PRIVATE ENFORCEMENT IN THE PUBLIC SPHERE— TOWARDS A NEW MODEL OF RESIDENTIAL MONITORING OF LOCAL GOVERNMENTS

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Private enforcement litigation, namely class and derivative actions, are powerful tools in the commercial domain. By empowering a representative-plaintiff to litigate in the name of a harmed dispersed group, these procedures solve collective action problems, and improve shareholder and consumer monitoring. The article explores the potential of using such litigation tools also in the local public sphere. It examines local residents' possibility to sue on behalf of a dispersed group of taxpayers ("taxpayer suits") and to receive remedy for harms the group (as a whole) suffers.

The article provides the most extensive analysis of such local taxpayer suits to date. We show that although taxpayer suits are legally available in almost all states, they are, by and large, a dead letter. As opposed to their commercial equivalents, and despite their considerable potential importance, taxpayer-plaintiffs scarcely use them; courts constrain them and the legal literature mostly ignores them. We argue that the implementation of several relatively simple reforms can increase the use of this forgotten legal tool—thereby improving the monitoring on local officials, decreasing corruption, and empowering local residents.

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INTRODUCTION

In 1861, Simeon Draper, a senior city official, was involved in the sale of real-estate property belonging to the city of New York.[1] Mr. Draper had a personal interest in the deal, but despite the conflict of interests, no city or state official barred his involvement. He participated in the negotiations, and was very much influential in procuring the conveyance.[2] Due to the city and state's inaction with respect to Draper's involvement in the deal, Roosevelt, a city taxpayer, turned to the courts.[3] He argued that under the city's ordinance Mr. Draper was prohibited from taking part in the transaction, and requested the court to void the deal.[4] The court agreed with Roosevelt on the merits, but refused to grant his request.[5] The court explained that although the city statute was violated, the plaintiff, as a taxpayer, had no rights "growing out of the violation."[6] The plaintiff was not part of the transaction, and he could show no special pecuniary interests that enabled him to "vindicate the law."[7] A few years later, referring to the situation in Roosevelt, the New York court explained the severity of the taxpayers' weakness as follows:

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1 Roosevelt v. Draper, 23 N.Y. 318, 319 (1861).
2 *Id.*
3 *Id.*
4 *Id.* at 322–23.
5 *Id.* at 326.
6 *Id.* at 330.
7 *Id.*

> Municipal corporations had become to an alarming extent the prey of the spoiler, and the tax-payer, upon whom the loss fell and the burden of the wrong-doing ultimately rested, was remediless . . . This utter helplessness of the tax-payer, and the fact that he was entirely at the mercy of officials who might prove unworthy of and criminally unfaithful to their trust, became an evil calling loudly for correction.[8]

As a response to the plight of taxpayers since the mid-19th century, courts and legislatures have developed a legal tool called: taxpayer suits.[9] A taxpayer suit is a type of class or derivative action in the public sphere.[10] Similar to the way class or derivative actions empower a representative-plaintiff to litigate in the name of consumers or shareholders, a taxpayer suit empowers a representative-plaintiff to litigate in the name of a group of taxpayers.[11] A local action injures a dispersed unorganized group of taxpayers (the damages suffered by each individual taxpayer being negligible), and the taxpayer suit procedure enables a representative plaintiff to seek remedy for the harm inflicted on the group as a whole.[12] The taxpayer suit is designed to facilitate the private enforcement of taxpayers' collective rights, and thus to relieve them, at least in theory, from the "mercy of officials who might prove unworthy."[13] The procedure can be used when local officials engage in self-dealing or receive excessive compensation,[14] when local decisions are taken without proper authority,[15] when the locality violates a group of taxpayers' rights,[16] or when the local government wastes public funds by conferring an unlawful benefit to a third party.[17]

As can be learned from the commercial sphere, the potential of private enforcement to improve monitoring on local governments can be significant.[18] Just as class and derivative actions incentivize shareholders and consumers—or, more precisely their lawyers—to monitor commercial corporations, taxpayer actions can incentivize taxpayers, or their lawyers, to monitor municipal corpo-

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[8] Ayers v. Lawrence, 59 N.Y. 192, 195–96 (1874).

[9] The procedure is also known as a "watchdog suit." *See*, *e.g.*, Charles W. Goldner, Jr., *State and Local Government Fiscal Responsibility: An Integrated Approach*, 26 WAKE FOREST L. REV. 925, 939–40 (1991).

[10] 74 AM. JUR. 2D *Taxpayers' Actions* § 4 (2017).

[11] 18 EUGENE MCQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS § 52:2 (3d ed. 2017).

[12] *Id.*

[13] *Ayers*, 59 N.Y. at 195.

[14] *See, e.g.*, Davis v. State ex rel. Hood, 198 So. 3d 367, 367 (Miss. Ct. App. 2015).

[15] *See, e.g.*, Sullins v. Cent. Ark. Water, 454 S.W.3d 727, 727 (Ark. 2015); Westbrook v. Prudential Ins. Co. of Am., 524 N.E.2d 485, 485–86 (Ohio 1988); State ex rel. Fent v. State ex rel. Okla. Water Res. Bd., 66 P.3d 432, 433 (Okla. 2003).

[16] *See, e.g.*, Comps, Inc. v. Town of Huntington, 703 N.Y.S.2d 225, 225–26 (N.Y. App. Div. 2000).

[17] *See, e.g.*, Square Parking Systems, Inc. v. Jersey City Business Adm'r, 449 A.2d 559, 559 (N.J. Super. Ct. Law Div. 1982); City of Wichita Falls v. Cooper, 170 S.W.2d 777, 778 (Tex. Civ. App. 1943).

[18] *Cf.* Max Schanzenbach & Nadav Shoked, *Reclaiming Fiduciary Law for the City*, 70 STAN. L. REV. (forthcoming 2018).

rations. The actions can create an army of private attorney generals that initiate legal proceedings when local officials' conduct seems illegal or corrupt, and the litigation may discipline the officials, deter corruption, and improve local decision-making processes—all at very little cost.[19]

But despite the potential of taxpayer suits to serve as a monitoring tool on local governments, and although the procedure is legally available in almost all states, today it is, by and large, a dead letter. Taxpayer-plaintiffs scarcely use this procedure; courts, despite their rhetoric, constrain its use, and the legal literature mostly ignores it. The legal tool developed to empower taxpayers vis-à-vis their local officials is all but forgotten, leaving local residents not much better than they were when the *Roosevelt* case was decided in 1861.[20] In this article, we aim to shed light on this woefully, under-explored procedure. We provide an extensive examination of local-taxpayer suits in various states (to the best of our knowledge, the first of its kind), and analyze them from both positive and normative perspectives.

To examine the use of local-taxpayer suits, we conducted a case-law survey of fourteen states. We looked at how often taxpayer suits were utilized by taxpayers, and how the suits were received by different courts. The data presented in the article shows that, despite the potential benefits of this procedure—and, as opposed to the multitude of class—and derivative actions—local taxpayer suits are rarely used. Since 1990, most states have seen less than fifty taxpayer actions (i.e., less than two taxpayer actions per year on average); Only two states (Ohio and California) saw more than 150 taxpayer actions (188 in California, and 155 in Ohio).[21] Overall, in the states examined, there were approximately 700 local-taxpayer cases in twenty-six years—i.e., on average, only 4 percent of the general purpose local governments dealt with even one taxpayer suit over the last quarter century.[22] Even if we compare taxpayer suits to a small subset of all class-action suits, i.e. federal securities class actions, the number of taxpayer suits is very small. The average number of local-taxpayer suits filed each year in all the states we examined (twenty-seven suits) is a seventh of the average number of securities class actions filed each year (188 suits)—even though the number of general purpose local governments in these states is almost four times the number of listed companies.[23]

The reasons for the scarcity of taxpayer suits, we maintain, can be divided into two broad categories: objective reasons and legal reasons.[24] The objective reasons are related to the information available to potential plaintiffs. As opposed to commercial corporations, local authorities do not disclose detailed in-

19 *See* discussion *infra* Section II.B and accompanying notes.
20 *See* discussion *infra* Section III.A and accompanying notes.
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24 *See* discussion *infra* Section III.C and accompanying notes.

formation about their operations,[25] and there are no share prices that reflect adverse events or quantify potential damages. The lack of information renders the initiation of litigation more difficult, and, as a result, fewer actions are filed.[26] These objective reasons, albeit important, are supplemented by legal reasons. Our examination reveals that although courts express their support for the taxpayer suits procedure, in practice they are somewhat reluctant.[27] Some courts require plaintiffs to meet certain standing requirements (even though these requirements are not mandated by statute); some courts narrowly interpret the statutes that provide for taxpayer suits, and perhaps most importantly, nearly all courts rarely award attorney's fees to representative-plaintiffs (even when they have statutory authority to do so).[28] Thus, plaintiffs have to bear the full costs of the litigation, but since they enjoy only a small portion of the benefits, they have little interest to initiate proceedings.

These courts' attitudes raise a normative question—should the legal system encourage taxpayer suits, or perhaps allowing only a few taxpayer suits is socially preferable? To answer this question, the article addresses three arguments raised against the extensive use of taxpayer suits—the separation of powers doctrine, the flood of litigation concern, and the circularity argument.[29] We examine each of these arguments, but argue they do not justify the courts' attitudes. Although these arguments raise valid criticisms, they do not require a narrow interpretation of judicial review in taxpayer suits. On the contrary, we maintain that, if properly administered, taxpayer suits can benefit residents by enhancing the monitoring of local officials, supporting weak groups in the locality, and reducing the power of special-interest groups.

In order to strengthen judicial review, therefore, we suggest several reforms.[30] First, contrary to the American rule, we argue that courts in taxpayer suits should award attorneys' fees to winning plaintiffs. The article shows that the mechanism of private enforcement relies on the award of attorneys' fees because it is the lawyers who conduct the monitoring and push for litigation. The courts' current approaches marginalize the lawyers' role, thus rendering the taxpayer procedure inefficient.[31] Second, we propose that courts adopt a corporate-like standard of judicial review also when scrutinizing municipal corporations. Corporate courts, especially in Delaware, are cautious when reviewing corporate officers' discretion, but they do intervene when officers behave unlawfully, without good faith, or when the decision-making process is

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[25] Darien Shanske, *The Feds Are Already Here: The Federal Role in Municipal Debt Finance*, 33 REV. BANKING & FIN. L. 795, 802–03 (2014); Theresa A. Gabaldon, *Financial Federalism and the Short, Happy Life of Municipal Securities Regulation*, 34 J. CORP. L. 739, 742–53 (2009).

[26] *See* discussion *infra* Section III.C.

[27] *See* discussion *infra* Section III.B and accompanying notes.

[28] *See* discussion *infra* Section III.B and accompanying notes.

[29] *See* discussion *infra* Part IV.

[30] *See* discussion *infra* Section IV.D.

[31] *See* discussion *infra* Section III.C.

flawed.[32] This is the type of judicial review we call for in taxpayer actions as well. Instead of shying away from judicial review altogether (as most courts do) or, conversely, instead of replacing the officials' discretion with their own, courts should take the middle ground. They should examine whether the procedure that led to the decision (the decision-making process) is proper, and, of course, whether the decision itself is legal, and intervene only to the extent it is not.

The article, we believe, makes several contributions to the existing literature. First, when exploring the monitoring of local governments, the literature so far has focused on three possible monitors: the locality's residents, the locality's creditors, and the state.[33] Little attention has been paid to the possibility of private monitoring through taxpayer litigation. Although the option of local taxpayer suits is available in most states (and even on the federal level), and although private enforcement is extremely successful in the commercial sphere, the legal literature largely overlooked it. In the article, we fill this gap. We do not claim that taxpayer suits should replace existing monitors, but we do argue that it can improve and empower local monitoring. Second, with respect to the taxpayer suits procedure itself, the literature so far has mostly concentrated on the Supreme Court's rejection of federal and state taxpayer suits, and pointed out that the state system is more receptive to this type of procedure.[34] In the article, however, we show that, even in state courts, taxpayer suits, or at least local-taxpayer suits, are neither prevalent nor very well received. This conclusion is based on novel data we gathered from hundreds of state courts' decisions (including information on parties, causes of action, remedies sought, acceptance rates, and the allocation of attorney's fees). Third, we use the empirical analysis to draw policy recommendations. We argue that the taxpayer procedure introduces the private lawyering sector as an additional monitoring agent that can help decrease the residents' collective-action problems. The reforms we suggest encourage the use of this tool by the private-lawyering sector that in turn enhances the judicial review on local governments and local officials.

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[32] Lynn A. Stout, *In Praise of Procedure: An Economic and Behavioral Defense of* Smith v. Van Gorkom *and the Business Judgment Rule*, 96 NW. U. L. Rev. 675, 675 (2002); Jamie L. Kastler, *The Problem with Waste: Delaware's Lenient Treatment of Waste Claims at the Demand Stage of Derivative Litigation*, 95 MINN. L. REV. 1899, 1902–03 (2011).

[33] Charles K. Coe, *Preventing Local Government Fiscal Crises: Emerging Best Practices*, 68 PUB. ADMIN. REV. 759, 759 (2008); Clayton P. Gillette, *Can Public Debt Enhance Democracy?*, 50 WM. & MARY L. REV. 937, 937 (2008); Omer Kimhi, *Reviving Cities: Legal Remedies to Municipal Financial Crises*, 88 B.U. L. REV. 633, 656 (2008); Richard C. Schragger, *Citizens Versus Bondholders*, 39 FORDHAM URB. L.J. 787, 789 (2012).

[34] Nancy C. Staudt, *Taxpayers in Court: A Systematic Study of a (Misunderstood) Standing Doctrine*, 52 EMORY L.J. 771, 773–75 (2003); Edward A. Zelinsky, *Putting State Courts in the Constitutional Driver's Seat: State Taxpayer Standing After* Cuno *and* Winn, 40 HASTINGS CONST. L.Q. 1, 3 (2012).

The article then proceeds as follows: In the first part of this article, following this introduction, we discuss local monitoring in general. We describe the various monitors, and show that local monitoring is lacking. In the second part, we look at private enforcement mechanisms, and show how they can contribute to local monitoring. The third part analyzes the data on local taxpayer suits. In the fourth part, we conduct a normative analysis and suggest possible reforms. The fifth part of the article concludes.

I. LOCAL GOVERNMENT MONITORING

Much like commercial corporations, municipal corporations suffer from agency problems.[35] As public choice theory indicates, local officials can also be viewed as a *homines economici*, whose aim is to increase their political power and control, rather than altruistically serve the public.[36] Local officials may spend public funds on unnecessary, even extravagant, infrastructure, succumb to the demands of interest groups in order to gain their political support, and are liable to overspend the local budget on salaries or pensions to avoid conflicts with municipal employees.[37]

Due to the perils of these agency problems—and, again, not unlike commercial corporations—local officials are monitored by several agents.[38] Just as corporate officers are monitored by the corporation's shareholders and creditors, local officials are monitored by the local residents, the locality's creditors, and the state that the municipality is located.[39] In this part, we examine the efficiency of this monitoring. We show that although each of these monitoring parties serves an important role, the monitoring of local officials and local activities can be lacking. Residents and creditors suffer from collective-action problems, and the state suffers from political biases.

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[35] An agency problem occurs when the welfare of one party (the "principal") depends on actions taken by another (the "agent"). The agent may not act in the best interests of the principal, but rather to maximize his own welfare. *See* John Armour et al., *Agency Problems, Legal Strategies and Enforcement* 2 (Harvard Law Sch. John M. Olin Ctr. for L., Econ. and Bus., Paper No. 644, 2009), http://lsr.nellco.org/cgi/viewcontent.cgi?article=1433&context=harvard_olin [https://perma.cc/J4ZZ-UHG4]. For a description of agency problems in the commercial-corporate context, *see* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 309 (1976).

[36] Robert J. Barro, *The Control of Politicians: An Economic Model*, 14 PUB. CHOICE 19, 26–31 (1973); Jean Tirole, *The Internal Organization of Government*, 46 OXFORD ECON. PAPERS 1, 1–2 (1994).

[37] Daniel A. Farber, *Democracy and Disgust: Reflections on Public Choice*, 65 CHI.-KENT L. REV. 161, 161 (1989); Clayton P. Gillette, *In Partial Praise of Dillon's Rule, or, Can Public Choice Theory Justify Local Government Law?*, 67 CHI.-KENT L. REV. 959, 962–64 (1991).

[38] Kimhi, *supra* note 33, at 647–55.

[39] *Id.*

A. The Residents

At first glance, residents appear to be the most obvious and potent monitors of local policies. They have a clear interest in monitoring because they live in the locality and the quality of their lives is influenced by the way the locality is managed. They also have the tools to influence because they vote in the local elections and participate in the Tieboutian market for residence (they can exit the locality).[40]

A closer look at the residents as monitoring agents, however, reveals some inherent difficulties. The residents suffer from collective-action problems.[41] Although the monitoring efforts can benefit the residents as a group, each individual resident has little incentive to invest in it. Monitoring not only consumes time and resources, but its benefits are spread among all the local residents—even those who do not share its costs. Thus, each resident has an interest in letting others invest in the monitoring for him, while he stays idle and "free ride[s]."[42] Since many residents are rationally indifferent, monitoring is under-provided, to the detriment of the community as a whole.[43]

The existence of special interest groups aggravates the residents' monitoring ability even further.[44] Interest groups are discrete, well-organized groups in the community that pursue a common goal.[45] By definition, an interest group does not seek to maximize the benefit of the locality, but rather to promote the narrow interests shared by the group's members.[46] The problem (or advantage) of interest groups is that they are more efficient in pursuing their goals than the large, dispersed public.[47] Due to their size, interest groups are better able to force their members to take part in the pursuit of the groups' goals, and since they have fewer members (when compared to the large, dispersed public), the members receive a larger portion of the benefits attained by the group.[48]

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[40] Clayton P. Gillette, *Bondholders and Financially Stressed Municipalities*, 39 FORDHAM URB. L.J. 639, 658 (2012).

[41] *See id.* at 658–59; Schragger, *supra* note 33, at 790.

[42] Gillette, *supra* note 40, at 659.

[43] As Clayton Gillette points out, monitoring is a type of public good. *See* Gillette, *supra* note 33, at 955. In economics, public good is defined as having two characteristics: non-rivalry and non-excludability. A good is non-rivalrous when its consumption by one individual does not reduce the amount of the good available to other potential consumers. A good is non-excludable when it cannot be excluded from those who did not share the costs of its production. *See* RONALD C. FISHER, STATE AND LOCAL PUBLIC FINANCE 41 (2d. ed. 1996). Since monitoring is both non-rivalrous and non-excludable, it is likely to be under-provided under regular market conditions.

[44] Gillette, *supra* note 40, at 659.

[45] MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 6, 9–16 (2d ed. 1971).

[46] Einer R. Elhauge, *Does Interest Group Theory Justify More Intrusive Judicial Review?*, 101 YALE L.J. 31, 35–41 (1991).

[47] OLSON, *supra* note 45, at 7.

[48] Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211, 211–13 (1976); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT.

Whereas unorganized residents are often rationally indifferent, interest groups—through lobbying, contributions or political support—are able to influence local officials. Policy is skewed in their direction, and the large, dispersed public can do little to prevent this outcome.[49]

Therefore, leaving the monitoring to the residents, can lead to inefficient outcomes. It can disproportionally benefit interest groups, at the expense of the general public.

B. The Creditors

Due to the residents' collective action problems, some scholars, most notably Clayton Gillette, have seen the locality's creditors as a possible substitute.[50] A locality's creditors, similar to the creditors of a commercial corporation, have an interest in monitoring their debtor. If the locality is poorly managed, or if it overspends its financial resources, the creditors are at risk of financial loss. Although the creditors do not have the residents' voting powers, they can exert influence on local officials through alternative tools.[51] Credit agreements may contain covenants that compel (or prevent) localities from taking certain actions,[52] and, in any event, the creditors control the extension of credit. If a locality takes a confrontational approach or ignores the creditors' demands, the creditors may raise interest rates or cease to extend them credit altogether.[53]

The creditors' monitoring, however, also entails difficulties. The primary problem, perhaps the main problem, is the scope of the creditors' monitoring. As opposed to the residents, who live, educate their children, and own real-estate in a locality, the creditors have a relatively narrow interest in that locality—the repayment of the credit they extend. From the creditors' point of view, city officials can act self-interestedly and implement whatever policy they wish, as long as the city has sufficient resources to pay them back.[54] They do not care about the level of services the city provides or the burden of taxes imposed on the residents. This is especially true when a certain action or policy harms the residents, but improves the local fiscal health. A local action may be dishonest, even illegal, but the creditors will have little incentive to prevent it, if the action decreases the chances of local insolvency. Creditors, for example, do not monitor whether the city levies taxes contrary to the law, or whether the mayor grants illegitimate favors to certain businesses.[55]

SCI. 3, 10–13 (1971); Robert D. Tollison, *Public Choice and Legislation*, 74 VA. L. REV. 339, 341–42 (1988).

49 *See* Elhauge, *supra* note 46, at 35–41; s*ee also* Gillette, *supra* note 40, at 659–64.

50 Gillette, *supra* note 33, at 966; Gillette, *supra* note 40, at 664.

51 Kimhi, *supra* note 33, at 661.

52 Gillette, *supra* note 33, at 952.

53 Kimhi, *supra* note 33, at 661.

54 Gillette, *supra* note 40, at 667.

55 *Id.* at 666–70.

A second problem with creditors' monitoring concerns their ability to affect local policies when they discover a malfunction. Although, as mentioned, creditors can pressure local officials, this may be insufficient. In many cases, officials are perfectly aware that a certain action or decision they take is objectionable to creditors, but take it anyway, either because they gain a personal benefit from it, or because they are bound by political circumstances or interest group pressures.[56] In these cases, the creditors' pressures do little good. Whether interest rates are raised, or even if credit is denied, local officials may be set in their ways.[57]

C. *The State*

The state is a third monitoring agent that can potentially solve these problems.[58] According to local-government law, local governments are creatures of the state. States regulate local governments in their jurisdiction, both in terms of operations and finances.[59] They set local debt and tax limitations, establish operational guidelines, and can establish environmental controls.[60] The state's monitoring activities are an extension of its regulatory capabilities. In case the local officials ignore the state's guidelines, the latter can sanction the disobeying locality or its local officials personally. In this respect, the state's monitoring is much more efficient than that of the residents or creditors. The state does not suffer from collective action problems, and it possesses the political powers and legal authority to influence local policies.[61]

However, the state's monitoring also has drawbacks. First, the state's monitoring involves significant costs. For the monitoring to be conducted effectively, the state needs to create a monitoring body with an adequate professional and administrative staff.[62] States are not necessarily willing to invest the funds needed for such a professional body, often preferring to downgrade the moni-

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[56] Kimhi, *supra* note 33, at 662–63.
[57] *Id.*
[58] *Id.* at 664; Clayton P. Gillette, *Dictatorships for Democracy: Takeovers of Financially Failed Cities*, 114 COLUM. L. REV. 1373, 1384–85 (2014).
[59] Local government law gives states plenary powers over local governments. Unless otherwise asserted in the state's constitution, the state has the requisite authority to force local governments to implement policies or take actions, whereas local governments have only those powers delegated to them by the state. *See* Hunter v. City of Pittsburgh, 207 U.S. 161, 178–79 (1907); 1 SANDRA M. STEVENSON & WENDY VAN WIE, ANTIEAU ON LOCAL GOVERNMENT LAW § 13.01 (2d ed. 2017); Richard Briffault, *Our Localism: Part I—The Structure of Local Government Law*, 90 COLUM. L. REV. 1, 6–9 (1990); Gerald E. Frug, *The City as a Legal Concept*, 93 HARV. L. REV. 1057, 1062–65 (1980).
[60] Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 YALE J. ON REG. 351, 385–91 (2010).
[61] *Id.* at 386.
[62] The Local Government Commission in North Carolina, for example, employs about 35 associates and additional administrative staff, and its budget is more than $2.5 million dollars. *See* Coe, *supra* note 33, at 45.

toring level.[63] This problem is particularly acute, since the state and its political officials do not always obtain political benefits from monitoring. Monitoring may improve the welfare of local residents or reduce the price of local debt,[64] but these benefits are long-term and hardly attributed to the state.[65] In the short term, especially when no locality is on the brink of financial calamity, monitoring may not bring state officials much political support.[66]

In addition, when states engage in monitoring, there is a danger that the monitoring will be politically oriented. State and local politics are, in many ways, intertwined,[67] and the state legislature and executive are politically motivated in the way they deal with localities.[68] These political motivations may be related to the local officials' party affiliation (and state officials' partisanship), but they may also be linked to the locality's geographical attributes—city or suburb, urban or rural, etc.[69] When a mayor and his governor are political rivals, or when the mayor does not have sufficient political influence in the state's corridors, the state's attitude towards the locality may be negative, and the monitoring can become politically-motivated instead of economically-driven.[70] Dorothy Brown's account of Bridgeport's municipal bankruptcy filing is a good example.[71] Per Brown, when monitoring Bridgeport's financial affairs, "State officials were motivated by their own political interests and not the best interests of Bridgeport's citizens."[72] The political rivalry between the

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[63] Omer Kimhi, *Chronicle of a Local Crisis Foretold–Lessons from Israel*, 39 FORDHAM URB. L.J. 679, 692–94 (2012).

[64] When the state closely monitors local governments' finances, it shows a commitment to the prevention of local crises. This reduces the risk of extending credit to all local governments in the state, hence reducing the interest rates localities are charged. North Carolina is a good example. Due to its Local Government Commission's exceptional work, credit rating agencies have upgraded the credit rating of North Carolina's local debt, lowering municipalities' interest rates. *See* Stephen C. Fehr, *North Carolina Agency Is Local Government Lifeline*, PEW CHARITABLE TR.: STATELINE (June 06, 2012), http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2012/06/06/north-carolina-agency-is-local-government-lifeline [https://perma.cc/DB8Q-QCKK].

[65] Kimhi, *supra* note 63, at 696–704.

[66] State voters (the local residents) do not always appreciate the state's monitoring, and state politicians do not derive political benefits from the funds the state invested in monitoring. It is politically convenient, therefore, to cut expenditures on local monitoring in favor of other state activities that are more politically beneficial.

[67] Nancy Burns & Gerald Gamm, *Creatures of the State: State Politics and Local Government, 1871–1921*, 33 URB. AFF. REV. 59, 89 (1997).

[68] *Id.* at 59 ("According to various accounts, this state-level interference has rarely been benign.").

[69] Nancy Burns et al., *Urban Politics in the State Arena*, 23 STUD. AM. POL. DEV. 1, 1 (2009).

[70] Kimhi, *supra* note 63, at 704–10.

[71] Dorothy A. Brown, *Fiscal Distress and Politics: The Bankruptcy Filing of Bridgeport as a Case Study in Reclaiming Local Sovereignty*, 11 BANKR. DEV. J. 625, 625 (1995).

[72] *Id.* at 634.

mayor and the state, argues Brown, much more than economic necessity, drove the city to bankruptcy.[73]

This is not to say that monitoring by the state, creditors, or residents is superfluous or redundant. On the contrary, their actions are important, as each of these agents monitor a different aspect of the city's affairs. The analysis, however, does indicate that the monitoring may be lacking. Due to the problems discussed, city officials' actions may not be sufficiently supervised, resulting in harm to city residents. This is partly why so many cities experienced financial distress and provided poor services to their residents in the last few years. Additional monitoring tools may be in order.

II. TAXPAYER SUITS

A possible tool to improve the monitoring is taxpayer suits. Taxpayer suits are legal proceedings brought by an individual taxpayer as a representative of a class of taxpayers.[74] The plaintiffs in this type of action seek remedy for harms they suffer as taxpayers, usually due to illegal government actions or other unauthorized government decisions.[75] The litigation may potentially benefit the resident-taxpayers (the class), because the court may enjoin illegal conduct by local officials, force city officials to take certain actions, or order damages either in favor of the class of plaintiffs or against a third party in favor of the local treasury.[76]

To better understand the rationale behind taxpayer suits, and how they can improve the monitoring of local officials, we begin by looking at their commercial equivalents—class-action suits and shareholders' derivative litigation. Class and derivative actions are important tools that allow shareholders to increase corporate accountability,[77] and by understanding their unique features, we can improve taxpayer actions to better suit their stated goals.

A. *Class and Derivative Actions in the Commercial Sphere*

Class and derivative actions are unique procedures.[78] Both actions do not fit the traditional litigation model, as they are designed to address problems faced by potential plaintiffs. The problems are liable to prevent plaintiffs from

[73] *Id*. at 663.
[74] 74 AM. JUR. 2D, *supra* note 10, § 1.
[75] JOHN MARTINEZ, 4 LOCAL GOVERNMENT LAW § 29:7 (2017).
[76] 18 MCQUILLIN, *supra* note 11, §§ 52:4, :19.
[77] Stephen P. Ferris et al., *Derivative Lawsuits as a Corporate Governance Mechanism: Empirical Evidence on Board Changes Surrounding Filings*, 42 J. FIN. & QUANTITATIVE ANALYSIS 143, 144 (2007).
[78] Alon Klement & Keren Weinshall-Margel, *Cost-Benefit Analysis of Class Actions: An Israeli Perspective*, 172 J. INSTITUTIONAL & THEORETICAL ECON. 1, 1 (2016).

initiating legal action, and the proceedings offer procedural solutions to facilitate the litigation.[79]

A class-action suit is designed to address the "free rider" (coordination) issue.[80] In a typical class-action situation, the defendant allegedly caused substantial damage to a large unorganized group of people, but the damage suffered by each individual in the group is relatively small. Due to the small damage suffered by the individual members, most members will be inclined not to sue. Their possible recovery does not warrant the costs and risks associated with the litigation, and, as a result, the injurer will not be brought to court and will not be forced to pay for the damages caused.[81] Class-action lawsuits offer a procedural solution to this problem: they allow an individual group member to prosecute as a representative of the group, without the need for all the group members to take action.[82] The representative plaintiff is required to adequately identify the group, and later notify the group members about the proceedings—however, the group members need not actively participate in the litigation.[83] The group members can opt out of the class action, but if they do not, they are bound by the result achieved by the class representative.[84]

Derivative suits are designed to solve a different issue—an agency problem.[85] Derivative actions address a situation where corporate officers breach their fiduciary duties towards a corporation, and, as a corollary, the corporation (and hence its shareholders) suffers damages.[86] In principle, the corporation, as a legal entity, has the capacity to sue its officers for such breach and recover the damages the officers caused. The problem is that the corporate officers—often the ones who breached their fiduciary duties in the first place—are the ones

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[79] Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 8–11 (1991).

[80] *Id*. at 8.

[81] *Id*. at 8–9.

[82] *Id*. at 9.

[83] Stephen C. Yeazell, *Collective Litigation as Collective Action*, 1989 U. ILL. L. REV 43, 43 (1989); Randall S. Thomas & Robert G. Hansen, *Auctioning Class Action and Derivative Lawsuits: A Critical Analysis*, 87 NW. L. REV. 423, 426–27 (1993).

[84] Due to the binding nature of class actions, a representative plaintiff must meet several prerequisites in order for the class action to be approved. These prerequisites include: numerosity (the class should be large enough so as to render a joinder of all members impractical), commonality (a predominance of the anticipated issues of fact and law raised in the litigation proceedings should be common to the class members), and adequacy of representation (the group should be adequately represented by the representative plaintiff). The court examines the resources of the representative plaintiff, the competence of the representative counsel, the relationship between the representative and the class, and so on. When these conditions are met, and if the class action is approved and succeeds on the merits, the group members—those who have not opted out—will receive their portion of the awarded compensation. *See* 1 WEINSTEIN, KORN & MILLER, CPLR MANUAL § 7.07[c] (3d ed. 2017).

[85] Macey & Miller, *supra* note 79, at 10.

[86] Donald E. Schwartz, *In Praise of Derivative Suits: A Commentary on the Paper of Professors Fischel and Bradley*, 71 CORNELL L. REV. 322, 327 (1985).

who decide whether the corporation will initiate legal proceedings, and naturally, the officers will hardly be inclined to take action against themselves or their peers. As a result, the corporation will fail to sue, and will not (nor will its shareholders) recover damages.[87] Derivative actions solve this problem by empowering shareholders to take legal action. They allow a representative shareholder to take the initiative out of the hands of incumbent officers and sue a third party (usually the incumbent officers themselves) on the corporation's behalf.[88]

Although class and derivative actions address different problems, they share common characteristics when compared to traditional models of litigation, especially with respect to attorney-client relationship.[89] As opposed to more traditional forms of litigation, in both procedures the plaintiffs' attorney does not represent a particular client or clients, but rather a vague, somewhat amorphic, group of allegedly injured parties (the injured class or dispersed shareholders).[90] Due to the typically large size of such groups and the small recovery by each of its members, group members usually do not closely supervise their attorney.[91] Plaintiffs' attorneys, therefore, can handle class actions or derivative litigation with great freedom and manage them in a way that serves their own interests.[92] In addition, in both types of actions, the plaintiffs' attorneys usually earn their fees only when the complaint has been successful (recovery is awarded from the fund created under the judicial decision or settle-

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87 Macey & Miller, *supra* note 79, at 10; Thomas & Hansen, *supra* note 83, at 427.

88 The Delaware Supreme Court explained that a derivative action is actually comprised of two suits: "First, it is the equivalent of a suit by the shareholders to compel the corporation to sue. Second, it is a suit by the corporation, asserted by the shareholders on its behalf, against those liable to it." *See* Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984); *see also* John C. Coffee, Jr. & Donald E. Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261, 264 (1981).

89 John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 677–79 (1986).

90 Agency problems between an attorney and her clients also exist in traditional forms of litigation. In order to minimize these problems, the legal profession developed several mechanisms, both market-based and regulatory, designed to incentivize attorneys not to abuse their clients' interests. *See* Geoffrey P. Miller, *Some Agency Problems in Settlement*, 16 J. LEGAL STUD. 189, 189 (1987). These mechanisms include: bar association admission and membership rules, rules of ethical conduct, reputation effects in the market for lawyers and so on. *See* Macey & Miller, *supra* note 79, at 12–19. All these mechanisms, however, require clients, at least to some degree, to monitor their attorneys' professional conduct. Such monitoring is absent in class and derivative actions, where the attorney represents a dispersed group of clients.

91 Myriam Gilles & Gary B. Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 U. PA. L. REV. 103, 132 (2006); Macey & Miller, *supra* note 79, at 19–20.

92 Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053, 2054–55 (1995).

ment).[93] If the court rejects the claim, the plaintiff's attorney receives nothing, even if she invested many hours of work and significant funds in the case.[94] This means that attorneys take cases only when they believe their gains will cover their investment.[95]

Due to these characteristics—the attorneys' relative freedom and the success-based fees—plaintiffs' lawyers in class and derivative proceedings are often considered the entrepreneurs of the litigation.[96] Often, it is the lawyer, rather than her clients, who finds a cause of action worth pursuing, and it is the lawyer, rather than her clients, who drives the legal proceedings.[97] The lawyers in these types of actions are sometimes referred to as "private attorney[s] general" and their actions are referred to as private enforcement.[98] Like an attorney general's work, the plaintiffs' lawyers' work—if successful—benefits the public (the plaintiff's class). The compensation awarded in the action forces potential violators to pay for the damages they caused, thereby internalizing the costs of the defendants' actions.[99] Like an attorney general, plaintiffs' lawyers also monitor corporations for potential causes of action. A viable cause of action can be profitable (due to the awarded attorney's fees), and so lawyers have an interest to check the corporate officers for violations, and initiate litigation when appropriate.[100]

B. *Private Enforcement in the Public Sphere*

The conceptual equivalents of the class and derivative actions in the public sphere are taxpayer suits.[101] Like class and derivative actions, taxpayer suits are representative in nature. In the latter, a locality or local official harms a group of residents (taxpayers), and an individual resident files a suit to correct the wrong on behalf of the group.[102] Note that taxpayer suits are distinct from indi-

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[93] Ferdinand S. Tinio, Annotation, *Attorneys' Fees in Class Actions*, 38 A.L.R. 3d 1384 § 2 (1971 & Supp. 2018).

[94] *Id*. § 3; Waters v. City of Chicago, 420 N.E.2d 599, 604 (Ill. App. Ct. 1981).

[95] Thomas & Hansen, *supra* note 83, at 431–33; Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees and Expenses in Class Action Settlements: 1993–2008*, 7 J. EMPIRICAL LEGAL STUD. 248, 249 (2010).

[96] Coffee, *supra* note 89, at 678 ("our legal system has long accepted, if somewhat uneasily, the concept of the plaintiff's attorney as an entrepreneur who performs the socially useful function of deterring undesirable conduct").

[97] Williams v. Balcor Pension Inv., 150 F.R.D 109, 118 (N.D. Ill. 1993).

[98] Gilles & Friedman, *supra* note 91, at 108–16. *See generally* William B. Rubenstein, *On What a Private Attorney General Is—And Why It Matters*, 57 VAND. L. REV. 2129, 2143–45 (2004).

[99] RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 349–50 (1973).

[100] Guy Halfteck, *The Law Enforcement Venture: Understanding the Effects of Investment in Class Actions on Corporate Liability Exposure* 1, 3, 11–12 (Harvard Law Sch. John M. Olin Ct. for L., Econ., and Bus., Paper No. 452, 2004), http://ssrn.com/abstract=497442 [https://perma.cc/XSC4-NZ52].

[101] 74 AM. JUR. 2D, *supra* note 10, § 4.

[102] 18 MCQUILLIN, *supra* note 11, § 52:2.

vidual suits filed by taxpayers.[103] In an individual suit, the action is designed to redress a private injury suffered by an individual taxpayer.[104] The individual taxpayer turns to the courts for his own benefit, not for the benefit of an undefined public (a class of taxpayers).[105] General taxpayer suits, on the other hand, are designed to redress a public injury.[106] The plaintiff raises an issue common to a class of taxpayers, and the requested remedy benefits the class as a whole, rather than the plaintiff alone.[107] In this article, we focus solely on general taxpayer suits, rather than on individual suits filed by taxpayers.

In most states, a taxpayer suit resembles a class action. A taxpayer believes that the locality acts illegally or wastes public funds, and sues the local authority for remedy.[108] In case the claim is affirmed, the local authority is enjoined from taking the illegal or wasteful action or is directed to pay damages to the injured public (the class). Some states also allow for derivative taxpayer actions[109] (Qui Tam actions).[110] A derivative taxpayer action, just like derivative actions in the commercial sphere, is not directed against the local authority itself, but rather against a third party—a local official or person (entity) who receives an illegal benefit from the local authority. When the locality fails (or refuses) to take advantage of a cause of action it has against such third party, a taxpayer can initiate an action in lieu of the local authority.[111] The action is filed on the local authority's behalf, and damages, if recovered, go to the local authority as well.[112] Other taxpayers thus benefit from the litigation derivatively, when the local treasury is enriched.[113]

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103 *Id.* § 52:1.
104 *Id.* § 52:2.
105 *Id.*
106 *Id.*
107 *Id.*; 74 AM. JUR. 2D, *supra* note 10, § 1.
108 1 STEVENSON & VAN WIE, *supra* note 59, § 73.04.
109 18 MCQUILLIN, *supra* note 11, § 52:18; Veazey v. Bd. of Educ. of Rich Twp. High Sch. Dist. 227, 59 N.E.3d 857, 864 (Ill. App. Ct. 2016) ("Taxpayers may have standing to sue either in their personal capacity as taxpayers or derivatively on behalf of a local governmental unit (taxpayer derivative).").
110 Qui Tam action is an action filed by an individual on behalf of a government. The idiom "Qui Tam" is short for the Latin phrase: "qui tam pro domino rege quam pro se ipso," which means "he who acts on the King's behalf as well as his own." *See* Jan P. Mensz, Note, *Citizen Police: Using the* Qui Tam *Provision of the False Claims Act to Promote Racial and Economic Integration in Housing*, 43 U. MICH. J.L. REFORM 1137, 1149 n.76 (2010). *See also* Franziska Hertel, Note, *Qui Tam for Tax? Lessons from the States*, 113 COLUM. L. REV. 1897, 1897–98 (2013). In the article, we refer to these actions as derivative actions, in order to emphasize the resemblance between the public and the commercial spheres.
111 18 MCQUILLIN, *supra* note 11, § 52:20.
112 1 STEVENSON & VAN WIE, *supra* note 59, § 73.01.
113 In states that allow a derivative taxpayer suit, the taxpayer is often required to show she has requested the local authority to bring suit and that the local officials refused to do so. If these conditions are met, taxpayers can litigate in the name of the local authority. *See id.* § 73.01[3].

The rationales for allowing taxpayer suits in the public sphere resemble those of class and derivative actions in the commercial sphere.[114] First, a harmful governmental act—for example, a waste of public funds—often does not significantly affect individual residents. The public as whole may be injured, but, due to the size of the locality, the loss each individual resident incurs may be negligible. A taxpayer suit facilitates the aggregation of these damages.[115] It empowers the representative plaintiff to litigate in the name of the public (the class as a whole), and to ask the court for a remedy that will benefit all injured members, rather than the plaintiff alone.[116] Moreover, many governmental actions affect residents in an equal manner. Individual residents do not suffer a particular damage, because the local action (law or policy) involves the public rather than distinct members thereof. Thus, since the general standing rule requires the plaintiff to show a particular injury, the primary purpose of the taxpayer suit is to "enable a large body of the citizenry to challenge governmental action which would otherwise go unchallenged in the courts because of the standing requirement."[117] It *renders* the regular standing rules more flexible and enables courts to scrutinize governmental acts to the benefit of the general public.[118]

Secondly, a taxpayer suit in its derivative form enables taxpayers to decrease "favoritism" on behalf of the local officials.[119] In cases where a senior local official acts improperly or where a municipality grants an illegal favor to a third party, the municipality itself may have little incentive to take action. The local attorney general may not wish to sue her colleagues, and political interests may deter local officials from confronting prominent donors, powerful corporations, or constituent-interest groups.[120] A derivative-taxpayer suit can overcome this agency problem by empowering residents to take the initiative to litigate through the municipality.[121] When, due to political interests or other ulterior

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[114] Gram v. Vill. of Shoreview, 106 N.W.2d 553, 557 (Minn. 1960) ("By analogy, the right of a taxpayer to maintain [a taxpayer's suit] is based on the same principles as the right of a stockholder in a private corporation to bring an action against the corporation or its officers . . . "); *see also* Bevelander v. Town of Islip, 10 A.D.2d 170, 172 (N.Y. App. Div. 1960); Richard A. Epstein, *Standing in Law & Equity: A Defense of Citizen and Taxpayer Suits*, 6 GREEN BAG 2D 17, 22–23 (2002).

[115] Richard A. Epstein, *Standing and Spending–The Role of Legal* and *Equitable Principles*, 4 CHAP. L. REV. 1, 28–29 (2001).

[116] 18 MCQUILLIN, *supra* note 11, § 52:2.

[117] Note, *Taxpayers' Suits: A Survey and Summary*, 69 YALE L.J. 895, 904 (1960); Faden v. Phila. Hous. Auth., 227 A.2d 619, 621–22 (Pa. 1967).

[118] *Taxpayers' Suits: A Survey and Summary*, *supra* note 117, at 896, 899–900.

[119] *Id*. at 904 ("Such litigation allows the courts . . . to add to the controls over public officials inherent in the elective process the judicial scrutiny of the statutory and constitutional validity of their acts").

[120] As a New York Court phrased it: "This utter helplessness of the tax-payer, and the fact that he was entirely at the mercy of officials who might prove unworthy of and criminally unfaithful to their trust, became an evil calling loudly for correction." *See* Ayers v. Lawrence, 59 N.Y. 192, 195–96 (N.Y. 1874).

[121] Epstein, *supra* note 115, at 28–29.

motives, local officials refuse to take advantage of a potentially beneficial cause of action, a representative resident can go to court and demand what rightfully belongs to the local treasury.[122] This not only enriches the locality, but also improves the monitoring of local officials and lessens the power of interest groups in the locality.

Thirdly, and as a corollary of the rationales above, a taxpayer suit enables individual members of the public (the plaintiffs and their lawyers) to influence public policy and monitor their elected officials.[123] Residents, who usually influence public policy only through the ballot box, can go to court and try to enjoin a government action, receive compensation, or prevent corruption. Just like in the commercial sphere, taxpayer suits can create an "army of potential private attorneys general."[124] Although the taxpayer plaintiffs may turn to court from personal motives (political, economic, or other), the creation of a large army of monitors can discipline officials and facilitate a more efficient government. As the New Jersey court explained,

> A taxpayer's suit is one of our system's strongest deterrents to corruption. It is a powerful check upon complacent or dishonest public officials. It is one efficacious mode by which an alert citizenry is able to maintain that eternal vigilance which still remains the price of freedom . . . Such an action then must not be unnecessarily restricted by the court through narrow judicial interpretation.[125]

And indeed, due to these rationales, private enforcement on local governments in the form of taxpayer actions has existed as early as the mid-19th century.[126] Initially, courts have based their jurisdiction on these actions using equity law.[127] Some courts viewed taxpayers as equity owners of the local

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[122] As early as 1881, John F. Dillon wrote in his treatise:

> But if the officers of the corporation are parties to the wrong, or if they will not discharge their duty, why may not any inhabitant, and particularly any taxable inhabitant, be allowed to maintain a suit to prevent or avoid the illegal act? Such a right is especially necessary in the case of municipal and public corporations, and if it be denied they are liable to be plundered, and the taxpayers and property-owners on whom the loss will eventually fall are without effectual remedy.

2 JOHN F. DILLON, COMMENTARIES ON THE LAW OF MUNICIPAL CORPORATIONS, 908 (3d ed. 1881).

[123] *Taxpayers' Suits: A Survey and Summary*, *supra* note 117, at 904.

[124] *Id*.

[125] Theurer v. Borrone, 195 A.2d 215, 218 (N.J. Super. Ct. Law Div. 1963); 1 STEVENSON & VAN WIE, *supra* note 59, § 73.04.

[126] Adriance v. Mayor of New York, 1 Barb. 19, 19–20 (N.Y.S. 1847). In this case, the plaintiff argued that the city council was improvidently wasting funds "by appropriating them to purposes not warranted by their act of incorporation." Judge Edmonds expressed some doubts about the court's jurisdiction over the case, but since the defendants conceded to the court's jurisdiction, he allowed it.

[127] Susan L. Parsons, Commentary, *Taxpayers' Suits: Standing Barriers and Pecuniary Restraints*, 59 TEMP. L.Q. 951, 953 (1986).

government's property,[128] and others adopted a trust theory.[129] By the end of the 19th century, local taxpayer suits were widely adopted. In 1879, for example, the Supreme Court allowed Zabriskie (a taxpayer) to challenge a transaction, made by the County of Hudson, for the purchase of real-estate to build a courtroom.[130] The court affirmed the claim, and explained Zabriskie's right to challenge the transaction as follows:

> *Of the right of resident tax-payers to invoke the interposition of a court of equity to prevent an illegal disposition of the moneys of the county* or the illegal creation of a debt which they [sic] in common with other property-holders of the county may otherwise be compelled to pay, *there is at this day no serious question. The right has been recognized by the State courts in numerous cases*; and from the nature of the powers exercised by municipal corporations, the great danger of their abuse and the necessity of prompt action to prevent irremediable injuries, it would seem eminently proper for courts of equity to interfere upon the application of the tax-payers of a county to prevent the consummation of a wrong, when the officers of those corporations assume, in excess of their powers, to create burdens upon property-holders.[131]

In time, some states also provided a statutory basis for local or state taxpayer suits (hereinafter "Taxpayer Statutes").[132] The Taxpayer Statutes formalize the courts' rulings, providing the courts with guidelines on handling such cases. They detail the grounds that a taxpayer may file such suits under the remedies she can receive, certain conditions for the filing (a minimum number of taxpayers, a bond requirement, etc.), and so on.[133]

Naturally, different states allow for different grounds for taxpayer actions. By and large, though, we can divide the causes of action into several categories. The most important category is the waste of local property.[134] Taxpayers attack local actions that they believe squander public funds and deplete the treasury—for example, unlawful compensation to local officials,[135] disposition of local

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[128] As equity owners, taxpayers have a right of action when their property is wasted, especially when an illegality of some sort can be proven. *See* People v. Holten, 122 N.E. 540, 542 (Ill. 1919).

[129] Under which the residents (taxpayers) are the beneficiaries and the local officials are the trustees. As trustees, the local officials have fiduciary duties toward the residents, and the residents have a right to take action when the duty is violated. *See* Haddock v. Bd. of Pub. Educ., 84 A.2d 157, 162 (Del. Ch. 1951); *see also* David M. Lawrence, *Local Government Officials as Fiduciaries: The Appropriate Standard*, 71 U. DET. MERCY L. REV. 1, 2–3 (1993).

[130] Crampton v. Zabriskie, 101 U.S. 601, 607–09 (1879).

[131] *Id.* at 609 (emphasis added).

[132] 18 MCQUILLIN, *supra* note 11, § 52:2.

[133] A more elaborate description and analysis of such statutes are given in Part C below.

[134] 74 AM. JUR. 2D, *supra* note 10, § 18; SANDRA M. STEVENSON, ANTIEAU ON LOCAL GOVERNMENT LAW § 73.04 (2d ed. 2013).

[135] *See, e.g.*, Chapman v. Bevilacqua, 42 S.W.3d 378, 384 (Ark. 2001); Miller v. Town of Gorham, 620 N.Y.S.2d 735, 735 (N.Y. Sup. Ct. 1994); City of Berea ex rel. Ward v. Trupo, 753 N.E.2d 286, 287 (Ohio Ct. App. 2001).

assets in less than their fair value,[136] or unlawful local expenditures.[137] The Mississippi Taxpayers Statute, for example, was used to reclaim $300,000 from Greg Davis, the mayor of Southaven, because the city financed his couples' therapy and other personal expenses.[138] A taxpayer suit was also filed against the City of Warr Acres in Oklahoma, because the city spent large sums of money in order to attract Wal-Mart to the city and taxpayers viewed the expenditure as a waste of public funds.[139]

A second category involves a taxpayers' attempt to void unauthorized or ultra-vires contracts.[140] Under this category a locality fails to properly authorize a contract, or a contract is signed in a conflict of interest situation,[141] and taxpayers attempt to annul the contract.[142] Cincinnati, for example, approved an ordinance allowing the city to sign an agreement to lease its parking system, and taxpayers argued that the approval of such ordinance required a referendum and tried to enjoin the signature.[143] A third category relates to local taxation processes.[144] This can take place either when a group of taxpayers is illegally assessed,[145] or when an illegal subsidy is given (thereby forcing other taxpayers to pay more taxes).[146] In the City of La Habra, California, for example, taxpayers challenged a utility-user tax, that used the revenues for general governmental purposes.[147] In a village in Nassau County, New York, taxpayers challenged a property tax exemption given to an adjacent property, because they argued that they were subject to higher property tax as a result.[148] And yet a fourth cat-

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[136] *See, e.g.*, Betters v. Knabel, 288 A.D.2d 872, 872 (N.Y. App. Div. 2001); Rath v. Two Rivers Cmty. Hosp., Inc., 467 NW.2d 150, 151–52 (Wis. Ct. App. 1991); 74 AM. JUR. 2D, *supra* note 10, § 21.

[137] Lehigh v. Pittston Co., 456 A.2d 355, 355 (Me. 1983); Shechtman v. Sverdrup & Parcel Consultants, Inc, 226 A.D.2d 268, 268 (N.Y. App. Div. 1996); Duffy v. Longo, 207 A.D.2d 860, 861 (N.Y. App. Div. 1994); Dibb v. Cty. of San Diego, 884 P.2d 1003, 1003 (Cal. 1994); 18 MCQUILLIN, *supra* note 11, §§ 52.31–.33.

[138] Davis v. State ex rel. Hood, 198 So.3d 367, 369 (Miss. Ct. App. 2015).

[139] State ex rel. Brown v. City of Warr Acres, 946 P.2d 1140, 1142–43 (Okla. 1997).

[140] 74 AM. JUR. 2D, *supra* note 10, § 25; STEVENSON, *supra* note 134, § 73.04[11].

[141] Roosevelt v. Draper, 23 N.Y. 318, 329 (1861).

[142] *See, e.g.*, Sullins v. Cent. Ark. Water, 454 S.W.3d 727, 727 (Ark. 2015); Westbrook v. Prudential Ins. Co. of Am., 524 N.E.2d 485, 485 (Ohio 1988); State ex rel. Fent v. Okla. Water Res. Bd., 66 P.3d 432, 433 (Okla. 2003).

[143] McQueen v. Dohoney, No. C–1301962013, WL 2647762, at *1 (Ohio Ct. App. 2013).

[144] 74 AM. JUR., *supra* note 10, §§ 19–20; STEVENSON, *supra* note 134, § 73.04 [7]–[8].

[145] *See, e.g.*, Batt v. City and Cty. of San Francisco, 65 Cal.Rptr.3d 716, 718 (Cal. Ct. App. 2007); Rider v. City of San Diego, No. D044907, 2005 WL 1391262, at *7 (Cal. Ct. App. 2005); Fairley v. City of Duluth, 185 N.W. 390, 390 (Minn. 1921); State ex rel. Fatur v. City of Eastlake, No. 2009–L–037, 2010 WL 1254369, at *1 (Ohio Ct. App. 2010).

[146] *See, e.g.*, Square Parking Sys., Inc. v. Jersey City Bus. Adm'r, 449 A.2d 559, 560 (N.J. Super. Ct. Law Div. 1982); City of Wichita Falls v. Cooper, 170 S.W.2d 777, 778 (Tex. Civ. App. 1943).

[147] Howard Jarvis Taxpayers Ass'n. v. City of La Habra, 23 P.3d 601, 603 (Cal. 2001).

[148] Colella v. Bd. of Assessors of the Cty. of Nassau, 741 N.E.2d 113, 113 (N.Y. 2000).

egory involves challenging local policies, often connected to civil liberties.[149] Under this category, taxpayers contested policies connected to access to local information,[150] environmental policies,[151] animal policies,[152] and more.[153]

Today local taxpayers' right to file a taxpayer suit is acknowledged in almost all states—either through statute or in equity.[154] The variety of issues taxpayer suits deal with, and the fact that they are broadly acknowledged, may create the impression that they are also widely used. But, in fact, the opposite is true. Taxpayer actions are rarely used, and they are certainly not as common as class or derivative actions in the commercial sphere. We elaborate on the scarcity of taxpayer suits later on in the article, but before we do so, we need to address a preliminary issue—standing.

C. *Standing in Local-Taxpayer Suits*

The legal literature on taxpayer suits often emphasizes a standing problem.[155] This literature focuses mostly on the federal court system and on federal or state taxpayer suits, and extensively analyzes the Federal Supreme Court's decision to deny standing to taxpayers.[156] This may create a misleading impression that taxpayers lack standing altogether. But, whereas standing poses an unsurmountable obstacle for federal and state taxpayer suits on the federal level, it presents less of a problem to local taxpayers, especially in the state system.

The standing requirement, at least in the federal system, stems from Article III, Section 2 of the Constitution that vests the courts with power over "cases" and "controversies."[157] Federal courts interpreted this section to require plaintiffs to demonstrate sufficient stake in their action's outcome, otherwise the action is rejected for lack of standing.[158] In order to show sufficient stake in the outcome, federal courts required plaintiffs to meet three conditions: the plaintiff has to show she suffered a concrete and particular injury, that the injury was

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[149] 74 AM. JUR. 2D, *supra* note 10, § 25.

[150] Comps, Inc. v. Town of Huntington, 269 A.D.2d 446, 446 (N.Y. App. Div. 2000).

[151] Garfield Heights ex rel. Kozelka v. City of Garfield Heights, No. 92511, 2009 WL 3043577, at *1–2 (Ohio Ct. App. 2009).

[152] Humane Soc. v. State Bd. of Equalization, 61 Cal.Rptr.3d 277, 278–79 (Cal. Ct. App. 2007).

[153] *See generally* Coshow v. City of Escondido, 34 Cal.Rptr.3d 19, 21 (Cal. Ct. App. 2005).

[154] *Taxpayers' Suits: A Survey and Summary*, *supra* note 117, at 895 ("'[T]axpayers' suits,' a form of action currently available to challenge state action in at least thirty-four states, and municipal action in virtually every jurisdiction").

[155] *See* James W. Doggett, *"Trickle Down" Constitutional Interpretation: Should Federal Limits on Legislative Conferral of Standing Be Imported into State Constitutional Law?*, 108 COLUM. L. REV. 839, 839 (2008); James R. Parks, *A New Theory of Taxpayer Standing*, 6 COLUM. J. TAX L. 118, 120 (2014); Epstein, *supra* note 114, at 18; Staudt, *supra* note 34, at 773; Zelinsky, *supra* note 34, at 2.

[156] Epstein, *supra* note 114, at 18–19; Epstein, *supra* note 115, at 4,12.

[157] U.S. CONST. art. 3, § 2.

[158] Staudt, *supra* note 34, at 782.

caused by allegedly illegal conduct, and that the court's decision is capable of redressing the plaintiff's harm.[159] Without these elements, there is no "case" or "controversy," and the courts have no jurisdiction.[160]

In the 1923 case of *Frothingham v. Mellon*, it was determined that federal and state taxpayers do not satisfy these conditions in taxpayer suits (in the federal system).[161] The *Frothingham* Court denied standing to a federal taxpayer aiming to enjoin the federal government expenditures under the Maternity Act of 1921, explaining that the plaintiff's interest in the government's action was shared with millions of others, and that it was relatively minute and indeterminable.[162] Under these circumstances, the court concluded, taxpayers can show no concrete personal harm, and therefore do not meet the federal court's standing requirement.[163] Despite a potential diversion at the end of the 1960s,[164] the *Frothingham* rule still stands, and today it is clear that federal and state taxpayers have no standing to challenge federal or state taxing or expenditures in federal courts.[165]

However, this is not the case with municipal taxpayers. The *Frothingham* Court expressly distinguished between municipal and federal taxpayers, mainly due to the local governments' smaller size.[166] As opposed to state or federal governments, Justice Sutherland reasoned, local governments have fewer residents, and so the "interest of a taxpayer of a municipality in the application of

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159 Lujan v. Defenders of Wildlife, 504 U.S. 555, 560 (1992).
160 *Id.* at 561.
161 Commonwealth of Mass. (*Frothingham*) v. Mellon, 262 U.S. 447, 486 (1923).
162 *Id.* at 487.
163 *Id.* at 488.
164 In *Flast v. Cohen*, 392 U.S. 83, 85–103 (1968), the Supreme Court introduced a possible exception to the bar on taxpayer suits. Chief Justice Warren explained that there was "no absolute bar in Article III to suits by federal taxpayers . . . " *Id.* at 101. The court clarified that a taxpayer can establish standing if she demonstrates a logical link between her status (as a taxpayer) and two factors: the type of legislative enactment attacked and the nature of the constitutional infringement alleged. *Id.* at 102. Applying these tests to facts in *Flast*, the Court reached the conclusion that the appellants had standing. *Id.* at 103. The challenged action involved a substantial expenditure of Federal tax funds, and the expenditures violated the establishment clause. *Id.* at 85–86. Subsequent cases, however, clarified that, notwithstanding the *Flast* decision, the general rule largely stands. In *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 332–34 (2006), for example, the Court declined to grant standing to plaintiffs who challenged a package of state and local tax credits given to Daimler-Chrysler. Chief Justice Roberts determined that the general standing rule announced in *Frothingham* still applies, and that the plaintiffs did not show a concrete and particular injury. *Id.* at 344. In *Ariz. Christian Sch. Tuition Org. v. Winn*, 131 S. Ct. 1436, 1447 (2011), the Court held the same approach, narrowing the *Flast* exception even further. The majority in *Winn* determined that the plaintiffs lacked standing because they challenged the organization's tax credits as opposed to challenging government spending (as was the case in *Flast*). *Id.* Tax credits, according to the majority, do not constitute a concrete injury, because the taxpayers cannot prove that if the tax credits had not been given, the taxpayers would benefit from a reduction in their own taxes. *Id.*
165 Zelinsky, *supra* note 34, at 52.
166 *Frothingham*, 262 U.S. at 486.

its moneys is direct and immediate and the remedy by injunction to prevent their misuse is not inappropriate."[167] Although local governments are significantly larger today than they were in 1923, when the *Frothingham* decision was decided, this holding was confirmed in *Asarco Inc. v. Kadish* in 1989.[168] In *Asarco*, the Court allowed municipal taxpayer suits, because it determined that the peculiar relationship between the local taxpayer and the local government "makes the taxpayer's interest in the application of municipal revenues 'direct and immediate.' "[169] This holding has not been reversed in later Supreme Court cases, such as *DaimlerChrysler Corp. v. Cuno*[170] or *Arizona Christian School Tuition Organization v. Winn*,[171] and so—as opposed to state or federal taxpayers—municipal taxpayers do have standing in federal court.

Standing rules in state courts are even more lenient.[172] State courts do not see themselves as bound by the "cases" and "controversies" requirement of Article III,[173] and different states have developed their own standing rules, that are usually more permissive than the federal one.[174] The requirements for standing may change from state to state, but in many states, at least with regard to injunctive relief, the plaintiff does not need to show special and particular injury. It is sufficient that the plaintiff show a public injury in order for the court to have jurisdiction.[175]

As we have seen, in some states, the legislatures believed that the courts' decisions allowing standing (usually based on equity law) are not enough, and provided a statutory or even constitutional basis for local (or state) taxpayer standing.[176] Arkansas' constitution, for example, affirms that "[a]ny citizen of any county, city or town may institute suit, in behalf of himself and all others interested, to protect the inhabitants thereof against the enforcement of any ille-

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[167] *Id.* at 478, 486.

[168] Asarco Inc. v. Kadish, 490 U.S. 605, 606 (1989).

[169] *Id.* at 613.

[170] DaimlerChrysler Corp. v. Cuno, 547 U.S. 332, 346 (2006).

[171] Ariz. Christian Sch. Tuition Org. v. Winn, 563 U.S. 125, 146 (2011).

[172] Zelinsky, *supra* note 34, at 36.

[173] *See, e.g.*, Armory Park Neighborhood Ass'n v. Episcopal Cmty. Servs. in Ariz., 712 P.2d 914, 919 (Ariz. 1985); Gregory v. Shurtleff, 299 P.3d 1098, 1102 (Utah 2013).

[174] M. Ryan Harmanis, *States' Stances on Public Interest Standing*, 76 OHIO ST. L.J. 729, 729 (2015); William A. Fletcher, *The "Case or Controversy" Requirement in State Court Adjudication of Federal Questions*, 78 CAL. L. REV. 263, 264 (1990). The Supreme Court acknowledged the states' authority in this issue, and even when it found that the plaintiffs lacked standing in the federal system, accepted the state courts' power to adjudicate matters under their own rules. *See Asarco*, 490 U.S. at 617 ("We have recognized often that the constraints of Article III do not apply to state courts, and accordingly the state courts are not bound by the limitations of a case or controversy or other federal rules of justiciability even when they address issues of federal law, as when they are called upon to interpret the Constitution or, in this case, a federal statute"); *see also* Staudt, *supra* note 34, at 774.

[175] 18 MCQUILLIN, *supra* note 11, §§ 52:13–:16; 74 AM. JUR. 2D, *supra* note 10, §§ 7–12.

[176] 18 MCQUILLIN, *supra* note 11, § 52:2.

gal exactions whatever."[177] South Dakota allows taxpayers to maintain action to prevent any violation of Title 9 of the State Code (the title that deals with municipal governments),[178] and the Californian provision grants taxpayers standing to contest "any illegal expenditure of, waste of, or injury to, the estate, funds, or other property of a county, town, city or city and county of the state."[179] Depending on the jurisdiction, standing may be granted not only against a locality, but also against its officers or other third parties that wasted the public funds, which we refer to as a derivative-taxpayer suit. The New York statute, for example, affirms that "all officers, agents, commissioners and other persons acting . . . on behalf of any . . . municipal corporation in this state . . . may be prosecuted . . . to restore and make good, any property, funds or estate."[180] In Oklahoma, when authorized state or local officials fail to institute proper proceedings by law to recover state or local property, residents may initiate legal proceedings in lieu of the officials.[181]

Due to the more lenient standing rules for municipal taxpayers, and especially in states that have an express statutory authorization for taxpayer actions, it seems reasonable to assume that the use of this tool will be prevalent. The expectation is that, just like in regard to commercial class and derivative actions, taxpayers will employ the taxpayer suit to monitor local officials and recover damages. The data we gathered, however, indicates otherwise: local taxpayer suits are not very common—in some states they are virtually nonexistent, especially when compared to their commercial equivalents. In the next part, we present the data.

III. THE DATA ON LOCAL TAXPAYER SUITS AND POSSIBLE EXPLANATIONS

To understand to what extent local taxpayer suits are utilized in state courts, we made use of the Lexis-Nexis database. We looked at hundreds of local taxpayer suits and analyzed how they were received. Our research focuses mainly on states that have local Taxpayer Statutes, because in these states, the case law on taxpayer suits is more easily traceable, but we also looked for cases in other states as well.

The analysis included two stages: first, using Lexis-Nexis, we searched for cases that cite local Taxpayer Statutes. This enabled us to assess how many local taxpayer suits were filed in these states, and to what extent this procedure is utilized.[182] Second, in several states we delved into the cases, and read the courts' opinions. This enabled us to understand on what occasions taxpayers

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[177] ARK. CONST. of 1874, art. XVI, § 13.
[178] S.D. CODIFIED LAWS § 9-1-6 (2017).
[179] CAL. CIV. PROC. CODE § 526a (West 2017).
[180] N.Y. GEN. MUN. LAW § 51 (McKinney 2017).
[181] OKLA STAT. ANN. tit. 62, § 373 (West 2017).
[182] The reason we used the statutes, rather than a general search for taxpayer suits, is that it is impossible to differentiate between taxpayer suits and individual suits filed by taxpayers in searching the database.

decide to initiate a taxpayer action, what remedies they seek, and how the courts view these actions. The two stages of analysis create a picture of how taxpayer suits are utilized, and whether they indeed provide an efficient tool to monitor local officials.

A. The Citation Search

The first stage of the analysis was a "technical" search for citations of local Taxpayer Statutes in court opinions in the past twenty-six years (since 1990). We refer to this search as technical, because at this stage of the analysis, we did not look into the various cases or the context of the citation. We simply counted how many times such cases were cited, as they appeared in the Lexis-Nexis database.

Our assumption in this analysis was that courts that deal with taxpayer actions will cite the enabling Taxpayer Statute. If this assumption is indeed correct, the number of cases citing Taxpayer Statutes serves as a good approximation to the number of times the taxpayer action was used in the different states. Naturally, courts can discuss these actions without referring to their statutory source, but we do expect most courts to at least mention the statute (when they deal with a taxpayer suit), even if they do not discuss it at length. Note also that, since at this stage we did not read the citing decisions (just technically counted them), the search results could have been over-inclusive.[183] Some of the decisions may cite the Taxpayer Statute, even though the cases were not taxpayer actions, and other decisions may have been duplicates (i.e., two decisions discussing the same case, for example, a trial court and an appeal). But, despite these problems, we believe the number of citations does give us a fairly good estimate of the frequency that taxpayers use the tool the legislature provided them.

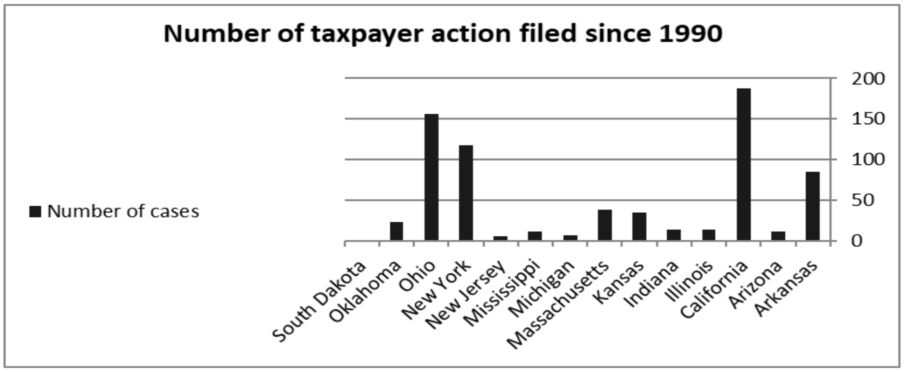
The technical search provided the following results:[184]

[183] In states where we read all of the courts' decisions, the table indicates the exact number of cases that deal with taxpayer actions, rather than the number that appears in Lexis.

[184] The table is updated as of November 14, 2016. States marked with "*" are ones for which we read all of the case law. In these states, there is a difference between the number of cases we know are taxpayer suits, and the number of citations as they appear in the Lexis-Nexis database. This is because some of the cases cited the Taxpayer Statute, but were not taxpayer suits. In the table, the number of cases is the actual number of taxpayer suits, whereas the number in parentheses is the number of citations that appear in Lexis-Nexis.

State	Statutes authorizing taxpayer suits ("Taxpayer Statutes")	Number of cases citing the statute since 1990
Arkansas*	ARK. CONST. art. XVI, § 13.	85
Arizona*	ARIZ. REV. STAT. § 35-213 (2017) (applies to both state and local taxpayers); ARIZ. REV. STAT. § 11-642 (2017) (county taxpayers).	10 (12) 1
California*	CAL CIV. PROC. CODE § 526a (West 2017).	188 (265)
Illinois	65 ILL. COMP. STAT. 5/1-5-1 (2017); 735 ILL. COMP. STAT. 5/20-104 (2017) (Derivative Taxpayer suit).	2 14
Indiana	IND. CODE § 4-6-2-124 (definition); IND. CODE §§ 34-13-5-1–12; IND. CODE § 36-2-6-13.	13
Kansas	KAN. STAT. ANN. § 60-907 (2017).	34
Massachusetts	MASS. GEN. LAWS ANN. ch. 40 § 53 (West 2017).	38
Michigan[185]	MICH. COMP. LAWS. SERV. § 129.61 (2017) (applies to townships and school districts); MICH. CONST. art. IX, § 32 (applies to both states and local governments).	7 0
Mississippi	MISS. CODE ANN. § 31-7-57 (West 2017).	11
New Jersey	N.J. REV. STAT. § 2A:15-18 (2017) (derivative); N.J. REV. STAT. § 2A:49-1 (2017) (class action).	4 1
New York*	N.Y. GEN. MUN. LAW § 51 (Consol. 2015)	117 (144)
Ohio*	OHIO REV. CODE ANN. § 733.59 (2017); OHIO REV. CODE ANN. § 309.13 (counties); OHIO REV. CODE ANN. § 5705.45 (liability for wrongful payment of public funds).	105 (119) 44 6
Oklahoma*	OKLA. STAT. tit. 62, § 373 (2017).	23 (25)
South Dakota	S.D. CODIFIED LAWS § 9-1-6 (2017).	1

[185] In addition to the two sections listed in the table, MICH. CONST. art. XI, § 5, empowers any resident of the state to request injunctive or mandamus relief in order to enforce the state's civil service laws. We did not include the section in the table, as it refers only to state, rather than local governments.



As we can see from the table, in most states there were less than fifty taxpayer actions in twenty-six years (i.e., less than two taxpayer actions per year). In only two states (California and Ohio), there were more than 150 actions, that translates to an average of seven taxpayer actions per year. Overall, in the fourteen states we examined, there were approximately 700 local taxpayer cases in twenty-six years, that means each general-purpose local government in these states dealt, on average, with 0.04 lawsuits[186] (or 4 percent of the general-purpose local governments dealt with an average of one lawsuit per year for the past twenty-six years).[187]

These numbers seem especially low when compared to commercial class-action litigation. According to a survey conducted by Carlton Fields, the number of companies facing *at least* one major class-action suit per year increased from 53.8 percent in 2014 to 60.6 percent in 2015.[188] On average, according to the same survey, each company had to deal with one additional new class-action suit in 2015,[189] bringing the average number of class-action suits per company to six.[190] As the table above reflects, the vast majority of municipal

[186] According to the United States Census Bureau, in the fourteen states detailed in the table, there are 37,324 local governments, 16,779 of which are general-purpose local governments. *2012 Census of Governments*, U.S. CENSUS BUREAU: AMERICAN FACT FINDER, https://factfinder.census.gov [https://perma.cc/6GGA-6SZ4] (last visited Mar. 16, 2018) (follow "Guided Search" hyperlink; then select "Specific Data Set"; then choose "Census of Governments," select the "2012 Census of Governments," and click next; then enter each of the states provided from the table above into the search and click next; then, from the list provided, select "Local Governments in Individual County-Type Areas: 2012"). In the past twenty-six years, there were 700 lawsuits in 16,779 localities, i.e.-an average of 0.04 lawsuits per municipality. In other words, 4 percent of the general-purpose municipalities in the states faced a single suit.

[187] If we look at all local governments in the states, including special purpose local governments, the numbers are even lower—2.3 percent.

[188] CARLTON FIELDS, THE 2016 CARLTON FIELDS CLASS ACTION SURVEY: BEST PRACTICES IN REDUCING COST AND MANAGING RISK IN CLASS ACTION LITIGATION 6 (2016).

[189] *Id.* at 11.

[190] *Id.* at 3. The issues commercial class actions deal with vary, but according to the survey, class actions dealing with labor and employment practices and with consumer fraud account for more than 50 percent of the overall claims.

corporations in the surveyed states had zero local-taxpayer suits filed against them in twenty-six years. Even if we take only a small subset of the class-action suits, i.e. federal securities class actions,[191] the number of taxpayer suits is very small in comparison. According to a report on federal securities class-action suits by Cornerstone Research, each year, an average of 188 securities class-action suits are filed.[192] The number of local taxpayer suits filed each year in all of the above states combined (twenty-seven suits) is a seventh of the number of securities class-action suits, even though the number of local governments in these states is almost four times the number of listed companies.[193]

In addition to the number of local taxpayer cases, the timing of the litigation is also telling. Empirical evidence suggests that commercial class and derivative actions tend to follow visible adverse corporate events. A corporation experiences an extraordinary event—such as a SEC investigation, a failed merger, or a bankruptcy—and shortly after the news about the event has been released, a private enforcement litigation is initiated.[194] The proximity between the publication of the adverse corporate event and the filing indicates that the publication prompted the litigation, rather than the injury to a particular client.[195] This is not the case as far as taxpayer suits are concerned. Here, we see little correlation between the filings and local corruption or fiscal distress. In 2000, Camden, New Jersey's mayor, for example, was indicted and then convicted on federal corruption charges.[196] Although the New Jersey statute allows every taxpayer or resident of a municipality to initiate litigation on behalf of a

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[191] According to the Carlton Fields survey, securities class actions comprise 8 percent of all class actions. *Id.* at 7.

[192] CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2016 MIDYEAR ASSESSMENT 5 (2016) (The research was conducted in association with the Stanford Law School Securities Class Action Clearing House).

[193] According to a World Bank report, in 2015 there were 4,381 listed companies in the United States. *Listed Domestic Companies, Total*, WORLD BANK https://data.worldbank.org/indicator/CM.MKT.LDOM.NO?locations=US&view=chart [https://perma.cc/K2KB-XRU8] (last visited Mar. 16, 2018). Compared to 36,359 local governments, 16,399 of which are general purpose local governments in the states listed in the table above. *See 2012 Census of Governments*, *supra* note 186.

[194] John E. Kennedy, *Securities Class and Derivative Actions in the United States District Court for the Northern District of Texas: An Empirical Study*, 14 HOUS. L. REV. 769, 807 (1977) ("The data here tends to support the theory that a dramatic event gives rise to a large number of filed cases."); *see also* Weiss & Beckerman, *supra* note 92, at 2060 n.32 (according to the data, 68.8 percent of the derivative and class actions filed by Weiss's law firm were filed ten days after the facts that gave rise to the plaintiffs' claims were revealed). The article also cites to Milt Policzer, showing that "of 46 class actions studied, 12 were filed within one day and another 30 were filed within one week of publication of unfavorable news about defendant corporation." *Id.*

[195] Coffee, *supra* note 89, at 681–82.

[196] Anne Marie Vassallo, Note, *Solving Camden's Crisis: Makeover or Takeover?*, 33 RUTGERS L.J. 185, 190 (2001); Iver Peterson, *In Camden, Another Mayor Is Indicted on Corruption Charges*, N.Y. TIMES (Mar. 31, 2000), http://www.nytimes.com/2000/03/31/nyregion/in-camden-another-mayor-is-indicted-on-corruption-charges.html [https://perma.cc/ZK2N-KJJA].

municipality, no taxpayer suits were filed in connection with this event.[197] Neither were any taxpayer suits filed in connection with the Orange County Embezzlement[198] or with Detroit's bankruptcy.[199] Although these events were highly publicized and no doubt damaged the cities or counties involved, the taxpayer procedure was not utilized.

These differences suggest that, despite the similarities between local-taxpayer actions and commercial class and derivative actions, the plaintiffs' use of these procedures is very different. Whereas class and derivative actions are numerous and tend to follow publicized events, local taxpayer suits are scarce and sporadic.

B. Examining the Decisions

To better understand the source of these differences, we delved into the decisions themselves, reading hundreds of court decisions and looking at characteristics that can explain the way plaintiffs use local-taxpayer suits. In some states, namely Arizona, Arkansas, California, New York, Ohio, Oklahoma, and Illinois,[200] we read and mapped *all* courts' opinions citing the Statutes since 1990.[201] In other states, we only read key cases that determined the prevailing law on local taxpayer suits in each state. The analysis focused on two main characteristics—the remedy plaintiffs seek and the courts' attitude towards taxpayer claims.

1. The Remedy Sought

In almost all states examined (except Oklahoma), the majority of taxpayer suits are for an injunctive or declaratory relief.[202] Some taxpayer suits are also for a writ of mandamus, but very few seek monetary recovery.

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[197] As the table above shows, since 1990, only five taxpayer suits were filed in New Jersey, none of which concern Camden's mayor's criminal affairs.

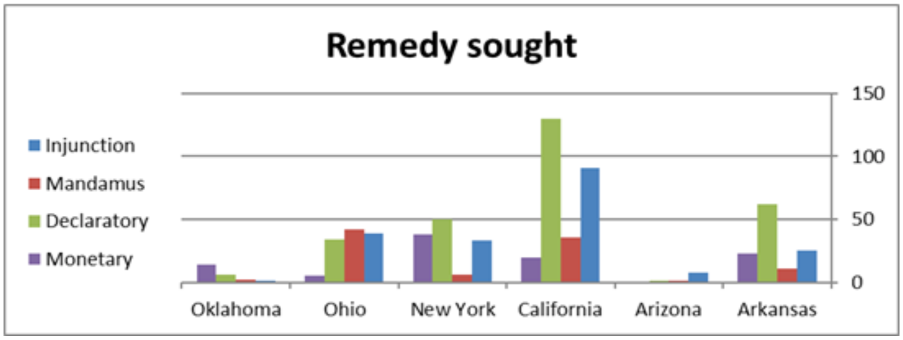
[198] *See* MARK BALDASSARE, WHEN GOVERNMENT FAILS: THE ORANGE COUNTY BANKRUPTCY 1, 3 (1998); Kevin P. Kearns, *Accountability and Entrepreneurial Public Management: The Case of the Orange County Investment Fund*, 15 PUB. BUDGETING & FIN. 3, 3 (1995).

[199] Melissa B. Jacoby, *Federalism Form and Function in the Detroit Bankruptcy*, 33 YALE J. ON REG. 55, 70–72 (2016).

[200] We chose these states because they have a relatively broad statute, allowing both a class and a derivative type of taxpayer actions.

[201] A summary of all cases we read in six states—New York, Ohio, Oklahoma, Arizona, Arkansas and Illinois—is available on request from the author.

[202] *See* 18 MCQUILLIN, *supra* note 11, § 52:18 ("Although a suit for an injunction is the usual form of a taxpayer's proceeding, other proceedings and forms of action are also common."); Parsons, *supra* note 127, at 965 ("The remedy most commonly sought by state and local taxpayers is the injunction."); *Taxpayers' Suits: A Survey and Summary*, *supra* note 117, at 907 ("The most usual relief is the injunction.").



In some states, like Kansas or Massachusetts, this phenomenon can be attributed to the state's legislature.[203] The language of the Taxpayer Statutes limits the available remedies,[204] and courts follow the statute language and deny other forms of recovery.[205] In other states, the court itself, rather than the legislature, limits the available remedies. In Maine, for example, courts distinguish between preventative-taxpayer suits and remedial-taxpayer suits.[206] Whereas they allow preventative suits, remedial suits will be denied unless the plaintiff shows a particular damage not shared by the community.[207] The same logic applies in Louisiana. In *Alliance for Affordable Energy v. The Council of the City of New Orleans*, the Louisiana court placed obstacles in the way of taxpayers seeking to compel a local action when compared to taxpayers seeking injunction.[208] The court determined that, whereas a taxpayer seeking to compel an action is rejected "absent a showing of some special interest which is separate and distinct from the interest of the public at large," a taxpayer seeking to restrain an unlawful action is not required to demonstrate a special or particular interest and a "mere showing of an interest, however small and indeterminable" will suffice.[209]

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203 KAN. STAT. ANN. § 60-907 (2017); MASS. GEN. LAWS ANN. ch. 40, § 53 (2017).

204 In Texas, the statute allows both injunction and mandamus, and the courts refused to allow monetary relief. *See* Burks v. Yarbrough, 157 S.W.3d 876, 880–81 (Tex. 2005).

205 A broad interpretation of the available remedies in taxpayer actions, however, is not impossible. In California, for example, the statute's language allows only for restraining and preventing illegal or wasteful local actions, CAL. CIV. PROC. CODE § 526a (2017), but the courts determined that the statute "does not . . forbid a taxpayer from seeking to recover, on behalf of his municipality, the same moneys if illegally expended." *See* Osburn v. Stone, 150 P. 367, 368 (Cal. 1915).

206 *See* Lehigh v. Pittston Co., 456 A.2d 355, 358 (Me. 1983).

207 *Id.* ("The preventative-remedial dichotomy is the heart of a long-established doctrine which governs the standing of taxpayers to sue the municipalities in which they reside. In substance, this doctrine operates to exempt taxpayers who seek 'preventative' relief from the general rule that standing must be predicated on particularized injury. In contrast, taxpayers who seek 'remedial relief' are required to show special or particularized injury: injury different from that incurred by every other taxpayer."); *see also* 1 STEVENSON & VAN WIE, *supra* note 59, § 73.04.

208 All. for Affordable Energy v. Council of New Orleans, 677 So. 2d 424, 428 (La. 1996).

209 *Id.*

But even in states that explicitly allow remedial monetary damages, taxpayer suits are mostly for injunction or declaratory relief. New York's Taxpayer Statute, for example, allows taxpayers to sue a local authority or its officials to "restore and make good, any property, funds or estate of such . . . municipal corporation,"[210] and yet relatively few monetary suits are filed. Out of 117 taxpayer cases (since 1990), only thirty-eight were for pecuniary damages (the vast majority were for damages in addition to other non-monetary remedies). Out of these thirty-eight cases, the court affirmed the monetary claim in only three cases, and the rest were rejected outright or the plaintiffs were only given a non-monetary remedy. In Ohio, the Revised Code allows for monetary taxpayer suits,[211] but taxpayers seldom take advantage of this opportunity. Section 5705.45 is hardly utilized at all,[212] and under Section 733.59, only four suits (out of more than one hundred) were for pecuniary damages. The same is true in Arkansas, where monetary suits account for 25 percent of the cases, and in Arizona, where no taxpayer suits for monetary relief were filed (although the Arizona statute expressly allows such remedy).[213] Oklahoma is the only state we found where the majority of taxpayer suits are for monetary relief, the courts rejected all claims, so, in effect, no taxpayer suits were accepted.[214]

The reasons why taxpayers are not pursuing monetary claims (when available) are, of course, not stated in the courts' opinions, but difficulties in assessing the damages seem to play a role. As opposed to commercial corporations, municipal corporations do not have a monetary value, and that makes it difficult to quantify the taxpayers' loss from a given local activity and to what extent they should be compensated.[215] Plaintiffs, therefore, prefer to correct the public wrong—they enjoin the action or enforce performance, rather than seek some vague pecuniary claim. In addition, it seems that in taxpayer suits, as opposed to class and derivative actions, plaintiffs are not in it for the money. The suits are initiated by benevolent residents wishing to improve the quality of life in their locality, rather than by plaintiffs (or lawyers) wishing to make a prof-

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[210] N.Y. GEN. MUN. LAW § 51 (McKinney 2017).

[211] OHIO REV. CODE ANN. § 5705.45 (West 2017) ("Any officer, employee . . . who expends or authorizes the expenditure . . . of any public funds on any such void contract, obligation, or order . . . shall be liable to the political subdivision for the full amount paid from the funds of the subdivision on any such order, contract, or obligation. . . . If the prosecuting attorney . . . of the subdivision fails, upon the written request of any taxpayer, to institute action for the enforcement of the liability, the taxpayer may institute suit in his own name in behalf of the subdivision."); OHIO REV. CODE ANN. § 733.59 (West 2017) ("If the village solicitor or city director of law fails, upon the written request of any taxpayer of the municipal corporation, to make any application provided for in sections 733.56 to 733.58 of the Revised Code, the taxpayer may institute suit in his own name, on behalf of the municipal corporation.").

[212] Since 1990, the section is cited in Lexis-Nexis only six times.

[213] *See* ARIZ. REV. STAT. ANN. § 35-213 (West 2017). The data on all states in available with the author.

[214] The data on all states is available with the author.

[215] *Cf.* Kimhi, *supra* note 60, at 357–58.

it.[216] Hence, in many cases, an injunction or writ of mandamus is sought, without the need for monetary compensation.

2. *The Courts' Attitude Towards Taxpayer Suits*

Another important aspect to note is the courts' attitude towards taxpayer suits. Although the majority of state courts recognize taxpayer suits' potential value, many still tend to treat them with suspicion. Contrary to the rhetoric they use, courts restrict the taxpayer actions, disincentivizing potential plaintiffs from initiating litigation. This approach is manifested in three different ways: standing requirements, narrow interpretation of Taxpayer Statutes, and reluctance to award attorney's fees.

Although, as explained earlier, almost all state courts grant standing to local taxpayers, some place restrictions on taxpayers' ability to have their day in court. Florida courts, for example, still follow what is referred to as the Rickman Rule, promulgated by the Florida Supreme Court in 1917.[217] According to the Rickman Rule, unless the plaintiff's case rests on constitutional grounds based directly on the legislature's taxing and spending power, she must show a particular damage to obtain standing.[218] The plaintiff's damage must be particular in kind, not only greater in degree, and must be traceable to the defendant's actions.[219] Likewise, the Michigan courts follow a "prudential approach,"[220] that the plaintiff must show a specific legal cause of action provided under law to obtain standing, and if such cause of action does not exist, the plaintiff needs to demonstrate a specific injury, right, or substantial interest.[221] The same is true in Utah, where Courts grant standing "where matters of great public interest and societal impact are concerned,"[222] and only when the issue is "not more appropriately addressed by another branch of government pursuant to the political process."[223] Even more extreme is a Kansas court, that determined taxpayers cannot challenge the acts of public officials unless "they suffered some peculiar personal injury separate and apart from all other taxpayers of the city alike."[224] Naturally, this Kansas requirement renders the taxpayer action a dead

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216 *See* discussion *infra* Section III(C).
217 Rickman v. Whitehurst, 74 So. 205, 207 (Fla. 1917).
218 Dep't of Admin. v. Horne, 269 So. 2d 659, 662 (Fla. 1972).
219 55 FLA. JUR. 2D *Taxpayers' Actions* §§ 4, 7 (2017).
220 Lansing Sch. Educ. Ass'n v. Lansing Bd. of Educ., 792 N.W.2d 686, 699 (Mich. 2010).
221 *See id.*; Kenneth Charette, *Standing Alone?: The Michigan Supreme Court, the* Lansing *Decision, and the Liberalization of the Standing Doctrine*, 116 PENN ST. L. REV. 199, 206 (2011).
222 Jenkins v. State, 585 P.2d 442, 443 (Utah 1978).
223 Gregory v. Shurtleff, 299 P.3d 1098, 1110 (Utah 2013); Utah Chapter of the Sierra Club v. Utah Air Quality Bd., 148 P.3d 960, 973 (Utah 2006).
224 *See* Edgington v. City of Overland Park, 815 P.2d 1116, 1120 (Kan. 1991) ("While a private citizen cannot attack the very existence of a city, the law does not preclude an attack on the internal organization of the city's government. Thus, an individual may have standing if

letter, and even when accepted, it is not a taxpayer suit in the sense we use in the article (that results in a public, rather than personal benefit).[225]

A second indication of the courts' apprehension of taxpayer suits is their interpretation of the Taxpayer Statutes' language. Here, New York provides a good example. The New York Taxpayer Statute allows local taxpayers to take action against a local authority, its officers or a third party "to prevent any illegal official act . . . , or to prevent waste or injury . . . " (emphasis added).[226] But although the statute clearly offers two alternative causes of action—illegal action or waste or injury—courts required these causes of action to be cumulative.[227] In *Murtha v. Incorporated Village of Island Park*, for example, the court rejected a taxpayer action to prevent an unnecessary payment of legal fees, stating that even if the allegation of waste was correct, "the plaintiffs have failed to allege an illegal or ultra vires act."[228] Moreover, although the Statute's language expressly states "any illegal act," New York courts determined that the mere illegality of a certain local action does not suffice. The court in *Mesivta of Forest Hills Institute, Inc. v. City of New York* explained that "failure to observe . . . statutory provisions does not constitute the fraud or illegality necessary to support a taxpayer action," and when the illegality is considered merely procedural the court will dismiss the claim.[229] Thus, a claim alleging failure to provide proper public notices for the appropriation of a water district reserve

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he or she has a special interest other than that of the general public"); Fransham v. McDowell, 451 P.2d 131, 135 (Kan. 1969).

[225] *See* 74 AM. JUR. 2D, *supra* note 10, § 11 ("Unless standing is conferred by statute, taxpayers generally must show that they have suffered a particularized injury distinct from that suffered by the general public in order to have standing to challenge a government action or assert a public right. Further, the damage must be peculiar in kind and not merely greater in degree").

[226] N.Y. GEN. MUN. LAW § 51 (McKinney 2017).

[227] *See* Murtha v. Inc. Vill. of Island Park, 202 A.D.2d 650, 650 (N.Y. 1994) ("Although the statute itself is written in the disjunctive, apparently permitting a suit to prevent either an illegal act or waste, the controlling cases interpreting the statute have required that both elements be present"). The court in *Murtha* acknowledges that the statute's language does not mandate the alleged "waste" to be illegal, but bound by prior case law, this is the chosen interpretation.

[228] *See id.* at 651; *see also* Mesivta of Forest Hills Inst., Inc. v. City of New York, 448 N.E.2d 1344, 1345 (N.Y. 1983) ("It is well established that a taxpayer action pursuant to section 51 of the General Municipal Law lies 'only when the acts complained of are fraudulent, or a waste of public property in the sense that they represent a use of public property or funds for entirely illegal purposes'"); Kaskel v. Impellitteri, 115 N.E.2d 659, 661 (N.Y. 1953) ("The decisions under section 51 make it entirely clear that redress may be had only when the acts complained of are fraudulent, or a waste of public property in the sense that they represent a use of public property or funds for entirely illegal purposes").

[229] *Mesivta*, 448 N.E.2d at 1345; 103 N.Y. JUR. 2D TAXPAYERS' ACTIONS § 26 (2017) ("While the statute is remedial in nature and to be liberally construed for the protection of taxpayers, allegations of illegality alone are an insufficient basis for a taxpayer's suit under the statute, and a taxpayer's action under this provision is not a vehicle for correcting purely procedural irregularities by governmental bodies").

fund,[230] a claim asserting a failure to specify the reasons for reacquisition of a school building,[231] and a motion to set aside an agreement that the local authority illegally entered[232] were all rejected, despite the local authority's proven illegal actions, because the courts deemed the illegalities to be formalities and no fraud was proven. This narrow interpretation of the local Taxpayer Statute shows the courts' lack of enthusiasm for local taxpayer suits, and their reluctance to encourage taxpayers to sue.[233]

Yet a third manifestation of this approach, and in our opinion the most important one, can be found in the willingness (or unwillingness) to grant attorney's fees. In order to explain the courts' approach in this matter, and to better understand the effects this approach has on potential plaintiffs, we first discuss the rules for awarding attorney's fees in general, and then the application of these rules in local taxpayer litigation.

The general American rule concerning attorney's fees is that each litigant is responsible for the compensation of her own attorney's fees.[234] Whether the claim is affirmed or rejected, both the plaintiff and the defendant pay their respective attorneys' costs.[235] Under certain conditions this rule has various exceptions (statutory and equitable) that enable the court to award attorneys' fees notwithstanding the American convention.[236] The equitable exceptions that are potentially relevant to local taxpayer suits are threefold: the common fund doctrine, the common benefit doctrine, and the private attorney general doctrine.[237]

The common fund doctrine allows the court to award attorney's fees when a common fund that benefits a class of plaintiffs is created.[238] In this case, courts use their equitable powers to determine that the attorneys' fees be paid

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230 Langdon v. Town of Webster, 270 A.D.2d 896, 897 (N.Y. 2000).

231 *Mesivta*, 448 N.E.2d at 1345.

232 Betters v. Knabel, 288 A.D.2d 872, 872 (N.Y. 2001).

233 Council of New York v. Giuliani, 5 A.D.3d 330, 331 (N.Y. App. Div. 2004) (the court explained the Statute "is not a vehicle for correcting purely procedural irregularities by governmental bodies.").

234 John F. Vargo, *The American Rule on Attorney Fee Allocation: The Injured Person's Access to Justice*, 42 AM. U. L. REV. 1567, 1575 (1993).

235 *Id.*

236 *See id.* at 1578–90 (listing all exceptions); Layne Rouse, Note, *Battling for Attorneys' Fees: The Subtle Influence of "Conservatism" in 42 U.S.C. Section 1988*, 59 BAYLOR L. REV. 973, 975 (2007).

237 Lloyd C. Anderson, *Equitable Power to Award Attorney's Fees: The Seductive Appeal of "Benefit*,*"* 48 S.D. L. REV. 217, 218–19 (2003).

238 A common fund is a monetary fund from which others, besides a representative plaintiff, can benefit (i.e. an entire class of shareholders, a group of taxpayers, etc.). The rationale of the doctrine is to force all fund beneficiaries to share the costs of the litigation that created it. Courts use their equitable powers to determine that the attorney's fees be paid out of the fund, thereby forcing the beneficiaries to pay their equitable share. The common fund doctrine is widely used and serves as a legal basis for paying the plaintiffs' attorney's fees in commercial-class actions where the plaintiffs receive monetary relief. *See* Trustees v. Greenough, 105 U.S. 527, 534 (1881); Anderson, *supra* note 237, at 223; Vargo, *supra* note 234, at 1579.

out of the created fund, thereby forcing the fund's beneficiaries to pay their share of the litigation costs. The common benefit doctrine concerns a situation where a non-pecuniary benefit is conferred upon a class of beneficiaries that own, or are members of, the defendant.[239] Here, although the benefit comes in the form of an injunction or a specific action, due to the plaintiffs' stake in the defendant, the same logic applies. Forcing the defendant to pay the plaintiff's attorney's fees shifts the attorney's fees to the class of beneficiaries, thereby preventing their unjust enrichment.[240] The third doctrine—the private attorney general doctrine—has a different rationale.[241] The rationale of this doctrine is to incentivize public-interest litigation by awarding attorney's fees to parties that vindicate a right that benefits a large number of people and is of societal importance.[242] Courts acknowledge that public interest litigation may not be initiated if the initiators are not compensated for their efforts, and the doctrine allows them to reward benevolent plaintiffs for the public service they provided.[243]

Most state courts, however, refuse to apply both the common benefit and private attorney general doctrines where local taxpayer suits are concerned. Instead, they are willing to deviate from the general American rule when the tax-

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[239] The doctrine was developed by the U.S. Supreme Court in *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 396–97 (1970). *See* Hall v. Cole, 412 U.S. 1, 9 (1973).

[240] Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 276 (1975) (Marshall, J., dissenting); Anderson, *supra* note 237, at 223; Scott J. Jordan, Note, *Awarding Attorney's Fees to Environmental Plaintiffs Under a Private Attorney General Theory*, 14 B.C. ENVTL. AFF. L. REV. 287, 294 (1987).

[241] Jordan, *supra* note 240, at 295.

[242] The different rationales of the common benefit and private attorney general doctrines explain their different applications. The public benefit doctrine applies only where the defendant is owned by the class of plaintiffs (like in a commercial corporation), or in cases where the benefitted plaintiffs are members of the defendant (like in a union). In these cases, due to the benefitted class's stake in the defendant, shifting the litigation costs to the defendant is the same as shifting the fees to the benefitted class. The defendant is the one paying the fees to the plaintiff, but since the benefitted class members own the defendant, in essence, they are the ones paying the fees. Jordan, *supra* note 240, at 294. The application of the private attorney general doctrine, on the other hand, does not require the plaintiff class members to own or be members of the defendant. Under this doctrine, the defendant pays the winning plaintiffs' attorneys' fees when the litigation promotes an important public policy, and the court wishes to incentivize such litigation to advance the interests of the public. Thus, in the case of the private attorney general doctrine, the class of beneficiaries should not be small and easily ascertainable (but rather the public at large), and the plaintiffs do not necessarily own, or are members of, the defendant. Anderson, *supra* note 237, at 232.

[243] Ann K. Wooster, *Private Attorney General Doctrine—State Cases*, 106 A.L.R.5TH 523 (2003). Note that the private attorney general doctrine was rejected by the Federal court system. In *Alyeska Pipeline*, the Supreme Court determined that "it would be inappropriate for the Judiciary, without legislative guidance, to reallocate the burdens of litigation . . . " *Alyeska Pipeline Serv. Co.*, 421 U.S. at 247. As a response to *Alyeska*, Congress enacted 42 U.S.C. § 1988(b), which allows the court to award attorney's fees in cases arising under certain civil liberty litigations. State courts, however, are not bound by the *Alyeska* ruling. Awarding attorney's fees is entirely a state law question, and California, for example, adopted the private attorney general doctrine despite the federal approach.

payer suit creates a common fund, but are reluctant to do so when a non-pecuniary benefit is conferred.[244] When there is no fund that the plaintiffs' costs can be taken, courts are disinclined to tax the local treasury for the plaintiffs' attorney's fees, even when the local authority has wronged or the plaintiffs' action benefitted the local residents.[245] The Tennessee Supreme Court explained this approach as follows:

> We know of no case holding or even intimating that, where counsel have by bill in equity enjoined illegal appropriations, the Court is authorized to declare lien upon the county treasury for attorney's fees, or to order such fees paid as court costs, however meritorious the services may have been.[246]

This approach is not only adopted in Tennessee, but in the majority of states, such as New York,[247] New Jersey,[248] Florida,[249] Alabama,[250] Indiana,[251] Connecticut,[252] Illinois,[253] Massachusetts,[254] Michigan,[255] Missouri,[256] Mississippi,[257] Texas,[258] and others,[259] and creates a significant hurdle for taxpayer-plaintiffs. As we have seen, most of the taxpayer suits are for injunctive, declaratory, or mandamus reliefs, and since a common fund is not created, plaintiffs' attorney's fees will rarely be awarded. In New York, for example, attorney's fees were not awarded (even when plaintiff won the claims submitted); in Ohio, attorney's fees were awarded in 14 percent of the cases (although plaintiffs won 35 percent of the claims submitted), and in 6 percent of the cases in Arkansas (although plaintiffs won 25 percent of the actions).[260]

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[244] 74 AM. JUR. 2D, *supra* note 10, § 80 ("Accordingly, where the taxpayer's action seeks to prevent the illegal disbursement or collection of funds, in which no money is brought into the common fund, it has been held that attorney's fees will not be awarded [sic] the complainant even though the complainant's act has rendered a great public service to the taxpayers."); *see also* 1 ROBERT L. ROSSI, ATTORNEYS' FEES § 7:19 (3d ed. 2017) ("The view has also been taken that where the taxpayer's objective is not to secure or preserve a common fund but to establish adverse interests therein, attorneys' fees will not be awarded").

[245] 74 AM. JUR. 2D, *supra* note 10, § 80; Southern v. Beeler, 195 S.W.2d 857, 873 (Tenn. 1946).

[246] *Id.*

[247] RACHEL M. KANE, 103 N.Y. JUR. 2D TAXPAYER ACTIONS § 78 (2d ed. 2017).

[248] MICHAEL A. PANE, 35A N.J. PRAC., LOCAL GOVERNMENT LAW § 29:17 (4th ed. 2017).

[249] COREY E. BURNHAM-HOWARD, 55 FLA. JUR. 2D TAXPAYERS' ACTIONS § 45 (2d ed. 2017).

[250] Shelby Cty. Comm'n v. Smith, 372 So. 2d 1092, 1096–97 (Ala. 1979); Ellison v. Green, 775 So. 2d 831, 835 (Ala. Civ. App. 2000).

[251] State Bd. of Tax Comm'rs v. Town of St. John, 751 N.E.2d 657, 662 (Ind. 2001).

[252] Doe v. State, 579 A.2d 37, 48–49 (Conn. 1990).

[253] Hamer v. Kirk, 356 N.E.2d 524, 528 (Ill. 1976).

[254] Pearson v. Bd. of Health of Chicopee, 525 N.E.2d 400, 402 (Mass. 1988).

[255] Nemeth v. Abonmarche Dev., Inc., 576 N.W.2d 641, 651–53 (Mich. 1998).

[256] Moore v. City of Pacific, 534 S.W.2d 486, 505 (Mo. Ct. App. 1976).

[257] Fordice v. Thomas, 649 So. 2d 835, 846 (Miss. 1995).

[258] *In re* Interest of S.J.O.B.G., 292 S.W.3d 764, 786–87 (Tex. Ct. App. 2009).

[259] Wooster, *supra* note 243, § 3(b); Parsons, *supra* note 127, at 977.

[260] Data is available with author.

Some courts are even reluctant to award attorney's fees to prevailing plaintiffs when their Taxpayer Statute expressly authorizes them to do so. In Arizona, for example, the Statute states that "[i]f the taxpayer prevails in the action, the court shall allow him costs and reasonable attorney's fees,"[261] but the Arizona court awarded attorney's fees in only three actions (out of ten that were filed, and six where plaintiffs prevailed).[262] In Oklahoma, the Statute provides that the "county, city, town or school district shall be liable to the resident taxpayer . . . for reasonable attorney fees,"[263] and yet since 1990, attorney's fees have not been awarded even once.[264] In California, the state legislature expressly adopted the private attorney general doctrine. In California, the Code of Civil Procedure allows the court,[265] under certain conditions, to award attorneys' fees in actions that have benefitted the public, and yet courts rarely use this authority in taxpayer suits.[266] In most taxpayer suits, courts do not award attorneys' fees, and plaintiffs finance the litigation themselves.

C. *The Scarcity of Local-Taxpayer Suits Explained*

We can now close the circle and explain the scarcity of local-taxpayer suits, especially in comparison to commercial class and derivative litigation. The reasons for this phenomenon, we believe, are twofold: first, it is much more difficult to initiate private enforcement action in the public sphere than in the commercial sphere; second, when initiated, the chances of the representative plaintiff to recover the costs of litigation, including attorney's fees, are much lower.

The first reason—the relative difficulty of initiating taxpayer litigation—concerns the amount of information available to potential plaintiffs.[267] In the commercial sphere, corporations are obligated by securities laws to disclose all relevant information about their activities.[268] They must reveal their transactions, risk factors, corporate events, etc., and all this information is readily available to potential plaintiffs. In addition, adverse corporate events are often reflected in corporate share prices.[269] The decrease in share price signals the existence of a potential cause of action, and also indicates the amount of damages plaintiffs can receive. Plaintiffs' lawyers, therefore, need only to follow the

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261 ARIZ. REV. STAT. ANN. § 35-213(C) (2017).

262 Data is available with author.

263 OKLA. STAT. tit. 62, § 373 (2017).

264 Data is available with author.

265 CAL. CIV. PROC. CODE § 1021.5 (West 2017).

266 Data is available with author.

267 *See, e.g.*, Securities Act of 1933, 15 U.S.C. § 77a (2012); Securities Exchange Act of 1934, 15 U.S.C. § 78a (2012).

268 John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 717 n.2 (1984).

269 Jeffrey N. Gordon & Lewis A. Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761, 770–72 (1985).

capital markets in order to detect cases in which they believe the potential damages justify the work they need to put in.[270] Unfortunately, though, these mechanisms are not available in the local sphere. First, municipal corporations, even those that issue municipal bonds, are exempt from many of the obligations under the Securities law.[271] As a result, local disclosure is basic and insufficient,[272] and local authorities are significantly less transparent than their commercial peers.[273] Second, the way the information is revealed to the public is lacking. Local governments' websites tend to hide adverse information,[274] and until 2008, there was not even a central place (website) to find all municipal disclosures.[275] Third, since local governments do not issue shares, there is no visible decrease in the "value" of a locality. The damage caused to local taxpayers from a certain local action is not easily discernable, and plaintiffs' lawyers can hardly assess whether the gains from a potential claim are worth their investment.[276]

These problems could have been mitigated if courts were receptive to local taxpayer suits—but, unfortunately, this is not the case. As we have seen, courts place hurdles upon taxpayer suits, and discourage potential litigants from acting.

The special standing requirements and narrow interpretation of Taxpayer Statutes decrease the plaintiffs' chances of winning taxpayer suits. This, in turn, decreases the chances of recovery, and thereby the motivation to initiate action in the first place. More importantly, even if the representative plaintiffs are successful in their claim (and even if they benefit the public), courts are reluctant to award them attorney's fees. Usually, Plaintiffs are forced to bear the costs of the litigation that tends to outweigh their potential benefits. Thus, the suits are initiated by a few benevolent plaintiffs acting for the good of the public.

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270 Baruch Lev & Meiring de Villiers, *Stock Price Crashes and 10b-5 Damages: A Legal, Economic, and Policy Analysis*, 47 STAN. L. REV. 7, 22 (1994).

271 Gabaldon, *supra* note 25, at 742–53.

272 There are no mandatory specifics as to the content of the disclosure, and the disclosure need not be preregistered. Shanske, *supra* note 25, at 802–03.

273 David A. Skeel, Jr., *States of Bankruptcy*, 79 U. CHI. L. REV. 677, 721 (2012) ("The state and municipal debt markets provide considerably less disclosure to investors than the markets for corporate bonds. Not only are state and municipal budgets more opaque than the balance sheets of most corporations (though large financial institutions come close); investors also have less access to current price data than with other bonds."); *see also* Maggie Guidotti, *Seeking* "*the SEC's Full Protection*"*: A Critique of the New Frontier in Municipal Securities Enforcement*, 82 U. CHI. L. REV. 2045, 2045 (2015).

274 Cory L. Armstrong, *Providing a Clearer View: An Examination of Transparency on Local Government Websites*, 28 GOV'T INFO. Q. 11, 11 (2011).

275 In 2008, the Electronic Municipal Market Access System was established, serving as the official source for municipal securities disclosure.

276 Although many local governments issue municipal bonds, bond prices are not as good indicators as are shares for identifying potential causes of action for taxpayer suits. Adverse events in the locality will affect bond prices only to the extent that they change the municipality's ability to repay its debts, but many events adversely affect taxpayers without having any influence on bondholders.

In addition, the fact that attorney's fees are so seldomly awarded abolishes the entrepreneurial aspect of taxpayer suits. In the commercial sphere, plaintiffs' lawyers are the initiators of the litigation.[277] If the action is successful, the lawyers get their share of the entire class's gains, so it is worth their while to find a cause of action and a client that best fits the prospective litigation.[278] Lawyers, therefore, monitor commercial corporations, look for breaches of fiduciary duties or securities frauds, and take action when appropriate. As Judge Zagel pointed out in *Williams v. Balcor Pension Investors*:[279]

> In truth, class actions are inevitably the child of the lawyer rather than the client . . . There are cases in which lawyers find clients and precipitate cases where perhaps no one client would ever come forward to complain. I suppose lawyers going out to find clients is not the bad thing it was once thought to be.

But in the public sphere, lawyers have no reason to act in the same manner. Attorney's fees are not granted by the courts, and so lawyers have no motivation to go out and find clients. Lawyers, in this respect, act as businessmen. If adequately compensated, they will be willing to monitor local governments (just as they do commercial corporations), and propel litigation that can potentially improve local governance. But without fees, they will not oversee local officials' behavior, and will hardly investigate waste or possible corruption. They have little incentive to invest multiple hours in researching for a cause of action or spend the required resources to prepare a case.

This analysis shows why, despite their declared purpose and great potential,[280] taxpayer suits do not serve as an effective monitoring tool. The legal system does not motivate private lawyers to act, and so it fails to take advantage of an army of private attorneys eager to monitor local authorities for profit. That leaves the monitoring to a few benevolent residents that suffer from collective action problems and can hardly do a proper job. In the following section, we try to explore the reasons for this legal approach. We examine the arguments given in its favor, and whether they justify the scarce use of taxpayer suits.

IV. A NORMATIVE EVALUATION OF LOCAL TAXPAYER SUITS—CRITIQUES AND REFORMS

So far, our analysis has been positive in nature. We saw that the number of local-taxpayer suits is relatively small, and discussed possible reasons for their scarce filing. Yet, it is not entirely clear that the small number of taxpayer suits

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277 Macey & Miller, *supra* note 79, at 7.

278 Weiss & Beckerman, *supra* note 92, at 2060. Weiss & Beckerman report that in a large number of class actions, the plaintiffs themselves are "poorly informed about the theories of their cases, are totally ignorant of the facts, or are illiterate concerning financial matters."

279 Williams v. Balcor Pension Inv'rs, 150 F.R.D. 109, 118 (N.D. Ill. 1993).

280 Theurer v. Borrone, 195 A.2d 215, 216 (N.J. Super. Ct. Law Div. 1963); 1 STEVENSON & VAN WIE, supra note 59, § 73.04.

is problematic. Perhaps the current state of affairs is desirable. Perhaps too many taxpayer suits are liable to waste judicial time and government resources.

The concern about an increase in the number of taxpayer suits stems from critiques often raised about class and derivative actions. In the commercial sphere, many believe that there are far too many actions being filed, rendering them inefficient and costly.[281] The actions force corporations to spend millions in legal expenses that are then passed on to consumers.[282] The same can be said about taxpayer suits: A flood of taxpayer suits may force localities to increase legal costs, thereby rendering local services more expensive. In addition, local officials may fear the potential litigation, and act defensively to avoid lawsuits instead of acting in accordance with what they believe is best for the locality. If this is the case, perhaps few taxpayer suits are better for the public.

In order to normatively analyze the desirability of local taxpayer suits, in this section we examine three types of critiques. First, we look at the separation of powers doctrine, then examine the flood of litigation argument, and lastly—analyze whether taxpayers (like shareholders) indeed benefit from the litigation. Addressing these critiques will enable us to examine whether the use of local taxpayer suits should be broadened, and if so—how.

A. Separation of Powers

The first argument raised against taxpayer suits is that of the doctrine of separation of powers.[283] This doctrine deals with the relationship among the three branches of government, and prohibits each branch from interfering with the work of the others.[284] The judiciary claims the doctrine should address par-

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[281] Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 261–63 (1986); Martin H. Redish, *Class Actions and the Democratic Difficulty: Rethinking the Intersection of Private Litigation and Public Goals*, 2003 U. CHI. LEGAL F. 71, 71 (2003); Coffee, *supra* note 89, at 671–72.

[282] *See* Buford v. Am. Fin. Co., 333 F. Supp. 1243, 1251 (N.D. Ga. 1971) ("This is an appropriate moment for the court to express its grave concern over the increasing resort to the class action device in actions seeking monetary relief. The class action is supposed to 'achieve economies of time, effort and expense, and promote uniformity of decision as to persons similarly situated, without sacrificing procedural fairness or bringing about other undesirable results.' Today, however, many claims which simply did not exist have been brought to life by our courts through the judicial act of allowing a class action to be maintained. . . . . [T]he plain truth is that in many cases Rule 23(b)(3) is being used as a device for the solicitation of litigation. This is clearly an 'undesirable result' which cannot be tolerated.").

[283] Staudt, *supra* note 34, at 784–85.

[284] For a more elaborate discussion of the separation of powers doctrine, see Bruce G. Peabody & John D. Nugent, *Toward a Unifying Theory of the Separation of Powers*, 53 AM. U. L. REV. 1, 2 (2003).

ticular injuries suffered by certain plaintiffs, while taxpayer suits concern public injuries that are political in nature.[285]

In the federal courts, the doctrine of separation of powers is one of the main reasons for rejecting federal and state taxpayer suits.[286] The Supreme Court determined that the "*general grievances*" in these types of cases (grievances not particular to any taxpayer), should be decided by the political system, and denied plaintiffs the opportunity to stand before the judiciary.[287] In state courts, although standing is not denied, due to separation of powers concerns, certain courts place limitations on taxpayer suits. In Utah, for example, the court grants standing "where matters of great public interest and societal impact are concerned,"[288] and only where the issue is "not more appropriately addressed by another branch of government pursuant to the political process."[289] New York's narrow interpretation of the local taxpayer action statute also draws on, at least in part, the separation of powers doctrine. In the case of *Montecalvo v. Herbowy*, the New York court denied the availability of a damage action, explaining that allowing that the "[t]axpayer resort to the judiciary implicates serious separation of powers concerns."[290]

These 'separation of powers' concerns, however, seem excessive to us. They do not derive from the doctrine as we interpret it, and do not conform to the usual scope of judicial review on local governments. The doctrine of separation of powers stops courts from replacing the discretion of the legislative or executive branches. According to the doctrine, courts should decide the cases presented before them rather than make general policy decisions or second-

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[285] *Taxpayers' Suits: A Survey and Summary*, *supra* note 117, at 910; Jay M. Zitter, *Constitutionality, Construction, and Application of Statutes Requiring Bond or Other Security in Taxpayers' Action*, 41 A.L.R.5TH 47 (1996).

[286] Heather Elliott, *The Functions of Standing*, 61 STAN L. REV. 459, 459 (2008).

[287] *Id.* at 476; *see, e.g.*, Schlesinger v. Reservists Comm. to Stop the War, 418 U.S. 208, 222 (1974). In this case, an association comprised of former and present armed forces reserves members challenged the membership of some congressmen in the reserves as being a violation of the Constitution's incompatibility clause. The Supreme Court rejected a taxpayer claim on grounds of standing, explaining that to allow such a claim would "*distort the role of the Judiciary in its relationship to the Executive and the Legislature and open the Judiciary to an arguable charge of providing* '*government by injunction.*'" *Id.* at 222 (emphasis added); Antonin Scalia, *The Doctrine of Standing as an Essential Element of the Separation of Powers*, 17 SUFFOLK U. L. REV. 881, 881 (1983).

[288] Jenkins v. State, 585 P.2d 442, 443 (Utah 1978).

[289] Utah Chapter of the Sierra Club v. Utah Air Quality Bd., 148 P.3d 960, 973 (Utah 2006); Gregory v. Shurtleff, 299 P.3d 1098, 1110 (Utah 2013).

[290] Montecalvo v. Herbowy, 656 N.Y.S.2d 176, 178–79 (N.Y. App. Div. 1997) ("Taxpayer resort to the judiciary implicates serious separation of powers concerns . . . The republican form of government contemplates separate spheres of governmental competence with an elaborate system of checks and balances to remedy abuses. While democratic innovations have led to a much broader role for taxpayers as participants in governance, the availability of damage actions as a check on official misconduct is still sharply limited. To empower taxpayer litigants disenfranchises the voters for whom representatives legislate").

guess the wisdom of statutes.[291] However, the doctrine does not instruct the judiciary to refrain from determining whether the decisions or actions of the executive or legislature comply with the constitution or rule of law. On the contrary: when other branches of government act absent proper legal authority or use improper legal procedures, it is the role of the judiciary to proclaim such illegality.[292] As Richard Epstein noted, a strong separationist approach is inconsistent with the principles of judicial review as determined in *Marbury v. Madison*.[293] In *Marbury*, Justice Marshall determined that "*[i]t is emphatically the province and duty of the judicial department to say what the law is*," and when the executive and legislature do not comply with the rule of law, the judiciary is called upon to intervene.[294]

This is especially true when the judicial review concerns local governments. According to local government law, local governments are creatures (subdivisions) of the state.[295] Courts constantly examine whether localities' actions are within the powers delegated to them by the state, and whether their decisions follow their own local ordinances and procedures.[296] Since, generally, local actions are under judicial review, we see no reason why separation of powers concerns should play a major role in taxpayer suits. If courts are anyway less apprehensive when scrutinizing local legislatures or executives (as compared to their review of state and federal legislatures and executives), they should not be concerned when doing so also in the framework of taxpayer suits. Even the Supreme Court allowed local taxpayer suits in the federal court system, despite separation of powers concerns,[297] and we see no reason why state courts should decide differently.

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[291] Morrison v. Olson, 487 U.S. 654, 705 (1988) (Scalia, J., dissenting); Matthew James Tanielian, Note, *Separation of Powers and the Supreme Court: One Doctrine, Two Visions*, 8 ADMIN. L.J. 961, 961 (1995).

[292] Epstein, *supra* note 115, at 35–36.

[293] *See id*. ("It all sounds good until we realize that this strong separationist sentiment is flatly inconsistent with judicial review under *Marbury v. Madison*, for the complaint here is not that the law is unwise, but that it lies beyond the power of Congress to enact."); s*ee also* Mark C. Rahdert, *Forks Taken and Roads Not Taken: Standing to Challenge Faith-Based Spending*, 32 CARDOZO L. REV. 1009, 1054 (2011) ("Consequently, the rule-of-law dimensions of *Marbury* not only support, but actually call for the judiciary to decide, and separation of powers issues are beside the point. This is, quintessentially, a matter for judicial determination.").

[294] Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177–78 (1803) (emphasis added).

[295] Hunter v. City of Pittsburgh, 207 U.S. 161, 178–79 (1907); Frug, *supra* note 59, at 1080–1120; Gillette, *supra* note 37, 963–68.

[296] *See* Harold H. Bruff, *Judicial Review in Local Government Law: A Reappraisal*, 60 MINN. L. REV. 669, 669 (1976). Bruff divides the judicial review of local governments into three main categories: first, since local governments' powers are delegated to them by the state, courts examine whether the delegating statutes are constitutionally valid; second, courts examine whether the local decisions or actions are within the confines of the delegating statute; and third, courts verify that the local decisions or actions are conducted pursuant the locality's own local ordinance.

[297] Asarco Inc. v. Kadish, 490 U.S. 605, 605 (1989).

B. A Flood of Litigation

A second concern about broadening taxpayer suits is, therefore, that opening the judiciary's gate too wide will bring in a flood of litigation that will disrupt both courts and local governments. According to the argument, too many taxpayer actions will not only cause court congestion, but will also delay or even halt public projects. Managing taxpayer suits will waste local officials' time and resources, and *ex-ante* officials are liable to behave defensively and bury complicated projects out of fear of litigation.[298] This concern is strongly echoed in the opinions of both federal[299] and state courts,[300] as a reason to limit, albeit not to reject, taxpayer actions.

But although this concern is valid, we believe it is exaggerated. As discussed earlier—contrary to commercial litigation in the public sphere—the investment required to initiate litigation is relatively high due to information gaps and difficulty in quantifying the damage to taxpayers.[301] As a result, even if the limits on local-taxpayer suits were lifted (and, most importantly, even if attorneys' fees were awarded to all successful plaintiffs), we would not expect a flood of litigation. The barriers potential plaintiffs (and plaintiffs' lawyers) face when filing a taxpayer suit are high enough as is, and it seems that additional judicial hurdles are not required to limit the number of suits.

This is especially true if, as we will suggest in the following part, the judicial review in taxpayer suits was limited to the local actions' legality or procedure. We presume most local decisions are legal and procedurally proper, and, therefore, a flood of litigation should not be expected. But even if we are wrong, and taxpayer-plaintiffs will start flooding the courts, it only means that the court's intervention is warranted. It is the courts' duty to remedy illegal or procedurally flawed decisions so that local governments and officials will correct their ways in the future—this is the meaning of monitoring.

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298 *Taxpayers' Suits: A Survey and Summary*, *supra* note 117, at 909–10.

299 *See* Commonwealth of Massachusetts (Frothingham) v. Mellon, 262 U.S. 447, 484–87 (1923) ("If one taxpayer may champion and litigate such a cause, then every other taxpayer may do the same, not only in respect of the statute here under review, but also in respect of every other appropriation act and statute whose administration requires the outlay of public money, and whose validity may be questioned. The bare suggestion of such a result, with its attendant inconveniences, goes far to sustain the conclusion which we have reached, that a suit of this character cannot be maintained.").

300 *See Taxpayers' Suits: A Survey and Summary*, *supra* note 117, at 910 n.83 ("The fear of a multiplicity of litigation has been one of the most common criticisms levelled at taxpayers' actions."); *see also* Chiatello v. City and County of San Francisco, 189 Cal. App. 4th 472, 472 (Cal. Ct. App. 2010); Ceres v. Modesto, 274 Cal. App. 2d 545, 555 (Cal. Ct. App. 1969); Mesivta of Forest Hills Ins., Inc. v. New York, 448 N.E.2d 1344, 1345 (N.Y. 1983); Doolittle v. Supervisors of Broome County, 18 N.Y. 155, 155 (N.Y. 1858).

301 *See supra* text accompanying notes 267–76.

C. Who Benefits from Allowing Taxpayer Suits?

This brings us to the final critique on taxpayer suits—that the benefit taxpayers derive from these actions is, in fact, small or even non-existent. This critique was not voiced in connection to taxpayer suits, but rather with respect to a segment of commercial class-action suits—securities class actions, but it is very relevant nonetheless.[302] In order to better explain the critique and its relevance to local-taxpayer suits, we first take a look at the gains (or lack thereof) shareholders derive from securities class actions, and then analyze the implications for residents in local-taxpayer suits.

A securities class action is filed on behalf of investors who suffered damages as a result of a securities law violation. A corporation publishes a misleading statement or fails to disclose a material fact, and, as a result, investors buy the corporation's shares at a higher price than they would have otherwise (had the corporation revealed more accurate statements).[303] *De jure*, the class action is designed to compensate shareholders for the excess amount they paid due to the misleading information, but *de facto*, it is not entirely clear that shareholders actually benefit from these suits. As John Coffee pointed out, on average, securities class actions do not enrich shareholders, and may even cause them losses due to high transaction costs.[304]

To understand Coffee's observation, we need to examine the parties involved in a securities class action. The plaintiffs' group in such actions consists of investors who purchased the corporation's securities from the time the misleading statement was revealed to the time corrective disclosure was made (hereinafter referred to as the "Class Action Period").[305] The defendants in these actions are those responsible for the misleading statements, usually both the corporation and some of its directors and officers (like the CEO or CFO). In most cases, however, the corporation is the only one to pay damages. The individual directors and officers are either insured or indemnified by the corporation,[306] and so, even if they are responsible for the securities violation, nothing will come out of their own pockets.[307]

Since the corporation is the only one paying, a securities class action essentially transfers wealth between two groups of shareholders. The transferring group is the current shareholders. As residual owners, they bear the cost of the payment, because when the corporation pays, the value of their shares in the

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302 John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1534 (2006).
303 Greg Niehaus & Greg Roth, *Insider Trading, Equity Issues, and CEO Turnover in Firms Subject to Securities Class Action*, 28 FIN. MGMT. 52, 52–54 (1999).
304 Coffee, *supra* note 302, at 1536–37.
305 Niehaus & Roth, *supra* note 303, at 54.
306 Note that in both cases involving indemnification or insurance, the corporation is the one paying the damages, either as indemnification to the insiders or as premiums to the insurance company.
307 Coffee, *supra* note 302, at 1550–51.

corporation decreases accordingly. The receiving group is the shareholders who bought their shares during the Class Action Period. They are the members of the plaintiffs' class, and as such, they are entitled to compensation for the misleading disclosures. In many cases, however, shareholders belong to both shareholder groups—the paying one and the receiving one.[308] If, for example, a shareholder bought her shares within the Class Action Period and continues to hold the shares after corrective disclosure is made, she both receives damages and pays them. As a current shareholder, she suffers the loss when the corporation pays, but as a member of the plaintiffs' group, she gains the damages paid. This also occurs when shareholders have a diversified portfolio (they buy and sell shares in multiple corporations). These shareholders will sometimes pay damages (as current shareholders) and sometimes receive them (as members of the plaintiffs' class). There is no reason to believe they will be on the receiving end more than on the paying end, or vice versa, and, on average, they will therefore transfer wealth to themselves.[309]

This self-transfer, albeit futile, would not have been so problematic had it not been associated with transaction costs. Because the transfer requires the payment of attorneys' fees, these eventually come out of the shareholders' pockets. The fees can amount to a substantial percentage of the awarded damages (often 20–30 percent), and they are paid out of the created fund.[310] Thus, in cases where there is a circular wealth transfer, on the paying end, shareholders lose the entire amount of the award, but on the receiving end, they receive only a fraction of the award (the award minus litigation costs). Thus, on average, the shareholders can be net losers, and be better off without the costly litigation initiated by the plaintiffs' lawyers.

This argument can also be applied to taxpayer suits. Like in the commercial sphere, if the municipality is the only one paying the taxpayer damages, taxpayer suits seemingly transfer wealth from the residents to themselves. The current residents bear the costs associated with the payment to the plaintiffs, while the plaintiffs—who were residents at the time of the misconduct—benefit from the awarded compensation. Since most of the residents at the time of the misconduct are likely to continue living in the locality, it seems that they transfer wealth to themselves. What they gain as plaintiffs, they lose as residents, but, once again, less the costs of litigation. The litigation brings them no benefit, but they still need to pay attorney's fees. If this is the case, surely taxpayer suits should not be encouraged, and it may be argued that the limitations placed by the courts are justified.

But this argument, albeit appealing, is not entirely accurate. There are important differences between shareholders and taxpayers, and some of these differences affect the benefits of each type of procedure. In the commercial

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308 *Id.* at 1556.
309 *Id.* at 1556–66.
310 Eisenberg & Miller, *supra* note 95, at 250.

sphere, the dispersed shareholders are very much alike. They all hold the same rights vis-à-vis the corporation, and they all have access to the same information.[311] If the corporation incurs unnecessary expenses, all shares suffer the same loss, and if the corporation discloses incorrect information, all public shareholders are misled.[312] Due to this equality, chances are high that what plaintiffs gain as damages, they lose as shareholders, and that the class actions will result in net losses. This is not the case with regard to local governments. In a local government, the residents are a diverse group. As opposed to shareholders, whose common goal is to maximize their shares' value, residents expect different things from their local government and consume diverse local goods and services. Some residents are individuals, while others are businesses; some enjoy the education system, while others prefer parks and recreation.[313] In addition, as opposed to shareholders, residents pay different amounts to the local government (not simply the share price). Tax rates often differ among residents according to their place of residence or socio-economic status, and different residents pay different types of special assessments and user fees according to the goods and services they consume from the locality.[314] In other words, there are many groups of residents in the locality, and taxpayer suits often concern the grievances of one group of residents rather than of others.

When the plaintiffs in the taxpayer action comprise a subset of the local residents (one group of residents), we cannot say that the plaintiffs transfer wealth to themselves. Rather, all residents in the locality pay the awarded damages, while only one group (the plaintiffs) receives the compensation. For example, a locality with 500,000 residents, where 20 percent of the residents (the "Group") pays a total of one million dollars in excess due to an illegally levied tax (or user fee). Without a taxpayer action, the Group loses a net of $800,000 due to the illegal tax. The Group pays one million dollars to the locality (the illegal tax), but assuming the locality spends the proceeds of the illegal tax evenly among all its residents,[315] the Group enjoys 20 percent ($200,000) of the benefit.[316] A taxpayer suit can offset this loss: If the Group wins the suit, the

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[311] George Jarvis Thompson, *Respective Rights of Preferred and Common Stockholders in Surplus Profits*, 19 MICH. L. REV. 463, 464 (1921) ("The implied contract of equality of shares in the simple corporate situation with its one class of stock is now accepted as a matter of course . . . ").

[312] This premise was accepted by the Supreme Court in *Basic Inc. v. Levinson*, 485 U.S. 224, 225 (1988). *See* Jonathan R. Macey et al., *Lessons from Financial Economics: Materiality, Reliance, and Extending the Reach of* Basic v. Levinson, 77 VA. L. REV. 1017, 1017 (1991).

[313] *See* Gillette, *supra* note 40, at 659.

[314] With respect to the levy of property taxes, *see, e.g.*, FISHER, *supra* note 43, at 326–51.

[315] This assumption can be rebutted, because often, groups that are harmed by local actions are ones that are powerless over city hall, and can hardly influence local officials. Local spending on these groups will then be disproportionately lower. Nonetheless, for convenience purposes, we assume even distribution of local spending on all residents.

[316] The loss is eight dollars rather than ten dollars, because we assume the benefits from the illegal assessment are evenly distributed among all residents. Thus, residents from the 20

locality pays back the one million dollars to the Group members. Since the payment comes out of the local treasury, it is financed by all local residents—including the Group (that comprises 20 percent of the locality). The Group then gains $800,000 from the taxpayer suit (one million dollars minus $200,000), that is exactly what it lost from the excess tax. Even if the Group pays 20–30 percent of this amount to attorneys, the initiation of the suit is still efficient and contributes to social justice in the locality. It enables injured groups in the locality to receive remedy from other groups for harms inflicted on them.

This is certainly true if we assume that the harmed group (the Group in the example above) is often comprised of the weaker residents in the locality. These residents are not connected to the local power bases (and hence are more vulnerable), and cannot influence city council members or city officials to correct the wrongful act. They also have difficulties taking legal action independently, because, as an unorganized group, they suffer from collective action problems and, as individuals, they do not have the incentives or the required resources to litigate. Incentivizing lawyers to initiate legal action can help solve this problem. Lawyers will undoubtedly take their cut from the plaintiffs' gains, but it will also propel these efficient and just wealth transfers. If the legal system properly incentivizes lawyers, they will be able to monitor the local government and represent vulnerable residents who are unable to stand their own.

Moreover, as John Coffee points out with regard to securities class action suits, the circularity of the class action is broken when the damages are not paid only by the corporation. When a third party pays at least part of the damages, wealth is transferred from the third party to the plaintiffs rather than (or at least not only) from the shareholders to themselves.[317] Taxpayer suits, in their derivative form, allow exactly that. These suits allow taxpayers to sue third parties on behalf of the municipality, when the municipality fails to take action. Enabling taxpayer suits in a derivative form is a good way for the local residents to recoup payments or subsidies the local government illegally gave to interest groups, thereby enriching the locality as a whole (rather than merely transferring wealth among different residents). It can also deter third parties (for example, local officials) from conduct that is corrupt or ridden with conflict of interests, since the officials can be personally liable for such conduct. These payments are by no means a futile self-transfer, as they can improve local monitoring *ex-ante* and enrich the local treasury *ex-post*.

D. Suggested Reforms

If we accept the premise that taxpayer suits can benefit taxpayers and local governments, we need to make several reforms to encourage potential plaintiffs. The reforms should change the way courts review taxpayer suits and in-

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percent Group paid ten dollars in excess, but still enjoyed 20 percent of the benefit from the payment, i.e., they lost eight dollars.

[317] Coffee, *supra* note 302, at 1558.

centivize lawyers to monitor local governments and initiate the filing of taxpayer suits when appropriate. The analysis in this paper suggests several reforms may be in order.

First, as we have seen, many states place statutory or judicial limitations on taxpayer suits. The legislature or courts limit the available remedies (sometimes only injunctive or declaratory reliefs are permitted), or require plaintiffs to meet certain conditions to achieve standing.[318] In order to encourage the use of taxpayer actions, we believe such limitations should be removed. States should enable taxpayers to receive all types of remedies, and should not demand that taxpayer-plaintiffs prove any particular damage. On the contrary: taxpayers' access to courts should be liberally construed, because the shortage of information available to plaintiffs renders the filing of a taxpayer suit difficult as is (even without the additional legal requirements posed by the courts). Indeed, if we believe that the current level of monitoring is insufficient—and to the extent we agree that taxpayer suits can contribute to the monitoring efforts—why discourage potential plaintiffs?

In addition, and perhaps even more importantly, courts should award attorney's fees to winning plaintiffs. In most states, such fees are awarded, if at all, only when a common fund is created, and not when a non-pecuniary remedy is conferred.[319] This, naturally, discourages potential plaintiffs, and as a result, taxpayer suits are initiated solely by few plaintiffs willing to bear the costs themselves. If we wish to encourage taxpayer suits, courts should award attorney's fees much more often. They should mandate payment to winning attorneys (or reimburse winning plaintiffs), so that they will not come out at a loss. The fees will motivate lawyers to search for and litigate winning cases, and the private enforcement will drive better local governance.

Clearly, at least in the non-pecuniary cases (where no common fund is created), the attorney's fees will come out of the local treasury (taxpayer money). This is justified, however, because even when a given taxpayer litigation concerns only a certain sector of the public, the public as a whole benefits from the taxpayer suit procedure. An efficient taxpayer suit mechanism *ex-ante* disciplines local officials, improves the decision-making process, and decreases corruption.[320] These consequences improve the local administration, benefitting the local public as a whole. The public should therefore share the costs of this "private attorney general" mechanism, especially since these costs are incurred only when the claim is successful. A successful claim means the municipality had done something wrong, and the monitoring was proven just.

Yet a third reform concerns the type of judicial review. Currently, many of the courts are apprehensive about second-guessing local officials' decisions or replacing their discretion. As a result, they shy away from conducting judicial

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318 *See supra* text accompanying notes 217–233.
319 *See supra* text accompanying notes 244–264.
320 *See supra* Section II.B.

review almost completely and refrain from passing judgment even when local officials have been negligent.[321] We, on the other hand, advocate for a corporate-like standard of judicial review that does not question the wisdom of the decisions taken, but rather reviews the decision-making process.[322]

Corporate courts, especially in Delaware, are extremely careful not to replace boards of directors' discretion with that of their own. They trust the corporate officers' business judgment, and will not intervene in their decisions even if, in hindsight, the court believes the decision was wrong.[323] However, corporate courts do examine the procedures through which corporate decisions are made.[324] They require corporate officers to make informed decisions and to act in good faith. This approach was explained in the *Caremark* case:

> Whether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through "stupid" to "egregious" or "irrational", *provides no ground for director liability*, so long as the court determines that the *process* employed was either rational or employed in a good faith effort to advance corporate interests.[325]

This is the type of judicial review we believe courts should adopt in taxpayer actions as well.[326] Rather than judging local decisions on their merits, courts should examine the decisions' legality and the decision-making process. If taxpayers prove that a decision was taken without due consideration, when local officials were insufficiently informed, and certainly when a decision was illegal, we see no reason why the court should not intervene. On the other hand, if the local officials made an informed decision in good faith, courts should uphold the decision even if, in hindsight, they believe it to be wrong. This standard respects the local officials' discretion, but it still makes sure local actions conform to proper legal and procedural standards. For example, in the *Warr Acres* case,[327] if a locality decides to spend a significant amount of money in order to attract a large corporation into the city, although the court should not second guess the policy behind the decision, it should examine the procedure that led to it. If the local officials decided on the expenditure with no factual data, no expert opinions, and without profound deliberation, (certainly when the decision is illegal or there is a conflict of interests) the decision should be overruled. If, on the other hand, the process employed by the local officials was proper, the court should uphold the expenditure even when it disagrees with the

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321 *See*, *e.g.*, *supra* notes 230–32.
322 Schanzenbach & Shoked, *supra* note 18, at 1.
323 Stout, *supra* note 32, at 675; Kastler, *supra* note 32, at 1902–03.
324 Douglas M. Branson, *Intracorporate Process and the Avoidance of Director Liability*, 24 WAKE FOREST L. REV. 97, 97 (1989); Thomas C. Wagner, Note, *Corporate Law—The Business Judgment Rule Imposes Procedural Requirements on Corporate Directors—*Smith v. Van Gorkum, *488 A.2d 858 (Del. 1985)*, 14 FLA. ST. U. L. REV. 109, 110 (1986).
325 *In re* Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959, 967 (Del. Ch. 1996) (emphasis added).
326 Lawrence, *supra* note 129, at 22.
327 State ex rel. Brown v. City of Warr Acres, 946 P.2d 1140, 1140 (Okla. 1997).

underlying policy. We believe courts do not overstep their authority when insisting on a correct procedure, and that local residents deserve an orderly and thoughtful decision-making process. If this is the standard we demand from those who manage our commercial corporations, we should expect no less of those making decisions that concern the public at large.

It may be argued that adopting such a standard with respect to local governments will deter quality residents from serving as city officials. Residents may become fearful of personal liability and prefer not to get involved in public affairs (at least as council members), certainly when the monetary compensation they receive (as opposed to corporate boards) does not justify the potential risk. Although we understand the concern, we believe it does not justify maintaining the low level of judicial review currently applied in taxpayer suits. First, our proposed standard of judicial review is not very high either. All city officials need to do in order to successfully meet the standard is to make informed deliberated decisions in good faith. Following this procedural requirement seems relatively easy, and if this minimum is not met, we think taxpayers are right to sue. Taxpayers, just like shareholders, may demand that their representatives make decisions after verifying the facts and conducting proper deliberations. Second, although the standard applies to the conduct of local officials (specifically their decision-making), the proposed standard does not require courts to impose personal liability on these officials. Courts can use alternative remedies, such as injunctions, mandamuses, or declaratory judgements, and impose pecuniary damages only on the local treasury[328] or on third parties other than the local officials personally (for example, third parties who gained from an unlawful subsidy). Imposing pecuniary damages on local officials, in our opinion, should be reserved to cases where local officials behaved in bad faith, under a conflict of interests or with malice—negligence in itself should not suffice. Third, if municipalities are apprehensive about courts imposing personal liability on their officials, they can always insure them or offer them indemnification.[329] Just like in the commercial sphere, the concerns of potential officials or council members can be alleviated, so as to attract good, yet risk-averse, officials to serve the public.

CONCLUSION

Local governments are complex entities. They provide an array of public goods and services to their residents, and they operate under various social, economic, and political constraints. Due to their complexity, efficient monitoring of their operations is hard to attain. The residents—the equivalents of consumers or shareholders—do not efficiently monitor local officials (because they are dispersed and unorganized); the creditors do not always have the interest or

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[328] As the example in Part C demonstrates, as long as the local action harms only a portion of the local public, payment by the local treasury is not circular and may be justified.

[329] The insurance or indemnification can be with a deductible paid personally by the official.

the tools to monitor, and the state's supervision is often political in nature. Local monitoring is under-provided, and this may enable local officials to behave self-interestedly to the detriment of the local public. The article argues that local-taxpayer' suits can serve as a tool to improve the local monitoring. In the article we looked at how this procedure is currently employed and analyzed whether and to what extent it should be reformed to increase local accountability.

Currently, despite some courts' rhetoric about the importance of local-taxpayer suits, the procedure is hardly used. In the article, we surveyed fourteen states that enacted a Taxpayers Statute (i.e. statutorily enabled a taxpayer suit procedure),[330] and saw that in most of these states the Statute is by and large a dead letter. In the last twenty-six years taxpayers filed taxpayer suits just once or twice a year per state,[331] and even when filed the suits were often rejected and the plaintiffs were not compensated. Courts were concerned about 'separation of power' considerations, and about flooding the courts with taxpayer litigation, and so they narrowly interpreted the Taxpayer Statutes. They posed standing requirements and refused to award attorneys' fees to winning plaintiffs, even when the plaintiffs conferred a benefit on the locality.

The article made the claim that this attitude is wrong; we argued that local-taxpayer suits can serve an important role in local monitoring by empowering local residents and disciplining local officials. Just like class or derivative actions do in the commercial sphere, taxpayer suits can create an "army" of private attorneys general. If properly compensated, private attorneys would have a financial interest to monitor localities and to take action when they notice an illegality or a flaw in the local decision-making process. This would potentially render local officials to be more conscious of their actions, and incentivize them to adopt proper internal procedures. The costs of this private enforcement are relatively low. The lawyers, the propellants of the procedure, are compensated only to the extent the litigation benefitted the locality, and the local (or state) treasury expends funds only when a locality has wronged.

To realize the potential of local-taxpayer suits, the article proposed several reforms. We suggested courts to interpret Taxpayer Statutes more broadly, to award attorney's fees to winning plaintiffs and to adopt a corporate like standard of judicial review. Adopting these measures will incentivize plaintiffs and lawyers to bring more actions, thereby changing the way local governments are managed for the better. This should not diminish the role of the other potential monitors (like the state), but it can enhance the oversight on local officials.

There is, of course, no guarantee that even if all the suggested reforms are adopted, taxpayer suits would be as prevalent as commercial class—or derivative actions—are, nor do we believe it is desirable. Implementing these reforms today may contribute to local monitoring, especially with regard to injuries in-

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330 *See supra* Section III.A.
331 *See supra* Section III.A.

flicted on weaker constituencies in the locality that have little political power. When localities experience financial difficulties, and in times of political instability, this can be a valuable step towards better, more efficient, local governance.