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The Impact of *Williams v. Pasquotank County* on Local Government Liability

Part II: Contract-Related Claims

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Introduction

This is the second of a two-part series examining the effect of *Estate of Williams v. Pasquotank County*[1] on the civil liability of local governments in North Carolina. In *Williams*, the North Carolina Supreme Court reformulated the standards for determining whether an undertaking by a local government qualifies as a governmental function or a proprietary function for purposes of governmental immunity. In the context of tort claims such as negligence or assault, this immunity protects municipalities, counties, and other units of local government from civil liability for injuries resulting from their performance of *governmental* functions but not from their execution of *proprietary* functions.

Part I in this series examines how the *Williams* inquiry has been used to analyze whether governmental immunity bars tort claims arising from unsafe conditions at public parks or local government office buildings.[2] Part II assesses how *Williams* has affected the application of governmental immunity to contract-related claims against local governments. In particular, it looks at how *Williams* has affected local government immunity from unjust enrichment and other equitable claims that plaintiffs can use to recover the value of goods or services supplied in the absence of a valid contract. It concludes that the United States Court of Appeals for the Fourth Circuit may have misunderstood how *Williams* fits in with earlier North Carolina cases

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1. 366 N.C. 195 (2012).

2. Trey Allen, *The Impact of* Williams v. Pasquotank County *on Local Government Liability, Part I: Public Parks and Government Office Buildings*, Local Gov't L. Bull. No. 137 (UNC School of Government, May 2015), http://sogpubs.unc.edu/electronicversions/pdfs/lglb137.pdf. Part I predicts that *Williams* probably will not do much to alter the way in which courts analyze whether governmental immunity bars tort claims premised on the negligent upkeep of parks. *Id.* at 13–14. It further speculates that *Williams*, as applied by the supreme court in a subsequent case, may have significantly narrowed the circumstances in which local governments can face liability for injuries allegedly caused by unsafe building conditions. *Id.* at 17–18.

addressing the extent to which governmental immunity may foreclose equitable claims. If not cleared up, this misunderstanding could deprive local governments of protection against equitable claims to an extent not contemplated by the supreme court in *Williams* and perhaps contrary to the legislative intent behind statutory provisions for certain county and municipal contracts. In order to avoid this outcome, Part II proposes an alternative reading of the relevant precedents.

This bulletin goes on to consider the impact of *Williams* on the availability of governmental immunity against tort claims stemming from a local government's interactions with a contractor. The limited case law on this topic makes it difficult to offer more than conjecture, but there appears to have been a real if modest expansion of the liability of local governments for negligent contract performance.

Finally, this bulletin explores the impact of *Williams* on the ability of local governments to end lawsuits in the early stages of litigation. The preliminary indications are that *Williams* could complicate efforts by counties, municipalities, and other units of local government to prevail on the basis of governmental immunity before they are forced to devote significant time and resources to cases brought against them.

The *Williams* Inquiry

Part I in this series describes the *Williams* inquiry in detail.[3] In brief, the supreme court's opinion in *Williams* sets out a three-step inquiry that should guide a judge's attempt to categorize an activity as governmental or proprietary for immunity purposes:

- Whether, and to what degree, the legislature has designated the specific activity that caused the plaintiff's injury as governmental or proprietary;
- Whether the activity in question is one that only a governmental entity could undertake; and
- Whether the activity is one traditionally undertaken by local governments, whether the defendant local government charged a substantial fee as part of the activity, whether any such fee generated a profit, and additional factors pertinent to the governmental/proprietary classification.

As explained in Part I, when the legislature has designated a particular activity as governmental or proprietary, the judiciary usually will defer to its determination, making consideration of the other steps of the *Williams* inquiry unnecessary.[4] Likewise, when an activity is one that only the government can undertake, it is ipso facto a governmental function, and resort to step three of the inquiry will not be needed. For reasons articulated in Part I of this series, in most cases the first two steps of the *Williams* inquiry are unlikely to resolve whether an activity counts as governmental or proprietary.[5] Rather, it seems probable that ordinarily judges will need to turn to step three when making these determinations. By focusing primarily on revenue, the factors of the third step indicate that an activity which generates substantial income for a local government runs a high risk of being deemed a proprietary function. As the supreme court remarked in *Williams*, however, changing circumstances could make other factors relevant to future governmental/proprietary determinations.[6]

3. *Id.* at 5–7.
4. *Id.* at 6.
5. *Id.* at 6–7.
6. *Williams*, 366 N.C. at 203.

Contract-Related Equitable and Tort Claims: A Few Basics

The remainder of this bulletin is devoted primarily to the impact of *Williams* on legal claims involving actual or alleged contracts between local governments and other persons, so a few words about such claims are in order. When one party to a contract fails to honor its obligations, the standard legal remedy available to the other party is a lawsuit for breach of contract. If a court finds that the defendant did indeed breach its contract with the plaintiff, the defendant may be ordered to pay damages to the plaintiff. Generally, a plaintiff who is not a party to contract may not recover on a claim for breach, but such a plaintiff may be able to maintain a breach claim if it is a beneficiary of the contract.[7]

Breach of contract is not a focus of this bulletin. As will become apparent, *Williams* has not altered the relationship between governmental immunity and breach-of-contract claims. Instead, the contract-related claims that are the focus of this bulletin fall into one of two categories: equitable or tort.[8] Some are commonly asserted when a plaintiff is worried about the legal sufficiency of its claim for breach of contract. Others tend to be alleged when a plaintiff fears that the damages recoverable for breach do not offer adequate compensation for the harm it has sustained.[9]

Contract-Related Equitable Claims

It can happen that one party furnishes goods or services to another in anticipation of payment only to find, when no payment is forthcoming and legal remedies are investigated, that its agreement with the other party might not constitute a valid contract and, thus, a claim for breach might not be viable. Depending on the situation, the injured party can have the option of seeking compensation through one or more of the equitable remedies created by the courts to prevent a party from unjustly profiting at another's expense.[10] To establish a claim for unjust enrichment, the generic form of many such remedies, a plaintiff must show that (1) it conferred a benefit on the defendant; (2) the benefit was not conferred by an officious or unjustified interference in the defendant's affairs; (3) the benefit was not provided gratuitously, that is, for free; (4) the benefit is measurable; and (5) the defendant consciously accepted the benefit.[11] The

7. Matternes v. City of Winston-Salem, 286 N.C. 1, 13 (1974), *cited in* Charles E. Daye & Mark W. Morris, North Carolina Law of Torts § 16.60[2][b], at 241 (3d ed. 2012). The *Matternes* decision sets forth the different categories of third-party beneficiaries in contract law and describes which of them may pursue actions for breach. *Id.* at 12–13.

8. Equitable remedies take many forms and can apply in an array of situations. Perhaps the best known equitable remedy is the injunction. *See* Pelham Realty Corp. v. Bd. of Transp., 303 N.C. 424, 431 (1981) ("It is fundamental that an injunction is an equitable remedy."). This bulletin's treatment of equitable remedies is limited to those likely to be invoked when the validity of a contract is in doubt. Any possible impact of *Williams* on governmental immunity as a defense to other kinds of equitable claims is not a part of this discussion.

9. *See*, *e.g.*, Champs Convenience Stores, Inc., v. United Chemical Co., Inc., 329 N.C. 446, 462 (1991) ("The focus of recovery of damages in a tort action is whether the consequences were the natural and probable result of the wrong which is different from the focus in contract actions which is whether the consequences were within the legal contemplation of the parties. Thus, the scope of the recovery of damages in a tort action is more liberal than recovery in a contract action." (citation omitted)).

10. *See* Britt v. Britt, 320 N.C. 573, 577 (1987) (noting the legal principle that "a person who has been unjustly enriched at the expense of another is required to make restitution" (internal quotation marks omitted)).

11. JPMorgan Chase Bank, Nat'l Ass'n v. Browning, ___ N.C. App. ___, 750 S.E.2d 555, 559 (2013).

measure of damages for unjust enrichment is the reasonable value of the goods and services provided to the defendant.[12]

Decisions by both the North Carolina Supreme Court and the North Carolina Court of Appeals characterize unjust enrichment claims as claims in "quasi contract" or "contract implied in law."[13] When a plaintiff alleges a quasi contract or contract implied in law for the reasonable value of services provided to the defendant, the claim is often described as one for *quantum meruit*—Latin for "as much as he has deserved."[14] When the claim is for materials or other goods furnished to the defendant, the expression *quantum valebant*—"as much as they were worth"—is sometimes used.[15] A plaintiff may not pursue an unjust enrichment claim, however, if a valid contract between the plaintiff and the defendant governs the transaction at issue.[16]

Another equitable remedy that a plaintiff may employ when a contract is of doubtful validity is estoppel. Estoppel by acceptance of benefits, for example, prevents a party that has accepted the benefits arising under a contract from later denying the contract's validity.[17] Likewise, estop-

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12. Booe v. Shadrick, 322 N.C. 567, 570 (1988).

13. *E.g.*, Whitfield v. Gilchrist, 348 N.C. 39, 42 (1998) (describing circumstances in which the courts will "impose a quasi contract or a contract implied in law in order to prevent an unjust enrichment"); Bain v. Unitrin Auto Ins. Co., 210 N.C. App. 398, 417 (2011) ("It is well settled . . . that a claim for unjust enrichment is a claim in quasi contract or a contract implied in law . . . ." (internal quotation marks omitted)).

As the terms "quasi contract" and "contract implied in law" suggest, the defendant's obligation to pay the plaintiff on a claim of unjust enrichment "is not based on a promise but is imposed by law to prevent an unjust enrichment." *Britt*, 320 N.C. at 577.

> A quasi-contractual obligation is one that is created by the law for reasons of justice, without any expression of assent and sometimes even against a clear expression of dissent, and generally, quasi or constructive contracts rest on the equitable principle that a person shall not be allowed to enrich himself unjustly at the expense of another, and on the principle that whatsoever it is certain that a man ought to do, that the law supposes him to have promised to do. The obligation to do justice rests on all persons, and if one obtains money or property of others without authority, the law, independently of express contract, will compel restitution of compensation.

Root v. Allstate Ins. Co., 272 N.C. 580, 583 (1967) (citations omitted) (internal quotation marks omitted).

14. *Whitfield*, 348 N.C. at 42 ("*Quantum meruit* is a measure of recovery for the reasonable value of services rendered in order to prevent unjust enrichment.").

The term *quantum meruit* has occasionally been defined to include equitable claims for materials as well as services. *E.g.*, Potter v. Homestead Preservation Ass'n, 330 N.C. 569, 578 (1992) ("*Quantum meruit*, a measure of recovery for the reasonable value of material and services rendered by the plaintiff, is an equitable remedy based upon a contract implied in law."); Data General Corp. v. Cnty. of Durham, 143 N.C. App. 97, 103 (2001) ("*Quantum meruit* operates as an equitable remedy based upon a quasi contract or a contract applied in law, such that a party may recover for the reasonable value of materials and services rendered in order to prevent unjust enrichment.").

15. *E.g.*, Coats v. Sampson Cnty. Mem'l Hosp., Inc., 264 N.C. 332, 334 (1965) ("Plaintiffs furnished to defendant there all the material and labor the value of which they now seek to recover in *quantum valebant* and in *quantum meruit*.").

16. *See, e.g., Britt*, 320 N.C. at 577 ("If there is a contract between the parties the contract governs the claim and the law will not imply a contract."). *See also Whitfield*, 348 N.C. at 42 ("An implied contract is not based on an actual agreement, and *quantum meruit* is not an appropriate remedy when there is an actual agreement between the parties."); *Potter*, 330 N.C. at 578 ("*Quantum meruit* is not an appropriate remedy when the plaintiff has alleged an express, oral contract.").

17. Brooks v. Hackney, 329 N.C. 166, 172 n.3. For an example of this use of estoppel, see *Capital Outdoor Advert., Inc., v. Harper*, 7 N.C. App. 501, 505 (1970) (Inasmuch as "[t]he contract has been fully and

pel by misrepresentation keeps a party from denying the enforceability of a contract if that party, by its actions, representations, admissions, or silence "'intentionally or through culpable negligence'" induced the other party to believe that their contract was binding and the other party relied on this belief to its detriment.[18]

Contract-Related Tort Claims

Lawsuits alleging breach of contract also commonly include negligence claims of some kind. The plaintiff alleges that it has suffered harm due to the defendant's negligent performance of contractual duties. The case law on when a breach of contract will sustain a negligence action is complicated, and a detailed review of it lies beyond the scope of this bulletin, but a few points deserve attention.

The tort of negligence is premised on the duty the law imposes on every person who undertakes an activity to exercise reasonable care to avoid harming others.[19] A party's failure to satisfy its contractual obligations must also involve a violation of this general duty of care if the defaulting party's conduct is to serve as the basis for both a breach-of-contract claim and a claim of negligence.[20]

The courts are most disposed to find that a plaintiff's breach of contract also contravened the general duty of reasonable care when the defendant's negligence leads to bodily injury or property damage.[21] Take the example of a plaintiff whose roof is damaged when the defendant hired by her to remove a tree performs the task carelessly. In addition to a claim for breach of contract, the plaintiff unquestionably has a negligence claim for the damage to her home.[22] On the other hand, the courts have been reluctant to concede that a breach of contract will sustain a negligence claim if the harm resulting from the breach is purely economic.[23]

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wholly executed by the lessor by constructing and erecting the highway signs according to the terms of the lease, . . . the defendant, having accepted the benefits of these signs, will not now be heard to repudiate the validity of the lease.").

18. Gaston-Lincoln Transit, Inc. v. Md. Casualty Co., 285 N.C. 541, 548 (1974) (quoting Boddie v. Bond, 154 N.C. 359, 365 (1911)). For there to be a valid claim of equitable misrepresentation

> there must exist a false representation or concealment of material facts, with a knowledge, actual or constructive, of the truth. The other party must have been without such knowledge, or, having the means of knowledge of the real facts, must not have been culpably negligent in informing himself. It must have been intended or expected that the representation or concealment should be acted upon, and the party asserting the estoppel must have reasonably relied on it or acted upon it to his prejudice.

Boddie, 154 N.C. at 365–66. *See also* Hawkins v. M & J Finance Corp., 238 N.C. 174, 177–78 (1953) (setting forth the factors to be considered when determining whether estoppel by misrepresentation applies).

19. Daye & Morris, *supra* note 7, § 16.60[2][a], at 233 (citing Firemen's Mutual Ins. Co. v. High Point Sprinkler Co., 266 N.C. 134, 140 (1966)).

20. *Id.* § 16.60[2][a], at 232.

21. City of Wilson v. Carolina Builders of Wilson, Inc., 94 N.C. App. 117, 119 (1989) ("The North Carolina courts have only recognized breach of contract as the basis for an action in tort where a promisor's negligent or willful act or omission in the course of performance of the contract results in personal injury or physical damage to property.").

22. Daye & Morris, *supra* note 7, § 16.60[2][a], at 233.

23. *Id.* § 16.60[2][a], at 239 ("Outside the sale of goods, the [N.C. Supreme Court] has often denied recovery in tort for purely economic losses."). *But see id.* (noting the existence of cases to the contrary allowing recovery in tort when the only damage is to the property that is the subject of the contract).

A plaintiff who is not a party to the contract may still maintain a negligence claim against the party in breach, provided the plaintiff has sustained bodily injury or property damage due to the other party's failure to exercise reasonable care.[24] Again, if the harm to the plaintiff is purely economic, such as lost profits, negligence usually will not afford a remedy.[25]

Negligent misrepresentation is a specific type of negligence claim sometimes alleged by plaintiffs with concerns about the soundness of their claims for breach of contract. "The tort of negligent misrepresentation occurs when a party justifiably relies to his detriment on information prepared without reasonable care by one who owed the relying party a duty of care."[26] Pecuniary loss is a necessary element of negligent misrepresentation, and unlike the standard negligence claim arising from the entry into or performance of a contract, a negligent misrepresentation claim does not require a showing of bodily injury or property damage.[27]

Impact of *Williams* on Liability for Contract-Related Equitable Claims

Equitable Remedies and Governmental Immunity Pre-*Williams*

The governmental immunity of local governments derives from the sovereign immunity of the state.[28] Sovereign immunity shields the state from most civil claims except to the degree that the state has waived its immunity from suit. In *Smith v. State*,[29] the supreme court identified one important way in which the state may waive its immunity from suit. The court held that, when the state enters into a valid contract, it implicitly consents to be sued for damages for its breach of that contract.[30] Inasmuch as governmental immunity is a diluted version of the state's sovereign immunity, the North Carolina Court of Appeals later aptly recognized that, in light of *Smith*, governmental immunity will not shield a local government that has entered into a valid contract from a claim for breach.[31] Like the state, "where [a municipality or county]

24. *Id.* § 16.60[2][b], at 241.

25. *Id.* at 243–44.

26. Raritan River Steel Co. v. Cherry, Bekaert & Holland, 322 N.C. 200, 206 (1988).

27. Howard v. Cnty. of Durham, ___ N.C. App. ___, 748 S.E.2d 1, 7 (2013) ("A claim for negligent misrepresentation must allege pecuniary loss."). *See also Raritan*, 322 N.C. at 214–16 (describing the extent of an accountant's liability under the tort of negligent misrepresentation for financial harm attributable to a negligently prepared audit).

28. Allen, *supra* note 2, at 3–4.

29. 289 N.C. 303 (1976).

30. *Id.* at 320 ("We hold, therefore, that whenever the State of North Carolina, through its authorized officers and agencies, enters into a valid contract, the State implicitly consents to be sued for damages on the contract in the event it breaches the contract.").

The court of appeals has opined that the remedies a party may pursue under the contract waiver acknowledged in *Smith* are not limited to breach-of-contract claims; a party to a contract with the state also has the ability to seek a declaratory judgment from a court of competent jurisdiction if the parties' respective obligations under the contract are in dispute. Atlantic Coast Conference v. Univ. of Md., ___ N.C. App. ___, ___, 751 S.E.2d 612, 621 (2013) ("The Court's holding in Smith explicitly waived the State's sovereign immunity in 'causes of action on contract' and we can discern no sound reason to limit that language to breach of contract claims when the Court's stated rationale is equally persuasive with respect to declaratory relief actions seeking to ascertain the rights and obligations owed under an alleged contract.").

31. Data General Corp. v. Cnty. of Durham, 143 N.C. App. 97, 100 (2001).

enters into a valid contract, [it] 'implicitly consents to be sued for damages on the contract in the event it breaches the contract.'"[32] Were it otherwise, governmental immunity would provide local governments with greater protection than the state enjoys under the doctrine of sovereign immunity.

The *Smith* case did not address whether sovereign immunity bars contract-related equitable claims against the state. The court confronted that issue for the first time in 1998 in *Whitfield v. Gilchrist*.[33] At the request of the local district attorney, the plaintiff law firm in *Whitfield* brought public nuisance actions against two corporations, each of which owned a motel or hotel in Charlotte.[34] After those actions resulted in the abatement of the nuisances, the plaintiff filed suit against the state alleging claims of *quantum meruit* for the value of its services in the nuisance actions.[35] The state argued that sovereign immunity barred the plaintiff's claims.

Ruling in the state's favor, the supreme court stressed that the outcome in *Smith* had turned on its conclusion that, "'when the state enters into a [valid] contract[,] it does so voluntarily and authorizes its liability'" for damages upon its breach of the contract.[36] Put differently, each time the state enters into a valid contract it necessarily signals a willingness to be sued for breach. To hold that the state has consented to be sued over a contract implied in law would require the court "first [to] imply a contract in law where none exist[ed] in fact, [and] then use that implication to support the further implication that the State ha[d] intentionally waived its sovereign immunity and consented to be sued for damages for breach of the contract it never entered in fact."[37] The court pronounced itself unwilling to pile up inferences in that way.[38]

By holding that sovereign immunity bars equitable claims against the state, *Whitfield* left open the possibility that governmental immunity could protect local governments from equitable claims. In cases decided prior to *Whitfield*, the supreme court had repeatedly held that

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32. *Id.* (quoting *Smith*, 289 N.C. at 320).

33. 348 N.C. at 40 ("The question presented for review is whether the doctrine of sovereign immunity bars recovery in *quantum meruit* upon an action based on a contract implied in law against the State of North Carolina.").

34. Chapter 19 of the General Statutes (hereinafter G.S.) covers certain public nuisances defined therein. It encompasses, *inter alia*, the erection or use of any building or place for prostitution, gambling, the illegal possession or sale of alcoholic beverages, the illegal possession or sale of controlled substances, or the illegal possession or sale of obscene or lewd matter. G.S. 19-1(a). When such a nuisance exists, the attorney general, the district attorney, county, municipality, "or any private citizen of the county" may bring a lawsuit to abate the nuisance and perpetually to enjoin all persons from maintaining the nuisance, except that a private citizen may not initiate proceedings under Chapter 19 if the nuisance involves the illegal possession or sale of obscene or lewd matter. G.S. 19-2.1.

35. It appears that the plaintiff did not allege breach of contract. This may have been because, as the supreme court remarked in its opinion, the district attorney could not have lawfully entered into a contract to pay the plaintiff for legal services without having first obtained the approval of other state officials. *Whitfield*, 348 N.C. at 43–45.

36. *Id.* at 42 (quoting *Smith*, 289 N.C. at 322).

37. *Id.* at 42–43. Fiscal concerns appear to have influenced the outcome in *Whitfield*. When the state enters into a contract, the court observed, it has the ability, "'with a fair degree of accuracy, [to] estimate the extent of its liability for a breach of contract.'" *Id.* at 42 (quoting *Smith*, 289 N.C. at 322). The state would find it much harder, if not impossible, to estimate its potential liability for unjust enrichment claims, largely because the state would have no way of identifying every unjust enrichment claim that might be alleged against it.

38. *Id.* at 43 ("Only when the State has implicitly waived sovereign immunity by *expressly* entering into a *valid* contract through an agent of the State expressly authorized by law to enter into such contract may a plaintiff proceed with a claim against the State upon the State's breach." (emphases in original)).

local governments may be liable for claims of *quantum meruit*, but apparently governmental immunity was not asserted as a defense in any of those cases.[39] Almost exactly three years after the supreme court issued its *Whitfield* opinion, the North Carolina Court of Appeals considered the effect of governmental immunity on equitable claims in *Data General Corp. v. County of Durham*.[40] The plaintiff company asserted claims for *quantum meruit*, estoppel, and negligent misrepresentation against the defendant county based on the county's purported refusal to make further payments for computer hardware and software it had kept following the expiration of its lease agreement with the plaintiff.

The county argued that governmental immunity barred the plaintiff's claims. It premised its argument partly on the contract's noncompliance with G.S. 159-28(a). That statutory provision sets out certain "preaudit" requirements that must be satisfied before a county or municipality may incur a commitment to pay money to another entity, if the obligation is accounted for in the local government's annual budget ordinance or in a project ordinance.[41] One of the requirements is that any contract, purchase order, or agreement subject to G.S. 159-28(a) must include a

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39. *E.g.*, Charlotte Lumber & Mfg. Co. v. City of Charlotte, 242 N.C. 189, 195 (1955) (holding that, in the absence of a valid contract, the plaintiff could recover "on basis of *quantum meruit* for the reasonable and just value of the sewer system" taken over by the defendant city); Hawkins v. Town of Dallas, 229 N.C. 561, 564 (1948) (holding that, when a construction contract is rendered illegal due to noncompliance with statutory bidding requirements, a plaintiff may nonetheless recover "on a *quantum meruit* for the reasonable and just value of the work and labor done and material furnished" if it has completed the project and its work has been accepted by the defendant municipality (internal quotation marks omitted)); Abbot Realty Co. v. City of Charlotte, 198 N.C. 564, 568 (1930) ("Notwithstanding the failure of plaintiff to sustain its contention that defendant is liable to it on the contract alleged in the complaint, the defendant . . . is liable for the reasonable and just value of the sewers, if . . . after their construction defendant took them over and incorporated them into its municipal sewerage system."); McPhail v. Bd. of Comm'rs of Cumberland Cnty., 119 N.C. 330, 335 (1896) ("As the repairs [to the bridge] have been actually made and accepted, the county is bound on a *quantum meruit* for the reasonable and just value of the work and labor done and material furnished, but not for the attempted contract of Harrison and McNeill, which, under the law, they had, and could have, no authority to make, so as to bind the county.").

40. 143 N.C. App. 97 (2001).

41. More specifically, an obligation undertaken by a county or municipality is subject to the preaudit requirements of G.S. 159-28(a) if: (1) it is accounted for in the annual budget or project ordinance, (2) the unit of local government is obligated to pay money by the terms of the contract or agreement, and (3) if the obligation is accounted for in the annual budget ordinance, the unit anticipates paying at least some of the money in the fiscal year in which the contract or agreement is entered into. Gregory S. Allison and Kara A. Millonzi, *Managing and Disbursing Public Funds*, *in* Introduction to Local Gov't Fin. 60–61 (Kara A. Millonzi, ed., 2nd ed. 2014).

When an obligation falls under G.S. 159-28(a), the subsection—as interpreted by the North Carolina Court of Appeals—requires the finance officer (or deputy finance officer approved by the local governing board for that purpose) to (1) ensure that there is a budget or project ordinance appropriation authorizing the obligation, (2) ensure that sufficient funds will remain in the appropriation to pay the amounts expected to come due, (3) reduce the contract or agreement to writing, and (4) affix the preaudit certificate to the contract or agreement and sign the certificate. *Id.* (citing Howard v. Cnty. of Durham, ___ N.C. App. ___, 748 S.E.2d 1 (2013); Exec. Med. Transp., Inc., v. Jones Cnty. Dep't of Soc. Servs., 223 N.C. App. 242 (2012)).

At the time of this writing, legislation is pending in the North Carolina General Assembly that would make significant changes to the preaudit process. For a discussion of the proposed amendments, see Kara A. Millonzi, *HB 44 and Proposed Changes to the Preaudit Process*, Coates' Canons: NC Local Government Law Blog (UNC School of Government, June 25, 2015), http://canons.sog.unc.edu/?p=8143.

preaudit certificate on its face.[42] The preaudit certificate is written confirmation that all preaudit requirements have been fulfilled. According to G.S. 159-28(a), an obligation incurred in violation of its requirements is "invalid and may not be enforced."[43]

The lease agreement at issue in *Data General* was subject to G.S. 159-28(a), but the evidence did not show the presence of a preaudit certificate. The court of appeals therefore held that no valid contract was formed between the plaintiff and the county and that the county did not waive its governmental immunity to be sued for contract damages. Turning to the plaintiff's equitable claims, *quantum meruit* and estoppel, the court further determined that governmental immunity defeated the plaintiff's efforts to recover in equity.

> In *Whitfield* . . . , our Supreme Court declined to imply a contract in law in derogation of sovereign immunity to allow a party to recover under a theory of quantum meruit, and we decline to do so here. . . . On this same basis, we conclude that [the plaintiff] may not defeat a claim of . . . governmental immunity upon a theory of estoppel.[44]

The court further stated that the plaintiff could not "recover under an equitable theory such as estoppel" because the lease agreement failed to satisfy G.S. 159-28(a) and "parties dealing with governmental organizations are charged with notice of all limitations upon the organizations' authority, as the scope of such authority is a matter of public record."[45]

Interestingly, in disposing of the plaintiff's equitable claims, the court took no notice of whether the county had interacted with the plaintiff in a governmental or a proprietary capacity. The court did, however, use the governmental/proprietary distinction to evaluate whether governmental immunity barred the plaintiff's claim for negligent misrepresentation. In particular, it determined that the county's entry into the lease agreement with the plaintiff qualified as a proprietary activity and, consequently, that governmental immunity did not block the plaintiff's claim for negligent misrepresentation. Presumably, given the court's ruling that the county had undertaken a proprietary function, application of the governmental/proprietary distinction to the plaintiff's equitable claims would have led the court to hold that the county was not immune to those claims. The collective holdings in *Data General* therefore seemed to suggest that governmental immunity could bar equitable claims without regard to whether the activity that produced them was a governmental function or a proprietary function.

In *Wing v. Town of Landis*,[46] roughly three years after *Data General*, the court of appeals once more examined the viability of an equitable claim against a local government. The plaintiff in *Wing* sought reimbursement for the cost of engineering plans for the extension of municipal water service to a proposed housing development expansion. On appeal from an order granting summary judgment in the defendant municipality's favor, the court of appeals conceded

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42. G.S. 159-28(a) states that the preaudit certificate must be worded substantially as follows:

> This instrument has been preaudited in the manner required by the Local Government Budget and Fiscal Control Act.
>
> _____
>
> (Signature of finance officer).

43. G.S. 159-28(a).
44. *Data General*, 143 N.C. App. at 103–04.
45. *Id.* at 104.
46. 165 N.C. App. 691 (2004).

the possibility of holding a local government liable on a claim of *quantum meruit*, provided adequate evidence supports the claim.[47] Yet the court took pains to observe that, because the municipality had not asserted governmental immunity as a defense, the court's opinion did not consider how that defense might have affected the plaintiff's claim.[48]

In *M Series Rebuild, LLC, v. Town of Mount Pleasant*,[49] the court of appeals in 2012 issued its last substantial decision in advance of *Williams v. Pasquotank County* on equitable remedies and governmental immunity. The plaintiff company alleged claims against the defendant municipality for breach of contract and unjust enrichment over unpaid repairs to the town's firetruck. The municipality moved to dismiss the lawsuit, and the trial court granted the motion. On appeal, the plaintiff admitted that its purported agreement with the municipality did not contain the preaudit certificate mandated by G.S. 159-28(a). It argued, though, that it should be allowed to pursue its claim of unjust enrichment in light of *Wing* and older supreme court decisions acknowledging that a municipality may be liable on a claim of unjust enrichment. The defendant municipality contended that *Data General* foreclosed the plaintiff's unjust enrichment claim.

The court of appeals determined that *Data General* did in fact control the outcome. Pursuant to *Data General*, the court held that the lack of a preaudit certificate meant that the parties had not entered into a valid contract and, thus, that the municipality had not waived its immunity for breach of contract. Although *Data General* involved a claim of *quantum meruit* and not, as in *M Series Rebuild*, one for unjust enrichment, the court observed that both types of claims are "claim[s] in quasi contract or contract implied in law."[50] Accordingly, "based on the reasoning in *Data General* and *Whitfield*," governmental immunity upended the plaintiff's attempt to recover for unjust enrichment.[51] The court explained that *Wing* was inapposite for two reasons: (1) the defendant in *Wing* did not assert an immunity defense and (2) *Wing* did not concern a contract subject to G.S. 159-28(a)'s preaudit requirements.

Once again the court's ruling that governmental immunity precluded a contract-related equitable claim did not turn on whether the defendant local government had acted in a governmental capacity. This enhanced the impression created by *Data General* that the governmental/proprietary distinction did not govern whether governmental immunity would bar an equitable claim against a county, municipality, or other unit of local government.

Equitable Remedies and Governmental Immunity Post-*Williams*

The *Williams* decision came along in 2012. Less than two years later, the court of appeals considered the availability of governmental immunity as a defense to equitable claims in *Viking Utilities Corp. v. Onslow Water and Sewer Authority*.[52] According to the complaint, the

47. *Id.* at 693–94 ("A party may recover from a municipality under a *quantum meruit* theory upon a proper showing.").

48. Ultimately the court of appeals affirmed summary judgment in favor of the defendant municipality because the evidence showed neither that the plans had been drafted in expectation of payment by the municipality nor that the municipality had benefited from completion of the plans. *Id.* at 695.

49. 222 N.C. App. 59 (2012).

50. *Id.* at 67 (internal quotation marks omitted).

51. *Id.*

52. ___ N.C. App. ___, 755 S.E.2d 62 (2014). A water and sewer authority is a kind of special purpose government created under Chapter 162A of the General Statutes. David M. Lawrence, *An Overview of Local Government*, *in* County & Municipal Gov't in N.C. 8 (Frayda S. Bluestein, ed., 2nd ed. 2014). It is formed by resolution of a board of county commissioners or by resolution of any two or more political

defendant water authority entered into an agreement to purchase the plaintiffs' wastewater system. The agreement specified that the authority would receive a credit of $250,000 toward the purchase price in return for allowing the plaintiffs to connect to the wastewater system at any location served by the authority without paying a connection—or "tap"—fee. The complaint alleged that, contrary to the agreement, the authority had required the plaintiffs to pay tap fees in order to connect to the sewer system. It sought damages not only for breach of contract but also for a full range of equitable claims: restitution, *quantum meruit*, unjust enrichment, and estoppel. The authority moved to dismiss the lawsuit and appealed after the trial court denied its motion.

In its brief to the court of appeals, the water authority cited *Data General* and *M Series Rebuild* for the proposition that governmental immunity barred the plaintiff's equitable claims.[53] The court of appeals ignored this contention, looking instead to the new *Williams* decision for guidance. It quoted the supreme court's remark in *Williams* that governmental immunity "'covers only the acts of a municipality or a municipal corporation committed pursuant to its governmental functions'" and "does not . . . apply when [a] municipality engages in a proprietary function."[54] The court of appeals took this remark to mean that immunity would not bar the plaintiffs' equitable claims if they stemmed from the authority's performance of a proprietary function. It further reasoned that the *Williams* inquiry had to be employed to ascertain whether the authority's undertaking was governmental or proprietary. In particular, the court explained, properly assessing the authority's immunity defense would require the trial court to

> consider the pertinent statutory provisions as well as factual evidence regarding [the] plaintiff's allegations, fees charged by the defendant, whether the fees cover[ed] more than the operating costs of the water authority, and any other evidence relevant to the issue of whether, in executing and interpreting its contract with [the] plaintiffs, [the] defendant was acting in a governmental or proprietary capacity.[55]

Because the trial court did not have all of the information necessary to conduct the full *Williams* inquiry, the court of appeals ruled that it had properly refused to dismiss the plaintiffs' claims at the outset of the litigation.

On the surface, *Viking Utilities* might seem at odds with *Data General* and *M Series Rebuild*. Whether the judges who decided *Viking Utilities* regarded their ruling as a departure from those earlier cases is unclear, for no reference to *Data General* or *M Series Rebuild* appears in the court's opinion. Such was the uncertain state of North Carolina law on governmental immunity

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subdivisions. G.S. 162A-3, -3.1. For purposes of forming a water and sewer authority, a "political subdivision" is "any county, city, town, incorporated village, sanitary district or other political subdivision or public corporation of this State now or hereafter incorporated." G.S. 162A-2(7). A water and sewer authority enjoys a wide range of powers related to the provision of water and sewer services, though it lacks taxing power. G.S. 162A-6; Lawrence, *supra* at 8.

53. The authority's brief refers to sovereign immunity rather than governmental immunity. The term *governmental immunity* is employed here to avoid confusion and conform to the preference of the North Carolina Supreme Court. *See* Craig *ex rel.* Craig v. New Hanover Cnty. Bd. of Educ., 363 N.C. 334, 335 n.3 (2009) ("The [school board] is a county agency. As such, the immunity it possesses is more precisely identified as governmental immunity, while sovereign immunity applies to the State and its agencies.").

54. *Viking Utilities*, ___ N.C. App. at ___, 755 S.E.2d at 64 (quoting *Williams*, 366 N.C. at 198 (internal quotation marks omitted)).

55. *Id.* at 66.

and equitable claims when, in 2014, the United States Court of Appeals for the Fourth Circuit decided *AGI Associates, Inc. v. City of Hickory.*[56]

AGI Associates grew out of an agreement between Profile Aviation and the defendant municipality for aviation services at Hickory Regional Airport. Profile obtained a leasehold interest in certain parcels of land at the airport under the agreement and used that interest as security to obtain financing from a bank, which in turn assigned its rights to the plaintiff. Profile defaulted on its repayment obligations and declared bankruptcy, and the bankruptcy court put the municipality in possession of the airport. The plaintiff asserted that, under the agreement between the municipality and Profile, the municipality should not have taken possession without first having cured Profile's default. It further maintained that the municipality owed it rental payments which the municipality had collected from airport tenants after taking possession. The plaintiff filed suit against the municipality in federal district court, alleging equitable claims for disgorgement of rents and unjust enrichment. The municipality moved to dismiss the plaintiff's claims, raising the defense of governmental immunity. Upon concluding that the municipality's operation of the airport constituted a proprietary function, the federal district court denied the motion.

The Fourth Circuit upheld the district court's ruling. It interpreted the North Carolina cases to establish that a county or municipality can waive its immunity against civil actions in one of three ways: (1) by entering into a valid contract, (2) by acting in a proprietary capacity, or (3) by purchasing liability insurance.[57] The plaintiff argued that the municipality had waived immunity by engaging in a proprietary function, namely, the operation of an airport.[58] The municipality countered by asserting that "North Carolina law limits waiver of governmental immunity under the proprietary function theory to contract and tort cases only."[59] In other words, the municipality insisted that a waiver of immunity for a proprietary undertaking does not extend to equitable claims. It cited *M Series Rebuild* and *Data General* as the foundation for its position.

The Fourth Circuit deemed the municipality's reliance on *Data General* and *M Series Rebuild* to be misplaced. Regarding *M Series Rebuild*, the court pointed out that the "proprietary function theory" of waiver is not discussed in the opinion of the North Carolina Court of Appeals.[60] The Fourth Circuit conceded, though, that *Data General* bolstered the municipality's argument. After all, "if immunity from equitable claims can properly be waived under the proprietary

56. 773 F.3d 576 (4th Cir. 2014).

57. As a corporation from another state, the plaintiff had the option of pursuing relief against the City of Hickory in federal court rather than state court, despite the lack of any federal claims in the complaint. *See* 28 U.S.C. § 1332. In such a case, when resolving a question of North Carolina law, the Fourth Circuit follows the decisions of the North Carolina Supreme Court. *AGI Associates*, 773 F.3d at 580. If the issue is one that the supreme court has not addressed, the Fourth Circuit looks to the decisions of the North Carolina Court of Appeals to try to predict how the supreme court would rule, though it may disregard those decisions if it concludes, based on other persuasive data, that the supreme court would disagree with the court of appeals. *Id.* at 580–81.

58. It has long been held that a local government's operation of an airport is a proprietary function. Rhodes v. City of Asheville, 230 N.C. 134, 139 (1949) ("The overwhelming weight of authority is to the effect that the construction, operation and maintenance of an airport by a municipality is a proprietary function and that such municipality may be held liable in tort for the negligent operation thereof.").

59. *AGI Associates*, 773 F.3d at 580.

60. The Fourth Circuit's discussion of *M Series Rebuild* begs the question. The plaintiff in *M Series Rebuild* did not allege any tort claims, so if engaging in a proprietary function does not waive immunity against equitable claims, the North Carolina Court of Appeals had no reason to evaluate whether the defendant municipality had undertaken a proprietary activity.

function theory, the court [in *Data General*] could have upheld the quantum meruit and estoppel claims on the same basis that it had upheld the negligent misrepresentation claim: that [the county] had acted in a proprietary capacity."[61]

Yet the Fourth Circuit determined that *Data General* should not be afforded "controlling weight."[62] It reasoned that *Viking Utilities* had called the soundness of *Data General* into question by making the applicability of governmental immunity to equitable claims there depend on whether the defendant water and sewer authority had acted in a proprietary capacity. The Fourth Circuit saw *Viking Utilities* as consistent with *Williams* and, as the court of appeals did in *Viking Utilities*, quoted the supreme court's statement in *Williams* that governmental immunity is confined to governmental functions. It ended by opining that the rationale behind the governmental/proprietary distinction supports the waiver of immunity from equitable claims arising from a proprietary function. That rationale, according to the Fourth Circuit, is that local governments warrant special protection from civil liability when they fulfill their governmental responsibilities but not when they act as corporations.

In short, *AGI Associates* views *Data General* as outdated in view of *Williams* and *Viking Utilities*. If this is correct, when a future case materially resembling *Data General* comes before the North Carolina Court of Appeals, the court should rule that governmental immunity does not defeat the plaintiff's equitable claim. As discussed below, though, grounds exist for thinking that the Fourth Circuit was wrong about the ongoing reliability of *Data General*. The next section of this bulletin explains the problem with the Fourth Circuit's analysis and offers a distinction that the court of appeals or the state's trial courts could employ if confronted with a case substantially similar to *Data General*.

Current Rules on Immunity and Equitable Claims

It is easy to understand why the Fourth Circuit perceived *Data General* and *Viking Utilities* to be in conflict. That being said, the two cases can be harmonized in a manner that makes sense. The key to reconciling them lies in the observation that G.S. 159-28(a)—the preaudit provision—was a factor in the outcome of *Data General* but not of *Viking Utilities*. When this distinction is grasped, and the two cases are carefully evaluated in light of each other and relevant precedents, the author believes that two complementary principles emerge. Each is discussed in detail below.

First Principle: When the failure to comply with the preaudit requirements of G.S. 159-28(a) invalidates a contract, governmental immunity will bar equitable claims arising from it, regardless of whether the contract concerns a proprietary function.

If *Data General* is construed to hold that governmental immunity blocks all contract-related equitable claims against local governments, the decision plainly is no longer good law after *Viking Utilities*. The former decision can and should be read more narrowly, however. In *Data General* the court of appeals identified the supreme court's declaration in *Whitfield* that sovereign immunity bars equitable claims against the state as authority for its ruling, but it also offered an alternative basis for its willingness to apply governmental immunity to the plaintiff's equitable claims. The court held that immunity barred the plaintiff's equitable claims because the lease agreement between the plaintiff and the defendant county violated G.S. 159-28(a)'s preaudit requirements. In *M Series Rebuild*, the court confirmed that G.S. 159-28(a) had indeed

61. *AGI Associates*, 773 S.E.2d at 580.
62. *Id.* at 581.

influenced its handling of the equitable claims alleged *in Data General*. The court expressly distinguished *Data General* from *Wing*, wherein it had permitted the pursuit of an equitable claim against a local government, by noting that, unlike the equitable claim alleged in *Wing*, the equitable claims asserted in *Data General* arose from a contract invalidated under G.S. 159-28(a).

By declaring that contracts entered into in contravention of its provisions are invalid and unenforceable, G.S. 159-28(a) reflects the General Assembly's judgment that local governments should not be bound by agreements executed in violation of preaudit requirements. Given the close relationship between claims for breach of contract and equitable claims, allowing a plaintiff to recover in equity when noncompliance with preaudit requirements forecloses a claim for breach would undermine the legislative intent behind G.S. 159-28(a).[63] The court of appeals said as much in *Finger v. Gaston County*,[64] a decision issued after *Data General* but before *M Series Rebuild*. The plaintiff, a former police officer, alleged breach-of-contract and estoppel claims over the defendant county's refusal to pay the supplemental retirement benefit specified in the parties' memorandum of understanding.[65] The court of appeals held that the lack of a preaudit certificate invalidated the memorandum and that *Data General* precluded the plaintiff's estoppel claim. It further justified its unwillingness to let the plaintiff proceed on a claim of estoppel as follows:

> Our General Assembly has in [G.S.] 159-28(a) made a policy determination to forbid counties from entering into contracts for payment of money that lack a preaudit certificate. To permit a party to use estoppel to render a county contractually bound despite the absence of the certificate would effectively negate [G.S.] 159-28(a). We are not free to allow a party to obtain a result indirectly that the General Assembly has expressly forbidden.[66]

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63. It can be argued that this same logic should have prompted the court of appeals in *Data General* to ignore the governmental/proprietary distinction in its treatment of the defendant county's immunity defense to the plaintiff's claim of negligent misrepresentation. Like the plaintiff's equitable claims, the negligent misrepresentation claim rested on alleged facts surrounding the contract between the plaintiff and the defendant county.

While this argument unquestionably has merit, preexisting case law pretty clearly made the county's immunity to the plaintiff's negligent misrepresentation claim contingent on the governmental/proprietary distinction. Long before *Data General* it was settled law in North Carolina that a tort claim's susceptibility to governmental immunity hinges on whether the conduct that produced the plaintiff's injury was governmental or proprietary. If the legislature wants noncompliance with G.S. 159-28(a) to bar tort claims along with claims for breach and equitable claims, an express declaration to that effect is probably necessary.

64. 178 N.C. App. 367 (2006).

65. The supplemental retirement benefit in question was the special separation allowance for law enforcement officers provided for in G.S. 143-166.41.

66. *Finger*, 178 N.C. App. at 371. The court echoed this point in *Transportation Services of North Carolina v. Wake County Board of Education*, 198 N.C. App. 590, 591 (2009): Local boards of education are bound by the preaudit requirements of G.S. 115C-441(a), which are "essentially identical" to those of G.S. 159-28(a). In *Transportation Services*, the defendant school board entered into a contract with the plaintiff for the transport of special needs students. When the board refused to pay for students who had not actually been transported, the plaintiff filed suit against the board alleging breach of contract and estoppel. Inasmuch as no preaudit certificate appeared on the contract, the court of appeals ruled that, under *Data General*, governmental immunity barred the plaintiff's claims. The court went on to state that "applying estoppel to hold the Board liable would allow [the plaintiff] to escape the purpose of the legislature in enacting [G.S.] 115C-441(a)." *Id.* at 599.

As demonstrated by the court of appeals' comments in *Finger*, the rejection of the equitable claims in *Data General* and *M Series Rebuild* can be perceived as judicial deference to the General Assembly's wishes. Rightly understood, then, *Data General* holds that governmental immunity applies to equitable claims arising from transactions subject to G.S. 159-28(a), not to all equitable claims against local governments.

Second Principle: When a contract is not subject to G.S. 159-28(a), governmental immunity will not foreclose equitable claims that stem from the contract if the claims arise from a proprietary function.

Both *Viking Utilities* and *AGI Associates* assume that ordinarily the distinction between governmental functions and proprietary activities will determine whether a county, municipality, or other unit of local government may block equitable claims through a defense of governmental immunity. *AGI Associates* is probably mistaken insofar as it regards *Data General* as wholly superseded by *Viking Utilities*, but it seems safe to conclude that, so long as compliance with preaudit requirements is not at issue, a court should employ the *Williams* inquiry when analyzing whether immunity defeats an equitable claim.

It might be asked whether a local government's purchase of liability insurance that covers equitable claims eliminates any need to resort to the *Williams* inquiry. As observed by the Fourth Circuit in *AGI Associates*, and as explained in Part I,[67] the purchase of such insurance can waive a local government's immunity from tort claims. No express reference is made to equitable claims in any of the waiver statutes, however. The statute permitting city councils to waive immunity through the purchase of liability insurance refers specifically to a waiver "in tort."[68] Similarly, local boards of education are statutorily authorized to waive their immunity in "negligence or tort" by purchasing liability insurance.[69] The term *tort* does not appear in the county waiver statute, but the statute's description of the kinds of claims to which a county's waiver-by-insurance may apply—"wrongful death or negligent or intentional damage to person or property"—seems to restrict the waiver to tort claims.[70]

The courts narrowly construe laws that limit governmental immunity.[71] There is little if anything in the waiver statutes, especially if they are narrowly interpreted, that should lead a court to hold that a local government's purchase of liability insurance covering equitable claims amounts to a waiver of immunity as to those claims. The statutory text plainly demonstrates that the legislature had tort claims, not equitable claims, in mind when it enacted the laws. Accordingly, regardless of any insurance purchased, a local government does not waive its immunity from equitable claims unless it undertakes an activity that constitutes a proprietary function under the *Williams* inquiry.

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67. Allen, *supra* note 2, at 14.

68. G.S. 160A-485(a).

69. G.S. 115C-42.

70. G.S. 153A-435(a).

71. Arrington v. Martinez, 215 N.C. App. 252, 260 (2011) ("[S]tatutes as to waiver of governmental immunity are strictly construed against waiver."). Admittedly, tension exists between this canon of construction and the judiciary's avowed tendency to restrict the scope of governmental immunity. *See* Koontz v. City of Winston-Salem, 280 N.C. 513, 529–30 (1972) ("[W]e recognize merit in the modern tendency to restrict rather than to extend the application of governmental immunity. . . . A corollary to the tendency of modern authorities to restrict rather than to extend the application of governmental immunity is the rule that in cases of doubtful liability application of the rule should be resolved against the municipality.").

The Impact of *Williams* on Liability for Contract-Related Tort Claims

The North Carolina Court of Appeals first addressed the impact of *Williams* on a local government's immunity from a claim of negligent contract performance in 2013 in *Town of Sandy Creek v. East Coast Contracting, Inc.*[72] The City of Northwest hired East Coast Contracting (ECC) to construct a sewer system. The nearby Town of Sandy Creek subsequently filed suit against ECC alleging that the construction of Northwest's sewer system had damaged Sandy Creek's streets. ECC brought Northwest into the lawsuit, alleging claims against it for breach of contract, negligence, contribution, and indemnity. In essence ECC contended that Northwest had violated its duty of reasonable care to ECC by failing to provide adequate contract documents, improperly certifying that ECC had completed its work in conformance with contract documents, and failing to retain sufficient contract funds to pay for the repair of Sandy Creek's streets.

Northwest argued that governmental immunity barred ECC's claims because the construction of a municipal sewer system is a governmental function.[73] While acknowledging that sewer system construction had been deemed a governmental activity, the court of appeals identified Northwest's handling of a contract and business relationship with ECC as the real focus of ECC's tort claims. The court categorized those activities as proprietary and affirmed the trial court's order denying Northwest's motion to dismiss the claims alleged by ECC. Northwest sought review by the North Carolina Supreme Court, which remanded the case to the court of appeals for reconsideration in light of *Williams*. On remand the court of appeals, without explicitly going through the *Williams* inquiry step-by-step, again held that Northwest's alleged negligence concerned a proprietary undertaking. The court "remain[ed] convinced that a local governmental unit acts in a proprietary function when it contracts with engineering and construction companies, regardless of whether the project under construction will be a governmental function once it is completed."[74]

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72. ___ N.C. App. ___, 741 S.E.2d 673 (2013).

73. Northwest cited *McCombs v. City of Asheboro*, 6 N.C. App. 234 (1969), in which the defendant municipality asserted governmental immunity as a defense to the plaintiff's wrongful death claim. According to the complaint, the defendant's employees dug a ditch for a new sewer line and a six-year-old boy was killed when the ditch collapsed on him. The court of appeals agreed with the defendant that governmental immunity defeated the plaintiff's wrongful death claim because "the construction of a sewerage system is a governmental function." *McCombs*, 6 N.C. App. at 240. The court so held even though the defendant charged for sewer service. *Id.* at 240–41.

It may be doubted whether the outcome in *McCombs* would have been the same had the case come down a few years later. In 1971, as part of its overhaul of the principal laws governing municipalities, the General Assembly enacted many of the public enterprise provisions now found in Chapter 160A of the General Statutes. Since then the tendency of the court of appeals has been to regard activities associated with fee-based public enterprises as proprietary functions. Sewer systems are no exception. The court has repeatedly said that "the operation and maintenance of a sewer system is a proprietary function where the municipality sets rates and charges fees for the maintenance of sewer lines." Harrison v. City of Sanford, 177 N.C. App. 116, 121 (2006). *See also* Bostic Packaging, Inc., v. City of Monroe, 149 N.C. App. 825, 829 (2002) ("[T]he *Pulliam* Court determined that the operation of the defendant[] [municipality's] sewer system, for which it charged rates, was a proprietary function." Pulliam v. City of Greensboro, 103 N.C. App. 748, 753 (1991). "[W]e hold that defendant [city] is not immune from tort liability in the operation . . . of its sewer system . . . ."). Thus, the current state of the case law seems to be that a municipality's construction of a fee-based sewer system is a governmental function, but the operation or maintenance of the system is a proprietary undertaking.

74. *Sandy Creek*, ___ N.C. App. at ___, 741 S.E.2d at 677.

The holding in *Sandy Creek* invites criticism. Many municipalities lack sufficient resources to construct a sewer system on their own.[75] A municipality in this category may have no choice but to hire a contractor if it wishes to have its own sewer system. It can plausibly be argued that, when hiring a contractor is necessary to undertake a governmental function such as the construction of a sewer system, a local government's dealings with the contractor should themselves be viewed as governmental in nature.

Whatever its merits, *Sandy Creek* is binding precedent for now, which makes it worthwhile to consider the decision's implications for the civil liability of local governments. At first glance *Sandy Creek* might appear to expand that liability significantly. Read broadly, it eliminates governmental immunity as a defense to a claim that a county, municipality, or other unit of local government has negligently performed its contractual obligations to a contractor, even if the contractor was hired to undertake a governmental function. The absence of immunity creates an incentive for contractors to accuse those governments of contract-related negligence when the contractors find themselves sued by third parties for harms attributable to the contractors' own acts or omissions. As in *Sandy Creek*, the contractor in such a situation would probably argue that the local government helped cause the plaintiff's injury by negligently failing to furnish the contractor with important information or adequate direction.

Yet the long-term effect of *Sandy Creek* on local government liability might not be as great as it initially appears. To get a more accurate picture of the decision's potential impact, the various legal claims alleged in *Sandy Creek* should be analyzed separately.

Negligent Contract Performance

Contractor Claims

The thrust of ECC's negligence claim against Northwest was that, by negligently performing its contractual duties, Northwest had exposed ECC to economic loss in the form of ECC's potential liability to Sandy Creek. Although *Sandy Creek* holds that governmental immunity does not bar claims of this sort, a contractor in a position like that of ECC could find it difficult to prevail on a claim of negligence. A ruling that immunity does not foreclose a negligence claim is not the same thing as a ruling that a local government acted negligently. To obtain an award for damages, the contractor still has to defeat any other defenses asserted by the local government and prove by a preponderance of the evidence that the local government actually engaged in negligent conduct to the contractor's detriment. At least two big legal hurdles can prevent the contractor from ultimately winning its lawsuit.

1. Historically, as noted above, North Carolina's courts have been reluctant to allow a party asserting purely economic losses to recover for another party's negligent performance of a contract. In other words, the contractor might succeed in overcoming an immunity defense only to have the court later rule that its claim for negligent contract performance is legally deficient.
2. In North Carolina contributory negligence is a complete bar to a negligence claim.[76] "Contributory negligence occurs when [the injured party] fails to exercise due care for his or her own safety, such that the [injured party's] failure to exercise due care is a proximate

75. According to figures available from the North Carolina League of Municipalities, the entire population of Northwest amounts to fewer than 800 residents. *See* www.nclm.org/resource-center/municipalities/Pages/Default.aspx#N.

76. Love v. Singleton, 145 N.C. App. 488, 491 (2001).

> cause of his or her injury."[77] Thus, when a contractor's own negligence in performing a contract with a local government renders the contractor liable to a third party, the defense of contributory negligence can stop the contractor from using a negligence claim to force the local government to reimburse it for damages paid to the third party.

In sum, the unavailability of governmental immunity is no guarantee that a contractor will succeed on a claim against a local government for negligent contract performance. The inability of the contractor to prove negligence by the local government or to overcome other defenses, such as contributory negligence, can torpedo the claim.

Third-Party Claims

The Town of Sandy Creek sued ECC but not Northwest for the damage to its streets. The court of appeals thus did not have to decide whether governmental immunity would have kept Sandy Creek from bringing a claim for negligence directly against Northwest. It seems obvious, though, that governmental immunity would not have prevented Sandy Creek from seeking damages from Northwest, assuming Sandy Creek premised its claim on Northwest's alleged negligence in dealing with ECC. If those interactions were proprietary and not governmental in character, then immunity would not have shielded Northwest from a negligence claim by Sandy Creek any more than it foreclosed ECC's claim.

While the holding in *Sandy Creek* could in some instances broaden the liability of local governments for harms inflicted by their contractors, the expansion probably is not dramatic for the following reasons:

- Employers typically are not liable for the torts of "independent contractors."[78] However, the courts do not accept an employers' designation of a worker as an independent contractor at face value. Whether the worker who injured the plaintiff should be classified as an independent contractor or an employee for liability purposes turns on the degree of control exerted by the employer. Whereas an employer exercises substantial control over the manner in which an employee performs his duties, and thus may be liable for injuries inflicted by an employee acting within the scope of those duties, an independent contractor is one who "contracts to do a piece of work according to his own methods and without being subject to the control of his employer, except as to the result of the work."[79]
  - Non-liability for independent contractors is a general principle of tort law, and consequently, its relevance to a case involving a local government does not depend on whether the job being performed by the contractor was governmental or proprietary. The upshot is that in many instances a third party may not hold a local government financially responsible for harm caused by the local government's contractor absent a showing that the local government itself was negligent and its negligence combined with the contractor's negligence to produce the third party's injury.

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77. *Id.*

78. Daye & Morris, *supra* note 7, § 23.30, at 565. There are many exceptions to this rule. For example, a municipality has a non-delegable duty to keep its streets and sidewalks in a reasonably safe condition; if injury results from a breach of this duty, the municipality may not escape liability by showing that it had hired an independent contractor to maintain them. *See* Bailey v. City of Winston, 157 N.C. 253, 256–57 (1911) ("The city . . . was under the duty to keep its streets in proper condition and repair. . . . It certainly cannot relieve itself from the duty which rests upon it by transferring that duty to the contractor.").

79. Cole v. City of Durham, 176 N.C. 289, 300 (1918).

- Under North Carolina law, a defendant usually is not liable in negligence for injuries resulting from the unforeseeable intervening negligence of another.[80] So, even if a third party can prove negligence on the part of a local government and the local government's contractor, it may not be entitled to damages from the local government if the contractor's negligence was later in time and unforeseeable.

Contribution and Indemnity

Like its negligence claim, ECC's claims against Northwest for contribution and indemnity were founded on Northwest's allegedly negligent performance of its contractual duties. Contribution and indemnity are remedies frequently pursued by "joint tortfeasors," a term that once referred only to those "who acted in concert in producing the plaintiff's harm" but nowadays also encompasses "those who commit separate wrongs without concert of action or unity of purpose, when the acts are concurrent as to place and time, and unite in setting in operation a single destructive and dangerous force that produces a single and indivisible injury."[81]

The purpose of contribution and indemnity is to allocate financial responsibility between or among tortfeasors for the harm suffered by an injured party. The right of contribution may be invoked by a tortfeasor to force other tortfeasors "to divide their mutual obligation to the injured party among themselves, usually in equal shares."[82] The rules for contribution are contained in the Uniform Contribution Among Tort-Feasors Act.[83] "Unlike contribution, indemnity shifts the entire liability to another wrongdoer. Indemnity is an all-or-nothing approach that transfers liability completely to one party, rather than dividing the liability among tortfeasors."[84]

Undoubtedly, *Sandy Creek*, by its expansive take on what constitutes a proprietary activity, has increased the exposure of counties, municipalities, and other units of local government to contribution or indemnity claims brought by contractors exposed to liability for bodily injury or property damage inflicted in connection with their performance of local government contracts. In light of *Sandy Creek*, governmental immunity is unlikely to preclude such claims, even when the contractor was hired to perform a governmental function. Nonetheless, significant legal principles associated with contribution and indemnity could complicate or derail a contractor's effort to obtain compensation from a local government.

- The right to contribution exists only when it can be shown that the injured party has a direct claim for negligence against each of the joint tortfeasors. Put differently, a contractor has no right to contribution from a local government unless the local government—or its

80. Daye & Morris, *supra* note 7, § 23.30, at 565.

81. *Id.* § 22.30, at 528.

82. *Id.* § 22.60, at 536.

83. G.S. 1B-1, -7. For a detailed discussion of the act's provisions, see Daye & Morris, *supra* note 19, § 22.60[1]–[5], at 537–42.

84. Daye & Morris, *supra* note 7, § 22.70, at 542–43. The form of indemnity discussed here is a common law tort remedy. For a thorough discussion of the common law rules of indemnification, see Daye & Morris, *supra* note 7, § 22.70, at 542–48.

Business contracts frequently include indemnity provisions, but such provisions concern the law of contracts not of torts. State law places an important limitation on contractual indemnity provisions. Specifically, G.S. 22B-1 renders void and unenforceable any contract provision that would "insulate a party from its own negligence under a construction indemnity agreement." Norma R. Houston, North Carolina Local Government Contracting: Quick Reference and Related Statutes 44 (2014).

officials or employees acting within the scope of their duties—negligently played a role in causing the injury for which the contractor is liable.[85]

- A joint tortfeasor has no right to contribution if it intentionally caused or contributed to the harm to the injured party.[86] Thus, even assuming negligence on the part of a local government, a contractor that inflicted injury through intentional rather than negligent conduct does not have a valid contribution claim.
- In general, no right to indemnity exists among joint tortfeasors.[87] An exception to this limitation occurs when one tortfeasor is actively negligent and the other is merely passively negligent.[88] Whether ECC could have carried this burden in *Sandy Creek* is uncertain, inasmuch as doing so would have required ECC to show that Northwest was "primarily liable" for the damage to the plaintiff's streets in order to prevail on its claim for indemnity.[89] Many contractors in similar cases could find the burden too heavy to bear.
- The right to contribution and the right to indemnification are mutually exclusive.[90] Consequently, a contractor may not obtain both remedies from a local government for the same injury, though the contractor may seek them in the alternative.[91]

The bottom line is that *Sandy Creek* has eliminated—for now anyway—governmental immunity as an obstacle to a contractor's claim for contribution or indemnity arising from a local government's negligent contract performance. This development by no means guarantees the contractor a win. Other legal principles that restrict the availability of contribution and indemnity will likely blunt the impact of *Sandy Creek*, and thereby *Williams*, on a local government's liability for these claims.

Impact of *Williams* on the Timing of Immunity Determinations

"Governmental immunity is an immunity from suit—not just immunity from having to pay damages at the conclusion of years of litigation."[92] It is "more than a mere affirmative defense, as it shields a defendant entirely from having to answer for its conduct at all in a civil suit for damages."[93] Accordingly, the later a definitive immunity ruling comes in a civil action, the less valuable the defense of governmental immunity is to the local government being sued.

The early returns indicate that *Williams* has made it harder for a local government to prevail on an immunity defense at the outset of litigation. The most common device for seeking dismissal on immunity grounds is a motion under Rule 12 of the North Carolina Rules of Civil Procedure, which allows a defendant to request dismissal of the plaintiff's claims if, for instance, the trial court lacks jurisdiction over the claims alleged or over the person of the defendant, or if the allegations in the complaint, taken as true, fail to state a viable legal claim.

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85. *See id.* § 22.60, at 537 ("Joint liability is a prerequisite to the recovery of contribution.").

86. G.S. 1B-1(c).

87. Ingram v. Smith, 16 N.C. App. 147, 151 (1972).

88. *Id.*

89. *In re* Huyck Corp. v. C.C. Mangum, Inc., 309 N.C. 788, 793 (1983), *cited in* Daye & Morris, *supra* note 7, § 22.70, at 543.

90. *Ingram*, 16 N.C. App. at 151 ("The rights of contribution and indemnity are mutually inconsistent; the former assume joint fault, the latter only derivative fault.").

91. Daye & Morris, *supra* note 7, § 22.70, at 543.

92. Arrington v. Martinez, 215 N.C. App. 252, 262 (2011).

93. *Id.* at 263.

A local government that asserts governmental immunity in a motion to dismiss typically argues that immunity deprives the trial court of subject matter or personal jurisdiction.[94] That is precisely what the defendant municipalities did in the post-*Williams* cases of *Horne v. Town of Blowing Rock*,[95] discussed at length in Part I,[96] and *Viking Utilities*. In each case the court of appeals held that the trial court had properly denied the dismissal motion as premature. Specifically, in *Horne*, after concluding that a definitive immunity ruling would have to be made under the third step of the *Williams* inquiry, the court of appeals announced that the trial court had properly rejected the municipality's motion to dismiss because no information had been presented "as to the revenue or income derived, if any, from [the defendant municipality's] operation of the park" where the plaintiff had been injured.[97] Although the complaint did not allege that the park had generated income for the municipality, the court of appeals did not view this omission as a sufficient basis for ruling that immunity barred the plaintiff's claims. It remarked that the pertinent facts about the municipality's park-generated revenue "could [be] easily resolved through discovery and presented to the trial court through a subsequent motion for summary judgment."[98] The court ruled similarly in *Viking Utilities*, noting there that the defendant municipality would have another chance to raise its immunity defense once sufficient documentary or testimonial evidence had been gathered.

The effect of the holding in each instance was to send the case back to the trial court so that the parties could proceed with discovery. Discovery normally lasts a minimum of several months and can be quite expensive, encompassing as it does taking witness testimony, serving and responding to interrogatories, and requesting and producing documents in preparation for trial. The *Horne* and *Viking Utilities* decisions leave the impression that, whenever the question of governmental immunity must be resolved under the third step of the *Williams* inquiry, the defendant local government may not be in a position to raise the immunity defense effectively until it has gone through costly and time-consuming discovery. This matters because, for

94. The North Carolina Supreme Court has yet to resolve whether the defense of sovereign or governmental immunity presents a question of subject matter jurisdiction or one of personal jurisdiction. *See* Teachy v. Coble Dairies, Inc., 306 N.C. 324, 328 (1982) ("Therefore, we do not determine whether sovereign immunity is a question of subject matter jurisdiction . . . ."); Meherrin Indian Tribe v. Lewis, 197 N.C. App. 380, 384 (2009) (noting that "our Supreme Court in *Teachy* declined to determine whether sovereign immunity is a question of subject matter jurisdiction or personal jurisdiction").

A local government asserting governmental immunity should take care not to restrict its dismissal motion to the question of subject matter jurisdiction. Under the statutory rules governing appeals in state courts, a defendant who files a motion to dismiss for lack of personal jurisdiction has the right to an immediate appeal if the trial court denies the motion; no such right automatically attaches to a motion to dismiss for want of subject matter jurisdiction. *See* G.S. 1-277(b). A county, municipality, or other unit of local government that raises governmental immunity solely in the context of subject matter jurisdiction can find itself without the option of an immediate appeal if its dismissal motion is denied. *Compare* Davis v. Dibartolo, 176 N.C. App. 142, 144–45 (2006) ("[T]he denial of a . . . motion to dismiss for lack of subject matter jurisdiction is not immediately appealable, even where the defense of sovereign immunity is raised."), *with* Can Am South, LLC v. State, ___ N.C. App. ___, ___, 759 S.E.2d 304, 308 (2014) (allowing an immediate appeal when the denial of a motion "premised on sovereign immunity constitutes an adverse ruling on personal jurisdiction").

95. 223 N.C. App. 26 (2012).

96. Allen, *supra* note 2, at 12–14.

97. *Horne*, 223 N.C. App. at 35.

98. *Id.* at 620.

reasons already stated, resort to the third step could prove to be the norm when a defense of governmental immunity hinges on whether the activity that allegedly injured the plaintiff was governmental or proprietary.

Extended discovery will not always be necessary for a local government to prevail under step three, of course. When the activity at issue is one from which a local government derives no income, an affidavit from the appropriate official—the finance officer comes to mind—combined with the pleadings filed by the parties to the lawsuit could supply the trial court with adequate information for a definitive immunity ruling near the start of litigation. In other cases, precedent will classify the undertaking that led to the plaintiff's injury as a governmental function, and the defendant local government will be entitled to a favorable immunity ruling on that basis. Thanks to *Bynum v. Wilson County*,[99] a decision discussed extensively in Part I,[100] this should already be true of cases in which the plaintiffs allege injuries resulting from the negligent maintenance of county office buildings that house both governmental and proprietary activities.

Conclusion

The 2012 decision of the North Carolina Supreme Court in *Estate of Williams v. Pasquotank County* has already had a profound effect on the availability of governmental immunity as a defense to contract-related equitable claims. As the case law now stands, governmental immunity will not defeat an equitable claim arising from the performance of a proprietary function, except when the equitable claim concerns a contract that has been rendered invalid through noncompliance with the preaudit requirements in G.S. 159-28(a). Moreover, as applied by the North Carolina Court of Appeals, *Williams* has largely removed governmental immunity as a defense against claims for negligent contract performance brought by contractors or third parties, though other legal barriers to liability for these claims still exist. Lastly, *Williams* as interpreted so far has made it more difficult for counties, municipalities, and other units of local government to use governmental immunity to end lawsuits during the initial stages of litigation.

99. 367 N.C. 355 (2014).
100. Allen, *supra* note 2, at 15–18.