
THE GOVERNANCE OF PUBLICLY OWNED URBAN MASS TRANSIT: A PROPOSED MODEL ACT AND COMMENTS

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I. INTRODUCTION

Urban mass transit is an appropriate focus for a model urban transit act for two reasons. The first reason is the enormous commitment of public funds to the subsidy of mass transit. In the 1970s transit was one of the most rapidly growing federal aid programs.¹ From 1970 to 1980 the federal subsidy to transit increased thirty-six fold. From 1980 to 1986 federal spending for transit continued at a level of three to four billion dollars per year.²

Because the Reagan Administration advocates the reduction of federal capital and operating subsidies, continuing but reduced federal

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1. See A. ALTSHULER, *THE URBAN TRANSPORTATION SYSTEM: POLITICS AND POLICY INNOVATION* 34 (1979); Pucher, *Distribution of Federal Transportation Subsidies*, 19 *URB. AFF. Q.* 191, 212 (1983). Although the respective proportionate use of transit and automobiles in passenger miles shifted from 35% and 65% in 1945 to 3% and 97% in 1975, public expenditure for public transportation remains high. M. Pikarski & C. Johnson, *After the Dust Settles: Transit in Transition* 9 (Sept. 1981) (unpublished manuscript). "Part of this disproportionate expenditure is a result of major efforts made in the last decade to recapture lost market share through *increases* in service, aggressive marketing, and operating subsidies designed to lower transit fares." *Id.*

2. Phelps, *Fate of Mass Transit Support Could be Decided by Congress*, *Minneapolis Tribune*, Feb. 10, 1986, at 7M.

subsidies for this industry seem likely.³ Although state and local governments remain committed to significant transit subsidies, fiscal pressures limit the subsidies that these levels of government can provide.⁴ At the same time, average transit operating costs have increased at approximately double the rate of inflation since federal transit subsidies started,⁵ and growth in transit ridership is disappointing.⁶ Reduced government subsidies and increased operating costs, combined with changing conditions in the transportation marketplace, create financial pressures that force communities to question the traditional approach of a heavily subsidized publicly owned mass transit monopoly that plans and produces transit services.⁷

The second reason that mass transit is appropriate for a model urban transit act is that mass transit in the United States shifted from primarily private ownership to almost total public ownership in less than 20 years during the 1960s and 1970s. As later discussion demonstrates, however, a widely accepted model of organizational law has not been developed for these systems.⁸

3. See *Department of Transportation and Related Agencies Appropriations for 1982: Hearings Before a Subcomm. of the House Comm. on Appropriations*, 97th Cong., 1st Sess. 527 (1981) (statement of Arthur Teele, Administrator, Urban Mass Transit Administration); Wiese, *Reaganomics: Spelling Trouble for Transit*, MASS TRANSIT 6, 7 (Oct. 1981); Hemily & Meyer, *The Future of Urban Public Transportation: The Problems and Opportunities of a Changing Rule*, 12 TRANSP. L.J. 287, 294-95 (1982). The resulting financial pressures on transit systems should provide an incentive for local officials and transit management to achieve cost-saving measures. *Id.* at 298. According to Pikarski, "[w]hat appears to be a crisis . . . is, in reality, both the death rattle of outdated institutions for delivering transportation service and the painful birth of many new delivery systems." M. Pikarski & C. Johnson, *supra* note 1, at 3.

4. Kemp & Kirby, *Government Policies Affecting Competition in Public Transportation*, in URBAN TRANSIT 277 (C. Lave ed. 1985).

5. The design of the federal transit subsidy program has reduced incentives for performance at lowest cost and has contributed to cost increases. See Pucher, Markstedt & Hirschman, *Impact of Subsidies on the Costs of Urban Public Transportation*, 17 J. TRANSP. ECON. & POL'Y 155, 157, 169 (1983).

6. Orski, *Redesigning Local Transportation Service*, in URBAN TRANSIT, *supra* note 4, at 255, 257-58.

7. *Id.* at 255-56; Kemp & Kirby, *supra* note 4, at 293-94.

8. Among the 117 largest U.S. cities (1970 census), only 10 had publicly owned transit systems in 1949. By 1959, three more systems had become publicly owned. From the late 1950s through the 1970s, however, transit farebox revenues failed to keep pace with costs. The continuation of transit service required large public subsidies, and political pressures developed to make the transit systems public. By 1969, 31 more systems were converted to the public sector, and by 1979, an additional 62 systems were converted. Thus, as of 1979, private carriers had survived as the major carrier in only 11 of the 117 largest cities in the United States. N. HAMILTON & P. HAMILTON, GOV-

This article focuses on the problem of organizational law for the planning, financing, and production of mass transit services through private firms and government enterprise,⁹ and develops a model act for the industry. In any government enterprise, organizational law and goal achievement are importantly and inextricably related to one another.¹⁰

A great diversity of organizational law exists in government enterprises, even within a single industry such as urban mass transit. Although diversity of organizational law within private enterprise exists, the term "private enterprise" suggests at least some basic points of comparison. For example, the private share offering company model is

ERNANCE OF PUBLIC ENTERPRISE: A CASE STUDY OF URBAN MASS TRANSIT 4 (1981).

9. The term "government enterprise" includes all production processes of goods or services that are effectively under the control of a government entity or a branch of the government established to conduct the undertaking.

10. Schmalensee suggests that the choice of institutional structural design influences the costs and benefits of various managerial and regulatory discretionary activity. R. SCHMALENSEE, *THE CONTROL OF NATURAL MONOPOLIES* 7-8, 146 (1979). The relationship between structural design and behavior, however, is little understood, and no single view or approach has emerged to lend a framework that would help to predict the behavioral implications of alternative arrangements of control. *Id.* at 61-62. Part of this developmental difficulty is that current literature focuses on criticism of the conduct of regulators and regulated firms, *id.* at 7, and negative information of this sort is not of great use in institutional design. *Id.* at 149.

Because a key factor in determining performance under public ownership seems to be the control exercised over enterprise managers and the management's accountability, more knowledge about the relation between administrative structure and management behavior would be useful. *Id.* at 97, 146. At present, we cannot describe structural conditions which will ensure that specific and narrowly defined tasks will be performed well and that administrative discretion is exercised acceptably. *Id.* at 149. Thus, we know a good deal less than we should, and a large number of areas would benefit from further economic research. *Id.* at 149-50.

For further discussions of the interrelationship of organizational structure and goal achievement, see H. LIEBENSTEIN, *GENERAL X-EFFICIENCY THEORY AND ECONOMIC DEVELOPMENT* 157, 178-80 (1978); UNITED NATIONS TECHNICAL ASSISTANCE ADMINISTRATION, *SOME PROBLEMS IN THE ORGANIZATION AND ADMINISTRATION OF PUBLIC ENTERPRISE IN THE INDUSTRIAL FIELDS* 17 (1954) [hereinafter UNTAA]; A. WALSH, *THE PUBLIC'S BUSINESS: THE POLITICS AND PRACTICES OF GOVERNMENT CORPORATIONS* 10, 202 (1978); Roberts, *An Evolutionary and Institutional View of the Behavior of Public and Private Companies*, 65 *AM. ECON. REV.* 415, 415-16 (1975); Seldman, *The Government Corporation: Organization and Controls*, 14 *PUB. ADMIN. REV.* 183, 185 (1954); B. Baysinger & H. Butler, *Performance Effects of Evolutionary Changes in Board Composition* (June 1984) (unpublished manuscript); *But see* R. POZEN, *LEGAL CHOICES FOR STATE ENTERPRISES IN THE THIRD WORLD* xxiii (1976) (in the context of the Third World countries, legal choices have relatively little impact on performance).

almost universal for large scale private enterprise. Moreover, in response to experience, education, and competitive market pressures, similar private firms have developed fairly similar divisions of policy formation and operational management functions.¹¹

No similar uniformity among government enterprises exists, even in the same industry. In Canada and the United States, at least three general types or models of government enterprise are in common use: the company form, the government department form, and the public corporation form.¹² In the transit industry, surveys reveal great differences from system to system with regard to policy formation and the policy-making and operations function distinctions.¹³ Government involvement itself creates considerable differences among government enterprises, depending on whether the focus of power is federal, state, local, or diffused among several governments.¹⁴

The task of designing an optimal organizational statute for urban mass transit is complicated because government enterprises have received surprisingly little academic attention in the United States. The explanation for this lack of study may be that the increase in the use of government entities in the United States has been gradual, not dramatic, and because government production of goods and services is an embarrassment to many Western economists.¹⁵ In the absence of significant research, little positive economic theory exists concerning government enterprise.¹⁶

Given both the limited positive economic theory and the great diversity of organizational law among government enterprise, caution is in order. At this stage, intuition and inductive reasoning play major roles in the analysis of these governance issues. The Model Act is therefore drafted to leave substantial leeway for experimentation in implementa-

11. See M. EISENBERG, *THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS* (1976); W. OUCHI, *THE M-FORM SOCIETY* 18-25 (1984).

12. For a definition of these terms, see *infra* notes 19-21. See also N. HAMILTON & P. HAMILTON, *supra* note 8, at 11-16; UNTAA, *supra* note 9, at 5.

13. N. HAMILTON & P. HAMILTON, *supra* note 8, at 16-27.

14. *Id.* at 32-36.

15. Pashigan, *Consequences and Causes of Public Ownership of Urban Transit Facilities*, 84 J. POL. ECON. 1239, 1240 (1976).

16. Rossant, *Foreword to A. WALSH, supra* note 10, at xi; S. BREYER, *REGULATION AND ITS REFORM* 183 (1982) (government ownership in the United States has not been studied to the point where firm conclusions are possible); R. SCHMALENSSEE, *supra* note 10, at 149-50; Baumol, *Toward a Theory of Public Enterprise*, ATLANTIC ECON. J. 13, 19 (1984).

tion. The Act is offered to prompt constructive debate toward the formulation of an optimal model of governance for the provision and production of mass transit services.

The body of this article is divided into two sections. Section II draws upon theoretical literature to develop a general public corporation model for the governance of urban mass transit service. Section III presents the Model Act with comments following each of the Act's major sections requiring further explication.

While the traditional approach to mass transit service has been exclusive public provision and monopoly production with significant losses to economic efficiency, the Model Act incorporates two major innovations. First, the Act recommends the separation of the planning and financing of transit services—the decision to *provide* transit services—from the actual production of the transit services. Second, the Act proposes contract bidding among competing producers to introduce competitive pressures for lower cost production into the production of transit.¹⁷

II. A GENERAL MODEL OF ORGANIZATIONAL LAW FOR THE PROVISION AND PRODUCTION OF URBAN MASS TRANSIT SERVICES

Much of the confusion concerning the organizational law of government enterprise originates in the lack of any coherent conception of the basic purposes that the three types of government enterprise serve.¹⁸ The purpose of organizational law for a transit system is to maximize the welfare of all persons affected by a transit system; in other words,

17. See Orski, *supra* note 6, at 274-75. Many of the ideas proposed in the Act were incorporated into the 1984 amendments to Minnesota's mass transit legislation for the Minneapolis and St. Paul metropolitan area. See MINN. STAT. §§ 473.371-.499 (1984). The writing and legislative testimony on privatization of government services of Ted Kolderie, project director of the Public Services Redesign Project, Hubert H. Humphrey Institute of Public Affairs, played a major role in the formulation of this legislation. See Kolderie, *Rethinking Public Service Delivery*, 64 PUB. MGMT. 6-9 (Oct. 1982). The author also provided research and legislative testimony on this legislation.

The Minnesota legislation is the most far reaching legislation separating policymaking and operating responsibilities. Orski, *supra* note 6, at 274. A number of the concepts in the Model Act also appear in the 1983 Illinois legislation that created the Regional Transportation Authority for Chicago. See Illinois Regional Transportation Authority Act, ILL. ANN. STAT. ch. 111½, §§ 701.01-.05 (Smith-Hurd Supp. 1985).

18. In an effort to help fill this gap, the author devoted several chapters of an earlier book to a broad examination of the purpose of government enterprise. For a full discussion, see N. HAMILTON & P. HAMILTON, *supra* note 8, at 47-92.

the goal is economic efficiency. In the presence of mass transit market failures such as the public goods aspect of transit¹⁹ or the existence of externalities²⁰ like air pollution, the government may undertake measures to remedy the market failures and establish conditions for economic efficiency.²¹

19. Public goods are usually defined as goods having the characteristics of nonappropriability and nonrivalry in consumption. Nonappropriability means that such goods, once made available, are equally available to all individuals. Nonrivalry in consumption indicates that for a given output, additional consumption by one person does not imply reduced consumption by another. A classic public good is the lighthouse, where one ship's receipt of the benefit of a warning signal in no way deprives others from receiving the warning as well. J. DUE & A. FRIEDLAENDER, *GOVERNMENT FINANCE: ECONOMICS OF THE PUBLIC SECTOR* 22 (1977). Thus, public goods in the present context are aspects of transit that an additional person can consume without a concomitant decrease in the consumption of another. They arise due to the altruistic nature of the public, many of whom do not use mass transit, but who wish to see distributional equity. See Dajani & Gilbert, *Measuring the Performance of Transit Systems*, 4 *TRANSP. PLAN. & TECH.* 99 (1978). Although some economists do not define departures from distributional equity as market failure, the stronger argument is to see distribution as a type of public good. The provision of transit to the transportation disadvantaged will clearly satisfy the altruistic preferences of an additional member of the public without any decrease in the consumption by other members of the public; that is, both nonappropriability and nonrivalry exist. See Wolf, *A Theory of Nonmarket Failure: Framework for Implementation Analysis*, 22 *J.L. & ECON.* 107, 111 (1979).

20. Externalities occur when the consumption or production decisions of one agent affect the consumption or production opportunities open to another agent directly rather than through the prices that the first agent faces. If any direct effects exist, the decision maker is neither fully charged for any costs his or her actions impose on other people, nor rewarded for any benefits he or she may confer. The prices faced, therefore, will not be efficient. See P. LAYARD & A. WALTERS, *MICROECONOMIC THEORY* 23 (1978).

In transit, externalities arise from several sources. Positive consumption externalities stem from a reduction in noise and air pollution and time and injury/life savings by automobile drivers from congestion reduction. A. ALTSHULER, *supra* note 1, at 107-10, 175. Positive production externalities stem from a reduced need for new highways and parking facilities, time saving by commercial and public vehicles (police, ambulance, and fire), and abatement of the nation's energy problems. *Id.* at 107, 109-10, 169-71.

21. Allocative efficiency requires that each decision maker be confronted with the social marginal cost of his or her actions. Basically, an individual pursues only those actions in which the perceived benefits exceed the perceived costs. If each person experiences a cost to himself for his actions, which is the same as the cost to society, then only actions with net sound gains will be undertaken under normal decision-making. Actions that result in a social cost greater than benefits are avoided, because the decision maker sees a personal cost greater than the personal benefit.

For consumers and producers, this condition is generally met when the price of a good equals its private marginal cost, perfect markets assumed. See P. LAYARD & A. WALTERS, *supra* note 20, at 14-15. Note that private marginal cost is the private producer's addition to total cost attributable to the addition of one unit of output. Social

In making these determinations, the governmental decision maker should be confronted with the marginal social cost of its actions.²² Marginal social costs are a function of the individual preferences of persons in the community.²³ Voting with improved information flow to the community is one mechanism through which a political decision maker is confronted with the marginal social cost of its actions.²⁴ In addition, those transit services for which the community expresses a preference must be produced at the lowest cost to achieve economic efficiency.²⁵

marginal cost is the resource cost to society of having an additional unit produced. Market failures, like externalities and public goods, may lead to a divergence between private marginal cost and social marginal cost. See C. FERGUSON & J. GOULD, *MICROECONOMIC THEORY* 474-76 (4th ed. 1975).

Government may take measures to correct these market failures. For example, as Layard and Walters point out in the case of positive or negative externalities, "while taxation or subsidy may be a suitable remedy in some cases, in others regulations will be administratively simpler. In addition, when we consider psychic externalities, policies relating to social institutions may be necessary." P. LAYARD & A. WALTERS, *supra* note 20, at 25. Similarly, the government must intervene to pay for pure public goods if they are to be provided: "To do this efficiently, [the government] has to make guesses about individual preferences, just as it must if it wishes to regulate externality." *Id.* at 196. The inevitable imperfections of democratic political processes in expressing individual choice, however, constrain the accuracy of the government's estimation of individual preferences. See J. HIRSHLEIFER, *PRICE THEORY AND APPLICATIONS* 468-78 (1976).

Policies addressing problems of market failure must take into account those distortions in the economy that are inevitable. This is the problem with the second best constraint principle, which states that if one of the standard efficiency conditions cannot be satisfied, the other efficiency conditions are no longer desirable. P. LAYARD & A. WALTERS, *supra* note 20, at 181. Second best constraints include the administrative capacities of the government and the nature of politics and bureaucracy. *Id.* at 202.

The existence of second best constraints advises caution but not paralysis. Kahn points out that even though things elsewhere in the economy are not organized optimally, it is plausible to expect policy formed after careful analysis and with common sense to yield improvements. A. KAHN, *THE ECONOMICS OF REGULATION* 70 (1971). Thus, it seems reasonable to require that government decision makers be confronted, to the degree possible, with the marginal social costs of their decisions. This will promote an accurate reflection of consumer preferences.

22. See *supra* note 21.

23. *Id.* The social choice literature discussing nonmarket mechanisms for revealing individual preference in situations involving market failures is not well developed. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 53; J. HIRSHLEIFER, *supra* note 21, at 468-78.

24. N. HAMILTON & P. HAMILTON, *supra* note 8, at 54-55.

25. In practice, welfare maximization in a market economy is achieved by creating conditions for Pareto optimality, provided certain income distribution constraints are met. See P. LAYARD & A. WALTERS, *supra* note 20, at 50. A Pareto optimal state is

The task is to outline the principal features of the entity that will define transit policy which reflects community preferences and execute this policy at the lowest possible cost. The theoretical literature, primarily of European origin, defines two principal approaches to the design of a legal structure for a government enterprise.

One approach is for government to directly undertake policy, objectives, and operations in the form of a government department or a subdivision of a government department.²⁶ Under this legal structure, direct responsibility on all matters devolves on the director of the department and ultimately on the chief executive of the government. Direct government control of operations is exercised through executive order and legislative review. Personnel are usually subject to civil service regulation.²⁷ Annual appropriations finance the enterprise, which in turn subjects it to government accounting, budget, and audit controls. The enterprise frequently possesses the sovereign immunity of the state.²⁸

A second more contemporary approach is to create a semi-autonomous legal entity with a separate board that shares responsibility for policy-making with the creator government.²⁹ The government can establish this semi-autonomous entity either in the legal form of a private company or as a public corporation.³⁰

In the private company form, the government registers the enterprise as a limited liability company under the corporation laws applica-

defined as a state in which no one can be made better off without making someone else worse off; the change in the affected party's welfare determines whether the Pareto optimal state is achieved. See J. HIRSHLEIFER, *supra* note 21, at 441.

When a Pareto optimal state is reached, all options to create better conditions for someone without harming someone else have been expended. The achievement of a Pareto optimal state is a relatively uncontroversial goal that involves net social gain without any accompanying individual loss.

The first condition needed to establish Pareto optimality is allocative efficiency. See *supra* note 20. The second condition required for Pareto optimality is the production of goods at lowest cost or production efficiency. These concepts are discussed fully in N. HAMILTON & P. HAMILTON, *supra* note 8, at 50-55.

26. R. JAILE, *MANAGEMENT OF STATE ENTERPRISES IN INDIA* 71 (1967); UNTAA, *supra* note 10, at 5-9.

27. UNTAA, *supra* note 10, at 6.

28. W. Friedmann, *Government Enterprise: A Comparative Analysis*, in *GOVERNMENT ENTERPRISE: A COMPARATIVE STUDY* 308-09 (W. Friedmann & J. Garner eds. 1970); UNTAA, *supra* note 10, at 6.

29. UNTAA, *supra* note 10, at 9.

30. *Id.*

ble to private firms.³¹ A board of directors, who respond independently to market conditions in order to maximize profits in the same way that private firms are operated, determines firm policy.³² A governmentally created private company differs principally from a private firm in that the government selects its directors and secures the benefits of its earnings.³³

Public corporation form encompasses a greater number of variations than department or private company form. The public corporation is not a government department because it has its own board of directors, accounts, and capacity to sue and be sued in its corporate name.³⁴ Except for appropriations to provide capital or cover operating losses, a public corporation is independently financed and is not subject to the budget, accounting, and audit procedures applicable to government departments. Unlike the private company form, the public corporation is established under separate legislation and is subject to government control as provided in the statute.³⁵

The question remains which of these principal models of governance is optimal for a transit enterprise. The directly elected city or regional officials in charge of a department form enterprise appear to be best informed on community preferences concerning transit. The inability of city officials to obtain information regarding transit abates the strength of this premise. A city council, in particular, lacks organization, expertise, time, and interest to cope with the complexities of transit. Members of a city council must divide their time over a wide field of complex issues.³⁶

Although a department form enterprise may promote responsive

31. For a discussion of private company form as utilized by the Indonesian Government, see R. Prasetya & N. Hamilton, *The Regulation of Indonesian State Enterprises*, in *LAW AND PUBLIC ENTERPRISE IN ASIA* 165-68 (1976).

32. UNTAA, *supra* note 10, at 9.

33. W. Friedmann, *supra* note 28, at 310-12; R. POZEN, *supra* note 10, at xx.

34. W. Friedmann, *supra* note 28, at 310-25; R. POZEN, *supra* note 10, at xx.

35. UNTAA, *supra* note 10, at 9.

36. R.L. Banks & Assocs., *Study and Evaluation of Urban Mass Transportation Regulation and Regulatory Bodies*, 1 SUMMARY & MAIN REP. 83 (1972). For example, management of one system operated as a department indicated that the mayor's staff also may have divided attention and lack transit knowledge. To be sure, dramatic issues or events may inspire interest in transit on the part of council or mayor, but its incidence will be uneven and unpredictable. The less informed the policy-making agencies, the less that policy will reflect either community preferences or the realities of transit operations. See Mashaw, *Civil Liability of Government Officers: Property Rights and Official Accountability*, 42 *LAW & CONTEMP. PROBS.* 8, 24 (1978).

policies, this form has serious problems in translating policy into operating objectives and criteria, meaningful performance measurement of those objectives, and assurance of lowest cost operations. The task of translating general policies into operating objectives and performance criteria and monitoring management performance requires policy makers who can serve as independent counsel in business matters and who are knowledgeable in transit operations. Day-to-day management of transit operations demands fulltime work and inside knowledge of the business. The government department model increases the risk that these tasks will be delegated to a bureaucracy that lacks these essential characteristics. Decision-making in department form enterprise usually suffers from insufficient information and lack of responsiveness to changing market conditions.³⁷ Serious shortcomings of the department form enterprise are both the failure to get and act on accurate information and the lack of flexibility necessary to give initiative and enterprise full rein.³⁸ Departments are often impervious to change because of red tape and bureaucracy.³⁹

Rigid rules for the purchase of supplies, placing of contracts, and promotion of personnel are examples of the inflexibility inherent in government department activity. These rules conflict with accepted commercial practices and hamper response to the market.⁴⁰ As an early United Nations report notes, endowing a government department with a high degree of operating flexibility is theoretically possible but empirically difficult.⁴¹ Strong pressures will be applied to force an enterprise to conform to standard government regulations and proce-

37. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 73-75.

38. R. JAILE, *supra* note 26, 43-44, 81-82.

39. R.L. Banks & Assocs., *supra* note 36, at 82. Thurston, noting this lack of responsiveness, comments:

A government department is notoriously poor at adaptation. Hampered by partisan control, operating on a fixed yearly budget, bound by rigid rules governing its purchases, accounting, expenditures, and personnel, unable to borrow on equipment or to expand working capital quickly, embarrassed by immunity from suit and other legal rules affording special privileges to the government which destroy commercial confidence and make it impossible to carry on business in accordance with the usual commercial practice, the government department is a sorry failure as an entrepreneur.

J. THURSTON, *GOVERNMENT PROPRIETARY CORPORATIONS IN THE ENGLISH SPEAKING COUNTRIES* 7 (1937).

40. UNTAA, *supra* note 10, at 6-7; Tierney, *Government Corporations and Managing the Public's Business*, 99 POL. SCI. Q. 73, 75-76 (Spring 1984).

41. UNTAA, *supra* note 10, at 8.

dures as long as it is not clearly differentiated from other types of governmental activity.⁴²

This analysis suggests that the government should create a separate board to run a transit system under either the private company or public corporation model. Company form can be disposed of quite quickly. General incorporation laws prescribe forms of organization, financing, and supervision not particularly well adapted to a public institution.⁴³ The chief advantages of the private company form—limited liability, pooling of investment, transferability of securities, perpetual existence, and shareholder supremacy—have little meaning for a government entity.⁴⁴ Because the company form operates independently of the government with profit maximization as a motive, it will present problems of policy definition and operating objectives for the allocation of public subsidies and possible lack of control. If the firm operates as a transit monopoly, it will also face inadequate competitive pressures.

This leaves the public corporation form. The autonomy from government control implicit in this form affords relief to the problems of insufficient information and lack of responsiveness to changing market conditions apparent in the department form. The key question is the optimal governance mechanism for definition of general policy and operating objectives and assurances of lowest cost production. The Model Act presented below addresses these issues.

III. THE BILL AND COMMENTS

A bill for an act

relating to the governance of mass transit; requiring the development of a regional transit board that is responsible for formulating a statement of policies and for implementing conditions necessary for producing transit services to meet these policies at lowest costs; providing for the administration thereof; providing for contracting for transit services; requiring the development of a transit commission that is responsible for the production of transit services; and providing for competitive contract management of the

42. *Id.*

43. H. Seidman, *Government Sponsored Enterprise in the United States*, in *NEW POLITICAL ECONOMY: THE PUBLIC USE OF THE PRIVATE SECTOR*, 99-100 (B. Smith ed. 1975); UNTAA, *supra* note 10, at 18.

44. R. JAILE, *supra* note 26, at 77.

transit commission's operations; repealing (state) statutes
 (cite) .

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF
 .

Section 1. [DEFINITIONS]

Subd. 1. The following terms as used in this Act have the meaning given them in this section.

Subd. 2. "Transit Board" means the Regional Transit Board, a public corporation created pursuant to this Act, which accomplishes the creation of a public transportation system.

Subd. 3. "Commission" means the Metropolitan Transit Commission, a public corporation created pursuant to this Act to operate the transit system.

Subd. 4. "Council" means the Metropolitan Council or other regional government body such as the Metropolitan Planning Organization (MPO).

Subd. 5. "Member" means the municipality, county, or political subdivision that in combination with another member or members comprises the Transit Board.

Subd. 6. "Municipality" means any city within the regional transportation area.

Subd. 7. "County" means any county within the regional transportation area.

Subd. 8. "Regional Transportation Area" means any two or more contiguous municipalities, counties, or political subdivisions, the boundaries of which are identical to the legal entities that constitute the authority.

Subd. 9. "Public Transportation System" means, without limitation, a combination of real and personal property, structures, improvements, buildings, equipment, plants, vehicle parking, or other facilities, and rights of way, or any combination thereof, used or useful for the purposes of public transportation.

Subd. 10. "Public Transportation" means transportation of passengers by means, without limitation, of a street railway, elevated railway or guideway, subway, motor vehicle, motor bus, or any bus or other means of conveyance operating as a common carrier within the regional transportation area, including charter service therein.

Subd. 11. "Board of Directors," hereinafter referred to as the Board, means the governing body of the Transit Board.

Subd. 12. "Director" means a person appointed to the Board of Directors.

Subd. 13. "Commissioner" means a person appointed to the Commission.

Subd. 14. "Policy" means a course or method of action dictated to or selected by the Board to guide and determine present and future decisions.

Comment: Policy can be stated in legislation or regulations creating or affecting the transit system and through action of the regional governing body such as a metropolitan council or a board of directors of the Regional Transit Board. Because the purpose of the organizational law for a transit system is to maximize the welfare of the people affected by the system, and because the impact of a transit system is almost entirely local, the Act places responsibility for formulating policy at the metropolitan level.⁴⁵

Policy can be organized into four categories that are delineated below for reference. *General policy* is policy stated in such a high degree of generality that it becomes an ambiguous goal that provides no guidance to transit management without additional elaboration.⁴⁶ The state legislature should determine general policy. In contrast, *stipulations* are policies stated in very specific terms that allow no managerial flexibility in implementation.⁴⁷ *Minimal performance constraints* are a third category that consists of policies which set absolute minimum and obvious standards of performance to direct management behavior. The nonfulfillment of this type of policy indicates poor performance.⁴⁸ Finally, policy can be stated in the form of *operating objectives* that guide management action but allow for management expertise to choose the optimal strategy to reach the objective.⁴⁹ This category is

45. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 48, 54. For example, the regional government in Minneapolis and St. Paul, the Metropolitan Council, has responsibility for long-range policy planning. Mid-range planning, one to five years, is the responsibility of the Regional Transit Board (RTB).

46. For example, a system may be directed to provide adequate and reliable transit services to meet the community's needs. This type of broad and poorly defined policy is common in transit systems. See *id.* at 9, 18-24.

47. For example, systems have been directed to have a load factor on local service at peak hours of not more than 1.33 passengers per seat. In other cases, the transit board focuses on operational transactions like the approval of payment of bills. See *id.* at 24-25.

48. For example, balanced budget constraints and regular audits are the only standards of performance for management in some transit systems. See *id.* at 29-30.

49. See Wolf, *supra* note 19, at 116-17; Granger, *The Hierarchy of Objectives*, 42

defined below in subdivision 15.

Subd. 15. "Operating objective" means a statement of policy made by the Transit Board or the Council that is translated into operational terms, particularly the relationship of movement of various passenger groups to the policies, and that leaves flexibility in operational implementation.

Comment: The formulation of operating objectives is of critical importance to the success of the model advocated in the Act. Inconsistent social choices and economic waste will result if desired objectives are not apparent to the decision-maker providing actual transit services.⁵⁰ A lack of objectives also often results in a "management by crisis" approach to operating the transit system. Dealing with problems on a last minute basis inevitably raises costs by preventing selection of low-cost alternatives that require development lead times.⁵¹ The articulation of operating objectives in terms of passenger mobility is fully discussed in the comment to section 4, subdivision 3.

Subd. 16. "Performance criteria" are a means of measuring the relative degree of attainment of the operating objectives.

Comment: In order to avoid a subjective evaluation of the attainment of objectives and to prevent decision makers providing the transit service from making only a minimum effort, a means of measuring the

HARV. BUS. REV. 63, 66 (1964); *See also* J. PRESSMAN & A. WILDAVSKY, IMPLEMENTATION xv-xviii (1973).

50. *See* Granger, *supra* note 49, at 64; Sheahan, *Experience with Public Enterprise in France and Italy*, in PUBLIC ENTERPRISE: ECONOMIC ANALYSIS IN THEORY AND PRACTICE 163, 174, 176 (W. Shepherd ed. 1976). A recent study of 30 transit organizations showed that 20 systems are currently using some form of management by objectives (MBO) process to increase organizational efficiency. M. Meyer & P. Hemily, *Public Transportation in the 1980's: Responding to Pressures of Fiscal Austerity* 19-20 (Feb. 1982) (unpublished manuscript prepared by the Center of Transportation Studies at the Massachusetts Institute of Technology for the University Research and Training Program, Urban Mass Transportation Administration, Washington D.C.).

Goals have to be specified and the linkages between the transit service provided and the well-being of the community must be made explicit. . . . The problem is of course how to make goals explicit and how to operationalize them. In this respect, the trend observed in the survey towards the development of MBO processes in many agencies might provide a good preliminary base since it establishes a coherent procedure to determine priorities.

Id. at 27.

51. *See* Granger, *supra* note 49, at 63; N. HAMILTON & P. HAMILTON, *supra* note 8, at 27-28; Hamilton, Feldthusen & Crisp, *A Comparison of Governance of Publicly-Owned Mass Transit*, 6 CANADA-U.S. L.J. 1, 30 nn.112-18 (1983).

expected performance levels must exist.⁵² Performance criteria are essentially scaled operating objectives that provide a means to determine whether transit providers are providing services efficiently. Transit efficiency is the lowest-cost production satisfying any given level of an operating objective.⁵³ Operating objectives and performance criteria are fully discussed in the comment to section 4, subdivision 3.

Section 2. [POLICY AND GOALS]

Subd. 1. [POLICY]

The legislature finds that, to provide essential mobility and transportation options in the metropolitan area, to encourage alternatives to the single-occupant vehicle, and to develop transportation service designed to maximize public welfare efficiently, a need exists for the creation of regional transit programs and agencies with the powers and duties prescribed by law.

Subd. 2. [GOALS]

The goals of the transit system are as follows:

- (a) to provide a basic level of mobility for all people in the metropolitan area at the lowest cost with the resources available;
- (b) to arrange for the provision of a comprehensive set of transit and paratransit services to meet the needs of all people in the metropolitan area at the lowest cost with the resources available;
- (c) to cooperate with private and public transit providers to assure the most efficient and coordinated use of existing and planned transit resources; and
- (d) to maintain public mobility in the event of emergencies or energy shortages.

Comment: This provision identifies the need for regional transit programs and agencies and sets forth the overall goals for the transit system. The goals are a course of action stated as general policy. No stipulations or minimum performance constraints are included.⁵⁴

52. See D. COOMBS, *STATE ENTERPRISE: BUSINESS OR POLITICS* 13-14 (1970); Granger, *supra* note 49, at 68-69; N. HAMILTON & P. HAMILTON, *supra* note 8, at 11, 30, 48, 99; M. Meyer & P. Hemily, *supra* note 50, at 20-21; Simon, *Rational Decision-Making in Business Organizations* 69 AM. ECON. REV. 493, 500 (1979).

53. Dajani & Gilbert, *supra* note 19, at 100.

54. For discussion of the importance of formulating operating objectives, see Comment to § 1, subd. 15. For examples of these broad statements of policy used within transit acts, see ILL. ANN. STAT. ch. 111 $\frac{2}{3}$, ¶ 701.02 (Smith-Hurd 1985); MINN. STAT. § 473.301 (1984).

Section 3: [TRANSPORTATION POLICY PLAN]

The Council shall adopt a transportation policy plan. The policy plan must include policies relating to all transportation forms and be designed to promote the legislative policies set forth in section 2. The transit elements of the plan must include the following:

(1) a statement of policies that govern the distribution, coordination, and general location of facilities, services, and service areas to be planned, deployed, or developed by or under the direction or auspices of the Transit Board.

(2) a general statement of timing and priorities in the planning, deployment, and development of services;

(3) a statement of the policies that govern the levels of public expenditure, both capital and operating, for various services and service areas; and

(4) a statement of the policies that govern total annual regional funding levels, the sources of funds, and the distribution of funds among the facilities, services, and service areas.

Comment: Political accountability is best satisfied if transit policies are made almost entirely at the local level and *not* the federal or state level. Policies should reflect the preferences of the local region principally affected by the transit system. Policy decisions rendered at the state and federal level demonstrate specialized expertise, but often suffer from lack of information concerning local conditions.

Because mass transit policy is just one aspect of urban transportation policy, which is part of urban development generally, the traditional view subsumes transit services under an overall regional development plan formulated by policy makers answerable to the regional community. The theory is that without such regional planning, local communities may capture the benefits that their neighbors generate and impose the costs of their own policies on others. In addition, policies that differ among communities do not necessarily incorporate an overall conception of development for the entire region.

As a practical matter, however, regional planning in many urban areas has been largely a disappointment and has played only a marginal role in these areas. One reason for this is that local governments and agencies are reluctant to relinquish their power. The Legislature must, therefore, grant the regional planning agency policy-making and enforcement capabilities, or the local communities may threaten to end

negotiations and to reject proposed plans as a form of manipulation.⁵⁵

Section 4: [REGIONAL TRANSIT BOARD]

Subd. 1. [CREATION OF THE TRANSIT BOARD] To achieve the goals of section 2 and to carry out the policy plan required by section 3, a Regional Transit Board is established as a public corporation and a political subdivision of the state.

Comment: Through this general enabling legislation, a separate agency (the Regional Transit Board) can be established to create a transit system. Different combinations of local governments may form a regional transit board to plan and finance transit services. The Transit Board then becomes essentially another layer of government, independent of other local jurisdictions.⁵⁶

Current legislation, which creates a single transit authority to plan, finance, and produce transit services, is deficient because of ambiguous legislative intent concerning the desired type of legal model. Whether the legislative body intended to create something similar to a private corporation, a department of a municipal corporation, or an independent public corporation is often difficult to determine.⁵⁷ As a result, no clearly understood and accepted model exists to guide the determination of policy or the conduct of operations, nor is there an accepted theory of organizational law for transit. Political or practical feasibility within each agency provides the structure for most policies and managerial techniques.⁵⁸ This lack of a generally accepted decision-making model leads to confusion concerning the responsibilities of the various groups involved in transit such as labor, management, the Transit Board policy makers, and local, state, and federal governments. The decision-making model proposed in the Act clearly allocates specific responsibilities to the various groups involved in planning, financing, and producing transit service.

This statutory provision could be worded to allow any political sub-

55. N. HAMILTON & P. HAMILTON, *supra* note 8, at 94-95.

56. For a synopsis of the organizational approach to the Chicago RTA, a similarly structured transit system, see Memorandum from Schlickman, Intergovernmental Affairs Officer, to Chairman Cardilli and CTA Board Members regarding RTA Legislation (Nov. 8, 1983) [hereinafter Schlickman]; ILL. ANN. STAT. ch. 111 $\frac{1}{2}$, ¶¶ 701.10-703.10 (Smith-Hurd Supp. 1985); MINN. STAT. §§ 473.371-394 (1984). A diagrammatic explanation of the proposed organizational scheme is provided in Appendix A of the text.

57. N. HAMILTON & P. HAMILTON, *supra* note 8, at 10.

58. See *id.* at 31; Horn, *Transit Boards, How Do They Work?*, TRANSIT J. 67, 68-69 (1977).

division or group of subdivisions to incorporate a regional transit board, rather than to statutorily authorize a specific regional transit board for a particular group of municipalities. An alternative provision could read:

Subd. 1. [CREATION OF THE TRANSIT BOARD (Alternative Provision)] The legislative body of any municipality, county, or political subdivision may incorporate a regional transit board as a public corporation and a political subdivision of the state to achieve the goals of section 2 and to carry out the policy plan required by section 3. The Transit Board shall be authorized all the powers and duties of this Act with respect to the public transportation system within the territorial boundaries of the regional transportation area that incorporates the Transit Board.

The Transit Board shall not exercise any of the powers hereby granted until articles of incorporation are adopted by an affirmative vote of the electors of each political subdivision. The manner of adoption shall be as follows: The governing body of any political subdivision may direct that the question of adoption of this section be submitted to the electors therein at any general, special, judicial, or local election. The clerk of such municipality, county, or political subdivision shall thereupon submit the question to popular vote. Public notice of the election shall be given at least twenty days prior to the election. If a majority of those voting on the question vote in the affirmative, this section shall be adopted in such municipality, county, or political subdivision.

Subd. 2. [POWERS OF THE TRANSIT BOARD]

(a) The Transit Board has the power and duties imposed by law. The exercise of any powers by the Transit Board must be consistent with the exercise by the Council of any of its powers.

(b) The Transit Board may sue and be sued.

(c) The Transit Board may enter into contracts necessary to carry out its responsibilities.

(d) The Transit Board may acquire by purchase, lease, gift, or grant property and interests in property necessary for the accomplishment of its purposes and may sell or otherwise dispose of property that it no longer requires.

(e) The Transit Board may make and adopt all rules and regulations and bylaws as may be necessary or desirable to enable it to exercise the powers and perform the duties conferred or imposed on it by the provisions of this Act.

(f) The Transit Board may appoint such officers and employees as it may require for the performance of its duties and fix and determine their qualifications, duties, and compensation. The Transit Board may retain or employ counsel, auditors, engineers, and private consultants on a contract basis or otherwise for rendering professional or technical services and advice.

Comment: The Transit Board's independence and freedom from bias in policy-making and performance review will be seriously questioned if the Transit Board relies solely on the transit producers to provide planning and performance data. The Transit Board must have its own staff to provide planning input data, to design operating objectives and performance criteria, and to evaluate whether the criteria have been met.⁵⁹

(g) When necessary and proper to the performance of its duties, the Transit Board may enter in a reasonable manner upon any premises for the purpose of making any reasonably necessary or proper investigations and examinations. The entry is not a trespass. The Transit Board is liable for any actual and consequential loss, injury, or damage from the entry. When necessary and proper to the performance of its duties, the Transit Board or its authorized agents may require the production of accounts, books, records, memoranda, correspondence, and other documents and papers of a person or entity receiving financial assistance from the Transit Board, may inspect and copy them, and may have access to and inspect the lands, buildings, facilities, or equipment of the person or entity.

(h) The Transit Board may require any employee to obtain and file with it an individual bond or fidelity insurance policy. The Transit Board may procure insurance in the amounts it deems necessary against the liability of the board or its officers and employees.

(i) The Transit Board may, for any of its purposes, apply for, accept, and disburse gifts, grants, or loans from the United States, the State, or from any person or entity on behalf of itself or any of its contract recipients. The Transit Board may enter into any agreement required for the gifts, grants, or loans and may hold, use, and dispose of money or property received therefrom according to the terms of the gift, grant, or loan. When the Transit Board has adopted an approved implementation plan and has certified to the governor that it is ready to receive federal funds, the governor shall take whatever steps necessary

59. N. HAMILTON & P. HAMILTON, *supra* note 8, at 113, 119-20.

to designate the Transit Board as a recipient of federal transit assistance for the regional transportation area.

(j) The Transit Board may establish one or more advisory committees composed of and representing transit providers, transit users, and local units of government to advise it in carrying out its purposes. The members of advisory committees serve without compensation.

Comment: Citizen's advisory committees are one means of making planning more sensitive to community needs. Viable citizen's advisory committees require: (1) clear and achievable objectives for citizens; (2) specific criteria for citizen selection; and (3) public credibility of agency personnel.⁶⁰

(k) The Transit Board may conduct research studies and programs or may contract with other persons for research studies and programs. The Transit Board may advise and assist the Council and other government units on transportation issues within its jurisdiction.

(l) The Transit Board shall develop an implementation plan as specified in subdivision 3.

(m) The Transit Board shall offer, use, and apply its services to assist and advise transit providers in the metropolitan transit area in the planning, promotion, development, operation, and evaluation of programs and projects that are undertaken or proposed to be undertaken by contract with the Transit Board, and shall seek out and select recipients of this assistance and advice.

(n) The Transit Board may provide financial assistance to the Commission and other providers as provided herein in furtherance of and in conformance with the implementation plan of the Transit Board.

(o) The Transit Board shall coordinate transit operations within the metropolitan area and shall establish a transit information program

60. For a general discussion supporting the use of Citizen's Advisory Committees, see Transportation Research Board, *Transportation Research Record No. 555, Citizen's Role in Transportation Planning* (1975). Citizen's advisory groups have been utilized with success in such companies as AT&T, Pennsylvania Power & Light, Wisconsin Public Service Commission, and Texas Electric Service. Boulter, *What Others Think*, 108 PUB. UTIL. FORT. 65 (Dec. 3, 1981). Still another utility, Kansas City Power & Light, has used a citizen's advisory group to help chart a long-term least-cost strategy to meet the energy needs of its customers through the year 2000. Smartt, *Pages with the Editor*, 108 PUB. UTIL. FORT. 7 (Dec. 17, 1981).

Following the utilities' lead, both the Illinois and Minnesota legislatures have adopted enabling provisions establishing Citizen's Advisory Boards. See ILL. ANN. STAT. ch. 111^{2/3}, §§ 703.08, 703A.11 (Smith-Hurd Supp. 1985); MINN. STAT. § 473.375(9) (1984).

to provide transit users with accurate information on transit schedules and service.

(p) The Transit Board shall annually submit a report to the Council, the governor, and the legislature detailing its activities and finances for the previous year.

Subd. 3. [IMPLEMENTATION PLAN]

(a) [REQUIREMENT] The Transit Board shall adopt a transit service implementation plan describing the planning, functions, and activities to be performed by or under the direction or auspices of the Transit Board in implementing the policy plan adopted by the Council or the MPO. The plan must cover at least the five-year period commencing with the first calendar year beginning after the plan's approval. The plan shall be updated annually.

(b) [CONTENT] The implementation plan of the Transit Board must contain at least the following elements:

(i) A description of the needs for transit services required to meet the policies in the Council's or the MPO's policy plan, based upon detailed surveys and analysis of service areas and markets identified in the Council's policy plan;

(ii) A detailed description of services and facilities planned to meet these needs, including an indication of priorities and timing among them;

(iii) A detailed statement of proposed delivery methods and producers;

(iv) A schedule of expected levels of public expenditure, both capital and operating, for the services and facilities planned;

(v) A schedule showing the expected sources of funds, including proceeds of bonds of the Transit Board and the Commission, areas and levels of taxes, user charges, and state and federal subsidies;

(vi) A plan and schedule showing the distribution of funds among various services, service areas and markets, and producers; and

(vii) A detailed statement of transit service operating objectives and performance criteria for each proposed delivery method and proposed producers.

Comment: In order for transit policies to reflect community preferences, the community must be informed as to how local policy makers exercise their power to formulate policy. Policymakers should be directed to regularly formulate a statement of policies to facilitate the flow of information to the community. A publicly stated policy plan of the Council is one step in this direction. Clearly, however, a "laundry

list" of general policies will not adequately inform either the community or the providers of transit services of the desired type of output. General policy provides little direction to, and almost no control over, producers of transit services. Producers can trade off general policy goals as they desire.⁶¹ The policies of an organization must be connected operationally with actions or the resulting ambiguity will allow self-interested management to set policy.⁶² Thus, the Transit Board's implementation plan is a necessary second step in adequately informing the community, directing transit producers, and holding producers accountable.

In order to direct producers and inform the community, the Transit Board must translate the policies of the Council into clear and consistent operating objectives.⁶³ Because the output and utility of a transit system is the movement of passengers, not empty seats, the operating objectives of a system should be passenger mobility objectives.⁶⁴ Passenger mobility can be measured in many ways. The simplest way, for example, is a calculation of the number of travelers and the distance traveled on any given day.⁶⁵ This type of aggregate mobility measure may not, however, satisfy the general policies of a system relating to, for example, reduction of congestion or to specific income redistribution policies concerning the handicapped.

A more refined approach to defining and measuring the output of a transit system would translate the Transit Board's general policies into

61. Multiple and contradictory goals will lead to poor performance. Tierney, *supra* note 40, at 90. See N. HAMILTON & R. HAMILTON, *supra* note 8, at 16, 98; S. BREYER, *supra* note 16, at 79. As Liebenstein points out, multiplicity of goals will also result in more inefficiency in production. H. LIEBENSTEIN, *supra* note 10, at 174.

62. Simon, *supra* note 52, at 500.

63. See R. Mundy, *Mass Transit Guidelines Versus a Consumer Orientation in Public Transportation Systems 2* (1977) (unpublished manuscript); Bhatt, *Institutional Framework and Public Enterprise Performance*, 12 *WORLD DEV.* 713, 715 (1984). Unless clear objectives are given, the details of the agency's decisions are not susceptible to effective review and thus overall performance cannot be precisely evaluated. R. SCHMALENSEE, *supra* note 10, at 17. Without effective evaluation, the inherent tension between delegation of broad authority and the need for regulation of performance is increased. *Id.* If subordinates are supplied with clear objectives in keeping with organizational goals, performance may be evaluated without monitoring details of decision-making. *Id.* at 18.

64. See Dajani & Gilbert, *supra* note 19, at 97, 99. See also G. FIELDING & R. GLAUTHIER, *DISTRIBUTION AND ALLOCATION OF TRANSIT SUBSIDIES IN CALIFORNIA* 15 (1976).

65. A. TOMAZINIS, *PRODUCTIVITY, EFFICIENCY AND QUALITY IN URBAN TRANSPORTATION SYSTEMS* 179 (1975).

desired levels of mobility for defined groups.⁶⁶ Mobility defined in terms of the movement of targeted groups also captures the goal of accessibility of the system, because the achievement of a certain movement objective cannot be reached unless the system is accessible.

The objectives should, therefore, be stated in terms of desired levels of movement for different groups of the population, such as commuters, the elderly, children, low-income people, or residents of certain geographical areas subject to a budget constraint.⁶⁷ Some policies, such as reduction in congestion, may be easier to state in mobility terms than others, such as management of urban growth. Each objective, however, should be viewed as a hypothesis concerning the relationship of various passenger group *movement* to the general policies. In reality, the relationship between the groups' mobility and the policy may not occur as hypothesized. The setting of objectives will, there-

66. For example, in order to effect a policy of reduction in congestion, the correlation between commuter's increased transit use and reduction in congestion must be ascertained. The appropriate amount of congestion abatement must be determined; the corresponding increase in passenger mobility for commuters thus becomes an objective of the system. Arthur Anderson & Co., Project FARE Task IV Report, Task and Project Summary 1-3 (1973).

67. R. WINNIE & H. HATRY, MEASURING THE EFFECTIVENESS OF LOCAL GOVERNMENT SERVICES: TRANSPORTATION 1, 59-64 (1973). It is possible to define a procedure for weighting passenger miles so that the maximization of weighted passenger miles subject to a budget constraint maximizes net social benefit. See Glaisler & Collings, *Maximization of Passenger Miles in Theory and Practice*, 12 J. TRANSP. ECON. & POL. 304, 321 (1978); See also Bos, *Distributional Effects of Maximization of Passenger Miles*, 12 J. TRANSP. ECON. & POL. 322, 329 (1978); Nash, *Management Objectives, Fares and Service Levels in Bus Transport*, 12 J. TRANSP. ECON. & POL'Y 70, 85 (1978). Of course, decision makers may prefer to conceal distributional weights to avoid accountability for their decisions. R. SUDGEN & A. WILLIAMS, THE PRINCIPLES OF PRACTICAL COST-BENEFIT ANALYSIS 238-39 (1978). A clear-cut system of determining weights rather than the implicit use of weights in an ad hoc manner will substantially increase accountability to the public. D. PEARCE & C. NASH, THE SOCIAL APPRAISAL OF PROJECTS 37 (1981). The monitoring and collecting of passenger information useful to ensuring contract performance of stated objectives could be performed effectively through electronic means. See Goldsack, *Electronics Breakthrough, Collecting Fares and Facts*, 9 MASS TRANSIT 19 (Nov. 1982); Demoro, *Zoned vs. Flat Fares*, 10 MASS TRANSIT 12 (May 1983). But see R. SCHMALENSSEE, *supra* note 10, at 20. Schmalensee agrees that a system of distributive weights could be attached to the real incomes of various segments of society to account for the effects of price changes on different economic groups. *Id.* at 21. Schmalensee believes no viable way exists, however, to provide regulators with such a set of distributive weights, and because allowing regulators to devise their own is not an appealing prospect, "the system should be aimed at efficient resource use and evaluated by its success in meeting that goal." *Id.* at 21, 40. The Model Act makes the Transit Board politically accountable for these distributive weight determinations.

fore, be a trial-and-error process, and mobility objectives must be redefined from time to time as experience is gained.

The mere statement of clear general policy and operating objectives provides information to the community and directs management efforts but does not provide a basis to measure the adequacy of management's performance. If objectives are defined without any method of measuring performance, evaluation is subjective and calls forth only the minimum threshold effort that management believes will satisfy the review. Objectives whose performance criteria define expected performance levels in specific measurable terms can provide this measurement capability.⁶⁸ Thus, the legislation also charges the Transit Board to develop performance criteria for purposes of measuring the degree to which the operating objectives are achieved.⁶⁹ Criteria are essentially scaled operating objectives. One definition of achievement, for example, could be the increase in the movement of handicapped. High achievement in terms of the scaled criteria, however, does not alone measure the performance or efficiency of management. The question arises, at what cost were the mobility criteria reached? Transit efficiency is the lowest cost production satisfying any given level of a mobility objective.⁷⁰

Thus, a first and second condition of cost minimization is the definition of clear operating objectives and performance criteria. Simplicity is desirable. The fewer the policies and objectives and the fewer the decisions in implementation and supervision, the more likely that the policy will ultimately be realized.⁷¹

Preservation of transit producers' autonomy over operational decisions is another prerequisite for cost minimization. The statute's delegation of duties makes clear that the Transit Board is not to make operational decisions. Producers of transit are to have sole control over operational decisions, and the Transit Board's scope of authority is limited to developing operating objectives and evaluating whether they have been met. Local policymakers cannot devise cost-minimizing production strategies that require full-time work and inside knowledge of a business, its markets, its products, and its technologies.

68. The Transit Board must establish tentative criteria in the form of standards for measuring the success of the broader objective. These are the yardsticks to measure the success of the state objective. The more tangible the yardsticks are, the more usable they will be. Granger, *supra* note 49, at 68-69.

69. D. COOMBES, *supra* note 52, at 167.

70. Dajani & Gilbert, *supra* note 19, at 100.

71. J. PRESSMAN & A. WILDAVSKY, *supra* note 49, at 143.

Stipulations dictated by policymakers lead to uninformed and unresponsive production decisions, and consequently to waste and to lost opportunities. Transit producers, not the Transit Board, are in the most informed position to make resources productive in the pursuit of the enterprise's objectives.⁷² If producers lack freedom to follow their own production strategy in pursuing operating objectives, they cannot be expected to achieve lowest cost production.

The differences between policy and the production process or day-to-day management remain to be outlined.⁷³ Realistically, no bright line separates policy from operations. The two concepts are merely part of a spectrum of decision-making that ranges from the most general questions of what service to produce and for whom, to specific questions concerning marketing or production. Thus, to reduce both the inherent ambiguity in the concepts and the risk of policymaker's interference in operations, the Transit Board should delineate a clearer definition of the areas of transit producer authority.⁷⁴

The Act's approach is to give producers sole control over all decisions that require detailed knowledge of the production function and market characteristics. Those who actually manage the provision of the service determine transit efficiency, which is a function of the technical relationships between inputs and outputs.⁷⁵

72. Drucker, *The Real Duties of a Director*, Wall St. J., June 1, 1978, at 20, cols. 3-5.

73. Much of the British literature on government enterprise simply assumes that a fine line can be drawn between policy and day-to-day management. See W. ROBSON, NATIONALIZED INDUSTRY AND PUBLIC OWNERSHIP 139, 141-42 (1960).

Even though the dichotomy between day-to-day operations and policy determination is well recognized, it is not enough to say only that broad policy decisions must be distinguished from transit operational decisions. With no clear distinction drawn between the two, supervisory agencies tend to encroach on the details of providing the service. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 27-28, 110-11.

74. To reduce the inherent risk of Transit Board interference in operations due to ambiguous definitions, Friedmann advocates that statutory guidelines clearly spell out the distinction between policy and operations. Friedmann, *supra* note 28, at 307. The vagueness of these statutory mandates is often a cause of observed regulatory inadequacy and, therefore, the regulator's mandates should be narrowed. R. SCHMALENSEE, *supra* note 10, at 62. "Inability to predict actual behaviors from knowledge of institutional structure suggests at least that the interests of effective administration are ill-served by grants of excessive discretion. . . ." *Id.* at 145. See *supra* note 10 for discussion.

75. See Dajani & Gilbert, *supra* note 19, at 100. These variables essentially involve routine business decisions made in the context of the private corporate governance model. The variables include operational components such as maintenance, rout-

This division of responsibilities between the Transit Board and transit producers helps to clarify the role of those producing the service and the role of the Transit Board in the regulatory process. A simpler, more understandable structure would reduce information costs incurred both by the Transit Board in monitoring producers and by the community in monitoring the Transit Board.⁷⁶ The separation of the planning and financing from the operating of transit will also lead to

ing/scheduling, service characteristics, personnel matters, labor relations, and promotional activity. See M. EISENBERG, *supra* note 11, at 13-15.

76. An example of a transit system that has carefully separated the planning, financial, and operations aspects is found in the Minneapolis/St. Paul metropolitan area. See MINN. STAT. §§ 473.371-.449 (1984). As in the Model Act, the organization of the Minnesota Act is three-tiered. The Minnesota Act clearly leaves the broad, overall metropolitan policy planning to the Metropolitan Council, whose duty is to consider and coordinate transit services along with the many other functions necessary to operate in a large area.

A separate entity, the Regional Transit Board (RTB), carries out the policies to achieve the objectives and goals necessary for the provision of essential mobility and transit operations in the metropolitan area. The RTB is responsible for mid-range planning, implementing transit plans, MINN. STAT. § 473.377, providing financial assistance for transit producers, *id.* § 473.375(13), contracting with producers, *id.* § 473.384, and preparing a transit budget that is subject to the Metropolitan Council's review and approval. *Id.* § 473.38.

Finally, the Act creates the Metropolitan Transit Commission (MTC), which is responsible for preparing the actual operations and service plans submitted to the RTB for approval, MINN. STAT. § 473.405(6), and for either operating the public transit system directly or entering into contracts for management services. *Id.* § 473.405(12). These three divisions keep transit planning in perspective with overall metropolitan goals and place mid- and short-range planning on levels closer to decision-making centers more familiar with and responsive to the day-to-day operations.

Contrast the above with the Illinois Regional Transportation Authority Act, ILL. ANN. STAT. ch. 111²/₃, §§ 701.01-705.05 (Smith-Hurd Supp. 1985). Under the Illinois Act, a two-tiered system exists. The first tier consists of the Regional Transit Authority (RTA), which is responsible for overseeing the second tier, which consists of three "Service Boards"—the CTA, the Suburban Bus Division, and the Commuter Rail Division. The RTA, like the Metropolitan Council, is responsible for long-range overall transit policy, *id.* § 702.01, and for transit budget approval. *Id.* § 704.11(2). Like the RTB, the RTA is also responsible for setting guidelines for grants to providers and purchasing service contracts, *id.* § 702.02, and for financial planning. The combination of broad policy planning and financial planning, resting within one department whose single concern is transit, may be too narrow a base to efficiently integrate transportation with other aspects of metropolitan planning.

A further blurring of functions occurs on the "Service Board" levels that combine many of the duties of the Minnesota RTB and MTC. For example, like the RTB, the Suburban Bus Division is responsible for mid-range planning and determining the level, nature, and kind of transportation that should be provided. *Id.* § 702.01. Similar to the MTC, however, the Suburban Bus Division is also responsible for either directly operating the public transit facilities or entering into contracts for services. *Id.* § 702.03.

more innovation in transit because the Transit Board may experiment with new types of services or contracting for services without losing either funds or power.⁷⁷

Subd. 4 [CONTRACTS]

(a) The Transit Board shall make contracts with eligible recipients for financial assistance to produce transit service within the metropolitan area. The Transit Board may not give financial assistance to a transit producer other than the Commission without first having executed a contract.

(b) To be eligible to receive financial assistance by contract under this section a recipient must be:

(i) a county, statutory, or home rule charter city or town or combination thereof, or public corporation organized and existing pursuant to state law providing financial assistance to or operating public transit; or

(ii) a private producer of public transit.

(c) The Transit Board shall establish procedures and standards for review and approval of applications for financial assistance under this section consistent with its approved implementation plan.

The Transit Board shall refine the operating objectives and performance criteria in the implementation plan as necessary to permit bidding by potential financial assistance recipients on the performance level of the operating objectives achievable by the recipient with the revenues available from federal, Transit Board, or other financial assistance, and the farebox. In order to gather information in preparation for bidding by potential financial aid recipients, the Transit Board shall require that prior to applying for financial assistance by contract under clause (a) of this subdivision, the applicant prepare and submit a transit study that must include the following elements:

(i) a determination of existing and future transit needs within the area to be served, and an assessment of the adequacy of existing service to meet the needs;

(ii) an assessment of the level and type of service required to meet unmet needs;

Thus, policy makers are also operation decision makers, which may lead to uninformed and unresponsive production.

77. Lave, *The Private Challenge to Public Transportation—An Overview*, in URBAN TRANSIT, *supra* note 4, at 1, 26-27.

(iii) an assessment of existing and future resources available for the financing of transit service; and

(iv) the type or types of any new government arrangements or agreements needed to produce adequate service.

The Transit Board may assist any applicant in the preparation of the transit study.

(d) Prior to bidding, the Transit Board shall make data on available subsidies and all previous contracts and their performance available to all eligible recipients. The Transit Board shall require the submission of a service plan from each eligible recipient submitting a bid. The service plan must include the following elements:

(i) a description of the service proposed for financial assistance, including vehicles, routes, and schedules;

(ii) a description of the amount required to establish and operate the proposed services and the proposed sources of the required amount, including farebox revenue and financial assistance from the Transit Board and other local, state, or federal sources;

(iii) the fare structure of the proposed service;

(iv) a proposal outlining what level of the performance criteria the bidder will achieve during the contract period;

(v) the financial or other information the Transit Board requires to carry out its duties; and

(vi) a description of the contract administration and review process.

(e) The Transit Board shall screen out bidders not competent to adequately perform the contract.

(f) The Transit Board may specify procedures, including public hearing requirements, to be followed by applicants that are cities, towns, counties, or combinations thereof in conducting transit studies and formulating service plans.

(g) For 10 years following the enactment of this statute, prior to entering into a contract for operating assistance with a recipient other than the Commission, the Transit Board shall evaluate the effect, if any, of the contract on the ridership, routes, schedules, fares, and staffing levels of the existing and proposed service provided by the Commission. A copy of the assessment must be provided to the Commission. The Transit Board shall make a finding whether the service to be assisted under the contract will impose a hardship on the ridership or the financial condition of the Commission.

(h) Except when the assessment under clause (g) of this subdivision

results in a finding of undue hardship to the Commission, the Transit Board shall select, from the responsible bidders, the bidder(s) committed to the highest level of performance of the operating objectives. For 10 years following the enactment of this statute, in the event of a finding of hardship to the Commission, the Transit Board shall give consideration to this factor in awarding contracts.

(i) The Transit Board may utilize reward and penalty clauses for superior and inadequate contract performance respectively.

Comment: Clear objectives and criteria and management autonomy are necessary conditions but are not in themselves sufficient to ensure lowest cost production. Government enterprises operating monopoly franchises are not subject to competitive pressures to minimize costs. Without such pressures, these firms can waste resources through managerial slack and inertia. This waste includes costs incurred in excess of those that a competitive firm would incur and dampened incentives for invention and innovation. Thus, the third necessary element for efficiency is the existence of competitive pressures on management to achieve the objectives at lowest cost.

The question is whether the valuable characteristics of market solutions can be retained to spur lowest cost production of transit services. The optimal result is a market consisting of a number of unfranchised suppliers—either government or private enterprises—who are all striving to offer the best particular product or service and competing for available subsidy dollars. This outcome is ideal because each producing firm faces the same environment, and selection among them is automatic by virtue of profit performance and free entry. The normal optimal competitive result applies here. If, however, the minimum optimal scale of transit producers is large relative to the size of the market, the market will consist of only a few producers and oligopoly distortions might attenuate the efficiencies that occur from competitive pressures.⁷⁸

Before publicly owned transit monopolies were created in the 1960s, the record suggested that the minimum optimal scale of private bus transit firms in many cities was sufficiently large to lead to monopoly production or a market consisting of few producers.⁷⁹ This result could also be explained by artificial regulatory restraints on entry im-

78. In the extreme case, when the market is so small that only one producer can achieve minimum optimal scale, no competition will exist at all except through the possibility of franchise bidding or bidding for management contracts discussed below.

79. R.L. Banks & Assocs., *supra* note 36, at 70-74.

posed at that time, which permitted existing firms to generate monopoly profits in some services in order to cross-subsidize loss-producing activities.⁸⁰

Statistical data on scale economies and minimum optimal scale of bus transit firms reveals very limited, if any, economies of scale.⁸¹ Studies conclude that: costs are directly proportional to bus miles produced;⁸² unit costs are rising disproportionately with respect to fleet size;⁸³ and average operating costs are, in the long run, rising disproportionately with respect to passenger miles produced.⁸⁴ If passenger waiting time and travel time are included as costs, studies show that costs decrease with respect to bus miles because more frequent service and a well coordinated system of routes reduces waiting and travel time.⁸⁵ The implication of this data⁸⁶ is that the transit market can consist of competing smaller producers rather than one larger producer in many cities, and that competition among the producers may result in cost savings. Two producers might serve medium sized urban areas

80. N. HAMILTON & P. HAMILTON, *supra* note 8, at 67. Lave, *supra* note 77, at 5; Kemp & Kirby, *supra* note 4, at 185-86.

81. The consensus among researchers is that significant economies of scale do not exist in urban bus transit. Lave, *supra* note 77, at 246. Economies of scale for fixed guideway mass transit may exist and justify natural monopoly characterization. See Kemp & Kirby, *supra* note 4, at 287-88.

Essentially constant costs prevail for producers up to about 5.5 million vehicle-miles per year (about the size of the Albany, N.Y. system), and at the level of the largest producers, quite large diseconomies of scale prevail. Morlok & Viton, *The Comparative Costs of Public and Private Providers of Mass Transit*, in URBAN TRANSIT, *supra* note 4, at 233, 246.

82. Lee & Steadman, *Economies of Scale in Bus Transport*, 4 J. TRANSP. L. & POL'Y 15, 27 (1979); but see Williams, *Firm Size and Operating Costs in Urban Bus Transportation*, 8 J. INDUS. ECON. 209, 216 (1979) (concludes that long-run marginal cost decreases as annual bus miles increase).

83. Wabe & Coles, *The Short-Run and Long-Run Costs of Urban Buses*, 9 J. TRANSP. ECON. & POL'Y 127-40 (1975); Miller, *Differences Among Cities, Differences Among Firms, and Costs of Urban Bus Transport*, 19 J. INDUS. ECON. 22-32 (1970); Pucher, Markstedt & Hirschman, *supra* note 5, at 166.

84. Oberg, *Bus Transit Cost, Productivity and Factor Substitution*, 19 J. TRANSP. ECON. & POL'Y 183, 189, 201 (1985).

85. Mohring, *Optimization and Scale Economies in Urban Bus Transportation*, 62 AM. ECON. REV. 585, 591-93 (1972). This latter data does not necessarily point toward natural monopoly in transit services, because transit planning and contracting for well defined services could also reduce waiting time and travel time.

86. See *supra* note 80 and accompanying text.

while six to ten firms might serve the largest transit markets.⁸⁷ Even with just two producers, the problem of market power concentration appears slight because non-legal barriers to entry such as start-up costs are low and minimum optimal scale is small.⁸⁸

Currently, private bus services are not well developed because publicly produced mass transit services are subsidized⁸⁹ and the regulatory power of the publicly-owned transit producer prevents private operators from producing service.⁹⁰ A third barrier to entry of private transit is the mindset of transit management, which favors traditional transit monopolies and opposes any diminution in their control over transit.⁹¹ Nonetheless, the number of private transit firms is growing, and as these barriers to entry are reduced more private firms will appear.⁹²

87. *Id.* See also Schofer, *Routes to the Future of Urban Public Transit*, 29 URB. AFF. Q. 149, 153 (1983).

88. Morlok & Viton, *supra* note 81, at 246-47.

89. Viton, *Privately Provided Transport Services*, 16 J. TRANSP. ECON. & POL'Y 85, 91-92 (1982).

90. Giuliano & Teal, *Privately Provided Commuter Bus Services: Experiences, Problems, and Prospects*, in URBAN TRANSIT, *supra* note 4, at 151, 177-78. The approach in the past has been consolidation into a publicly owned monopoly. Johnson & Pikarski, *Toward Fragmentation: The Evolution of Public Transportation in Chicago*, in URBAN TRANSIT, *supra* note 4, at 49, 73.

91. Giuliano & Teal, *supra* note 90, at 177-78. These barriers to private production are very substantial. As the Wall Street Journal recently noted:

Despite its undeniably enormous potential, privatization of government services in general, and of transportation in particular, will not be developed unless the financial community, government at the local, state and federal levels, and the public recognize the extent to which existing laws, regulations, customs and lending practices limit private efforts to construct and maintain the infra structure.

Gilsen, *Private Transportation is a Pipe Dream*, Wall St. J., May 26, 1985, at F2, col. 3.

92. For example, charter bus and school bus companies already exist and can quickly respond to market opportunities in fixed route transit. Schofer, *supra* note 87, at 154-55 (1983). In a number of urban areas, private firms operating under contract are producing part, or in some cases all, of the transit service.

See Lave, *supra* note 77, at 14-16; Orski, *The Private Challenge to Public Transportation* in URBAN TRANSIT, *supra* note 4, at 311, 327. One example of the success of privatization of public transit can be found in the Minneapolis suburb of Plymouth, which recently "opted out" of the public bus system and substituted private producers. Within seven months, the daily ridership increased 18%. Adams, *Metrolink Outpaces MTC in Plymouth*, Minneapolis Star & Tribune, Sept. 28, 1984, at B1, col. 1.

In Dallas, private companies operate regular high volume commuter services with their own buses under contracts with the transit authority. In a newer variation of this theme, the transit authority will own the buses that the private companies will operate. Hayes, *Dallas Negotiates Its Way Out of the Computer Business*, N.Y. Times, Feb. 2, 1986, at E5, cols. 1-5.

The effort to obtain the benefits of competitive pressures on production costs must not sacrifice the benefits of governmental agency oversight of regional coordination and policy development, which ensures that the public's tax dollars are spent in a way that maximizes the community's welfare. The Act delegates coordinated policy-making functions to the Council and the Transit Board. The benefits of competition are realized through competitive bid contracts for service, and transit service producers bidding on contracts can be publicly owned or privately owned entities.⁹³

Because of the uncertainty surrounding both the nature of the transit producer markets that will emerge in the future and the workability of untried contractual arrangements, the Act gives maximum flexibility to the Transit Board to experiment with contractual arrangements best suited to changing market conditions. For example, the best option for fixed route service might be to contract out individual routes, or to divide the metropolitan area into districts and contract out districts, or

93. Kolderie was one of the first scholars to emphasize this distinction between government provision and government production of a good or service. He advocates that governments remain the providers of important services, but that they get out of monopoly production through contracting for services. The key, according to Kolderie, is to obtain the benefits of competition among producers for the service contract. Producers can be either government or private enterprises. Kolderie, *supra* note 17, at 6. "The essential mode of operation for a local government setting out to change the community service system . . . is not to do things itself as a producer, but to let things be done by others. *Id.* at 9. To reduce financial commitments and gain better control over costs, greater use must be made of private sector providers. M. Pikarski & C. Johnson, *supra* note 1, at 19, 26-27. "Rather than owning and operating systems, the public sector may become more of a travel information broker, a facilitator, a technical adviser and a manager of set service contracts." *Id.* at 27. See also M. Bendick, Jr., On the Efficiency of Markets Created by Government: A Review of Recent Experience with the For-Profit Privatization of Public Services 2-9 (July 1982) (paper prepared for the Urban Institute and presented at the conference on Social Needs and Business Opportunities); C. Lave, The Private Challenge to Public Transportation 22-31 (Mar. 18, 1984) (unpublished manuscript, Economics Department, University of California, Irvine).

The author's earlier book points out that competition among suppliers to produce a good or service, which the government financed, is a preferred solution if (1) government policy makers can create the proper incentives to elicit desired behavior from private firms, and (2) enough suppliers exist to result in workable competition. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 66-71. Case studies in transit revealed severe shortcomings, however, in the definition of policy by boards, and the data available in 1980 was more ambiguous concerning minimum optimal scale in bus transit and the possibility of competition in production. Given this information, the book focuses on introducing competition through bidding for contract management in order to introduce pressure for lowest cost production. See *id.* at 105-09. The Model Act is also drafted to permit experimentation with competition for contract management of the transit commission.

to allow more than one operator on given routes or in certain districts.⁹⁴ Thus, if the market consists of a number of unfranchised suppliers competing with one another, this competition will ensure lowest cost production. Even if a market contains only one firm that theoretically produces at lowest cost, available research indicates that periodically inviting a number of enterprises to bid for the opportunity to operate a franchise is more efficient. Contract bidding may be significantly more efficient than monopoly public production if a number of producers are willing to bid at each contract renewal.⁹⁵

Several scholars have identified problems with franchise bidding, both in the bidding process itself and in the behavior expected of the winning bidder during the term of the franchise. Analyzing the bidding process itself, one commentator points out that even if bidding ensures lowest cost production, it still does not guarantee economic efficiency because product selection and price structure issues must also

94. Kolderie, *The Redesign of Public Transit: Changing the "Givens"*, PUBLIC SERVICES REDESIGN PROJECT 10 (1983). Pagano, *Private Sector Alternatives for Public Transportation*, 38 TRANSP. Q. 404, 413 (1984).

95. Government enterprise is often assumed to be synonymous with monopoly production, and privatization is assumed to be the only means to introduce competition among producers. Thus, advocates of privatization rest their case on the premise that small, privately-run enterprise provides more choice and is inherently more efficient than a large monopoly sustained by the taxpayers. G. ROTH & G. WYNNE, *LEARNING FROM ABROAD: FREE ENTERPRISE URBAN TRANSPORTATION* vi (1982). This will be true because monopoly public enterprise: (1) has the ability to inefficiently absorb losses due to subsidization from tax revenues; (2) is unable to resist political pressures; and (3) invariably utilizes cross-subsidization, which allows some services to be inefficiently operated at a loss by operating others at excess profits. *Id.* at 29, 54-58.

In the Model Act, the government enterprise will cease to be a monopoly supplier and will become a bidder for contracts along with private enterprises. Because good management performance in private enterprises can be more directly rewarded monetarily or penalized by shareholder dissatisfaction and lower stock prices, some scholars believe that private enterprise is inherently more efficient. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 68-69; Hamilton, Feldthusen & Crisp, *supra* note 51, at 1, 22-23; Conybeare, *Bureaucracy, Monopoly and Competition*, 28 AM. J. POL. SCI. 479, 496 (1984).

A 1983 study of the effect of management on cost concludes that private transit management is associated with operating costs per hour that are \$1.72 less than for publicly owned systems. Pucher, Markstedt & Hirschman, *supra* note 5, at 170 (1983). In Australia, costs of private urban bus operators are between one-half and two-thirds those of publicly owned operators providing the same service. Roth, *The Overseas Experience*, in URBAN TRANSIT, *supra* note 4, at 215. *But see* R. SCHMALENSSEE, *supra* note 10, at 95 (concluding that literature does not support assertions of dramatic efficiency differences between municipality owned and private electric utilities). This data suggests that publicly owned transit producers may have difficulties securing contracts with a bidding system.

be addressed.⁹⁶ The Act addressed this problem by requiring the Transit Board to define scaled mobility objectives. Transit producers then bid the highest mobility objective they can attain with the subsidy resources available and expected farebox revenues.⁹⁷

A second problem in the bidding process occurs when winners of the original competition have substantial advantages over nonwinners at contract renewal.⁹⁸ While in some industries such as electric utilities problems exist regarding immobile assets and their valuation if the existing franchise loses the bid, these problems are not as severe with mobile assets like buses. The existing franchise does enjoy a certain advantage both because of better information about actual cost and demand conditions for purposes of bidding and because the existing franchise does not have a high cost transition period in which its management must learn firm-specific technical and personnel aspects of the job.⁹⁹ The existing franchise's advantage, however, should be small. The Act provides that data on previous contracts and their performance shall be made available to potential bidders. Start-up costs in bus transit appear to be low and minimum optimal scale is small.¹⁰⁰

A second set of problems identified with franchise bidding concerns the expected behavior of the winning bidder during the franchise term. First, the longer the contract, the greater the need for the contract to have a provision for renegotiation in response to changes in costs, demand, or technology.¹⁰¹ This is an area for experimentation, but given the mobility of bus transit assets, contracts of three years should be long enough to permit the recovery of the initial bidding costs, but still short enough that uncertainty about future conditions is minimized.¹⁰²

Because wages and salaries comprise roughly seventy to eighty percent of all operating costs, labor relations and labor costs will be the major area of concern for bidders.¹⁰³ All bidders will face the same

96. R. SCHMALENSEE, *supra* note 10, at 70-71.

97. The transit producers must define both prices and product selection in their bids, given the resources available.

98. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 69-70.

99. R. SCHMALENSEE, *supra* note 10, at 72.

100. See *supra* discussion at notes 87-92.

101. R. SCHMALENSEE, *supra* note 10, at 69.

102. The Dallas Transit Authority has a three year contract with Trailways for regular high volume commuter service in which unanticipated cost increases are taken out of Trailways' profits. Hayes, *supra* note 92, at E5, cols. 1-5.

103. N. HAMILTON & P. HAMILTON, *supra* note 8, at 111.

labor conditions at contract renewal and each must estimate its performance over the contract period, taking into account the probable outcome of labor negotiations. Problems may arise in the event of a strike. Transit labor can bring strong public pressure to bear on the Transit Board through transit stoppage.¹⁰⁴ Given the existence of alternative suppliers, a sensible solution is to give the existing suppliers a defined time period to resolve the strike, at the end of which the Transit Board may seek other suppliers.

The second potential problem concerning the winning bidder's behavior during the franchise term is the franchisee's tendency to underinvest in fixed assets or cut back on maintenance or service quality during a franchise term in order to make more profit and reduce losses in the event the contract is not reawarded to the existing franchisee.¹⁰⁵ The reward and penalty clauses discussed below are designed to alleviate this problem. Falling ridership, as a result of a reduction in quality of service, will cause the franchisee to fail to meet contractual obligations and thus trigger penalties.

Because municipalities have had little experience with private suppliers of transit service, the optimal provisions for a private producer contract are a matter for experimentation. The contractor's profit must be tied to the operating objectives in the simplest possible terms and detailed service considerations must be the province of operating managers familiar with changing demand and cost conditions. If the transit producer is committed to achieve a particular level of mobility for passengers, for example in terms of passenger miles, consumer response will then dictate success or failure in achieving this mobility. The means of eliciting favorable consumer response must, therefore, be in the hands of the producer.

If the contract is complex and has detailed vehicle and performance standards, only large bus operators will bid to produce the service.¹⁰⁶ Small producers will find the transaction costs of understanding and complying with detailed requirements disproportionately high and will not bid.¹⁰⁷ At this early stage in the development of private alternatives, complex contractual requirements will discourage both diversity of supply and innovation in privately produced transit.

104. *Id.*

105. R. SCHMALENSEE, *supra* note at 69-70.

106. *See* Giuliano & Teal, *supra* note 90, at 162.

107. *See* Lave, *supra* note 77, at 16; Johnson & Pkarski, *supra* note 90, at 62.

If the Transit Board dictates detailed service characteristics to a contractor, no assurance exists that this is what the consumers want.¹⁰⁸ The Transit Board's role is to monitor the actual performance as compared to the agreed upon performance objective and to assess penalties or provide rewards at regular intervals as agreed upon in the contract.¹⁰⁹

Reward and penalty clauses in the contract must be designed to provide producers with the incentive to perform correctly. Present transit management rewards often depend on the number of employees managed and the base wage rate paid to the drivers. Thus, increases in organizational size or in the salaries of subordinate personnel normally cause the manager's salary to increase.¹¹⁰ An incentive system that rewards a producer for exceeding a baseline performance and penalizes it for falling short of agreed performance expectations could correct such perverse incentives. In the alternative, the contract could specify an amount that the Transit Board would pay, leaving producers free to adapt service to the market or to decrease costs so as to increase profits.¹¹¹ The Transit Board should not be alarmed if producers who achieve exceptional results realize large performance rewards, because the production of the significantly greater service will have been achieved at costs substantially lower than anticipated.¹¹²

Despite the uncertainty that remains concerning the optimal form of contract bidding, the Transit Board's efforts in experimentation with and improvement of the contracting process are focused in the right direction. Even if perfect bidding parity is not possible among all bidders at contract renewal, the threat of potential competition will keep costs down.¹¹³ Management of private transit service suppliers will also have a greater incentive to bargain effectively with transit labor, and the existence of alternative suppliers will equalize transit labor's

108. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 109-15; Morlok & Viton, *supra* note 81, at 251-52. Detailed contracts lead to significant increases in administrative costs to coordinate and to monitor performance, loss of flexibility, and strained relations with contractors. See Johnson & Pikarski, *supra* note 90, at 62.

109. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 106.

110. Simpson, *Implications of Efficiency Incentives on Use of Private Sector Contracting by the Public Transit Industry*, in URBAN TRANSIT, *supra* note 4, at 299, 300.

111. Schofer, *supra* note 87, at 156.

112. Simpson, *supra* note at 305. Incentive contracts are currently utilized in Phoenix and Chicago. Johnson & Pikarski, *supra* note 90, at 61; Lave, *supra* note 77, at 27.

113. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 107; Morlok & Viton, *supra* note 89, at 240.

presently enjoyed market power.¹¹⁴

In the transition to a contracting process that will introduce competitive pressures, the Transit Board should consider the potential disruption to ridership or finances of the current publicly-owned monopoly producer. This will ease the impact of the transition on transit labor and the community.

Subd. 5 [MEMBERSHIP]

(a) The Transit Board shall be governed by a Board of Directors comprised of six members appointed by the Council plus a chair appointed by the governor. One member must be appointed by the Council from each of six Metropolitan Council districts, and each such member must be a resident of the district for which he is appointed during his term of appointment.

Each member must have at least a minimum knowledge of the community, business matters, and transit operations. The minimum skill level must be met in the following manner:

(i) Directors shall be required to reside one year before and during tenure on the Board within the regional transportation area serviced by the public transportation system;

(ii) Directors shall possess, prior to assuming Board responsibilities, a familiarity with the management of complex organizations, and knowledge of corporate business and finance;

(iii) Directors shall acquire knowledge of transit operations, accomplished through a mandatory training program provided by the Transit Board; and

(iv) Directors may not during their term of office hold any other office as a regional commissioner or hold a judicial office. Each member will take the oath of office as prescribed in the state constitution.

Comment: A multi-member Board of Directors contributes to the Board's knowledge of community preferences and business matters and provides a check against arbitrariness and bias.¹¹⁵ The Board should

114. See Schofer, *supra* note 87, at 156. Managers of government enterprises generally have no incentive to bargain as hard as private enterprise managers. Shaw & Clark, *The Practical Difference Between Public and Private Collective Bargaining*, 19 UCLA L. REV. 867, 876 (1972). With the creation of a single transit supplier in most urban areas, transit workers obtained the power to cripple a city with little risk of losing their jobs. Johnson & Pikarski, *supra* note 90, at 74.

115. U.S. COMMISSION ON ORGANIZATION OF THE EXECUTIVE BRANCH OF GOVERNMENT, REPORT OF THE COMMITTEE ON INDEPENDENT REGULATORY COMMISSIONS 21 (1949); J. THURSTON, *supra* note 39, at 150. Besides bringing more input to the transit operations, having a multi-member staff or larger size has been suggested as a

not be so large as to diffuse responsibility and accountability. In addition, the requirement that a member be appointed from each metropolitan council district creates a geographical distribution covering the area that the transit system will serve, which provides a second insurance of fair representation.

The appointment process requires consideration of the background and qualifications of potential Board members (subdivision 4 § (b)). To ensure the working competency of the Board, the Act articulates a minimum skill level that all directors must meet.¹¹⁶ These qualifica-

factor in bringing about the additional advantage of lower utility rates. See Smiley & Greene, *Determinants of the Effectiveness of Utility Regulation 21-22* (June 1981) (unpublished manuscript). The Illinois and Minnesota Legislatures have followed the multi-member approach in establishing their regional boards of directors. See ILL. ANN. STAT. ch. 111^{2/3}, ¶ 703.01 (Smith-Hurd Supp. 1985); MINN. STAT. § 473.373(2) (1984). But see Address by B.J. Cudahy, *Mass Transit in American Cities* (Feb. 17, 1981). Discussing the weakness of a board organizational structure, Cudahy states:

In its best manifestation, the board of directors provides general policy guidance to a professional staff who have been hired to conduct day-to-day operations. All too often, however, the board of directors concept falls prey to a variety of human failings and becomes a stumbling block to the achievement of any kind of ordinary progress.

Id. at 14.

116. In many cases, members of existing transit boards have limited knowledge of business management generally or transit management in particular. Horn, *supra* note 58, at 30; Barvick, *The Effect of Commission Structure on Decision Making—Part I*, 112 PUB. UTIL. FORT. 15 (Nov. 10, 1983) (discussing the same deficiency with respect to utility commissioners). This increases the possibility of error. Bernstein urges that "regulatory success hinges more on the quality of the individual commissioners than any other single factor." M. BERNSTEIN, *REGULATING BUSINESS BY INDEPENDENT COMMISSION* 103 (1955). The question is what qualities should be utilized for board membership?

In order to undertake the task of defining policies that reflect the preference of the community, Board members must have at least minimum knowledge of the community by residing in it. The task of translating these policies into operating objectives and performance criteria also requires a capacity for independent counsel in business matters, and a basic knowledge of transit operations. With respect to knowledge of business matters, Soloman observes that a director should possess a familiarity with the management of complex organizations and knowledge of corporate business and finance. Soloman, *Restructuring the Corporate Board of Directors: Fond Hope—Faint Promise*, 76 MICH. L. REV. 581, 603 (1978); See also Barvick, *supra*, at 18.

Recognizing these needs, the enabling act for the Chicago Transit Authority has a requirement that board members shall be persons of recognized business ability. ILL. REV. STAT. ch. 111^{2/3}, ¶ 319 (1970), and Minnesota requires all members of its Metropolitan Transit Commission to have management experience. MINN. STAT. § 473.404(5) (1984). Few statutory mandates, however, show such foresight. Because few members of existing boards have knowledge about transit before their appointment, Board members should receive mandatory training on transit operations. Horn, *supra* note 58, at 20, 29.

tion requirements will increase the Board's efficiency and minimize its errors. Qualifications include familiarity with the management of complex organizations, knowledge of corporate business and finance, and the willingness and time to acquire knowledge concerning transit operations.¹¹⁷

Another factor to consider during the nomination and appointment of Board members is the importance of minimizing conflicts of interest.¹¹⁸ To ensure that possible conflicts of interest are examined, this provision prohibits members from holding commissionerships or judicial office. Other provisions could be added to further guard against conflicts of interest, including prohibiting members from holding elective office, being employed by federal, state, county or municipal government, or having a financial interest in any business of the transit authority.

The Council appointment of Transit Board members, who are expected to be responsive to the Council, should encourage the Board's sensitivity to the regional community served by the transportation system. To provide a strong link to state government and broaden state

117. Individuals experienced in business and knowledgeable about the community can absorb information much faster than those without experience. Pelosci has commented on the potential benefits of improving the educational level of board members: "Not the least of these will be the relative facility and speed with which well-educated appointees can pass through unproductive instruction periods. Staff domination of the commission proceedings will also be increasingly less likely." Pelosci, *The Energy Crisis and the New Breed of Regulators: A Study of State Public Utility Commissions*, 13 MIDWEST REV. PUB. ADMIN. 51 (1980).

Board membership should not be an occasion for remedial work in business knowledge or community preferences. Another potential benefit is that members with extensive business backgrounds seem to be more effective in keeping rates down. T. Pelosci, *The Energy Crisis and the New Breed of Regulators: A Study of State Public Utility Commissions* 27 (1979) (unpublished manuscript).

The trend clearly seems to be in the direction of seeking commissioners with general business backgrounds. Pelosci, *supra*, at 52; Samprone & Riddell-Dudra, *State Regulatory Climate: Can It Be Predicted?*, 108 PUB. UTIL. FORT. 41, 42 (Oct. 8, 1981); Smith, *Regulatory Commissions in 1984—Are the Dice Loaded?*, 113 PUB. UTIL. FORT. 15, 19 (May 10, 1984).

118. See J. THURSTON, *supra* note 39, at 159. In order to maintain board autonomy, Ohio has prohibited elected officials from serving as board members. 1973 Op. Att'y Gen. 73-016; see also ILL. ANN. STAT. ch. 111²/₃, ¶ 703.01 (Smith-Hurd Supp. 1985) (a board member cannot be a member or an employee of another public body); MINN. STAT. § 473.404(5) (1984) (prohibiting MTC members from being a member of the Metropolitan Council, other metro commissions, boards, or agencies, or from holding judicial office).

concerns regarding transportation and its financing, the governor appoints the chairperson.

(b) The Council shall establish a Transit Board Appointments Committee composed of community leaders from the area served by the Transit Board. The Appointments Committee is responsible for screening potential directors' qualifications and competence.

The Appointments Committee shall notify in writing the governing body of the statutory and home rule charter cities, towns, and counties having territory in the district for which the director is to be appointed. The notification must describe the appointment process and invite participation and recommendations on the appointment. The Appointments Committee shall hold a public hearing in each district for which a member is to be appointed. Following the hearing, the Appointments Committee shall submit to the Council a written report that includes both a list of persons who have applied or have been nominated or recommended for the position, along with a description of the background and qualifications of each, and the recommendation of the Appointments Committee concerning the appointment.

The Appointments Committee shall also compile a list of nominees for the position of chair for submission to the governor. The Council shall, by resolution after a public hearing on the subject, provide the governor with a list of nominees.

Comment: The Appointments Committee, as a separate entity from the Council, aids in monitoring the qualifications of Transit Board appointees, assists in achieving a long-run balance in representation, and serves as an additional check on the integrity of the appointment process.¹¹⁹ The appointment of Transit Board members based on the nominee's qualifications is more likely to satisfy the competency requirements for directors than would an election.¹²⁰ Thus, accountabil-

119. The Ohio legislature adopted a similar appointment process with its creation of a Public Utilities Commission Nominating Council. See OHIO REV. CODE ANN. § 4901.021 (Page Supp. 1984). This method is also analogous to merit-selection committees proposed for judicial appointments. See Heggs, *Merit Selection for the Ohio Judiciary: An Analysis of S.J.R. 6, and a Proposal for Implementation*, 28 CASE W. RES. 628, 638 (1978). See also *supra* note 60 for a discussion of Citizen's Advisory Committees. For a skeptical view of whether any promise exists in such mechanisms to improve personnel, see S. BREYER, *supra* note 16, at 343.

120. The question whether the transit corporation board should be elected or appointed is an extremely difficult one and has no certain answer. Good arguments exist on both sides of the question.

The populist preference for direct election of public officials, including judges and regulatory commissioners, is based on the inevitability of political influence in any ap-

ity of the Transit Board is best achieved through an appointment process rather than through direct election.

pointment process. The argument is that the very fact that some political authority has to make the selection permanently injects politics into the matter. The shift from an elective process to an appointive one, therefore, results in transferring the matter from an overtly political arena to one in which politicking is more "clubby" than it should be because it is less visible to the public. The elective process, as poor as it might be, is then always to be preferred to an indirect method of selection that is not necessarily representative of the people who have to abide by the governmental decisions. See Hegggs, *supra* note 119, at 638; Smiley & Greene, *supra* note 115, at 19.

The assumption that the elective process leads to selection of officials representative of the people is questionable. Indeed, the political nature of elected officials is more often challenged as producing special problems very likely to influence negatively the regulatory climate of state commissions. See Ferguson, *Depreciation Issues of the Eighties: It's Back to Basics*, 110 PUB. UTIL. FORT. 30, 32 (Dec. 9, 1982); R. SCHMALENSEE, *supra* note 10, at 16, 62; Samprone & Riddell-Dudra, *supra* note 117, at 42. The electorate does not have sufficient knowledge of planning and production function problems to have a clear notion of Transit Board competence. See Hegggs, *supra* note 119, at 644; T. Pelosci, *supra* note 117, at 14, 23. Unless glaring inadequacies are manifest, the community will probably have little knowledge of Transit Board performance. The value of incumbency at the time of reelection also suggests that elected boards are not answerable to the people. *Id.* at 645; see also Pelosci, *supra* note 117, at 54.

Even if direct election yields Transit Board members more responsive to the community, elected Transit Board members may not possess the capacity to give independent counsel on business matters. This lack of expertise may inhibit the Transit Board from both implementing its policy-making role and monitoring transit providers. Failure to translate general policy into operating objectives or failure to monitor transit producer performance will prevent the realization of the lowest cost production of services. This will decrease the community welfare, which the Transit Board is directed to maximize.

For example, in a survey of elected and appointed public utility commissions in the United States, Pelosci found clear evidence that rates were substantially higher under elected commissioners than under appointed ones. T. Pelosci, *supra* note 117, at 22. Schmalensee also found evidence that regulatory performance is better with an appointed commission than with an elected one. R. SCHMALENSEE, *supra* note 10, at 62. Other authorities disagree. Research by Smiley and Greene, based on 1970 data, considered among other factors residential prices charged by the utilities and inferred that utilities regulated by elected commissions achieved more favorable results in that area than those regulated by appointed officials. Smiley & Greene, *supra* note 115, at 19-24. Mann and Primeaux, using data from 1979, produced evidence that the election of commissioners correlated with lower electricity rates. Mann & Primeaux, *The Controversial Question of Commissioner Selection*, 111 PUB. UTIL. FORT. 23-24 (Mar. 17, 1983). The latter study concluded, however, that the choice between election and appointment cannot be made on that basis alone. *Id.* at 24.

The most recent studies and literature propose that the manner in which commissioners are selected has no significant impact on the rates consumers pay. Costello, performing a regression analysis using 1980 data, concluded that "contrary to what one might expect, elected commissions do not favor residential customers any more than appointed commissions do." Costello, *Electing Regulators: The Case of Public Utility Commissions*, 2 YALE J. ON REG. 83, 88 (1984). The article indicated that lower rates under elected officials may be attributable to the fact that states with elected commis-

(c) Directors shall serve in office for terms of three years, except for the initial terms as provided. One third of the Transit Board shall be initially appointed for a term length of one year, one third shall be initially appointed for a term length of two years, and one third shall be initially appointed for a term length of three years. Directors may be reappointed for additional terms. A director may not, however, serve more than two consecutive full terms.

Comment: Staggered initial appointments of Transit Board directors prevents the terms from expiring at the same time.¹²¹ Although simultaneous expirations and appointments would reduce the amount of time spent on the appointment process and would simplify the training program, the operation of the Transit Board would be disrupted. In addition, no experienced, active directors would be on hand to aid the inexperienced members.

The term for service on the Transit Board is set at three years, because long tenure on a board can lead to inertia. More frequent turnover contributes to greater openness to innovative proposals and increased sensitivity to the social dimensions of transit policy.¹²² Also,

sions, on average, are more favorably situated with regard to fuel costs, distribution costs, and taxes. *Id.* at 99. Harris and Navarro concur. Using 1980 statistical data, they found that "while there may appear to be a superficial correlation between lower rates and the election of utility commissioners, statistically the observed phenomenon cannot be attributed to the method of selecting commissioners." Harris & Navarro, *Does Electing Public Utility Commissions Bring Lower Electric Rates?*, 112 PUB. UTIL. FORT. 23 (Sept. 1, 1983). See also NEWSBEAT: REGULATION, ELECTRICAL WORLD 13 (1984).

Given the ambiguity in the current evidence, it seems intuitively preferable to create a mechanism to ensure that the factor of competence is incorporated into the choice of board members. Appointment to the Transit Board by elected local officials or the Metropolitan Council on the basis of qualifications has a higher likelihood of satisfying the Model Act's condition that a Transit Board be competent, and "may be a reasonable compromise toward obtaining qualified commissioners and at the same time allowing the public to participate in the selection by broad representation on the panel." Mann & Primeaux, *supra*, 24. For examples of transit acts that currently provide for the appointment of board members, see ILL. ANN. STAT. ch. 111 $\frac{2}{3}$, §§ 703.01, 703A.02 (Smith-Hurd Supp. 1985); MINN. STAT. §§ 473.373(2), 473.404(2) (1984).

121. See MINN. STAT. §§ 473.373(4), 473.404(3) (1984).

122. Shorter tenure is considered desirable for public officials because "more is lost by long continuance of [individuals] in office than is generally to be gained by their experience." F. MOSHER, *DEMOCRACY AND THE PUBLIC SERVICE* 62 (1968). See Pelosci, *supra* note 117, at 55; Roberts, *supra* note 10, at 424. The rationale for such a conclusion is that longer terms of office tend to isolate commissioners from public pressure and thus make them less responsive to community needs. Smiley & Greene, *supra* note 115, at 22; Hagerman & Ratchford, *Some Determinants of Allowed Rates of Return on Equity to Electric Utilities*, 19 BELL J. ECON. 46, 53 (1978).

consecutive terms of service are limited to ensure regular turnover. This is particularly useful because appointing authorities rarely use their power of dismissal and Transit Board members are usually reappointed at the expiration of a term if they wish to continue service.¹²³

(d) Each director shall receive a fixed annual salary, which the Metropolitan Council shall establish from time to time. In addition, directors shall be reimbursed for reasonable expenses incurred in the performance of their duties. Directors may not be the recipients of gifts, rewards, or perquisites.

Comment: Transit Board salaries must be sufficient to attract qualified candidates and encourage responsible performance.¹²⁴ An adequate Transit Board salary will increase a director's willingness to spend the necessary time on Transit Board related activities. Compensation must be high enough so that directors will not be making difficult trade-off decisions regarding income-producing employment and Transit Board responsibilities.

Directors should be compensated on a salary basis rather than on a "per meeting" basis. Because director utility is not a function of the number of meetings attended, "per meeting" compensation would confuse attendance of meetings with productivity and result in unnecessary and unproductive meetings.¹²⁵

(e) The duties of the chair are:

(i) to preside over all Transit Board meetings at which the chairperson is in attendance;

(ii) to serve as the principal transit spokesperson within the metropolitan area before the legislature, other state and regional agencies, local units of government, and the general public;

(iii) to present to the governor and the legislature, after approval by the Council, the Transit Board's financial plan for public transit in the metropolitan area; and

123. Horn, *supra* note 58, at 68; Garner, *Public Corporations in the United Kingdom*, in GOVERNMENT ENTERPRISE: A COMPARATIVE STUDY, *supra* note 28, at 14.

124. Pelosci concluded that low inducement levels in terms of salary and staff size inhibits the entry of well-educated individuals onto utility commissions. Pelosci, *Energy Crisis*, *supra* note 117, at 57; See also ILL. ANN. STAT. ch. 111²/₄, §§ 703.04, 704A.09 (Smith-Hurd Supp. 1985) (granting a \$25,000 per year salary for RTA directors but no compensation for Service Board members); MINN. STAT. § 473.404(7) (1984) (establishing compensation for members of the Metropolitan Transit Commission). S. BREYER, *supra* note 16, at 343-44; Smith, *supra* note 117, at 19. Smiley & Greene, *supra* note 115, at 19, 22.

125. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 117-18.

(iv) to perform other duties assigned by law or by the Transit Board.

Comment: The governor's appointment of the chairperson should lend prestige and credibility to that position. These powers are intended to assist the chairperson in providing direction and leadership to the Transit Board.

(f) Transit Board members may resign or be removed under the following conditions:

(i) Any director may resign from his office, to take effect when his successor is appointed.

(ii) The Council may remove any director it has appointed at will. The governor may remove the chairperson at will.

(iii) Every office shall become vacant before the expiration of the term of such office on the happening of the following events.

(a) Death of the incumbent;

(b) Resignation;

(c) Removal;

(d) Ceasing to be an inhabitant of the district for which that director was appointed;

(e) Conviction of any infamous crime, or of any offense involving a violation of his official oath;

(f) Refusal or neglect to take the oath of office, or to give or renew his official bond, or to deposit or file such oath or bond within the time prescribed;

(g) The decision of a competent tribunal declaring his election or appointment void; or

(h) Death of the person appointed to fill a vacancy, or to serve a full term, before he qualifies, or before the time when by law he should enter upon the duties of the office to which he was appointed, in which case the vacancy shall be deemed to take place at the time when his term of office would have begun.

Comment: The ability of superiors to impose sanctions on a director is an important check on the accountability of an appointed board. Critics charge that appointed boards are insulated from public opinion and are unresponsive to the community.¹²⁶ Granting the appointing

126. See A. WALSH, *supra* note 10, at 6. Walsh states:

Public authorities that are supposed to act in the general interest of a state, region, or city frequently do not. Because of their insulation, they overemphasize financial returns and reflect or accept the viewpoints of banking and business participants.

authorities the power to remove directors at will alleviates this tendency.¹²⁷

Subd. 6. [ORGANIZATION OF THE BOARD]

(a) As soon as possible after the appointment of the initial directors, the Transit Board shall organize for the transaction of business, including the formation of committees, and adopt bylaws, rules, and regulations to govern its proceedings.

(b) The Transit Board shall appoint a secretary and treasurer, who need not be members of the Transit Board, to hold office at the pleasure of the Transit Board. Before entering upon the duties of their respective offices, they shall take and subscribe an official oath.

Comment: A committee structure can further develop specialized Board expertise. Committees are often a more efficient method of operation than full Transit Board participation. If expertise is developed and issues are consolidated prior to presentation before the full Transit Board, time is more effectively allocated among the various committees.¹²⁸

The committee types may include the following:

(i) The audit committee, which is primarily responsible for financial accountability;

(ii) The management committee, which is responsible for formulating a policy statement, operating objectives, and performance crite-

They bias government investment in favor of physical infrastructures for short-term economic return.

Id.

127. The Illinois Transit Act provides for removal of RTA directors and Service Board members upon a "formal finding of incompetence, neglect of duty or malfeasance." ILL. ANN. STAT. ch. 111²/₃, ¶¶ 703.03, 703A.03 (Smith-Hurd Supp. 1985). The Minnesota act allows for the removal of MTC members "for cause." MINN. STAT. § 473.404(6) (1984).

128. The Securities and Exchange Commission (SEC) favors the establishment of a strong committee system as one method of strengthening the independence of private corporation boards and enabling the boards to better serve corporations in an oversight capacity. Securities and Exchange Commission, Proposed Rules Relating to Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally 293, 297 (proposed July 18, 1978). In addition, parallels can be seen in private businesses in which top management often delegate decision-making authority to profit centers to minimize transaction costs. R. SCHMALENSEE, *supra* note 10, at 15. The need for a specialized staff also exists under public ownership because of collective choice problems and the requirement of expertise. *Id.* at 49, 54. Ultimately, decision-making power is efficiently located where the best information is found. Spence, *The Economics of Internal Organization: An Introduction*, 6 BELL J. ECON. 163, 165-66 (1975).

ria, and for reviewing and selecting transit providers with whom the Transit Board shall contract;

(iii) The performance measurement committee, which shall monitor management performance with respect to the criteria established by the Transit Board to ensure efficiency; and

(iv) The capital projects committee, which shall undertake capital planning and monitor capital projects.¹²⁹

Any issue or group of issues resolved by a committee shall be presented to the full Transit Board for final discussion and approval.

Subd. 7. [CONDUCT OF BOARD MEETINGS]

(a) Regular meetings of the Transit Board will be held at least once in each calendar month, at a time and place fixed by the Transit Board.

(b) A majority of the Transit Board constitutes a quorum for the transaction of business. The Transit Board has the power to act by majority vote of directors present at a meeting at which a quorum is in attendance. All action by the Transit Board will be by ordinance or resolution.

(c) All ordinances, resolutions, meetings, and proceedings of the Transit Board and all documents and records in its possession are public records and open to public inspection or attendance, except such meetings and proceedings and such documents and records as are kept or prepared by the Transit Board pertaining to negotiations, actions, or proceedings to which the Transit Board is a party. Notice of special meetings shall be published in a newspaper of general circulation published in the regional transportation area not less than ten days prior to the meeting.

Comment: Providing information to the public facilitates both an accurate response to community preferences and achievement of the lowest-cost provision of service. On one hand, the community must be informed before it can effectively monitor policymakers.¹³⁰ The community relies primarily on the media for information concerning policies adopted and the level of production efficiency attained.¹³¹ The

129. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 116-17; T. Pelosci, *supra* note 117, at 13.

130. R.L. Banks & Assocs., *supra* note 36, at 27. The Illinois Transit Act specifically provides for hearings to encourage participation in the development and service of public transportation policy. ILL. ANN. STAT. ch. 111 $\frac{2}{3}$, ¶ 705.01 (Smith-Hurd Supp. 1985).

131. UNTAA, *supra* note 10, at 57. Robson maintains that concern by the press is the first safeguard against maladies that may afflict public undertakings. W. ROBSON, *supra* note 73, at 452.

media must have a guaranteed access to information before it can fulfill this rule. In addition, open meetings will encourage directors to attend board meetings.

On the other hand, the openness of decision-making should be limited in some instances. Meetings and proceedings, documents and records relating to negotiations, and actions or proceedings to which the Transit Board is a party may be too sensitive for public view. When this is the case, informal exchange and debate may be inhibited, disputes may be resolved inefficiently, and certain private interests may be allowed to benefit at the public's expense. In addition, heavy reliance upon the media to inform the community on these issues may create distortions and biases affecting the outcome of the negotiation or action.¹³²

(d) A Transit Board member is required to attend all committee, special and Transit Board meetings. Attendance falling below eighty percent is cause for removal.

Comment: Minimum attendance levels are justifiable because the level of performance expected of a compensated board is substantially higher than that of a noncompensated board. This provides an incentive to directors to maintain their competence and fulfill their duties.¹³³

Subd. 8. [BUDGET; REGIONAL TRANSIT BOARD]

(a) The Transit Board shall prepare, submit for review, adopt, and implement budgets annually.

At least thirty days prior to the beginning of the first full fiscal year after creation of the authority, and annually thereafter, the Transit Board shall cause to be prepared a tentative budget that shall include all revenues and expenses for the ensuing fiscal year. The Transit Board shall consider a tentative budget at a public meeting, after notice published in a newspaper of general circulation published in the regional transportation area not less than ten days prior to the meeting. No expenditures in excess of the budget shall be made during any year except by the affirmance of a majority of the full Transit Board.

132. N. HAMILTON & P. HAMILTON, *supra* note 8, at 129; Recchie & Chernoski, *Government in the Sunshine: Open Meeting Legislation in Ohio*, 37 OHIO ST. L.J. 497, 508 (1976). See also Little & Tompkins, *Open Government Laws: An Insider's View*, 53 N.C.L. REV. 451, 475 (1975); Note, *The Iowa Open Meeting Act: A Lesson in Legislative Ineffectiveness*, 62 IOWA L. REV. 1008, 1125, 1128 (1977); Note, *What Constitutes a "Meeting" Under the Minnesota Open Meeting Law?*, 11 WM. MITCHELL L. REV. 251 (1985).

133. Horn found three transit authorities that have attendance requirements. Horn, *supra* note 58, at 61.

Along with its annual budget, each year the Transit Board shall prepare a financial plan for the succeeding three calendar years. The financial plan must be consistent with the Transit Board's implementation plan. The financial plan prepared in even-numbered years must contain a proposed request for state financial assistance for the succeeding biennium. The Transit Board shall submit the financial plan to the Council for review and approval or disapproval. The Council may approve or disapprove the plan in whole or in part. The Council may disapprove the plan only for inconsistency with the policy of the Council.

Comment: The budget process should not define system policy. Rather, the policy plan and implementation plan should guide the budget.¹³⁴ Defining policy through the budget process obfuscates the actual policies being pursued and eventually inhibits outside evaluation by voters or appointing authorities. Also, the budget process tends to be accretionary and does not take a comprehensive view of the system's mission and the final impact desired.¹³⁵ In practice, transit management develops the budget in many systems with the Transit Board making few changes after the budget is presented for approval.¹³⁶ The result of this process is that producers ultimately create transit policies rather than the Board.

Subd. 9. [LOCAL PLANNING AND DEVELOPMENT PROGRAM] In preparing and amending its implementation plan pursuant to subdivision 3, the Transit Board shall establish a program to ensure

134. When the board fails to articulate policy to guide management, or if general policy is relatively undeveloped, it is the budget that allocates the resources available and implicitly sets policy in many transit systems. N. HAMILTON & P. HAMILTON, *supra* note 8, at 25-26.

135. The balancing and planning necessary for maximizing the change in welfare are absent. Due and Friedlaender point out that existing programs are not reviewed in detail in the preparation of a budget: "The presumption is that existing activities will continue unless there is strong evidence that their existence should be reconsidered." J. DUE & A. FRIEDLAENDER, *supra* note 19, at 133. "There should be comparison of the relative merits of various requests. The traditional presentation of material in a budget does not facilitate this task." *Id.* at 138.

136. N. HAMILTON & P. HAMILTON, *supra* note 8, at 26. Even the data provided for purposes of monitoring the budget and evaluation of management performance are basically a product of management initiative in many systems. Horn, *supra* note 58, at 68; *but see* Schlickman, *supra* note 56, at 2 (when "service boards" would have the authority to determine fare and service levels subject to the "bottom line" budget review of the Illinois RTA); ILL. STAT. ANN. ch. 111²/₃, ¶ 704.11 (Smith-Hurd Supp. 1985); MINN. STAT. § 473.435 (1984) (giving the operations division (MTC) the power to formulate a budget subject to final approval by the planning division (RTB)).

participation by representatives of local government units and local government coordination of transit planning and development. The Transit Board shall encourage the establishment of local transit planning and development boards by local governments for the purpose of:

(a) assisting and advising the Transit Board in preparing the implementation plan, including the identification of service needs and objectives;

(b) preparing, or advising and assisting local units of government in preparing the transit study and service plan required herein; and

(c) preparing or advising the Transit Board in the review of applications for assistance as provided herein.

The Transit Board may provide local boards with whatever assistance it deems necessary and appropriate.

Comment: This provision promotes local involvement in planning and development by encouraging the participation of local governments. The local boards can serve as advisory committees and study groups for the Transit Board and as a check on the quality of transit services being provided.¹³⁷

Subd. 10. [SPECIAL TRANSPORTATION SERVICE]

(a) [PROJECT OBJECTIVES] The Transit Board shall implement a project to coordinate special transportation service in the metropolitan area. The project has the following objectives:

(i) to provide greater access to transportation for the elderly, handicapped, and others in the metropolitan area with special transportation needs;

(ii) to develop an integrated system of special transportation service providing transportation tailored to meet special individual needs in the most cost-efficient manner; and

(iii) to supplement rather than replace existing public and private providers of service wherever possible and to increase the productivity of all special transportation vehicles available in the area.

(b) [FINANCING; IMPLEMENTATION; MANAGEMENT AND ADVISORY GROUPS] The Transit Board shall contract for

137. For an article discussing the value and importance of governing board member exchanges of information and fostering positive relations with other arms of local government, see Tarbett, *Effective Governing Boards*, 42 PUB. POWER 26 (May-June 1984). Both the Illinois and Minnesota enabling acts instruct their regional planning boards to establish programs ensuring the participation of local government units and coordination of planning and development. See ILL. ANN. STAT. ch. 111 $\frac{2}{3}$, ¶ 702.12 (Smith-Hurd Supp. 1985); MINN. STAT. § 473.382 (1984). See also discussion at note 60 *supra*.

services necessary for the project's operation through the same steps outlined in subdivision 4 of this section. The Transit Board shall establish a special transportation service committee to set policies, operating objectives, and performance criteria for the project. The committee must include the chairperson of the Transit Board or the chairperson's designee, representatives of persons contracting to produce services for the project, representatives of users of the service, and representatives of appropriate agencies. The meetings of the committee shall be public and minutes of all meetings must be taken, preserved, and made available for public inspection. The Transit Board shall establish an advisory task force of individuals representing the elderly, handicapped, and other users of service provided by the project to advise the committee.

(c) [DUTIES OF BOARD] In implementing the project the Transit Board shall:

(i) encourage participation in the project by public and private producers of special transportation service;

(ii) encourage individuals using service provided through the project to use the type of service most appropriate to their particular needs;

(iii) encourage shared rides to the greatest extent practicable;

(iv) encourage public agencies that provide transportation to eligible individuals as a component of human services and educational programs to coordinate with the project and to allow reimbursement for services provided through the project at rates that reflect the public cost of providing those services; and

(v) establish criteria to be used in determining individual eligibility for special transportation services.

(d) [COORDINATION REQUIRED] The Transit Board may not grant financial assistance to any recipient that proposes to use any part of the grant to provide special transportation service in the metropolitan area unless the program is coordinated with the project in the manner determined by the Transit Board.

(e) [ACCESS FOR SPECIAL TRANSPORTATION SERVICES] Special transportation projects receiving assistance by contract with the Transit Board shall be subject to the following provisions:

(i) a person operating or assisting the operation of a vehicle while employed by a program providing transportation to those with special transportation needs may leave the vehicle to enter premises in order to assist a person who does not require emergency ambulance service to

gain access and entrance to the vehicle. The assistance shall include assisting through the first entrance to a building. Operators of the special transportation vehicles shall provide the necessary passenger assistance for door-through-door service.

(ii) Assistance shall also include assisting wheelchair passengers over any exterior steps essential to either departure or destination buildings, subject to both the steps and the wheelchair being in good repair.

(iii) If an operator or assistant refuses to assist wheelchair passengers because of the condition of the steps or the wheelchair, the operator of the service shall send letters to the commissioner of transportation and the person denied service detailing the corrective measures necessary to qualify for service.

Comment: A group of citizens cannot use fixed route transit services because they have special transportation needs. This subdivision requires the Transit Board to accommodate these needs through a special transportation service.¹³⁸

Section 5. [METROPOLITAN TRANSIT COMMISSION]

Subd. 1. [ESTABLISHMENT] There is created a Metropolitan Transit Commission as a public corporation and political subdivision of the State.

Subd. 2. [POWERS]

- (a) The Commission has the powers and duties imposed by law;
- (b) The Commission may sue and be sued;
- (c) The Commission may enter into contracts necessary to carry out its responsibilities;
- (d) The Commission may acquire property necessary for the accomplishment of its purposes by purchase, lease, gift, grant, or condemnation proceedings, and may sell or otherwise dispose of property that it no longer requires.
- (e) The Commission may make and adopt all rules and regulations and bylaws as may be necessary or desirable to enable it to execute the powers and perform the duties conferred or imposed upon it by the provisions of this statute.
- (f) The Commission may engineer, construct, equip, and operate transit and paratransit systems, projects, or any parts thereof, including road lanes or rights of way, terminal facilities, maintenance and

138. See MINN. STAT. § 174.29 (1984) for an example of providing for special transportation needs of the elderly, handicapped, or disabled individuals.

garage facilities, ramps, parking areas, and any other facilities useful for or related to any public transit or paratransit system or project.

(g) The Commission may acquire all or any part of an existing transportation system within the metropolitan area, and may lease any municipal- or privately-owned facilities for operation and maintenance by the Commission. The Commission may acquire, construct, improve, own, maintain, and operate any system or part thereof, exercising when necessary the power to acquire licenses, franchises, rights, interests, engineering and technical studies, data, or reports owned or held by any person and determined to be necessary, convenient, or useful to the commission in connection with the acquisition, construction, improvement, ownership, maintenance, or operation of any system.

(h) The Commission shall prepare the transit plans and service plans required by the Transit Board for submission to the Transit Board for approval.

(i) The Commission may apply for and accept gifts, grants, or loans of money or other property from the United States, the State, or any person or entity for any of its purposes. The Commission may enter into any agreement required in connection therewith, may comply with any federal or state laws or regulations applicable thereto, and may hold, use, and dispose of the money or property in accordance with the terms of the gift, grant, loan, or agreement.

(j) The Commission may provide for self-insurance or otherwise provide for insurance relating to any of its property, rights, or revenue, workers' compensation, public liability, or any other risk or hazard arising from its activities, and may provide for the insurance of the commissioners, officers, or employees against the risks or hazards at the expense of the Commission. If the Commission provides for self-insurance against its liability and the liability of commissioners, officers, employees, and agents for damages resulting from the Commission's torts and those of commissioners, officers, employees, and agents, including its obligation to pay basic economic loss benefits, it shall be entitled to deduct from damages and basic economic loss benefits all money paid or payable to the persons seeking damages and benefits from all governmental entities providing medical, hospital, and disability benefits.

(k) The Commission may enter in a reasonable manner upon any lands, waters, or premises for the purpose of making any reasonably necessary or proper surveys, soundings, drillings, and examinations. The entry may not be deemed a trespass, except that the Commission is

liable for any actual and consequential loss, injury, or damage therefrom.

(l) The Commission may appoint such officers and employees as it may require for the performance of its duties, and fix and determine their qualifications, duties, and compensation. The Commission may retain or employ counsel, auditors, engineers, and private consultants on a contract basis or otherwise for rendering professional or technical services and advice.

(m) The Commission may require any officer, employee, or contract management firm to obtain and file an individual bond or fidelity insurance policy.

(n) The Commission may, in lieu of directly managing any public transit system, or any part thereof, enter into contracts for management services. The contracts may provide for compensation, incentive fees or penalties, the employment of personnel, the services provided, and other terms and conditions that the Commission deems proper. The Commission shall advertise for bids and select contractors for management services through competitive bidding. The terms of the contract may not be longer than three years. The contract must include clear operating objectives, stating the service policies of the Commission in terms of the movement of various passenger groups, and performance criteria, by means of which success in achieving the operating objectives can be measured. Employees of a contract manager may serve only in operations.

Comment: Clear objectives and performance criteria, producer autonomy over operational decisions, and bidding for service contracts under section 4, subdivision 4 of the Act may not in themselves be sufficient to ensure lowest cost production. In many cases, no bidder may exist other than the existing government-owned transit authority that historically has had a transit monopoly. This may be particularly true in the initial years after enactment of this legislation because new entrants may appear slowly.

Government enterprises operating monopoly franchises are not subject to competitive pressures to minimize costs. Without such pressures, these firms can waste resources through managerial slack and inertia, which includes incurring costs in excess of those that a competitive firm would demonstrate and also dampening incentives for invention and innovation. The third necessary element for efficiency is the existence of competitive pressures on management to achieve the objectives at lowest cost.

Competitive pressures will be introduced into the transit system if contract management firms are allowed to bid for the opportunity to manage the publicly-owned monopoly provider.¹³⁹ Bidding for recur-

139. Given the predominance of public ownership by monopoly in the transit industry, rivalry-type competition could be effectuated in two ways: (1) compare performance among systems to introduce intercity competition; or (2) allow management firms the opportunity to manage the publicly-owned provider. The latter is not possible with government enterprises that directly employ management or with a public purchase and leaseback to a private firm. A contract management scheme, however, is amenable to management competition.

Consider first the possibility of creating competitive pressures by comparing management performance among transit systems. The principal obstacles to making such comparisons is that transit monopolies do not sell in the same geographic market and consequently do not face the same conditions of demand and cost. The cost differences, therefore, may not be attributable to managerial competence. Posner, *Natural Monopoly and Its Regulation*, 21 STAN. L. REV. 548, 628-29 (1969). An attempt must be made to factor out the influence of these differences in conditions. In addition, the relationship of costs to policies cannot be ignored. Some types of service, for example, service to the transportation disadvantaged, may be more costly than other types. Transit costs are thus, in part, a function of both operating objectives and a very large number of factors other than managerial competence. These include population density; road; traffic; and parking conditions; demographic characteristics; the character of the labor force, climate; and topography. PUBLIC TECHNOLOGY, INC., PROCEEDINGS OF THE FIRST NATIONAL CONFERENCE ON TRANSIT PERFORMANCE, NORFOLK, VIRGINIA 39 (1978).

Regression analyses can possibly be refined to accommodate all these differences in objectives and other influences on costs. Regression analysis is not, however, a practical means of introducing competitive pressure for transit management for several reasons. The skills needed to carry out complex regression analyses of this type are in short supply. It would be better not to do it at all than to do it badly. Even if the technical skill were available, the cumulative cost of the initial analyses and subsequent updates would be very high. Management would dispute the methodology, raising the costs.

Most important, however, is that institutional limits exist regarding what policymakers can understand and implement. As Posner points out, "[a]nyone who believes that a fruitful direction for forward movement in regulation is toward increasing the amount of data and the sophistication of the conceptual apparatus used in arriving at regulatory judgments is ignoring the lesson of experience." Posner, *supra*, at 629. Posner's conclusion finds support in that state public service commissions are generally not using the regression models developed for electric utilities by several economists. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 104.

This leaves the possibility that competitive pressures could be introduced by having contract management firms bid for the opportunity to manage the transit system. See M. Pikarski & C. Johnson, *supra* note 1, at 26-27. Some public transit agencies have successfully embraced the concept of cost savings through private contracting. "Although these transit agencies have encountered some implementation problems, as with any innovation, they have achieved very substantial cost savings." Lave, *supra* note 77, at 14. For examples of successful utilization, see *id.* at 18-20; MINN. STAT. § 473.405(12) (1984).

Lave points out, however, that contracting faces many difficulties: few suppliers may

rent short-term management contracts is attractive for a number of reasons. First, the Commission cannot judge how challenging the objectives and criteria will be to accomplish without several proposals to review. A competitive approach will determine the highest level of performance that can be attained with the available revenue. Second, even if perfect bidding parity at contract renewal is not reached, the existing management firm is subject to survival threats that will spur performance and efficiency.¹⁴⁰ Third, keeping terms short, to two or three years, has advantages. Under conditions of uncertainty, future policy objectives, available subsidies, costs, and consumer demand cannot be satisfactorily specified in longer-term contracts.¹⁴¹

A contract management approach to lowest cost production is considerably more simple and more effective for the Transit Commission

exist; the bidders may need guidance in working with an administrative agency; and the agency may have to make a small investment in the private transit infrastructure. *Id.* at 16, 17. Schmalensee agrees that bidding for management contracts is not an approach that can be recommended without careful study of the situation. R. SCHMALENSEE, *supra* note 10, at 81. Additional problems include: (1) A contractor's pursuit of his own gain will need to be carefully controlled and the government agency will need to probe and understand the details of the enterprises' operations. *Id.* at 77; (2) Because contractors are only indirectly responsible to equity suppliers, the pressure against wasteful behavior may be weak. *Id.* at 78; (3) Because performance depends on decisions by both the public officials and operating management, close coordination is essential and may be difficult to maintain. *Id.*; (4) The likely gains from opportunistic distortion of information flow may be substantial. *Id.*; (5) Both the government and operating management must bear some of the consequences of changes in cost and demand conditions beyond managements' control, or shocks that other sectors of the economy impose on the enterprise may be intolerably huge. *Id.*

Finally, Schmalensee suggests that under this type of management scheme, a contract of any duration must be defined and redefined over time, thus resembling regulation in any event. *Id.* at 79. This is certainly true when, for example, management is subject to unanticipated and relatively uncontrollable cost increases due to labor negotiations. To forestall such a problem, the enabling legislation may wish to specify certain provisions with which contracts with labor organizations must comply. For example, in Illinois, RTA labor contracts may not prohibit part-time operators, and two-thirds of the RTA members must prove the cost of the contract. If approval is not given, the contract may be reopened. ILL. ANN. STAT. ch. 111^{2/3}, ¶ 328a (Smith-Hurd Supp. 1987).

140. See Roberts, *supra* note 10, at 421. The fact that rival groups of shareholders in a private corporation may at times seize capital is thought to be a powerful incentive to management efficiency. W. SHEPHERD, *THE TREATMENT OF MARKET POWERS: ANTITRUST, REGULATION AND PUBLIC ENTERPRISE* 202-03 (1975).

141. See Williamson, *Franchise Bidding for Natural Monopoly—In General and With Respect to CATV*, 7 BELL J. ECON. & MGMT. SCI. 73, 78-79 (1976). "The future is permitted to unfold and adaptations are introduced, at contract renewal intervals, only to those events which actually materialize . . . sequential decision-making procedure economizes greatly on bounded rationality." *Id.* at 83.

and management than engaging in management audits and other minimal performance constraints.¹⁴² First, the Commission's attention will be properly focused on ensuring that the contract management firm meets the contract criteria. Second, once the management firm contract establishes the criteria, the monitoring of management performance poses relatively limited problems of data collection and interpretation. Management is relieved of the burden of generating a multitude of reports for the Transit Board because adequate performance is self-imposed under a scheme that produces financial rewards for efficient performance. Finally, the effectiveness of the contracting process should improve over time. Each subsequent round of comprehensive review and contract negotiations should provide feedback to assist in examining criteria for the next management contract.

A contract management approach also avoids the political roadblocks that traditionally make transit management posts unattractive to extremely able managers. As in a private firm context,¹⁴³ salaries sufficiently high to attract top management talent and incentive compensation schemes to elicit superior performance are both possible.¹⁴⁴

Subd. 3. [MEMBERSHIP]

(a) The Metropolitan Transit Commission consists of three members appointed by the Council. No two members may be residents of the same political subdivision within the regional transportation area. Each member of the Commission must have management experience. A member shall not be a member of the Council, the Transit Board, or any other independent regional commission, board, or agency, or hold judicial office during his term of office. Each member shall qualify by taking and subscribing to the oath of office as prescribed in the state constitution.

(b) The term of each member of the Commission shall be three years except for the initial terms as provided. One member of the Commission shall be initially appointed for a term length of one year,

142. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 29-30, 101-03.

143. See Lave, *supra* note 77, at 33, 35-36; Garner, *supra* note 123, at 13. W. ROBSON, *supra* note 73, at 453; N. HAMILTON & P. HAMILTON, *supra* note 8, at 16, 101-02.

144. This proposal is simple and quite possible to implement given present conditions in the transit industry. In fact, within the past several years it has become increasingly utilized in the transit industry. As of 1979, five contract management firms provided management services to a total of sixty-six urbanized areas to operate their transit system. Crosby, *Contract Management—The Way to Go?*, MASS TRANSIT 46 (August 1976). See N. HAMILTON & P. HAMILTON, *supra* note 8, at 108-09, for a description of current procedures for awarding management contracts.

one member shall be initially appointed for a term length of two years, and one member shall be initially appointed for a term length of three years. Members may be reappointed for additional terms. A member may not, however, serve more than two consecutive full terms.

(c) The Commission shall annually elect a member to serve as the chair of the Commission for a term of one year. The chair shall preside at all meetings of the Commission, if present, and shall perform all other duties assigned to him by the Commission or by law. The chair may call special meetings of the Commission.

(d) Members may be removed by the Council at will. If the office of a member becomes vacant, the vacancy must be filled in the same manner in which the appointment to that office was made.

(e) Members shall receive a fixed annual salary, to be established from time to time by the Council. That salary shall be substantial enough to attract qualified candidates and to encourage responsible performance. In addition, members shall be reimbursed for reasonable expenses incurred in the performance of their duties. Members may not be the recipients of gifts, rewards, or perquisites.

Subd. 4. [COMMISSION; ANNUAL REPORTS]

(a) The Commission on or before _____ of each year shall prepare a report for the preceding fiscal year, and as far as practicable, for the further time up to the preparation of the report, containing in addition to such other matters as the Commission may deem proper, the following:

(i) the activities of the Commission during the period covered by the report;

(ii) the Commission's operating objectives and performance criteria, and an explanation of how the Commission is achieving lowest cost production;

(iii) the financial condition of public transit systems under the control of the Commission; and

(iv) a complete financial accounting of the financial accounts and affairs of the Commission during the fiscal years.

(b) Each report must be filed with the secretary of the Commission and a copy must be filed with the Transit Board, the Council, and the secretary of state. Copies must also be submitted annually to the legislature and to the governor, to each member of the legislature, to each county, and to each elected chief executive of each municipality in the metropolitan area.

(c) The Commission shall employ a certified public accountant or

firm to make an annual audit of the Commission's financial accounts and affairs for the last fiscal year on or before _____ of each year, and copies of the report shall be filed and kept open to public inspection in the offices of the secretary of the Commission, the Transit Board, and the secretary of state. The information in the audit shall be contained in the annual report and distributed in accordance with clause (a) of this subdivision.

Comment: To ensure financial accountability, the Act provides for financial audit of the management by an independent outside auditor. Another requisite for financial accountability is sufficient Transit Board competence to effectively monitor the financial integrity of the firm.

Section 6. [TORT LIABILITY]

Subd. 1. The Transit Board and the Commission shall be liable for the acts and negligence of the directors, commissioners, servants, and employees of the Transit Board or the Commission in the management and operation of the Transit Board and the Commission and of the properties owned, leased, and operated by it. The directors and commissioners shall not be personally liable for discretionary acts within the scope of their authority.

Comment: Similar to private corporations, the Transit Board and Commission may sue and be sued under section 4, subdivision 2(b) and section 5, subdivision 2(b). The personal liability of directors and commissioners, however, is a separate question. Common law has long accorded personal immunity for discretionary action or acts when an official, acting within the scope of his authority, has the power to make choices among alternatives as contrasted with a mere obedience or execution of policy without judgment.¹⁴⁵ Transit Board and Commission actions in financing, planning, awarding of contracts, and management of the transit operations are clearly discretionary and thus receive the protection of personal immunity for such acts.¹⁴⁶

145. Jaffe, *Suits Against Government and Officers: Damage Actions*, 77 HARV. L. REV. 209, 218 (1963). The "scope of authority" concept may be somewhat manipulable in some states, resulting in declarations that official actions are ultra vires when the equities favor compensation. Sikora, *Public Officers' Personal Liability for Money Damages*, 62 MASS. L.Q. 31, 37-38 (1977).

146. Mashaw, *supra* note 36, at 20. The Illinois act attempts to limit liability. It removes the Regional Transit Authority from any civil liability for injury or agency acts or omissions that may tend to run to the Authority by virtue of having funded or hired

The Civil Rights Act of 1871¹⁴⁷ qualifies the immunity from civil liability for discretionary actions within the Transit Board's or Commission's scope of authority. State and local authority boards exercising discretionary authority are exposed to personal liability and money damages pursuant to section 1983 of the Act if, under an objective test, their actions are proved to have been taken without good faith to abridge a right guaranteed by the federal laws or constitution.¹⁴⁸ To the degree that directors and commissioners are exposed to civil liability under section 1983, directors' insurance seems appropriate.¹⁴⁹

Subd. 2. The Commission shall be liable in tort to passengers and to persons in the exercise of due care who are not passengers nor in the employment of the Commission for personal injury, death, and damage to property; provided that any such action for personal injury, death, or property damage shall be commenced only within two years after the date of such injury, death, or damage.

Section 7. [JUDICIAL REVIEW]

Any person aggrieved by any rate or service or change of service fixed by the Transit Board or Commission may bring an appeal against the Transit Board or Commission in the Court of Appeals for the purpose of determining the validity of any such charge, service, or change of service. The ground for such an appeal shall be restricted to an error of law; otherwise all such actions by the Transit Board or Commission are final. Upon finding the Transit Board or Commission ac-

the transportation producer. ILL. ANN. STAT. ch. 111^{2/3}, ¶ 705.03 (Smith-Hurd Supp. 1985).

Historically, this immunity was granted for the policy reasons that civil liability would induce timidity in decisionmaking on the part of public officials, *see* Mashaw, *supra* note 36, at 26; *Gregorie v. Biddle*, 177 F.2d 579, 581 (2d Cir. 1949), and deter able persons from participating as directors. *See* Note, *Personal Liability of Directors of Federal Government Corporations*, 30 CASE W. RES. 733, 765-66 (1980).

147. 42 U.S.C. § 1983 (1982).

148. *See* *Harlow v. Fitzgerald*, 457 U.S. 800 (1982); *Wood v. Strickland*, 420 U.S. 308, 322 (1978); *Scheuer v. Rhodes*, 416 U.S. 232, 247-48 (1974).

149. Baxter points out that liability induces the employee to adopt risk-averting behavior that is suboptimal from the standpoint of the employer. Baxter, *Enterprise Liability, Public and Private*, 42 L. & CONTEMP. PROBS. 45, 49 (1978). The community as employer is not served if able candidates will not accept appointment because of possible liability exposure. Moreover, liability insurance probably does not undermine the deterrent effect of civil liability. Any finding of negligence still has a significant effect on professional reputation. M. SCHAEFFTLER, *THE LIABILITIES OF OFFICE: INDEMNIFICATION AND INSURANCE OF CORPORATE OFFICERS AND DIRECTORS* 81 (1976).

tion to be an error of law, the court shall issue an order setting aside the error and returning the matter to the Transit Board or Commission for such further action as is consistent with the findings of the court. No cause of action shall exist on behalf of any person directly or indirectly, under which any court shall have jurisdiction or power to suspend the operation of any order or rule of the Transit Board or Commission that fixes rates, fares, tolls, rents, or other charges for the use of services or that changes services of the transportation facilities under the jurisdiction of the Transit Board or Commission.

Comment: The Transit Board and Commission should be subject to the customary standards of judicial review of agency action in order to determine whether the Transit Board or Commission has exceeded the discretion delegated to it or to compel the Transit Board or Commission to perform its duty.¹⁵⁰ Judicial review will be limited, however, to the extent that the statute expressly precludes judicial review of the Transit Board's actions and to the extent that the action has been committed to agency discretion.¹⁵¹

The Act expressly designates that the Transit Board's actions are final and reviewable only as to an error of law, legislatively restricting any review of questions of fact.¹⁵² Board and Commission actions must be unreviewable as "committed to agency discretion" because the types of powers and duties that they are mandated to perform, particularly the financing, planning, and management decisions, are those types of activities that require agency skill and expertise.¹⁵³ Transit

150. See N. HAMILTON & P. HAMILTON, *supra* note 8, at 125.

151. Administrative Procedure Act § 10, 5 U.S.C. § 701(a) (1982).

152. Courts recognize a basic presumption of reviewability of agency action unless clear and convincing evidence exists of a legislative intent to preclude review. See *Abbott Laboratories v. Gardner*, 387 U.S. 136 (1967). Even when such intent has been shown, as in the Model Act, finality clauses will be narrowly interpreted when vital personal interests are at stake. W. GELLHORN, C. BYCE & P. STRAUSS, *ADMINISTRATIVE CASES AND COMMENTS* 942 (7th ed. 1979). When, however, the administrative action in question relates to less vital matters, for example, statutorily created "benefits" such as transit service, the finality clause will generally be given a more sympathetic, if not literal, interpretation. *Id.* at 943. Thus, the Model Act makes the Transit Board's decisions reviewable only to the extent that an error of law or statutory interpretation is alleged.

153. The courts have been reluctant to review decisions by administrators who are responding to complex decision-making. When statutes have committed action to agency discretion, the courts have refrained from entering the highly specialized areas of administration for the purpose of determining whether discretion has been abused. For example, courts are unlikely to review an authority's rate setting except to ensure that specified procedures are met, for the breadth of the statutory mandate makes it

Board and Commission actions, however, should always be reviewable to the extent necessary to ensure that an agency has not violated its statutory authority. Otherwise, the agency concerned may perceive a standing invitation to disregard the statutory requirements and to exceed the powers conferred.¹⁵⁴ Thus, Transit Board and Commission actions are reviewable for an error of law only.¹⁵⁵

Section 8. [TAXATION] [The Act contains no provision for tax revenues earmarked for the transit system].

Comment: The question of whether or not to earmark specific tax revenues for transit purposes is unresolved. Advocates list several benefits. The first of these is the possibility of lower costs. The grant of earmarked tax revenue to the Transit Board may increase efficiency because of the reduction both in uncertainty with regard to system revenues and in the possibility that local government will use the purse strings to interfere with transit operations. Great uncertainty concerning the amount of future transit subsidies will prevent long term planning.¹⁵⁶ A second more general benefit is that earmarking of tax

difficult to find judicial standards to apply. N. HAMILTON & P. HAMILTON, *supra* note 8, at 125. Along these lines, one court stated:

[i]t would be most unusual for Congress to subject to judicial review discretionary action by an agency in administering a contract which Congress authorized it to make. Other factors tending in the direction of nonreviewability are the managerial nature of the responsibilities. . . .

Langevin v. Chenango Court, Inc., 447 F.2d 296, 303 (2d Cir. 1971).

154. See B. SCHWARTZ, ADMINISTRATIVE LAW 445-46 (1984).

155. Tension and confusion have long existed between the nonreviewability of actions "committed to agency discretion" and the congressional mandate that a court shall review and hold unlawful an agency action found to be an abuse of discretion. See Administrative Procedure Act § 10, 5 U.S.C. § 706(2)(A) (1982). The question becomes "how is it . . . that an action committed to agency discretion can be unreviewable and yet courts still can review agency actions for an abuse of that discretion?" Heckler v. Chaney, 105 S. Ct. 1649, 165 (1985).

Heckler squarely addresses this question and determines that the courts face three separate classes of cases: (1) those in which review is expressly precluded, such as in this Model Act; (2) those in which actions committed to agency discretion are unreviewable because "the statute is drawn so that a court would have no meaningful standard against which to judge the agency's exercise of discretion," (the exercise of discretion being "impossible to evaluate," it is committed to the agency's discretion "absolutely"); and (3) those in which neither of the above situations apply, when actions committed to agency discretion may be reviewed for an abuse of discretion. *Id.* at 1655.

Falling clearly into category one, the Model Act thus prohibits review of questions of fact and managerial decisions delegated to the board's discretion, but preserves a review for any error committed involving statutory authority or a question of law.

156. N. HAMILTON & P. HAMILTON, *supra* note 8, at 124.

revenues gives the individual voter greater choice in expressing his or her attitude about government spending. Thus, tax increases earmarked for transit purposes may receive more focused public attention than tax increases for general government activities.¹⁵⁷

Several disadvantages to earmarking tax revenues for transit purposes exist. Earmarking impairs the unity of the governmental budget and decreases legislative flexibility in adjusting expenditures to meet changing conditions.¹⁵⁸ Recent research also indicates that dedicated state and local subsidies relying on revenue elastic sales or income taxes are cost inflationary.¹⁵⁹ These dedicated funds reduce local transit authorities' incentives to eliminate highly unprofitable services, to bargain for more moderate labor settlements, and to increase productivity.¹⁶⁰ In the balance, earmarking of tax revenues for the transit system does not seem to make sense.

Section 9. [SEVERABILITY] If any clause, provision, paragraph, subdivision, division, or section of this Act should be held illegal or invalid by any court, the invalidity of such clause, provision, paragraph, subdivision, division, or section shall not affect the remaining clauses, provisions, paragraphs, subdivisions, divisions, or sections, which shall be construed and enforced as if such illegal or invalid clause, provision, paragraph, subdivision, division, or action had not been contained herein.

Section 10. [REPEALS] _____ is hereby repealed.

Section 11. [EFFECTIVE DATE] This act is effective _____.

IV. CONCLUSION

The heart of the Model Act is the separation of planning and financing functions from the actual production of transit services, and the creation of conditions to foster lowest cost production of transit services. In the Model Act, local policy makers are to formulate a state-

157. *Id.* at 125.

158. *Id.* at 124.

159. Morlok & Viton, *supra* note 81, at 138-39. Pucher, Markstedt & Hirschman, *supra* note 5, at 157, 167.

160. Few, if any states make subsidy payments contingent on meeting performance standards. Pucher, Markstedt & Hirschman, *supra* note 5, at 157. In one study, transit systems with more than one half of their state and local subsidies coming from taxes earmarked for transit had costs that were \$2.38 per hour higher (15%) than systems without the dedicated subsidy. *Id.* at 169. These recent studies indicate that the negative incentives created by dedicated taxes outweigh the possible benefits.

ment of policies reflecting the appropriate social opportunity costs and income redistribution constraints. Policymakers must ensure that these policies are realized at lowest cost. In order to achieve this, policymakers must translate their policies into a few unconflicting operating objectives, not stipulations, framed in terms of the production of utility. A transit system's utility arises only from the movement of passengers. The operating objectives allow for flexibility in policy and can be graduated to create performance criteria to measure the degree of accomplishment of the objectives. Articulation of operating objectives and criteria allows the Transit Board to utilize bidding procedures to obtain transit producers committed to the highest production of services at a given subsidy level.

Under the above measures the implementation of conditions to spur realization of the policies at lowest cost is made possible. The introduction of bidding for the provision of public transit under short term contracts will both define what can be achieved with the resources available and make its accomplishment at lowest cost more likely.

APPENDIX A PROPOSED MODEL TRANSIT SYSTEM STRUCTURE

Metro Council or other Regional Government Body

- *Coordinate the planning and development of the Metropolitan Area as a whole.
- *Plan long-range, comprehensive transportation policy to promote legislative determinations.
- *Incorporate a Regional Transit Board to plan, finance and cause to be operated a public transit system.
- *Review and adopt all mid-range transportation policy plans submitted by RTB.
- *Review and adopt transportation budget submitted by RTB.

RTB Responsibilities

- *Carry out Metro Council policy plan by developing an implementation plan indicating technical considerations, engineering, financing necessary for implementation.
- *Develop detailed statement of transit services, operating objectives and performance criteria.
- *Plan, finance and cause to be operated the public transit system.
- *Contract for the production of transit services with eligible recipients for financial assistance.
- *Prepare, adopt, implement transportation budget submitted for review by Metro Council.
- *Acquire property and interests necessary to accomplish purposes.
- *Assist and advise transit producers in planning, promotion, development, operation and evaluation of programs and projects.

MTC Responsibilities

- *Operate transit or paratransit systems directly.
- *Let bids and enter into contracts for management services.
- *Acquire existing metro transit system or lease municipal or privately owned facilities.
- *Develop clear operating objectives, service policies and goals.
- *Prepare operational transit and service plans for submission to RTB.
- *Prepare annual financial accounting and activities report for submission to Metro Council, RTB and Secretary of State.

Metropolitan Council or other Regional Government Body (Metro Council)
Large Multi-Member Group

Regional Transit Board (RTB)
Large Multi-Member Group

Metropolitan Transit Commission (MTC)
3 members

Metro Council Membership

- *Members and Chairperson appointed by Governor subject to advice and consent of Senate.
- *Members must be residents of Metro Area.
- *Each council district shall be represented by one council member.
- *Members elect their own officers.

RTB Membership

- *Governed by board of directors of 6 members appointed by Metro Council, plus a chairperson.
- *Chairperson appointed by Governor.
- *Directors serve 3 year terms and may be removed at will.
- *Directors must possess familiarity with management of complex organizations, knowledge of corporate business and finance, and knowledge of transit operations.
- *Directors may not hold other offices as regional commissioners or judicial office.

MTC Membership

- *3 members appointed by the Metro Council.
- *No two members may be residents of the same political subdivision.
- *Serve 3 year terms and may be removed at will.
- *Must have management experience.
- *May not be a member of the Metro Council, RTB or other commission or agency or hold judicial office.
- *Members elect own chairperson for a one year term.

SUPREME COURT SYMPOSIUM

