

Don't Let the Golden Goose Get Away: The Need for Caution When Contracting with a Local Government Unit

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When contracting with a local government unit, it is important for businesses to consider additional legal requirements that, if not complied with, may void what appeared to be a golden opportunity.

Introduction

Businesses generally believe that their contracts will be enforceable, especially when they contract with a local government unit—such as a city, town, county, school board, or special district. Contracts involving local governments, however, often require additional regulatory approvals to be valid and enforceable. Two often applicable requirements are a preaudit certification and Local Government Commission approval. It is important for you to be aware of such requirements. Otherwise, you may be left without recourse when a local government unit fails to comply with its contractual obligations to you or your business.

I. Preaudit Certification

North Carolina law requires that local government units "preaudit" certain types of contractual obligations. In order to preaudit a contract, the unit's finance officer should include on the contract a signed authorization stating that the finance officer has examined the contract to ensure that it complies with section 159-28(a) of the North Carolina General Statutes which provides, in part:

No obligation may be incurred in a program, function, or activity accounted for in a fund included in the budget ordinance unless the budget ordinance includes an appropriation authorizing the obligation and an unencumbered balance remains in the appropriation sufficient to pay in the current fiscal year the sums obligated by the transaction for the current fiscal year. No obligation may be incurred for a capital project or a grant project authorized by a project ordinance unless that project ordinance includes an appropriation authorizing the obligation and an unencumbered balance remains in the appropriation sufficient to pay the sums obligated by the transaction. If an obligation is evidenced by a contract or agreement requiring the payment of money or by a purchase order for supplies and materials, the contract, agreement, or purchase order shall include on its face a certificate stating that the instrument has been preaudited to assure compliance with this subsection unless the obligation or a document related to the obligation has been approved by the Local Government Commission, in which case no certificate shall be required.

(A similar statute applies specifically to school boards: N.C. Gen. Stat. § 115C-441.)

While the language of § 159-28(a) is somewhat complicated, the upshot is that a government unit must preaudit a specific contractual obligation where it will have to make that payment out of the current fiscal year's budget, or the Local Government Commission must approve the contract..

In addition, any long-term capital project or a project resulting from a project ordinance—such as many construction projects—require preaudit certification.

If a contract does not contain the necessary preaudit certification, the contract "is invalid and may not be enforced." Thus, if the contract is with you or your business, you can be left without any recourse due to the unit's failure to take the proper steps to preaudit your contract.

The purpose behind preaudit certification is to promote responsible budgeting. The statute seeks to ensure that the local government unit examines its budget to ensure it can pay an obligation due in the current fiscal year. Payments required in future fiscal years generally are not a concern because the local government unit can draft its future budgets to ensure that the required funds are available.

Only specific types of contractual obligations require preaudit certification. Nevertheless, local government units sometimes try to apply the preaudit requirement in a more aggressive manner. For instance, newly elected or appointed leadership may desire to avoid a preexisting contract that it does not support. If you are knowledgeable of when the statute does not apply, as well as when it does, you will be in a position to fight to save your contract.

If you can't save your contract because the statute does apply and you didn't guide the local government unit into obtaining the preaudit certification when you negotiated your contract, the result can be a harsh one. When you seek to enforce your contract, the local government unit may simply refuse to pay you even though you have already supplied your goods or services.

For example, in a 2001 North Carolina Court of Appeals case entitled Data General Corporation v. County of Durham, Data General contracted to lease computer equipment to Durham County. The county continued to use the equipment after the lease term expired, but the county refused to make any payments to Data General during this period. Data General sued to recover the payments it claimed the county owed, but the North Carolina Court of Appeals held that the obligation was unenforceable due to the missing preaudit certification. Further, due to governmental immunity, no other legal cause of action was available to Data General to recover from the county. Although the county benefited from the use of Data General's computer equipment for two years without payment, Data General was left with no legal recourse.

Only those contractual obligations that fall under the specific requirements of the North Carolina General Statutes require preaudit certification. But because of the harsh result that can arise when trying to enforce a contractual obligation missing a required preaudit certification, and the aggressiveness with which local government units may try to apply the preaudit defense, you should carefully analyze the possible preaudit requirement whenever you contract with a local government unit. You also should require that the certification be made before you supply any goods or services pursuant to your contract. Don't rely on the local unit to know or comply with the statutes!

II. Local Government Commission Approval

In addition to the preaudit certification requirement, North Carolina law also requires that, in certain cases, local government units obtain the approval of the North Carolina Local Government Commission before entering into contracts.

The Local Government Commission ("Commission") is a nine-member body that provides fiscal management assistance to North Carolina's local governments. The primary purpose of the Commission is to monitor and approve certain long-term debt financing, such as the issuance of local government bonds. The Commission generally receives credit for helping to promote the fiscal stability of North Carolina's local governments.

The relevant requirements again appear primarily, but not exclusively, in Chapter 159 of the North Carolina General Statutes. While the focus of the Commission is on long-term debt financing, there are certain other contracts that require Commission approval. Again, without a required Local Government Commission approval, your contract with a local government unit will be void and unenforceable. For example, § 159-149 provides:

A unit of local government may not enter into any contract subject to this Article unless it is approved by the Local Government Commission as evidenced by the secretary's certificate thereon. Any contract subject to this Article that does not bear the secretary's certificate thereon shall be void, and it shall be unlawful for any officer, employee, or agent of a unit of local government to make any payments of money thereunder.

Contracts and agreements that require Commission approval typically involve long-term obligations, such as a debt financing arrangement or something comparable. For instance, § 159-148 requires Commission approval for certain contracts, agreements, and memoranda of understanding "relating to the lease, acquisition, or construction of capital assets" where the contract extends for five or more years and meets other specific requirements, including a particular monetary threshold (usually \$500,000.00) and the possibility that the local government entity may need to exercise its taxing power to meet the obligation. In addition, § 159-153 essentially provides a "catch-all" provision for any contractual obligation where a local government unit incurs indebtedness or enters into "any similar type of financing arrangement" that is analogous to borrowing money.

You should make yourself aware of the various scenarios where Commission approval is required, particularly where a long-term contract or financing arrangement is involved. Therefore, if you are contemplating entering into a contract with a local government unit, determine if Commission approval is required, and if it is, make sure the contracting unit obtains the approval before you provide the promised goods or services or invest heavily in preparing to do so. Otherwise, your contract may be void.

Conclusion

Contracting with local government units to provide various goods and services can be good business for you and your company. However, it is important to remember that dealing with local governments may require meeting additional legal requirements. This Article has provided an overview of two such requirements: preaudit certification and Local Government Commission approval. Make sure you are aware of when North Carolina law requires preaudit certification or Local Government Commission approval, and make sure you obtain any required certification or approval for your contract. Otherwise, you could get burned. Failure to meet these legal requirements can mean that you or your business will be left with no means to enforce your contract.

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