporate law. Similarly, nonprofit corporation statutes and cooperative corporation statutes, which once also limited the purposes for incorporation, now generally provide that organizations can be incorporated under the statutes for any lawful purpose.¹⁶⁶

It is important to keep in mind that “purpose” in this context refers to the type of activity undertaken by the SPG, such as electricity distribution or fire protection. It does not concern the manner in which the activities are undertaken. For example, a question we will address below is whether an SPG can be formed with the object of running a business – say, a shoe store – that will produce profits for residents of the associated territory. A reasonable answer to this question is no. One might express this by saying that profit-seeking is not a proper “purpose” for an SPG. But that is not the sense in which the word “purpose” is being used here. Operating a shoe store may be a proper purpose for an SPG if the membership, control, and finances of the store meet the relevant statutory requirements, while operating a shoe store for profit would not be.

¹⁶⁴ E. Merrick Dodd, Jr., *Statutory Developments in Business Corporation Law, 1886-1936*, 50 HARV. L. REV. 27, 29 (1936) (“Financial institutions and railroads were generally regarded as requiring special treatment, but the earlier manufacturing corporation acts tended to evolve, either by the inclusion of other types of corporations or by the insertion of a provision for the formation of corporations for any lawful purpose other than those specifically excepted, into substantially what we know today as business corporation acts.”).

¹⁶⁵ *Id.*

¹⁶⁶ [REFERENCES AND CITATIONS]

This said, there seems to be no need to put limits on the purposes that SPGs can pursue. For example, there is no general reason to bar an SPG from being established to construct and operate a movie theater or a shopping mall, both of which might, in particular circumstances, appropriately be undertaken in that form (as when there is room in the market for only one such firm of efficient size).

C. Number of Purposes

In contrast to limiting the *types* of activities an SPG can undertake, there are good arguments for restricting the *number* of activities an SPG can undertake. When, as is commonly the case, an enabling statute provides for only a particular type of SPG, then of course the SPGs formed under that statute are necessarily limited to a single purpose. But when an enabling act permits formation of SPGs that provide for any of a range of services, the question arises as to whether an individual SPG can be formed to provide more than one of those services. The question is often left unanswered by existing statutes. And when a limit on the number of permissible purposes for a single SPG is imposed, it can be puzzling. For example, Utah's recently-reformed and highly comprehensive general statute limits the number of permissible purposes to four,¹⁶⁷ for no obvious reason.

Limitations on the number of permissible purposes are, to be sure, virtually unknown in the enabling statutes for other types of organizations, such as business corporations, nonprofit corporations, and limited partnerships. But SPGs are distinct from these other forms of organization in that SPGs have a power to compel membership that purely private organizations, whether nonprofit or for-profit, do not have. That power can, it appears, be adequately constrained by appropriate regulation of, among other things, the territory governed by an SPG and the types of assessments it can charge, as discussed below. An SPG that provides two or more services becomes much more vulnerable to the instability and opportunism that we described earlier, and to which we attributed the fact that multi-purpose SPGs are rare.

The better wisdom, therefore, is arguably to provide that an SPG may have no more than one purpose – which is to say, it can provide no more than one service. SPGs should be not just *special-purpose* governments, but *single-purpose* governments. To be sure, this may be an unnecessary restraint. As noted above, many SPG enabling statutes already allow more than one purpose. But this freedom seems rarely to have led to problems. The two-purpose district at issue in *Ball v. James* appears to be very much an outlier. The sharp conflict of interests inherent in such organizations probably suffices to discourage their formation in general. At the same time, a single-purpose rule might be a helpful device for permitting judicial scrutiny of the rare SPGs that take on multiple purposes and thereby create a substantially enhanced risk of abuse.

A statutory single-purpose requirement must, of course, be accompanied by criteria that determine when two activities constitute a single purpose as opposed to two distinct purposes. Our discussion of voting problems above suggests two important considerations. The first is the extent to which the two activities are similar in the distribution of their benefits across residents of the territory involved. The second should be the extent to which the two activities share costs and hence provide substantial economies of scope. These broad criteria can be refined as needed

¹⁶⁷ UTAH CODE ANN. § 17B-1-202(3)(a) (West 2017).

by state agencies or the judiciary. It seems plausible, however, that little refinement will be needed.

D. Territory

Two criteria seem, on the basis of logic and experience, particularly important in determining the territorial boundaries of an SPG. The first is that the boundaries of the territory not be extended opportunistically to include residents who receive little benefit from the SPG but who can be subjected to assessments that will cross-subsidize the services enjoyed by other members of the district who control a majority of the votes. The second is that the boundaries of the territory not be restricted to exclude residents from receiving the service when inclusion would be efficient – that is, when the benefits of membership in the SPG for the residents concerned exceed the costs to the SPG of extending services to those residents.

In short, the territory should be defined, to the extent feasible, to include all and only residents for whom the benefits of membership exceed the costs. Appropriately interpreted, this criterion would generally bar a wealthy community from creating an SPG that excludes from its territory a neighboring residential community that is less prosperous, even if inclusion of the latter community requires that they be subsidized by their wealthier neighbors.

E. Finance

SPGs typically derive their revenue from some combination of user fees, ad valorem property taxes, and special assessments on property (such as a charge levied on homeowners to pay for streetlights that is apportioned according to the number of front feet the homeowner's property occupies on the road involved). States generally require, as a matter of constitutional or statutory law, that the taxes and assessments imposed on a resident of an SPG not exceed the benefits that the SPG confers on that resident's property.¹⁶⁸ Assuming – as is generally the case – that this requirement is applied with sufficient flexibility as to be administratively feasible, it is sensible. It helps assure that the SPG's activities are overall efficient. In particular, proportionality limits use of an SPG by one group of residents to expropriate another, and it helps homogenize the interests of the SPG's residents which, in turn, renders voting control by residents both more efficient in outcome and less costly in process.

To be sure, proportionality of costs and benefits essentially rules out the use of SPGs for substantial redistribution among a territory's residents. But there seems little alternative. Such small, specialized, and locally controlled governments are poorly suited to pursue redistribution in any event, just as are private housing cooperatives and condominiums. Indeed, absent a proportionality requirement, there would likely be stronger incentives to use SPGs for exploitation than for progressive redistribution.

In general, redistribution works best when it is undertaken at the highest level of government possible (so that exit from the government's territory is as difficult as possible). And SPGs are the lowest level of government. Here again, they are close in character to private enterprise.

The state courts already have experience in interpreting and applying the proportionality requirements imposed by many state statutes and constitutions. Sometimes the courts, at least in

¹⁶⁸ [Authority needed.] [CT statute]

their rhetoric, seem unnecessarily strict in their interpretations – for example, by requiring that the assessment levied on each person be demonstrably smaller than the benefits received by that person.¹⁶⁹ But the precise criteria for adequate proportionality between assessments and benefits is among matters that seem well suited for experimentation by state legislatures and courts.

X. CONTROL RIGHTS

A. Default Election Rules and Governance Powers

Like all organizations, SPGs require an internal governance structure. In SPGs, as in private corporations, this typically takes the form of an elected board that has ultimate authority to exercise the powers of the firm. Those powers typically include the general powers held by legal entities, including hiring officers to whom many of the board's powers can be delegated.

There is great variation across states, and across different types of SPGs within a given state, in the voting rules by which the board can be, or must be, selected. All these rules have in common, however, an effort to allocate voting rights among residents proportionally to their economic stake in the organization, and in particular to the assessments levied upon them. As with the allocation of assessments, allocation of voting rights according to this principle homogenizes the interests of the members of the SPG and does so in a manner that incentivizes choice of efficient management. As a consequence, a unitary SPG statute that imposes an overall requirement of proportionality among gross benefits, assessments, and voting rights seems workable and appropriate, substituting a broad standard applicable to all SPGs for the prevailing disparate group, within any given state, of largely arbitrary voting rules for individual types of SPGs.

In addition to standards for the allocation of voting rights among the members of an SPG, there must be some statutory rules – default and/or mandatory – that determine how those votes can be deployed. These rules include the quorums necessary for voting both by members and by directors, whether a majority or simply a plurality of votes is required to elect a director, the maximum length of term for directors and whether those terms can or must be staggered, and the available mechanisms for members of the district to nominate insurgent candidates for the board of directors. These and other such details -- which are by no means trivial -- seem suitable subjects for experimentation among the states.

B. Distribution of Profits

Should SPGs be permitted to make current cash distributions to members if they run a surplus, as is the case with cooperative corporations? While -- given the limited and quasi-private character of SPGs -- there is room for argument, the best answer is almost certainly no. Again, the fundamental problem is the heterogeneity of the membership, combined with the monopolistic character of the services that SPGs typically provide. The ability to make cash distributions may too easily be employed to exploit one group of members for the benefit of another. It may also tend to distort members' and directors' view of the ultimate objective of the enterprise, which should be to counter monopoly rather than to make a profit. SPGs should be allowed to run surpluses, but any such profits seem best devoted to investment in capital or reduction of future assessments.

¹⁶⁹ [Cite.]

A more difficult question is whether distributions should be permissible upon dissolution of an SPG. Such authority can lead to the transfer of wealth from those who exit before dissolution to those who remain, and the potential for such transfers can create unwanted incentives. This suggests prohibiting not just current distributions but also distributions upon dissolution. If an SPG has positive net assets upon dissolution, a reasonable provision would be to require that those assets escheat to the state¹⁷⁰ or, as under the Utah SPG statute, that they be transferred to the local government(s) (whether GPG or SPG) that bear, or have borne, most of the burden of providing the services formerly provided by the dissolving SPG.¹⁷¹

There is, to be sure, a pragmatic argument for permitting current members of an SPG to receive, upon dissolution of the SPG, a pro rata fraction of (at least part of) any net assets that remain. The argument is not based principally on fairness, since often those net assets will have been paid in by earlier generations of SPG members. Rather, the argument is based on a need for incentives to dissolve SPGs that have become inefficient. The problem is essentially one of collective action. While the benefits of dissolving a government, like the benefits of forming or merging one, are widely shared among the community it serves, the costs of initiating one of these actions burden only a small number of activists who take that burden upon themselves.¹⁷² Moreover, once an SPG has been formed – with a board, staff, budget, and taxing powers of its own—it can give rise to entrenched special interests with strong incentives to oppose its demise. These issues are perhaps one reason why some states have had problems with districts sticking around past their prime.¹⁷³

The potential for a liquidating distribution might help stimulate not only a few activists but many members of a superannuated district to press actively for its dissolution. Precisely this approach has been taken with mutual banks and insurance companies. In the last decades of the 20th century, many states revised their enabling acts for mutuals to give their members – depositors in the case of mutual banks and policyholders in the case of mutual insurance companies – a right to share pro rata in at least a fraction of the company's net capital upon the company's merger or dissolution. Prior to these enactments, many state statutes, like the charters of the companies themselves, made no provision at all for dissolution, much less for distributing assets to current members. The motivation for the new statutory provisions was not to do justice to the members of mutual companies, who had little equitable claim to assets that had often been accumulated over more than a century. Rather, it was simply to create a windfall financial incentive for members of no-longer-efficient mutual companies to support the dissolution of those companies or – more commonly – their conversion to stock companies (that is, ordinary business corporations).

On balance, however, there is reason to doubt not just the fairness but also the efficiency of this approach to dissolution of mutual companies, and even more reason to doubt whether it is appropriate for SPGs. Among other things, creating rights to distributions upon dissolution arguably establishes excessive incentives for profiteering by organizational insiders who can strategically manipulate the timing and method of dissolution. It seems the better wisdom to

¹⁷⁰ [Try to find a statute to cite – perhaps Wisconsin?]

¹⁷¹ [citation to statute]

¹⁷² See BURNS, *supra* note 66, at 17.

¹⁷³ See Conor Clarke, *Merging and Dissolving Special Districts*, 31 YALE J. ON REG. 493, 501 (2014) (describing Kentucky's problems with special districts).

require that all SPGs be barred from making distributions either currently or upon dissolution – which is to say that they must be strictly nonprofit entities -- and to rely upon other mechanisms to encourage dissolution of SPGs that no longer serve a socially useful purpose.

C. Dissolution

Unfortunately, many state statutes governing SPGs not only have no clear rules for dissolution of inefficient SPGs, but have no clear rules for dissolution under any circumstances. One recent study reports that all but six states have dissolution procedures that the authors describe as “unclear or nonexistent” for at least one category of SPG in the state.¹⁷⁴ Almost a quarter of statutes governing special districts do not provide any procedures for dissolving the entities whose creation they authorize.¹⁷⁵

A reasonable basic procedure for dissolution is that which is typically prescribed for business corporations, under which dissolution must first be proposed by the corporation’s board of directors and then accepted by the membership by a simple majority of votes cast. However, because the problem of entrenchment may be more serious with SPGs than with ordinary business corporations owing to the lack of a market for control in SPGs, there is a strong case for adding a secondary procedure for dissolution that does not require an affirmative vote of the organization’s board of directors. The reason is that, given the absence of a market for control of SPGs (through which inefficient SPGs could be taken over by more efficient managers), or of a competitive market for an SPG’s services (which might force dissolution, via bankruptcy, of inefficient SPGs), the managers of an ineffective SPG may be able to stave off dissolution, and hence protect their positions, for a very long time –especially if voters pay only mild attention to the regular elections of the board.

One alternative might be a right for a stated minority of members (perhaps 5%) to force a vote of the entire membership on dissolution, with no accompanying requirement for approval of the dissolution by the board of directors. Another would be a statewide agency with a general mandate to assist and monitor SPGs, and empowered to, among other things, bring suit to force dissolution of SPGs that cannot bear the burden of showing that, overall, the benefits of the services they provide exceed the costs. And there are of course a variety of other mechanisms that might also be used for this purpose. The choice of such mechanisms seems an appropriate focus for state experimentation.

D. Merger

As with dissolution, relatively few states have consistent and clear rules for merger of SPGs.¹⁷⁶ In some states there are three different ways to merge or annex special districts.¹⁷⁷ In other states, the merger process is simply “whatever the parties wish it to be—there are no state

¹⁷⁴ Bauroth, *supra* note 176, at 574.

¹⁷⁵ *Id.* at 575-76.

¹⁷⁶ See Nicholas G. Bauroth, *The Strange Case of the Disappearing Special Districts: Toward a Theory of Dissolution*, 40 AM. REV. PUB. ADMIN. 568, 574 (2010); see also Clarke, *supra* note 173.

¹⁷⁷ See Clarke, *supra* note **Error! Bookmark not defined.**, at 500 (noting that “there are at least three different ways to merge or annex special districts in the state of Oregon: with petitions from two special districts that want to merge, with petitions from a special district (or districts) and a city that proposes to annex the district, or with a resolution of the boards of two or more districts”).

statutes governing the process.”¹⁷⁸ In still other states, merging special districts requires affirmative action from the state legislature.¹⁷⁹ Not surprisingly, the presence of established procedures for consolidation is positively correlated with the frequency of changed boundaries, just as the frequency of dissolutions corresponds to the presence of clear rules for dissolution.¹⁸⁰

A seemingly reasonable rule for mergers is to provide that, to take force, a merger agreement must be approved by the boards of the two (or more) SPGs involved, and approved as well by a majority of the members of each SPG. Because of the dangers of management entrenchment and member passivity already referred to, a high quorum seems uncalled for. In fact, as with dissolution, there is a strong argument for allowing shareholders to petition the managers of their SPG to negotiate terms of merger with another SPG. For similar reasons, it may be useful to permit the managers of an SPG to force the managers of another SPG to put a plan of merger to a vote if the members of the initiating SPG have voted to authorize such action, thus creating a mechanism something like the hostile takeover among business corporations.

¹⁷⁸ E-mail from Dan Beardsley, Exec. Dir., R.I. League of Cities & Towns, to author (Sept. 30, 2013, 10:28 EDT) (on file with author).

¹⁷⁹ In Virginia, one official recalls “no statutory provisions for the consolidation of special districts” and notes that “[c]onsolidation would require the legislature [acting] to allow the merger of two or more districts.” E-mail from Ted McCormack, Former Assistant Dir., Va. Comm’n on Local Gov’t, to author (Oct. 7, 2013, 11:59 EDT) (on file with author).

¹⁸⁰ See Bauroth, *supra* note 176, at 589 (“[T]he greater the freedom allowed by the state at the ‘chartering level,’ the more instances of local boundary change such as district disappearance.”).

XI. TOWARD FREE INCORPORATION?

SPG formation typically requires several steps.¹⁸¹ The first is a petition from some minimum number of the residents or property owners in the proposed territory of the SPG. The second is a public hearing open to anyone who has an interest in the proposed district. The third is a vote among residents or owners to accept or reject the proposal. And the fourth is approval by a higher level of government – an approval power that the governing statute ordinarily gives to a county or state official, court, or agency. This fourth and final step is generally not pro forma; the higher levels of government that are called upon to review an SPG can and do exercise real discretion. The first three of these four requirements seem appropriate. The justification for the fourth requirement, however, is less clear.

One of the consistent features of American business law is that anyone can form a business entity simply by filing the appropriate paperwork. No discretionary approval by a state official is needed. One reason for this liberal approach is that no person can be made a member of a business entity, and hence subject to its internal rules and powers, without consent. There is, furthermore, widespread consensus that allowing business incorporation as a matter of right is overwhelmingly beneficial. Allowing unrestricted incorporation did away with artificial government-granted monopolies, expanded equality of opportunity, and helped foster a competitive economy and vibrant civil society.¹⁸² And the same is true of cooperative and nonprofit corporations. Given this fundamental difference, can the evolution of free incorporation in the business world – and in the world of cooperative, nonprofit, and mutual organizations -- offer any guidance for the way we create governments? We consider this question in three parts.

A. How Easy Should It Be To Create a Government?

The very idea of forming governments with the same freedom available in forming business corporations might strike some as hopelessly idealistic, foolish, or downright harmful. And, undeniably, the tradeoffs are hard to evaluate: The benefits of lowering barriers seem inextricably paired with the costs. More numerous and fragmented government can produce a tighter fit between local preferences and local services (perhaps those adjoining neighborhoods have irreconcilably different preferences for fire services), but it can also lead to the inefficient replication of fixed costs (perhaps one firehouse would really be enough). Likewise, more governments can mean more competition between governments: The familiar Tiebout Hypothesis suggests that increasing the varieties and combinations of services and service providers that potential residents can choose from can stimulate competition that will generate more efficient provision of public services.¹⁸³ But having more governments can also mean sacrificing economies of scale and scope, and can make it more difficult to eliminate inequalities through local redistribution.¹⁸⁴ (If the wealthiest neighborhood can carve out its own service districts, it will be less willing to subsidize service for the rest.) And, as discussed above, a

¹⁸¹ Here we are generalizing based on our reading of state statutes that govern formation.

¹⁸² See Millon, *supra* note 94, at 207-8. For a general discussion of these benefits, see DOUGLASS C. NORTH, JOHN JOSEPH WALLIS & BARRY R. WEINGAST, *VIOLENCE AND SOCIAL ORDERS: A CONCEPTUAL FRAMEWORK FOR INTERPRETING RECORDED HUMAN HISTORY* 22 (2009).

¹⁸³ See generally Tiebout, *supra* note 9 (describing this result).

¹⁸⁴ See FOSTER, *supra* note 118, at 30.

proliferation of special districts may increase transaction costs and impose additional decision-making costs on voters and residents.¹⁸⁵

Given these various tradeoffs, it can seem difficult to say something satisfying or decisive about the appropriate ease for forming a government. Nonetheless, thinking about local governments through the lens of business law offers three insights about formation that are absent from the current debate over the costs and benefits of localism in American government.

First, many of the concerns about the proliferation of local governments are about the externalities of forming a new government, for those within and without the relevant territory. But business corporations can likewise create externalities, and are subject to no such restraints on formation. Similarly, nonprofit organizations in most states no longer have to receive approval before coming into being.¹⁸⁶ Yet nonprofit corporations may in some ways be more likely to impose inefficient burdens on society for much longer than SPGs, since SPGs (like cooperatives but unlike non-membership nonprofits), have voting members with other things to do with their money and the power to dissolve the organization at will (although, as we suggest above, the latter power might usefully be strengthened).

Second, forming governments, unlike forming investor-owned firms, presents a collective action problem. The benefits of a new government are widely shared — everyone in the neighborhood gets the new street lamps or the improved fire protection — but the costs of creation fall most heavily on the small number of residents who start the petition and fill out the forms. This creates an incentive to free ride, leaving it to someone else to go through the costly process of petitioning for the new firehouse or water system. In general, one might expect that the higher the costs of creation, the greater the likelihood that such free riding will occur. This can be contrasted with business corporations, where the returns to entrepreneurial effort are more easily captured. Lower barriers to forming governments can help compensate for these obstacles.

Third, the history of both business and government formation should remind us of one of the key reasons why decentralization is desirable: namely, to avoid the patronage and rent-seeking of central allocation. One of the “vital”¹⁸⁷ drivers of the shift from “privilege” to “right” in corporate formation was the widespread feeling that the legislatures allocating corporate charters (for what were often local monopolies) did so for reasons of nepotism and patronage — and not for reasons of fairness or efficiency. Those concerns about the privilege system still apply to discretionary chartering for special districts.

B. The Trend toward Freer Incorporation

Although most states require that proposals to form new SPGs receive the approval of some higher government authority, this is not universally true. Indeed, several states have recently enacted laws that allow for groups of citizens to form special districts with little or no prior approval. The apparent success of these statutes (or at least the absence of conspicuous

¹⁸⁵ See MISSOURI MUNICIPAL LEAGUE, *supra* note 130, at 6 (“Special districts, if properly governed and wisely used, are an important and effective unit of government. However, in Missouri, the proliferation of various types of special districts, particularly special road districts, has created a confusing patchwork of local government.”).

¹⁸⁶ They do, however, need to receive prior approval to get tax exemption.

¹⁸⁷ See Vasudev, *supra* note 95, at 252.

problems) provides a notable counterpoint to the idea that the formation of governments — in contrast to the formation of the types of corporation conventionally considered private — requires special oversight. These newer statutes also contain procedures that offer important lessons in reducing the barriers to SPG creation.

The newer, more permissive SPG statutes can generally be divided into two categories, neither of which gives direct veto power to a higher government authority. First, there are statutes in which the requirements of an initial petition process are relatively mild — perhaps only a small percentage of residents or voters need to sign on to a petition — but then there is a difficult second step: say, the petition is submitted for a general vote. Sanitation districts in Maine have a representative two-step method: a petition signed by at least 10% of the resident voters leads directly to mandatory notice and a majoritarian referendum at the next election.¹⁸⁸

Second, there are statutes in which the original petition requirement imposes a high bar to formation — say, a large majority of voters or property owners must sign on to the original proposal — but, once that happens, the remaining barriers to formation are low or nonexistent. In some of these statutes, the higher government authority is given a formal role (akin to making sure the papers are in order and properly signed) but does not decide the question of whether the district should or should not exist. In Minnesota, for example, rural water districts are created when a petition is signed by 50 percent of the landowners. When such a petition is received, the local court simply makes sure that the signatures are accurate.¹⁸⁹ Montana law contains a similar one-step mechanism: When a majority of residents and a third of the landowners in a given territory want to form a water district, the district judge is only authorized to verify that the signatures on the petition are accurate.¹⁹⁰

There are several important differences between these two types of process. States that combine the petition process and the election process into one step — a verified petition with signatures serves the function of an election — might be seen as saving a step: The clerk does not need to engage in a costly notice process or organize a subsequent election. On the other hand, the one-step process has important drawbacks. The two-step process — in which a petition with a relatively modest number of signatures leads to notice and then a general election — arguably strikes a better balance, for a number of reasons. First, the two-step process preserves the secret ballot. A signed and verified petition, by definition, does not. In theory, secret ballots offer a reasonably objective measure of voters' preferences without subjecting them to personal or political pressure — and there is strong evidence that the mechanism has been

¹⁸⁸ 38 ME. REV. STAT. § 1101 (“Upon receipt of a written petition signed by at least 10% of the number of voters . . . the municipal officers shall submit the question to the voters of the proposed district at the next general, primary or special election within the proposed district.”)

¹⁸⁹ MINN. STAT. ANN. § 110A.12 (West) (“The petition must be signed by 50 percent of the landowners . . . within the area outside the limits of any city constituting the proposed district. . . . Upon receipt of the petition, the court shall determine whether it complies with the requirements of sections 110A.01 to 110A.36”).

¹⁹⁰ MONT. CODE ANN. § 85-8-121 (2017) (“If it appears that the petition has been signed as required in this part, the court or judge shall so find and order any necessary amendments to the petition, shall divide the district into three divisions, as nearly equal in area as possible, and shall appoint three suitable and competent persons as commissioners and fix their temporary bonds.”).

successful in reducing corruption and other abuses.¹⁹¹ Second, a two-step process does more to verify that a district project has the actual support of people living there. Besides offering another check against corruption, it helps ensure that enough people are interested in a project to make arranging a public referendum worthwhile. (Thus, a single resident cannot subject the public to repeated elections over some quixotic plan.) Furthermore, it helps capture something about the intensity of local preferences — since presumably the people willing to pay the costs of the petition process must be especially interested in and invested in the outcome. Finally, the two-step mechanism makes it possible for a deliberative process to play out. This is particularly true if, as is the case in many states, the general election must be preceded by a public hearing.¹⁹²

Such a process – petition, hearing, and election – provides reasonable assurance that an SPG is created only if it has broad and informed support from its prospective members, while at the same time providing the opportunity for a small minority of residents or landowners to pitch their idea for a new SPG to prospective members as a whole at a public hearing.

C. Ex Post Checks on District Formation

In addition to the procedures described above, several state statutes attempt to address the potential risks of forming too many governments by including some form of ex post adjudication process in their procedures. A relatively new Kentucky statute, for example, allows any city that contains a new district — or any citizen living within that new district — 30 days to appeal the formation from the district court to the appeals court.¹⁹³ A North Dakota statute, likewise, allows “any person who is aggrieved” to appeal an SPG formation decision made by the state engineer.¹⁹⁴ And in Maryland, interestingly, the landowners who do not sign a petition for district formation are issued summonses by a court, which suggests that a similar kind of mandatory ex post litigation process is built into the formation procedure.¹⁹⁵

Somewhat more broadly, many other states include opportunities for objection from landowners who fall within a proposed district.¹⁹⁶ And, notably, such statutes allow the type of objection made by an affected resident to extend beyond the simple question of whether or not the district is formed. For example, one representative North Carolina statute provides that any

¹⁹¹ See Jean-Marie Baland & James A. Robinson, *Land and Power: Theory and Evidence from Chile*, 98 AM. ECON. REV. 1737 (2008) (offering empirical evidence for the benefits of the secret ballot).

¹⁹² See, e.g., COLO. REV. STAT. § 32-1-305 (2017).

¹⁹³ KY. REV. STAT. ANN. § 65.186 (West) (“Any city containing all or any portion of the service area or any state agency with jurisdiction over the taxing district or any citizen living in the proposed area of the taxing district may, within thirty (30) days of the decision of the fiscal court, appeal the decision of the fiscal court on the formation of a district to the Circuit Court.”).

¹⁹⁴ N.D. CENT. CODE ANN. § 61-05-20 (West) (“An appeal may be taken to the district court from any order or decision of the state engineer by any person who is aggrieved thereby.”).

¹⁹⁵ MD LOCAL GOVT § 27-204 (noting that “[e]ach landowner who has not signed the petition is a respondent,” and that the “designated officer shall issue a summons to be served on each respondent”).

¹⁹⁶ See MO. ANN. STAT. § 242.020 (West) (describing a process in which “owners of a majority of the acreage” file a petition with the county court; then notice; then opportunity for objection – which operates as a kind of ex post litigation). N.C. Gen. Stat. Ann. § 156-57 (West). Usually this means that due diligence has been used to determine the names of all landowners within the area of the proposed district; then summons can be issued for such landowners.

person who thinks he “will not be benefited by the improvement and should not be included in the district may appeal from the decision of the court.”¹⁹⁷ A typical Nebraska statute likewise allows that, “[if] any owner of real estate located in the proposed district satisfies the court that his or her real estate, or any part thereof, will not be benefited thereby, then the court may exclude such real estate as will not be benefited and declare the remainder a district as prayed for.”¹⁹⁸

The sheer variety of objections that might be posed to a new district is perhaps why a court — as opposed to a higher legislative or administrative authority — is often the body that oversees the petition, formation, and *ex post* adjudication process.¹⁹⁹ And even those states in which the formation process is not overseen by a court include some adjudicatory oversight procedures, like hearings before a commission or some other body after a petition for formation is submitted.²⁰⁰

The bottom line is that there is a wide variety of methods for correcting a problem that is (or would be) created by a new SPG. *Ex post* checks — hearings and adjudication *after* a district has been formed — have begun to appear more recently. To us, this suggests that formation ‘by right’ is compatible with safeguards against the most serious SPG concerns. Again, we think experience is probative: The states that have experimented with creation as of right (coupled with *ex post* adjudication) have not encountered serious difficulties as a consequence — suggesting that the resultant litigation would not be overwhelming.

D. Are Ex Ante Checks Useful?

This leaves us to consider the other side of the question: In states that have adopted strong *ex ante* approval mechanisms — say, required approval from a court or the board of county commissioners — are the mechanisms useful? We have found little evidence that they are. In most states, the *ex-ante* approval mechanism never results in a rejected application. Our interviews failed to reveal more than a tiny handful of cases, confined to a small number of states, in which the relevant authority failed to approve a petition to form an SPG. It is of course possible that the petitions submitted to state supervisory institutions are crafted *ex ante* to conform to the requirements generally imposed by the approval mechanism — in which case, even if the *ex-ante* controls are rarely used, they cast the shadow in which proposals are formulated. But we find such a relationship doubtful:

We asked dozens of practitioners who work with SPGs about the circumstances under which a petition to form a new government is *rejected*. If, for example, the statute requires that the county board of commissioners sign off on all new water districts, do the commissioners ever say *no*? Only one person with whom we spoke was able to identify an instance of an application being rejected (apparently because the district’s taxing power would not be subject to democratic

¹⁹⁷ *Id.* §§ 156-66 (West).

¹⁹⁸ NEB. REV. STAT. § 31-730.

¹⁹⁹ For a representative statute that gives jurisdiction to a court, see 82 OKLA. STAT. ANN. § 542 (West).

²⁰⁰ In Texas, for example, a relatively small number of residents can submit a petition to form an emergency services district to the county board of commissioners, which then holds a public hearing before making the ultimate decision about formation. *See, e.g.*, TEX. HEALTH & SAFETY CODE ANN. § 775.011 (West).

oversight).²⁰¹ Several were surprised to learn that their state statutes had approval mechanisms to begin with. While it is possible to imagine that dropping these approval mechanisms would open the floodgates to problematic new SPGs, few practitioners we spoke to thought this was a plausible concern.²⁰²

Voters do seem to occasionally reject proposals for new SPGs in majoritarian referenda²⁰³ — but this is different from a court or commission rejecting a district that has been approved by the majority. And there is evidence, at least from the early days of SPGs, of proposed districts in which the boundaries were drawn to include a strongly opposed minority²⁰⁴ — something which, we believe, could be handled as well or better by means of ex post adjudication.

More broadly, we found few reported cases of SPGs being unfairly imposed on unwilling residents. The most frequently reported problems tend to fall into two categories. First, there are problems of notice, such as cases in which people do not know they are living under a special district and are poorly informed of their rights or obligations. Second, there are reported cases of multiple overlapping or otherwise confusing special districts — suggesting, perhaps, that some could be merged productively, or otherwise have their boundaries rationalized. While notable, these strike us as problems that can be solved with tweaks to the statutory framework — such as better notice and easier merger mechanisms — and not problems that reflect an inherently exploitative relationship between districts and residents.

E. Incorporation as of Right?

There is, as the previous sections suggest, great variation in the procedures for forming an SPG. But there is, as far as we can tell, little rhyme or reason to this variation. To us, this variation suggests a statutory landscape that is fertile for reform.

Even in states that do have a petition and hearing process, there is ample room for rationalizing those processes. Because different enabling statutes have been passed decades apart, there are often mysterious, inexplicable variations in how the petition processes operate. In Iowa

²⁰¹ E-mail from LeGrand Bitter, Exec. Dir. Utah Assoc. of Special Districts, to author (Oct. 4, 2013, 1:11 EST) (on file with author) (“The only situation that I am aware of where a proposal to create a district was rejected[] occurred because of citizen fears of taxation without representation.”).

²⁰² E-mail from Karen Horn, Vermont League of Towns and Cities, to author (Oct. 7, 2013, 10:52 EST) (on file with author) (“I don’t think there would be a proliferation of new districts. I sort of think that time is past.”).

²⁰³ E-mail from Thomas J. Mahon, Merrimack Town Council, to author (Oct. 2, 2013, at 3:44 PM) (on file with author) (“In the last ten years, I believe slightly more have been rejected that have been authorized. . . . A small group in an area wish to be free of the host government and do not carry the rest of the residents of the proposed district, often because the cost will likely be higher to them.”); E-mail from James Angle, Florida Association of Special Districts, to author (Sept. 30, 2013, at 8:07 EST) (on file with author) (“Usually, the idea of creating a district will clear its political hurdles before an advocate petitions for creation. When a petition is reject[ed], it is usually because it became politically controversial after being requested.”)

²⁰⁴ See Hutchins, *supra* note 121 at 9 (“Some of the earliest districts met disaster or at least years of obstruction because of the inclusion of too much land belonging to persons opposed to district organization. This cause of failure, while still to be reckoned with, is not so pronounced as it was some years ago.”).

alone, for example, some petition processes require the owners of at least 30 percent of all real property within the proposed district; others require twenty-five percent of the resident property owners; others require either 25 property owners or 25 percent of the property owners of the proposed district; still others require any 25 or more eligible electors residing within the limits of the proposed district.²⁰⁵ In other states, the bar is higher. In Ohio, property owners of at least 60 percent of the ‘front footage’ can petition the appropriate legislative authority, or owners of at least 75 percent of the land area within the proposed district petition the appropriate legislative authority.²⁰⁶

Finally, there is room for rationalizing who *considers* the petition for formation. The list of public bodies that oversee these processes is long and messy – what one practitioner described as “a really mixed bag and very frustrating.”²⁰⁷ The state auditor, the secretary of state, county commissioners, circuit courts, and city governments are variously assigned to approve or reject special district petitions. The variations both across states and within states are seemingly random: In some states, fire districts must be formed by petitioning the county; in others, it is the local circuit court.

F. A Proposal

To simplify these issues, we suggest that each state use the same procedure for forming all SPGs within that state, without regard to the type of service to be provided by the SPG. More particularly, we suggest a formation procedure involving the following basic steps.

Petition. The first step is a petition signed by a given, relatively low, percentage (perhaps 10%) of the residents who will be included in the proposed district and – if the SPG is to be financed by taxes or assessments on real property -- by the owners (resident or nonresident) of a similar percentage of the land within the proposed district’s territory. The petition is to be submitted to a state official designated by the statute – perhaps the Secretary of State (as is common with business corporations), or perhaps a state agency created specifically to oversee SPGs, or perhaps a local court. In any event, the role of the state official is simply to make certain that the petition is sufficiently clear about the main elements of the proposed SPG and has the requisite number of valid signatures. The official is not to act on the basis of his or her perception of the merits of the proposed SPG. The official will be given only limited time (perhaps 30 or 60 days) to act on the petition, after which it will be automatically deemed suitable.

Hearing. After the petition is approved, the promoters of the proposed SPG must arrange for a hearing on the proposal that is open to the general public. All members of the proposed district must be given adequate notice of the hearing, as must persons outside the territory of the proposed SPG who might be materially affected by it.

²⁰⁵ See IOWA LEGAL SERVICES DIVISION, SPECIAL DISTRICTS (2009), <https://www.legis.iowa.gov/docs/publications/LG/12355.pdf>.

²⁰⁶ Gregory A. Davis, Special Improvement District: A Tool for Targeting Investment (2009), <http://ohioline.osu.edu/cd-fact/pdf/1566.pdf>.

²⁰⁷ E-mail from Randy Cole, Ohio Controlling Board, to author (Sept. 30, 2013, at 11:36 EST) (on file with author).

Vote. The proposal, as modified after the hearing, must then be submitted to a vote among the members of the proposed SPG. While there are various ways in which a statute might reasonably allocate voting rights for this step, we suggest the following: If the proposed SPG will be funded in part or in whole by general property taxes, it must be approved by a majority of those who vote both in terms of numbers of property owners and assessed value. If the proposed SPG will be funded in part or in whole by assessments tied in some other manner to the benefits of the services provided – for example, by acreage in production if an irrigation district is proposed – then formation of the SPG must (also) be approved by a majority of the votes of the persons who will be subject to such assessments, both in terms of the number of persons and also weighted according to the expected allocation of assessments among those persons.²⁰⁸

The results of the vote should then be submitted – again, for verification only – to the same official to whom the original petition was submitted. Upon verification of a successful vote, the official must give notice that the SPG has come into being as a legal entity.

Ex-Post Adjudication. Decisions of the designated state official concerning the petition and the final vote should be subject to challenge only on the narrow grounds that the appropriate number of signatures on the petition, or votes on the final proposal, was not properly determined, with the result that the SPG was either permitted or denied formation inappropriately. Other objections to the character of the new SPG should be provided for in the form of litigation brought after official formation of the SPG.

In particular, persons who believe they were improperly included in, or excluded from, the territory governed by the SPG should be given standing to bring suit (as a class, if appropriate), with the SPG as defendant, to challenge their inclusion or exclusion. If the court decides that their inclusion or exclusion was inconsistent with the statutory standards (sketched above²⁰⁹) for determining the appropriate boundaries of an SPG's territory, the court can order appropriate adjustments to the territory. If those adjustments are such that, if they had been included in the original plans for the SPG, they might have affected the outcome of the original vote to approve the SPG, the court can order a new vote. Standing to bring such a suit might be limited in time -- for example, to 180 days after formation of the SPG -- although the potential for problems to develop over time, as they did with the SPG at issue in *Ball v. James*, suggests that the better alternative is to allow such suits to be brought anytime during the lifetime of an SPG

Challenges to the validity of the assessments charged to individual members of the SPG should, in contrast, be permitted when, and only when, an assessment is actually levied. Established constitutional doctrine clearly requires only this of an SPG; it does not require a right to bring suit contesting the formation of an SPG before the SPG has taken actions that, in themselves, offend the Constitution, nor does the Constitution require a right to bring suit claiming wrongful inclusion or exclusion prior to the levying of assessments,²¹⁰

²⁰⁸ Note that we have also suggested, above, that voting rights in the normal operation of the SPG, after it is formed, be weighted according to the size of special assessments, so that benefits, assessments, and voting rights should all be allocated proportionately among members of the SPG, both during and after its formation.

²⁰⁹

²¹⁰ [Memos from AED.]

G. Variations

The formation process that we outline here, like the other elements that we propose for a prospective SPG enabling statute, is quite general, leaving many details to be filled in. These include, for example, the forms of notice that are required for the hearing and subsequent vote to approve formation, and whether the promoters of the SPG can have their reasonable expenses reimbursed by the SPG after its successful formation.

Our purpose in sketching a sample statute, however, is simply to illustrate the potential for achieving the goals we think important in creating an appropriate legal environment for SPGs. Those goals, and their rough order of importance, are the following:

- To unify the enabling statutes for SPGs (excluding school districts) within each state, providing a single body of organizational law that does not vary according to the services that an SPG provides. (This must leave room, of course, for supplementary state statutes, or even local ordinances, that regulate the delivery of particular kinds of services, such as hospital care or fire protection.)
- To provide effective procedures for merger and dissolution of SPGs.
- To remove limitations on the purposes for which SPGs can be formed.
- To remove requirements for state officials to exercise discretion in authorizing the formation of SPGs.
- To provide for the formation of SPGs as of right.
- To establish uniformity across states in the enabling statutes for SPGs.

Note that our first priority is statutory uniformity within each state, while uniformity *across* states is our lowest priority. In fact, we believe that cross-state uniformity should remain a goal rather than become a reality. Where the statutory provisions in one state are clearly superior to those of another, it would be well to change the latter to conform to the former. But the legal, economic, political, and social context in which SPGs function is likely to change with sufficient rapidity that the ideal statute will never be achieved, and the incentive and opportunity to experiment with new legal approaches to the formation and functioning of SPGs will always be needed.

We have limited our proposal for a general SPG enabling statute, with formation as of right, to organizations providing only a single service. And we have suggested, as the best test of whether two activities constitute a single service, is whether the distribution of their benefits is strongly correlated. We see no reason to deny formation of BIDs under a general SPG statute so long as the BID meets this requirement, and meets as well the other statutory requirements we propose – including, in particular, that the SPG be democratic. Other BIDs should be formed as authorities, either under special legislative acts or under a general enabling act designed to accommodate their special characteristics.

XII. CONCLUSION

Special purpose governments lie on the boundary between public and private enterprise. They are analogous to consumer cooperatives in that they are typically formed to provide for consumer control over a service that constitutes a local monopoly. Electoral control of the organization by its customers removes the organization's incentive to exploit its monopoly position. But, as with fully private cooperatives -- and indeed all forms of organization -- collective control by a numerous electorate evidently becomes quite costly as the electorate

becomes more heterogeneous in its preferences concerning the conduct of the organization. In organizing local governments, there seem to be two polar solutions to this problem that are relatively effective. One is to create a government that is devoted explicitly to providing a single service, and that ties the allocation of costs and of voting control relatively tightly to the benefits each person obtains from the service. The other solution is to bundle together a large number of services for provision by a single government, with the effect of inducing in the electorate a shared concern for competent general managers that overshadows concerns for particular levels of the individual services in the bundle.

The result is that there is a great divide in practice between single-purpose governments and general-purpose governments. This divide permits the law to regulate single-purpose governments – for example, concerning voting rules and the right to formation -- in a manner that is reasonably uniform across that class of governments, and that leaves the regulation of general-purpose governments largely unaffected. The divide also makes it clear just how close many special-purpose governments are to private enterprise in structure and function.

The law has been slow to adapt to these realities, however, leaving most states with a hodgepodge of particularized statutes that impose arbitrarily different requirements on special-purpose governments according to the particular services they provide. We have therefore sketched the main outlines of a unified enabling statute providing for the formation of special purpose governments of all kinds. Recognizing the strong parallels between special-purpose governments and conventional forms of private enterprise (including business corporations, cooperatives, condominiums, and nonprofits), and drawing on the lived experience with special-purpose governments in the various states, our proposed statute eliminates restrictions on the purposes for which special-purpose governments can be formed and permits creation of special-purpose governments as of right, while limiting those governments to provision of a single service and providing mechanisms and principles for reforming, merging, or dissolving special-purpose governments that are malformed or have become anachronistic.

The general statutory principles that we sketch leave a variety of choices to be made and details to be filled in. It is our judgment that each individual state should provide for these details as they see fit, but in the same way for all SPGs within the state. At the same time, variation in statutory details *across* states is likely to yield fruitful experimentation, and should be encouraged.