Contracts That Bind the Discretion of Governing Boards

David M. Lawrence

Consider the following hypothetical situations.

A citizens group in a small North Carolina town has urged the town board to build a senior center on a vacant lot owned by the town. The board likes the idea, but there is no money available to build the center. In response the citizens have proposed that they organize a private fund-raising campaign to raise half of the amount needed, with the town providing the other half from town resources. The fund-raisers, however, want to be able to assure potential donors that the town will provide its share. Therefore they ask that the board commit the town to doing so. The request creates a difficulty for the board because the fund-raisers expect to take at least two years to raise the private funds and by then a new board will have taken office. No one is quite sure whether the current board can commit a future board to matching the private contributions for the senior center.

A new board has taken office in a North Carolina county. The new chairman is spending a good bit of time in the county office building, and he has come to dislike the background music that is played in offices there. On looking into the matter, he discovers that fourteen months earlier the previous board had entered into a five-year contract with the private company that provides the music. The chairman would dearly like to get out of the contract, but he is not sure that it is possible.

These two situations, disparate as they are, both raise a recurring question in local government: to what extent may a governing board enter into a contract that binds its own future discretion? (This question is frequently phrased in terms of the capacity of the present board to bind its successors, but, as we shall see, that phraseology understates the basic doctrine.) This article addresses that question under North Carolina law.

The Basic Rule

The leading case in North Carolina—and perhaps the United States—is *Plant Food Company v. City of Charlotte.*[1] Plant Food had contracted with the city to remove sewage sludge from city drying beds, paying the city according to a schedule set out in the contract. The contract extended for ten years, with an option for either party to extend the contract another ten years. But within a year or two of the contract's execution, a new governing board took over in the city and sought to negate the contract. When Plant Food sued the city for breach of contract, the city argued that the previous board had no power to enter into a contract that bound the current one.

The national rule, as developed by the courts of many states, was (and is) that a city may enter into a contract that binds future boards if the subject of the contract is a *proprietary* activity of government. If, however, the subject is a *governmental* activity, such a contract is beyond the power of the local government and therefore void. The city pointed out that sewer services had been held to be a governmental activity in the context of local government immunity from tort liability, and it argued that therefore this contract involved a governmental activity and could not bind a later board. The trial court agreed.

On appeal, the North Carolina Supreme Court accepted the dichotomy between proprietary and governmental activities but refused to simply transfer the distinctions made in tort law to this different context. The

The author is an Institute of Government faculty member who specializes in local government law.

public policies behind the distinctions were different in the two contexts, and the court reasoned that those differences necessarily led to a different placement of the line between proprietary and governmental activities. "The true test," according to the court, "is whether the contract itself deprives a governing body, or its successor, of a discretion which public policy demands should be left unimpaired." If that sort of discretion is not involved, then the contract would not be invalid simply because it extended beyond the terms of office of the original governing board. The court did not find the necessary discretion involved in the Plant Food contract itself. Rather, the contract was an ordinary commercial transaction, and the city was bound by it. If the contract was no longer acceptable to city officials, the city would have to pay damages for its breach.

Future Boards Only?

The city in *Plant Food* made its argument in terms of the capacity of one governing board to enter into contracts that bind a later board with different members. The argument fit the facts of that case, and the doctrine of law under discussion in this article is popularly framed as a limitation on the ability of one governing board to bind by contract the discretion of its successor or successors. But, as noted in the introduction, that framing understates the force of the doctrine. In fact, the doctrine also applies to contracts that purport to bind only the current board.

First of all, to limit the doctrine to contracts that extend past the term of the current board assumes a distinction between this year's board and next year's that is not accepted in the law. The courts have consistently characterized the governing board of a city or county as a continuing body, one that maintains its corporate identity regardless of any changes in its membership.[2] It is this continuity of identity that permits a board to hold a public hearing in October, before an election, and to act on the subject of the hearing in December, after the election, even though an entirely new set of members may have been elected and qualified in the interim.

Second, such a limit on the doctrine suggests that if the contract will be fully executed before the next election, it will be valid even if it does purport to bind the board's discretion. But does anyone really believe that a city council can validly contract in January to rezone a piece of property in a particular way in April or levy a stated rate of tax in June simply because no election intervenes in that period? Certainly not the supreme court. Recall the court's language in *Plant Food*: "The true test is whether the contract itself deprives *a governing body, or its successor*, of . . . discretion."[3] The limitation on contracting powers, that is, applies as much to the present board as it does to a future board. Just as today's board cannot by contract force a future board to adopt a particular ordinance, rezone property in a particular way, open a street, or levy a tax, so it cannot by contract force itself to take any of these actions. The current board must retain that discretion just as much as the future board.

The Nature of Discretionary Activities

The basic rule, then, is that a local government may enter into a contract that binds itself, whether now or in the future, *unless* the contract purports to bind the government on a matter on which public policy requires that the government retain discretion as to whether and how to act. For what kinds of decisions is that continuing discretion necessary?

The court in *Plant Food* did not attempt to define the category of discretionary powers. Rather, it set out a number of examples to "roughly indicate the quality of the power involved," which included the powers

1) to adopt ordinances,
2) to lay out and maintain streets,
3) to preserve order,
4) to regulate rates,
5) to levy taxes, and
6) to levy special assessments.[4]

The list is actually quite narrow. Fundamentally, the listed examples involve the exercise of either the government's police power (adopt ordinances, lay out streets, preserve order, regulate rates) or the government's taxing power (levy taxes or special assessments). (The taxing power also includes the power to appropriate the taxes that are levied—that is, the power to spend money.) Cases from other states suggest one other probable example, the appointment and retention of a board's principal officers, such as a city manager or attorney. But that is about as long as any such list would be.

Understood in this way, the list is consistent with the decided cases in North Carolina. The appellate courts have invalidated contracts that purported to bind a city to keep certain ordinances in force for twenty-five years or to rezone property in a particular way.[5] They have

invalidated contracts that purported to bind a local government to open a particular street; to locate a new highway in a specific location; and to build a boulevard, with side street access, rather than a limited-access highway. [6] They have denied that a city could bind itself not to annex a particular tract of land.[7] And they have denied that a county could be required to levy taxes for a particular activity.[8]

The distinctions made by the North Carolina court in *Plant Food* are also consistent with the results of cases decided in other states in the last two decades. The Nebraska Supreme Court, for example, upheld a twenty-year contract under which a city that operated an electric utility leased space on city-owned electric poles, at a fixed rate, to the local cable television operator.[9] While the city could not have bound itself to a twenty-year rate structure for utility services, pole rental was not such a service. A California appellate court upheld a contract under which a city reserved sewer-treatment capacity for a particular developer.[10] And a Texas appellate court held that a bank services contract involved a commercial, rather than a governmental, activity for the contracting local government.[11] On the other side, courts have invalidated contracts that purported to give multi-year terms to the governing board's attorney, to limit a city's ability to annex, and to require the city to tax property at a reduced rate (multiple tax rates were legal in that state).[12]

Legislative Authorization to Bind a Board's Discretion

The North Carolina courts, in keeping with the courts of other states, have characterized contracts that attempt improperly to bind the discretion of a local governing board as being in violation of the *public policy* of the state. That is, the contracts violate common law doctrines that apply to local government. The courts have not, however, sought to ground the doctrine in the state constitution. They do not cite any provision of the constitution, and the opinions do not imply that these contracts are unconstitutional.

If, then, the contracts are void because they violate public policy, a change in public policy should lead to their being held valid. And the primary source of public policy for the state is the General Assembly. That is, the logic of the cases suggests that the General Assembly may, by specific statutory authorization, permit a local government to enter into a contract that binds its own discretion, because such a statute would represent a change in public policy.

None of the North Carolina cases directly addresses this point, although two or three can be interpreted to support the legislature's power to authorize such contracts. But there is some support in North Carolina legislative practice, and there are examples of such legislation from other states that have been upheld.

A number of North Carolina statutes indicate an assumption that the General Assembly does have the power to authorize contracts that bind a board's discretion. School boards, for example, are authorized to enter into two- and four-year employment contracts with superintendents, their chief executive officers.[13] Cities are permitted to contract with housing authorities and agree to adopt certain ordinances, including zoning ordinances.[14] Counties are authorized to commit themselves to make specific levels of capital outlay appropriations to school boards in future years, in order to support multiple-year construction or equipment purchase contracts.[15] At least one city has been authorized to contract with a property owner to delay the annexation of the owner's property into the city.[16] And the basic general obligation bond pledge, which is authorized by specific statute, permits a local government to contract to levy taxes for many years into the future.[17] Indeed, when we turn to revenue bonds, the General Assembly has sought to limit its own ability to pass laws that weaken the capacity of a local government to pay debt service on such bonds.[18]

Except for the taxing-power pledge of general obligation bonds, however, none of these statutes has been tested in the North Carolina courts. But comparable statutes have been tested in other states, and they have been upheld. Illinois law, for example, permits cities to enter into "preannexation agreements" with property owners.[19] Under such an agreement, the property owner agrees to petition for annexation to the city. In return, the city agrees to zone the newly annexed property in specific ways. These agreements have been upheld and enforced by the Illinois courts.[20] California law permits a county to enter into ten-year contracts with the owners of agricultural land.[21] In return for the owner's commitment to keep the property in agricultural use, the county agrees to tax it at a lower rate. These contracts have been upheld, and a number of courts have upheld other arrangements under which tax exemptions or classifications have been granted by local government

contract.[22] Finally, the New Jersey Supreme Court has upheld a contract under which a city agreed to adopt specific regulatory and zoning ordinances, because the contract was specifically authorized by state law.[23]

Thus, legislative practice in North Carolina and judicial precedent from other states support the ability of the General Assembly to permit local government contracts that bind the governing board's discretion.

Remedies if a Contract Is Invalid

What would be the consequences if a city entered into a contract that was later held to be invalid under the doctrine discussed in this article? If the other party to the contract had made expenditures in reliance on the contract, would the city have to refund the money, or pay for the value of the goods or services rendered?

The most extensive judicial discussion of this question is found in a North Carolina Court of Appeals case, *Rockingham Square Shopping Center, Inc. v. Town of Madison*.[24] The shopping center developers alleged that a contract had existed between the town and themselves, under which they would grade and pave an existing town street, in return for which the town would open and construct a new street. The new street would provide access to the shopping center, and the developers alleged that the purpose of the entire contract was to entice development of the center. The developers did grade and pave their street, but the town never opened the second street. The center eventually failed, and the developers sued the town for damages.

The court held that it was beyond the power of the town to contract to open a street, and therefore the contract was invalid. The developers then argued that it would be unjust to allow the town to reap the benefits of the contract—the graded and paved street—without paying the developers at least for their cost in providing those benefits. The court refused, holding that to do so would permit the developers to benefit indirectly from a contract that was against public policy. Thus, under this decision, any person entering into a contract with a local government that seeks improperly to bind the discretion of that government does so entirely at his or her own risk.

The *Rockingham Square* decision has been cited with approval in other states, and it seems to represent the law of many states on this question. It is not clear, however, that it represents the law in North Carolina. Just three years after *Rockingham Square* was decided, another contract dispute came before the state's appellate courts. The City of Washington had leased waterfront property to Frank Lewis on the condition that he construct public boat slips on the property. For him to make that use of the property, however, it was necessary for the city to rezone the property, and ultimately the city council refused to do so. Lewis sued, seeking either specific performance (that is, a mandated rezoning) or damages (that is, return of his rental payments). The trial court, properly, held the contract to be invalid to the extent that it required the city to rezone property, but that court was ready to allow damages. On appeal, however, the court of appeals refused damages as well, citing *Rockingham Square*.[25]

The case then went to the supreme court. In a very short opinion, that court affirmed the court of appeals decision, but with one modification.[26] Lewis was permitted to make his claim for damages. Because the modification was not accompanied by any explanation, it is not clear why the court made it. But one obvious guess is that the court disagreed with the rule of *Rockingham Square*. That is, the supreme court believes that it would be unjust to allow the local government to retain the benefits of an invalid contract, unless it paid the other party to the contract the value of the goods or services supplied to the government. If that is the correct reading of the supreme court's decision in *Lewis*, then entering into contracts that improperly bind the government's discretion is not a risk-free endeavor for the government.

Our Two Examples

How does the doctrine examined in this article apply to the two examples with which the article opened? Clearly, the first example proposes a contract that would violate the doctrine. In effect, the town is being asked to guarantee to levy a tax at some future point, in order to raise the money necessary to match the private contributions for the senior center. If the town wants to be able to make that guarantee, it will need to seek legislative authority to do so. Just as clearly, the second contract, for the background music, does not violate the doctrine. The subject of the contract is trivial—unpleasant as the music may be—and does not affect the county's discretion in any important matter. If the county wants the music to stop, it will have to pay damages to the company providing it. ❖

Notes

1. 214 N.C. 518 (1938). *Plant Food* is described as the "principal case" in Mariano & Assoc., P. C. v. Board of County Comm'rs, 737 P.2d 323 (Wy. 1987), and is treated as such in C. Antieau, Municipal Corporation Law, §10.18 (1989), one of the leading treatises on local government law.

2. Pegram v. Commissioners of Cleveland County, 65 N.C. 114 (1871); 4 E. McQuillin, Municipal Corporations § 13.40 (3d ed. 1968).

3. *Plant Food*, 214 N.C. at 520 (emphasis added).

4. *Plant Food*, 214 N.C. at 520.

5. Britt v. City of Wilmington, 236 N.C. 446 (1952); Lewis v. City of Washington, 63 N.C. App. 552 (1983).

6. Rockingham Square Shopping Center, Inc. v. Town of Madison, 45 N.C. App. 249 (1980); Johnson v. Board of Comm'rs, 192 N.C. 561 (1926); Bessemer Improvement Co. v. City of Greensboro, 247 N.C. 549 (1958).

7. Thrash v. City of Asheville, 95 N.C. App. 457 (1989).

8. Tilghman v. West of New Bern Volunteer Fire Dep't, 32 N.C. App. 767 (1977).

9. T.V. Transmission, Inc. v. City of Lincoln, 374 N.W.2d 49 (Neb. 1985).

10. Morrison Homes Corp. v. City of Pleasanton, 130 Cal. Rptr. 196 (Cal. Ct. App. 1976).

11. International Bank of Commerce v. Union Nat'l Bank, 653 S.W.2d 539 (Tex. Ct. App. 1983).

12. Harrison Cent. School Dist. v. Nyquist, 400 N.Y.S.2d 218 (N.Y. App. Div. 1977); City of Leeds v. Town of Moody, 319 So. 2d 242 (Ala. 1975); City of Louisville v. Fiscal Court of Jefferson County, 623 S.W.2d 219 (Ky. 1981).

13. N.C. Gen. Stat. § 115C-271.

14. N.C. Gen. Stat. § 157-42.

15. N.C. Gen. Stat. § 115C-441(c1).

16. 1987 N.C. Sess. Laws ch. 201.

17. N.C. Gen. Stat. § 159-46.

18. N.C. Gen. Stat. § 159-93.

19. Ill. Ann. Stat. ch. 24, para. 11-15.1-1 through -5 (Smith-Hurd 1989).

20. Union Nat'l Bank v. Village of Glenwood, 348 N.E.2d 226 (Ill. App. Ct. 1976).

21. Cal. Gov't Code §§ 51240 through 51255 (West 1983).

22. County of Marin v. Assessment Appeals Bd., 134 Cal. Rptr. 349 (Cal. Dist. Ct. App. 1976); "Tax Exemptions and the Contract Clause," *A.L.R.* 173 (1948):15-249.

23. Terminal Enter., Inc. v. Jersey City, 258 A.2d 361 (N.J. 1969).

24. 45 N.C. App. 249 (1980).

25. Lewis v. City of Washington, 63 N.C. App. 552 (1983).

26. 309 N.C. 818 (1983).