Are Ordinances Contracts? A Cautionary Tale of Proprietary and Governmental Functions, Immunity, and Waiver

By Bradford E. Bullock



Lawyers are a lot like the horse, Old Paint. Old Paint, being old and rather set in his ways, likes to stick to the paths with which he's familiar. He knows where all the potholes and slippery rocks are on the well-worn path, and his rider can practically take a nap in the saddle, secure in the knowledge that Old Paint will get him home safely. Old Paint gets decidedly grumpy, however, when the path he's so used to taking gets paved over for yet another Super Target, which forces Old Paint to learn a new trail.

Like Old Paint, I'm grumpy. I'm grumpy because, earlier this year, the Texas Supreme Court handed down a decision, *City of Houston v. Williams*.[1] The ruling has caused some municipal lawyers to groan, as we now have to figure out how we are going to explain to our cities that the distinction between proprietary and governmental functions just got a little blurrier.

Background

In 1978, a Texas appellate court decided the case of *Overton v. City of Houston*, which addressed the issue of entitlement to termination pay for certain employees.[2] The City employees contended that they were entitled to back pay pursuant to the terms of an ordinance, arguing that the ordinance constituted a unilateral contract. Disagreeing with this premise, the appellate court held that an ordinance, alone, could not constitute a contract.[3] Rather, the record had to evidence a contract, in writing, between the plaintiffs and the City, into which the ordinance could be read.[4] This distinction was critical because the City had raised a limitations claim. This was based on the standard two-year taking personal property statute, which the employees had missed; for their part, the employees claimed that the matter was subject to the four-year limitations period for collecting a debt under a contract, which they had met. Because the court held there was no contract, the shorter limitations period applied and the employees' claim was dismissed.

Fast forward, now, to 2004. City of Houston firefighters brought a declaratory judgment action against the City which asked the court to interpret City ordinances and to award monetary damages against the City for improperly withholding back pay. Houston filed a plea to the court's jurisdiction asserting that, because the firefighters sought monetary damages, a declaratory judgment was an improper vehicle for their claim, and that the "sue and be sued" language in the City Charter was not a waiver of governmental immunity because it did not constitute a clear and unequivocal intent to waive immunity.

Having just decided the important case, *Tooke v. City of Mexia*, the Texas Supreme Court overturned the lower court's denial of Houston's plea, holding that the "sue and be sued" language was not a clear and unambiguous waiver of immunity, and that the declaratory judgment statute could not be used as a "back door" method of suing the sovereign for monetary damages. Meanwhile, the Texas Legislature retroactively waived governmental immunity for certain contract claims by enacting Subchapter I, Local Government Code Chapter 271, in 2005.[5] Section 271.152[6] provides:

> A local governmental entity that is authorized by statute or the constitution[7] to enter into a contract and that enters into a contract subject to this subchapter waives sovereign immunity to suit for the purpose of adjudicating a claim for breach of the contract,

subject to the terms and conditions of this subchapter.[8]

Accordingly, numerous lawsuits, including the Houston case, were subsequently remanded to the trial courts to determine whether Chapter 271 waived assertions of immunity in pending cases.

On remand, the firefighters claimed that the ordinances in question constituted a unilateral contract for which immunity was waived under Chapter 271. The trial court and appellate court agreed with the firefighters, and the Texas Supreme Court weighed in on this claim, again. In contrast with the ruling in *Overton*, the City was significantly less happy with the result.

Proprietary vs. Governmental Functions

Municipal practitioners understand the difference between governmental functions and proprietary functions. "Generally speaking, a municipality's proprietary functions are those conducted 'in its private capacity, for the benefit only of those within its corporate limits, and not as an arm of the government,' while its governmental functions are 'in the performance of purely governmental matters solely for the public benefit.'"[9] This distinction is important to local governments because they can get sued for proprietary functions, but are immune from suit and liability for their governmental functions.[10]

More specifically, immunity from suit deprives the trial court of subject-matter jurisdiction and bars an action against the governmental unit in the absence of an express, clear, and unambiguous consent to suit.[11] Because a municipality can function both as a private corporation and as an arm of the government, municipal attorneys have to be cognizant of the difference between conduct that can get their clients sued and conduct for which a shield exists.

The difference between governmental and proprietary functions was not always clear at common law. For example, constructing and maintaining a storm sewer was considered proprietary at common law, whereas street design and maintenance had always been considered governmental.[12] Moreover, because the Texas Constitution gives, to the Legislature, the power to define governmental and proprietary acts and to amend those definitions as it sees fit, the rules of the game can change from legislative session to legislative session.[13]

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Depending on the political winds of the moment, sometimes cities come out ahead and sometimes they don't. For example, in the case of storm-sewer maintenance and construction, the Legislature redefined this function from proprietary to governmental in the Texas Tort Claims Act.[14] And, although the Texas Legislature is usually loathe to create the opportunity for more litigation, that is precisely what it did when it enacted Chapter 271 of the Local Government Code, a chapter that essentially restated what everybody already knew to be the law—that is, that contracting is a proprietary function.

An Unambiguous Waiver of Sense?

Although the two terms are frequently used interchangeably, sovereign immunity is the proper terminology for the immunity to which the state is entitled, and consists of immunity from suit and liability.[15] When performing governmental functions, political subdivisions derive "governmental immunity" from the state's sovereign immunity. Any waivers of this immunity can only be done by the legislature, in clear and unambiguous language.[16]

One of the relatively few immunity waivers available at common law is when the state (or a political subdivision) contracts with a private party.[17] This axiom is well known to municipal practitioners and is part of the advice we regularly give our clients, namely: "You do realize that you can get sued for breach of contract, right?"[18]

Nevertheless, in spite of a veritable hornbook's worth of cases reiterating, over and over, that municipalities waive their immunity when they contract with another party, the Texas Legislature, in its finite wisdom, decided to enact Chapter 271 in 2005.[19] As mentioned, Section 271.152 provided, generally, that a local government that entered into a contract waived sovereign immunity to suit "for the purpose of adjudicating a claim for breach of the contract."[20]

Unilateral Contracts

There are five elements required to create a binding contract. As restated in Section 271.152(2), these are: (1) the contract must be in writing, (2) it must state the essential terms of the agreement, (3) it must provide for goods or services, (4) to the local governmental entity, and (5) be executed on behalf of the local governmental entity.[21]

Unlike a traditional bilateral contract in which two parties make mutual promises, a unilateral contract is created when a promisor promises a benefit if a promisee performs.[22] In the employment context, a unilateral employment

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contract is created when an employer promises an employee certain benefits in exchange for the employee's performance, and the employee performs.[23]

How an Ordinance Turns Into a Unilateral Contract

If one starts with the premise, as the Texas Supreme Court did in *City of Houston v. Williams*, that a municipality utilizes ordinances "as a means to conduct its business," and doesn't distinguish between proprietary business and governmental business, it's slightly easier to see how the court could end up at this result.[24] The court in *Williams*, relying on a 1936 case, *City of San Antonio v. Frizzell*, stated that it had "implicitly recognized that municipalities sometimes contract with third parties by way of ordinance."[25] In describing the ordinance in the 1936 case, the court noted that the ordinance evidenced "the entire contract between a city and a third party."[26]

A slightly closer reading of the *Frizzell* case reveals a couple of inconsistencies with this premise. First, that case noted that, "[t]he ordinance contained the following provision: 'See copy of proposal of said Frizzell hereto attached, marked Exhibit 'D.'"[27] In fact, the very provisions that the *Frizzell* court ended up construing—and which turned out to be central to their holding[28]—were *not* part of the ordinance. Rather, they were part of the plaintiff's proposal documents that were submitted to the City for approval, which approval was furnished by the ordinance.

Second, as the *Frizzell* court noted, it was clear from reading the provisions of the ordinance in question that the City intended to enter into a contract with the plaintiff.[29] The City simply evidenced that approval by passing an ordinance, whose language adopted the language proposed by the plaintiff (as opposed to what most cities would do in 2011, which is to vote to authorize the city manager-administrator to sign the contract).

In *Williams*, the Texas Supreme Court explained that it had regularly recognized that ordinances could act as contracts,[30] but each case that the court cited for this proposition indicated that, in every instance, the municipality had intended to enter into a contract, and for the ordinance in question to either be a part of a separate contract document, or to be the contract itself.[31]

In all likelihood, most ordinances that are intended to be legislative pronouncements will not suddenly become unilateral contracts.

No Disclaimer for You

The Texas Supreme Court also made short work of Houston's defenses. First, the City argued that to declare the ordinance a unilateral contract would create a debt in violation of the Texas Constitution.[32] The Texas Constitution states that "no debt shall ever be created by any city, unless at the same time provision [is] made to assess and collect annually a sufficient sum to pay the interest thereon and create a sinking fund of at least two per cent thereon."[33]

The court dismissed this seemingly solid defense by digging up a 1895 case, and noting that the prohibition did not extend to pecuniary obligations that were intended by the City to be payable out of current revenues for the year of the contract.[34] Again, the problem with this rather abrupt dismissal is that the case upon which the court relied specifically referenced pecuniary obligations that a city intended to incur and that were payable out of current fiscal year revenue that had been appropriated for that purpose.[35]

Houston also pointed to the disclaimer in the ordinance itself, which stated:

> That the provisions of article III of chapter 14 of the Code of Ordinances, Houston, Texas, as amended in section 2 of this ordinance, are subject to amendment or repeal at any time and payment of benefits thereunder is subject to the appropriation or allocation of funds for that purpose by the city council. No provision of this ordinance shall be construed to create a vested right of compensation for sick leave benefits or, where applicable, for termination payments.[36]

Municipal lawyers read this and think that their municipality hasn't entered into a unilateral contract. The action taken by council is specifically subject to more action—that is, a separate vote to appropriate and allocate funds. In other words, the city hasn't promised anything. However, the Texas Supreme Court read the provision and held that the disclaimer amounted to a warning, to City employees, that the City could change the benefits over time, but that, by setting forth the specific terms of sick leave, overtime, and the like, the City *had* obligated itself to vote in favor of appropriating and allocating future funds to cover these expenses— until such time as the City decided to amend or repeal the ordinance.[37]

Conclusion

The City, and amici in the *Williams* case (including the Texas Municipal League), raised concerns that the impact of the holding would be to transmute vast numbers of ordinances into contracts. Nonsense, the Texas Supreme Court said.[38] That scare tactic overlooked the basic requirement of contract law, as most municipal ordinances did not contain the detailed request for performance and promised compensation[39] found in the Houston ordinance.

Well, that's true. In all likelihood, most ordinances that are intended to be legislative pronouncements will not suddenly become unilateral contracts. But the point is that *some* legislative pronouncements, which were never intended to obligate the expenditure of future funds, could be so transmuted. The point of a contract is that two par-

ties come together, have a meeting of the minds and agree to undertake some mutually beneficial action. The point of legislation is to set forth the policy of a city. Unfortunately, in Texas, that distinction is not as clear as it used to be. And Old Paint isn't happy.

Notes

1. City of Houston v. Williams, 54 Tex. Sup. J. 713, 2011 Tex. LEXIS 229 (Tex. Mar. 18, 2011).
2. Overton v. City of Houston, 564 S.W.2d 400, 401 (Tex. Civ. App. 1978).
3. *Id.* at 404.
4. *Id.*
5. Act of May 23, 2005, 79th Leg., R.S., ch. 604, §§ 1–3, 2005 Tex. Gen. Laws 1548, 1548–49 codified at TEX. LOC. GOV'T CODE §§ 271.151-.160).
6. TEX. LOCAL GOV'T CODE § 271.152.
7. That would be all of them.
8. The other terms and conditions of the subchapter included provisions such as "no exemplary damages," which was already the established common law of the land.
9. Tooke v. City of Mexia, 197 S.W. 3d 325, 343 (Tex. 2006).
10. *See* Fed. Sign v. Tex. S. Univ., 951 S.W. 2d 401, 405; 40 Tex. Sup. Ct. J. 676 (Tex. 1997) (discussing sovereign immunity, from which governmental immunity is derived), superseded by statute on other grounds.
11. TEX. GOV'T CODE ANN. § 311.034 (Vernon 2005) ("[A] statute shall not be construed as a waiver of sovereign immunity unless the waiver is effected by clear and unambiguous language"); Travis County v. Pelzel & Assocs., Inc., 77 S.W.3d 246, 248 (Tex. 2002) ("Express consent is required to show that immunity from suit has been waived"), superseded by statute on other grounds.
12. *See* TEX. TRANSP. CODE ANN. § 311.002; Dilley v. City of Houston, 222 S.W.2d 992 (Tex. 1949); Dykes v. City of Houston, 406 S.W.2d 176, 182 (Tex. 1966).
13. TEX. CONST., ART. XI, § 13.
14. TEX. CIV. PRAC. & REM. CODE ANN. § 101.0215(A)(9); City of Tyler v. Likes, 962 S.W.2d 489, 501 (Tex. 1997).
15. Tooke v. City of Mexia, 197 S.W. 3d 325, 331 (Tex. 2006).
16. *See* City of Galveston v. State, 217 S.W.3d 466, 469 (Tex. 2007).
17. Gen. Servs. Comm'n v. Little–Tex Insulation Co., 39 S.W.3d 591, 594 (Tex. 2001).
18. *See, e.g.*, City of Odessa v. Barton, 967 S.W.2d 834 (Tex. 1998) (breach of employment contract); Flagship Hotel, Ltd. v. City of Galveston, 117 S.W.3d 552 (Tex. App. 2003) (breach of lease agreement); Johnson v. City of Dublin, 46 S.W.3d 401 (Tex. App. 2001) (action by former chief of police for breach of contract, wrongful termination, and Whistleblower Act violations); Texas Indus., Inc. v. City of Dallas, 1 S.W.3d 792 (Tex. App. 1999) (plaintiff lessor leased its property to city for use as a landfill; summary judgment granted on limitations grounds against lessor who sued city); Municipal Admin. Servs., Inc. v. City of Beaumont, 969 S.W.2d 31 (Tex. App. 1998); City of Beaumont v. Excavators & Constructors, Inc., 870 S.W.2d 123 (Tex. App. 1993) (breach of contract action by excavating contractor for inefficiency and delay damages); City of Harker Heights v. Sun Meadows Land, Ltd., 830 S.W.2d 313 (Tex. App. 1992) (suit by developers involving city's refusal to refund escrowed funds that had not been used for agreed purpose); City of Terrell v. McFarland, 766 S.W.2d 809 (Tex. App. 1988) (breach of contract suit by resident against city for failure to reimburse portion of costs of constructing sewer line on his property); Cook v. City of Plano, 656 S.W.2d 607 (Tex. App. 1983) (breach of contract action in which real-estate broker sued city for failure to use broker as exclusive real-estate agent); City of Baytown v. Bayshore Constructors, Inc., 615 S.W.2d 792 (Tex. Civ. App. 1980) (breach of contract action in which contractor for construction of underground sewer lines sued to recover for extra work caused by city's alleged failure to provide adequate plans and specifications); Brodhead v. City of Forney, 538 S.W.2d 873 (Tex. Civ. App. 1976) (breach of contract action in which developer sued for failure to install water and sewer lines and do street work); B.L. Nelson & Assocs., Inc. v. City of Argyle, 535 S.W.2d 906 (Tex. Civ. App. 1976) (engineer's suit to recover for services rendered).
19. They also could have been bored one day during session. As the Texas Legislature meets only every two years, they feel especially compelled to get a lot of stuff "done."
20. TEX. LOCAL GOV'T CODE § 271.152.
21. TEX. LOCAL GOV'T CODE § 271.152(2) ("Contract subject to this subchapter" means a written contract stating the essential terms of the agreement for providing goods or services to the local governmental entity that is properly executed on behalf of the local governmental entity).
22. Vanegas v. Am. Energy Servs., 302 S.W.3d 299, 303 (Tex. 2009).
23. *Id.* (quoting 2 JOSEPH M. PERILLO & HELEN HADJIYANNAKIS BENDER, CORBIN ON CONTRACTS § 6.2 (1995)).
24. City of Houston v. Williams, 54 Tex. Sup. J. 713, 2011 Tex. LEXIS 229 at *17 (Tex. Mar. 18, 2011), citing *Cent. Power & Light Co. v. City of San Juan*, 962 S.W.2d 602, 613 (Tex. App. 1998).
25. *Id.*, citing *City of San Antonio v. Frizzell*, 91 S.W.2d 1056, 1056–57 (1936).
26. *Id.*
27. City of San Antonio v. Frizzell, 91 S.W.2d 1056, 1057 (Tex. 1936).
28. The fight was over the calculation of damages.
29. "It is obvious that by the ordinance [the city] intended to accept and approve [plaintiff's] proposal." *Frizzell*, 91 S.W.2d at 1057.
30. City of Houston v. Williams, 54 Tex. Sup. J. 713, 2011 Tex. LEXIS 229 at *17, *18 (Tex. Mar. 18, 2011).
31. *See, e.g.*, Byrd v. City of Dallas, 6 S.W.2d 738, 740 (Tex. 1928); S. Union Co. v. City of Edinburg, 129 S.W.3d 74, 76 (Tex. 2003).
32. TEX. CONST., ART. XI, § 5.
33. *Id.*
34. McNeal v. City of Waco, 33 S.W. 322, 323–24 (Tex. 1895).
35. *Id.*
36. Houston, Tex., Ordinance 96-1088 § 7 (Oct. 23, 1996).
37. City of Houston v. Williams, 54 Tex. Sup. J. 713, 2011 Tex. LEXIS 229 (Tex. Mar. 18, 2011). The court also held that the ordinances, when duly enacted by the City with the intent to be bound, were "executed" under section 271.151(2).
38. *Id.* at *36.
39. Notwithstanding, further, that the said "promised compensation" was contingent upon funds being appropriated and allocated. That detail is conveniently overlooked. **ML**