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RISKY BUSINESS: THE DANGERS OF CONTRACTING WITH MUNICIPALITIES

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A private company may eye a potential contract with a North Carolina county or city as a lucrative opportunity, but contracting with a municipality has its dangers. A contractor may think it is protected because it has a signed contract—and may even fully perform it—only to find out that there is no valid contract, the municipality cannot be held liable for breach, and the contractor will not be paid. This harsh and surprising result occurs because the municipality failed to comply with the statutory requirement of a "pre-audit certificate." When a county or city enters into a contract that creates a monetary obligation in the municipality's current fiscal year, the county or city must sign a pre-audit certificate in order for there to be a valid contract—and hence a right for the contractor to be paid.

The requirement of a pre-audit certificate is found in General Statutes section 159-28(a), part of the Local Government Budget and Fiscal Control Act. The law requires a written certificate, signed by the municipality's finance officer, stating that "This instrument has been pre-audited in the manner required by the Local Government Budget and Fiscal Control Act." This law is intended to ensure that contractual obligations incurred by a municipality are appropriated and that the municipality has sufficient funds to pay the financial obligations that are due in the current fiscal year. If the pre-audit certificate is not included, the contract or purchase order is invalid and cannot be enforced. This requirement applies to any county, town or city, as well as any board, agency, commission, or institution of a county, town or city. A different law imposes a similar requirement on contracts with school boards.

The recent North Carolina Court of Appeals case of *Charlotte Motor Speedway v. County of Cabarrus*, ___ N.C. App. ___, 748 S.E.2d 171 (2013), drives home the point that it can be very risky to do business with a municipality on an informal basis. The Lowes Motor Speedway threatened to leave Cabarrus County unless the county paid for infrastructure improvements to accommodate both its existing race track and a planned drag strip that would be built nearby. Cabarrus County and the City of Concord sent the Speedway's CEO a letter stating that they were "committed to providing $80,000,000" for "the financing, design and construction of road, pedestrian, utility and noise attenuation projects." Of that amount, $20,000,000 would have to be funded by the State of North Carolina, but, if that could not be done in three years, the County "pledged to provide it from other sources."

The letter closed by noting that "all parties anticipate that the $80,000,000 will be formalized in an agreement . . . ." Both the city's mayor and the chairman of the County Commission signed the letter. After the Speedway's CEO received it, he called the mayor and told him "we have an agreement." No formal contract was signed, and the County's finance officer did not sign a pre-audit certificate. Nevertheless, the Speedway built its drag strip at a cost of $60,000,000 and spent another $4,000,000 on public infrastructure improvements near the Speedway. Once this construction work was completed, the County tendered a formal written agreement which the

Speedway rejected as having terms to which it had not agreed. The Speedway filed suit against the County seeking to recover damages, but its case was dismissed.

The Court of Appeals affirmed the dismissal, finding that the letter was not a valid contract but merely an agreement to agree with terms that were too indefinite to be enforced. The parties argued over the issue of a lack of a pre-audit certificate, but the Court of Appeals decided to reach the merits of the plaintiff's contract claim rather than dismiss the case on a statutory technicality that some might say unfairly penalizes contractors who deal in good faith with municipalities. The Speedway has further appealed its case to the North Carolina Supreme Court, where it faces a major hurdle: even if the County's letter is an otherwise valid contract, there is no pre-audit certificate.

If the Speedway loses its final appeal, it will be in good company. Contractors have been on the losing end of the statute since it was enacted, and in recent years there have been a spate of cases in which contractors have lost and counties and cities have triumphed. For example, in another 2013 case, *Howard v. County of Durham*, ___ N.C. App. ___, 748 S.E.2d 1 (2013), the Court of Appeals affirmed the dismissal of a claim brought by a former employee for breach of a settlement agreement entered into with a county. The courts have used the statute to nullify a broad variety of other types of contracts, including contracts to buy real estate, equipment leases, employment contracts and other service agreements, contracts for post-employment benefits, contracts to issue permits, and contracts agreeing to allocate a percentage of profits. The statute has been applied regardless of whether the contract is in writing or is a verbal agreement. Because any person contracting with a municipality will be charged with knowledge of the statute's requirement, as well as the duty to prove compliance if the agreement is the subject of litigation, familiarity with the statute is essential.

Strict compliance with the statute is required. A contract is void if the pre-audit certificate was included with the contract but was not signed. Having the county manager sign is not good enough—it has to be the finance manager. Although a pre-audit certificate is not required when the municipality's obligation to pay money will arise in future fiscal years, the entire contract is invalid if at least some of the obligation will be incurred during the fiscal year in which the agreement is made.

If the municipality does not comply with the statute, the loss will fall on the contractor with whom it did business. A claim for money damages will fail and the municipality will be protected from liability under the doctrine of sovereign immunity. Normally, a municipality waives sovereign immunity—and consents to being sued for breach of contract—when it enters into a *valid* contract. But if the contract is invalid because no pre-audit certificate was signed, the municipality has not waived its sovereign immunity. The contractor who has fully performed its contract and now wants to be paid will get no relief if the municipality raises the pre-audit certificate defense. Alternative theories such as estoppel or unjust enrichment will fail just as certainly as a breach of contract claim. The law will not allow a contractor to obtain compensation indirectly through a non-contract claim when the statute directly forbids recovery of damages through a contract claim.

Charlotte Motor Speedway reminds us that, when a contract with a municipality creates a monetary obligation in the current fiscal year, it is vital that the contractor stay its hand and does not perform unless and until it has a formal written contract signed by the municipality that clearly lays out all of the terms of the parties' agreement *and* it has a pre-audit certificate signed by the municipality's finance officer. Failing to obtain both could leave the contractor holding the bill for goods or services it provided to a city or county.

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