UPDATE ON CONTRACTS IMMUNITY

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Update on Contracts Immunity

This paper provides an overview of important case law developments in the area of governmental immunity in breach of contract cases brought against Texas municipalities. First, the paper provides a background on sovereign immunity and an explanation of the "governmental/proprietary dichotomy". Second, the paper examines the Wasson Interests Ltd. v. City of Jacksonville line of decisions. Third, the paper examines the Texas Supreme Court's decision in Hays Street Bridge Restoration Group v. City of San Antonio. Fourth and finally, the paper examines the Texas Supreme Court's decision in Rosenberg Development Corporation v. Imperial Performing Arts, Inc.

1. Background on Sovereign Immunity and the Governmental/Proprietary Dichotomy

"Texas is inviolably sovereign."[1] The principle of sovereign immunity is inherent in Texas statehood and has long provided protections to the state from suits for money damages.[2] Political subdivisions of the state—such as counties, municipalities, and school districts—share in the State's inherent immunity.[3] However, counties, municipalities, and school districts "represent no sovereignty distinct from the state and possess only such powers and privileges as have been expressly or impliedly conferred upon them."[4]

As a corollary to the above rules, the Texas Supreme Court has long distinguished "between those acts performed as a branch of the state and those acts performed in a proprietary, non-governmental capacity."[5] Commonly known as the "governmental/proprietary dichotomy", this concept provides that "immunity protects a governmental unit from suits based on its performance of a governmental function but not a proprietary function."[6] Municipalities share in the sovereign immunity of the State when they act "as a branch" of the State but not when they act "in a proprietary, non-governmental capacity."[7]

The Texas Supreme Court has described "governmental functions" as municipal activities in the performance of "purely governmental matters solely for the public benefit."[8] Historically, governmental functions have consisted of activities "normally performed by governmental units" such as "police and fire protection."[9] Such activities are performed pursuant to powers conferred

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[1] *Wasson Interests, Ltd. v. City of Jacksonville*, 489 S.W.3d 427, 429–30 (Tex. 2016).
[2] *Id.* (citing *Alden v. Maine*, 527 U.S. 706, 713, 119 S.Ct. 2240, 144 L.Ed.2d 636 (1999), *Tex. Nat. Res. Conservation Comm'n v. IT–Davy*, 74 S.W.3d 849, 853 (Tex. 2002).
[3] *Id.* (citing *Reata Constr. Corp. v. City of Dallas*, 197 S.W.3d 371, 374 (Tex.2006)).
[4] *Id.* (citing *Payne v. Massey*, 145 Tex. 237, 196 S.W.2d 493, 495 (1946)).
[5] *Id.* (citing *Dilley v. City of Houston*, 148 Tex. 191, 222 S.W.2d 992, 993 (1949); *City of Galveston v. Posnainsky*, 62 Tex. 118, 127 (1884)).
[6] *Wasson Interests, Ltd. v. City of Jacksonville*, 559 S.W.3d 142, 146 (Tex. 2018).
[7] *Wasson Interests, Ltd. v. City of Jacksonville*, 489 S.W.3d 427, 430 (Tex. 2016).
[8] *Tooke v. City of Mexia*, 197 S.W.3d 325, 343 (Tex. 2006) (citing *Dilley v. City of Houston*, 148 Tex. 191, 222 S.W.2d 992, 993 (1949)).
[9] *Wasson Interests, Ltd. v. City of Jacksonville*, 559 S.W.3d 142, 147 (Tex. 2018).

from the State to municipalities "for purposes essentially public" and pertain to the "administration of general laws made to enforce the general policy of the state."[10]

By contrast, proprietary functions are those "performed by a city, in its discretion, primarily for the benefit of those within the corporate limits of the municipality," and "not as an arm of the government."[11] These are usually activities "that can be, and often are, provided by private persons."[12] Acts that are proprietary in nature are not done "as a branch of the state" and thus "do not implicate the state's immunity for the simple reason that they are not performed under the authority, or for the benefit, of the sovereign."[13]

Although courts have long recognized the governmental/proprietary dichotomy as a matter of common law, the Texas Constitution authorizes the Legislature to "define for all purposes those functions of a municipality that are to be considered governmental and those that are proprietary, including reclassifying a function's classification assigned under prior statute or common law."[14] Exercising that authority, the Legislature has defined and enumerated in C.P.R.C. § 101.0215 a non-exhaustive list of governmental and proprietary functions for the purposes of determining whether immunity applies to tort claims against a municipality.[15]

Section 101.0215(a) identifies the following "governmental functions": (1) police and fire protection and control; (2) health and sanitation services; (3) street construction and design; (4) bridge construction and maintenance and street maintenance; (5) cemeteries and cemetery care; (6) garbage and solid waste removal, collection, and disposal; (7) establishment and maintenance of jails; (8) hospitals; (9) sanitary and storm sewers; (10) airports, including when used for space flight activities; (11) waterworks; (12) repair garages; (13) parks and zoos; (14) museums; (15) libraries and library maintenance; (16) civic, convention centers, or coliseums; (17) community, neighborhood, or senior citizen centers; (18) operation of emergency ambulance service; (19) dams and reservoirs; (20) warning signals; (21) regulation of traffic; (22) transportation systems; (23) recreational facilities, including but not limited to swimming pools, beaches, and marinas; (24) vehicle and motor driven equipment maintenance; (25) parking facilities; (26) tax collection; (27) firework displays; (28) building codes and inspection; (29) zoning, planning, and plat approval; (30) engineering functions; (31) maintenance of traffic signals, signs, and hazards; (32) water and sewer service; (33) animal control; (34) community development or urban renewal activities undertaken by municipalities and authorized under Chapters 373 and 374 of the Local Government Code; (35) latchkey programs conducted exclusively on a school campus under an interlocal agreement with the school district in which the school campus is located; and (36) enforcement of land use restrictions under Subchapter E, Chapter 212 of the Local Government Code.

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[10] *Wasson Interests, Ltd. v. City of Jacksonville*, 489 S.W.3d 427, 433 (Tex. 2016)
[11] Wasson Interests, Ltd. v. City of Jacksonville, 559 S.W.3d 142, 147 (Tex. 2018) (citing *Gates v. City of Dallas*, 704 S.W.2d 737, 739 (Tex. 1986), *Dilley*, 222 S.W.2d at 993)).
[12] *Id.*
[13] *Id.* (*Wasson Interests, Ltd. v. City of Jacksonville*, 489 S.W.3d 427 (Tex. 2016)
[14] Tex. Const. art. XI, § 13.
[15] Tex. Civ. Prac. & Rem. Code § 101.0215.

By comparison, Section 101.0215(b) identifies the following "proprietary functions": (1) the operation and maintenance of a public utility; (2) amusements owned and operated by the municipality; and (3) any activity that is abnormally dangerous or ultrahazardous.

The above statutory provisions, although located in the Texas Tort Claim Act, have proven to be persuasive statutory authority frequently cited in court decisions concerning the governmental / proprietary dichotomy in a breach-of-contract context.

2. **The *Wasson Interests Ltd. v. City of Jacksonville* Line of Decisions**

As discussed above, the Texas Supreme Court has long held that the governmental/proprietary dichotomy applies to tort claims.[16] In 2016, the Texas Supreme Court held in Wasson Interests, Ltd. v. City of Jacksonville (Wasson I) that the governmental/proprietary dichotomy also applies to contract claims.[17] Prior to 2016, there had been a split in the courts of appeals as to whether the dichotomy applied only to tort claims, or whether the dichotomy applied to both tort and contract claims.[18]

In Wasson I, the appeals court did not address whether the city in question, Jacksonville, was performing a proprietary or governmental function. Accordingly, the Supreme Court remanded the case back to the court of appeals to address this question. On remand, the appeals court held that the city was performing a governmental function. The appeals court focused on the specific acts underlying the plaintiff's breach of contract claim.[19] Specifically, the court of appeals considered the following facts of note:

- The plaintiff was leasing a residential property from the city on the waterfront of Lake Jacksonville.
- After the plaintiff began operating short-term rentals on the property, the city sent an eviction notice, notifying the plaintiff that its short-term rentals constituted a commercial use of the property, which violated local zoning ordinances.

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[16] *Wasson Interests, Ltd. v. City of Jacksonville*, 489 S.W.3d 427, 429 (Tex. 2016) (citing *Tooke v. City of Mexia*, 197 S.W.3d 325, 343 (Tex. 2006)).

[17] *Wasson Interests, Ltd. v. City of Jacksonville*, 489 S.W.3d 427 (Tex. 2016).

[18] *Compare City of Georgetown v. Lower Colo. River Auth.*, 413 S.W.3d 803, 812 (Tex.App.—Austin 2013, pet. Dism'd) ("conclud[ing] that the proprietary-governmental dichotomy does apply to contract claims under the common law"), *with City of San Antonio ex rel. City Pub. Serv. Bd. v. Wheelabrator Air Pollution Control, Inc.*, 381 S.W.3d 597, 603-05 (Tex. App.—San Antonio 2012, pet. denied), (holding that *Tooke* created a default presumption of governmental immunity and thus the dichotomy does not apply to contract claims) and *Republic Power Partners, L.P. v. City of Lubbock*, 424 S.W.3d 184, 193 (Tex.App.—Amarillo 2014, no pet.) ("Finding . . . *Wheelabrator* to be convincing [and] extend[ing] that ruling to find immunity does apply to claims arising from the breach of an express contract arising out of the performance of a proprietary function.").

[19] *Wasson Interests, Ltd. v. City of Jacksonville*, 513 S.W.3d 217, 221–22 (Tex. App.—Tyler 2016).

- The city and the plaintiff entered into a reinstatement agreement that specified the property's acceptable uses under the lease.
- The plaintiff unsuccessfully sought a variance from the Lake Jacksonville Advisory Board and the Jacksonville City Council to allow commercial use of the property.
- The city later sent a second eviction notice based on the plaintiff's continued commercial use of the property. The notice informed the plaintiff that its use of the property was a violation of the reinstatement agreement.
- The plaintiff filed suit, alleging that the city breached the lease by improperly terminating the lease and evicting the plaintiff.[20]

The court of appeals concluded that the act forming the basis of the plaintiff's claim was the city's use of its zoning ordinances and the lease restrictions to terminate the lease.[21] The appeals court further concluded that this action was a proper use of the city's police power to (1) maintain a healthy and safe water supply for the general welfare of its residents; (2) protect local residents from the ill effects of urbanization and enhance their quality of life; and (3) preserve and maximize lease lot property values.[22] In so finding, the court of appeals cited C.P.R.C. 101.0215(a), which identifies as government functions the development and maintenance of reservoirs, as well as the regulation of "waterworks" and "water and sewer service".[23]

The plaintiff again appealed to the Texas Supreme Court. On October 5, 2018, the Texas Supreme Court issued its second decision in the case, commonly referred to as "Wasson II". In its decision, the Supreme Court reversed the court of appeals, holding that the relevant question is whether the municipality "engaged in a governmental or proprietary function when it entered the contract, not when it allegedly breached the contract."[24] In other words:

> [T]he focus belongs on the nature of the contract, not the nature of the breach. If a municipality contracts in its proprietary capacity but later breaches that contract for governmental reasons, immunity does not apply. Conversely, if a municipality contracts in its governmental capacity but breaches that contract for proprietary reasons, immunity does apply. This approach is most consistent with the purposes of both immunity and the governmental/proprietary dichotomy, and it provides clarity and certainty regarding the contracting parties' rights and liabilities.[25]

The Texas Supreme Court then announced a four-factor test to determine whether an action is governmental or proprietary in contract cases:

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[20] *Wasson Interests, Ltd. v. City of Jacksonville*, 513 S.W.3d 217, 219–20 (Tex. App.—Tyler 2016).
[21] *Id.* at 222.
[22] *Id.*
[23] *Id.*
[24] *Wasson Interests, Ltd. v. City of Jacksonville*, 559 S.W.3d 142, 149 (Tex. 2018)
[25] *Id.*

> [W]e consider whether (1) the City's act of entering into the leases was mandatory or discretionary, (2) the leases were intended to benefit the general public or the City's residents, (3) the City was acting on the State's behalf or its own behalf when it entered the leases, and (4) the City's act of entering into the leases was sufficiently related to a governmental function to render the act governmental even if it would otherwise have been proprietary. [26]

On the first factor, the Court held that the city's decision to lease its lakefront property to the plaintiff was discretionary, and therefore indicative that the city was performing a proprietary function.[27] The Court observed that a city can control its contractual liabilities by "refusing to enter into the contract" in the first place, and that the city had no obligation to lease the lakefront lots to private parties.[28] For example, it could have left the land unused, used it strictly for the city's purposes, or designated it as parks, a golf course, or some other form of recreational activity.[29]

On the second factor, the Court held that the city's decision to lease the lakefront property primarily benefited its own residents, not the public at large, and therefore indicative that the city was performing a proprietary function.[30] In so finding, the Court clarified that this factor concerns which parties "a contract *primarily* benefits".[31] The Court noted that although non-residents benefited from the city's decision to lease the lakefront property, the record indicated the city's primary objective was to develop the lake and that the lease raised funds for the city budget.[32]

On the third factor, the Court held that when the city entered into the lease agreement, the city was acting on its own behalf, not as a branch of the state, and therefore indicative that the city was performing a proprietary function.[33] The Court referred to its analysis on the first two factors, noting that the decision to lease the property was discretionary and primarily benefited the city's residents, not the public at large.[34]

On the fourth factor, the Court held that the city's decision to lease the lakefront property was not sufficiently related to its governmental functions, and therefore indicative that the city was performing a proprietary function.[35] The Court further held that the leasing of the property was not "closely related to or necessary for" the performance of governmental activities, noting that a city's

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[26] *Id.* at 150.
[27] *Id.*
[28] *Id.* at 150-51
[29] *Id.* at 151.
[30] *Id.*
[31] *Id.* (emphasis in original)
[32] *Id.* at 151-52.
[33] *Id.* at 152.
[34] *Id.* at 152.
[35] *Id.*

proprietary action may be treated as governmental only if it is "essential to the city's governmental actions." [36]

The Supreme Court therefore found that all four factors supported the conclusion that the city of Jacksonville was engaging in a proprietary function by leasing out the waterfront properties for residential use. Accordingly, the city did not have governmental immunity against the plaintiff's breach of contract claim. However, the Supreme Court noted that "[i]n some cases, some factors may point to one result while others point to the opposite result."[37] In such cases, courts should "consider immunity's nature and purpose and the derivative nature of a city's access to that protection." [38]

3. **Hays Street Bridge Restoration Group v. City of San Antonio**

On March 15, 2019, the Texas Supreme Court issued Hays Street Bridge Restoration Group v. City of San Antonio, 570 S.W.3d 697 (Tex. 2019), which provides further clarification regarding the proper immunity analysis in breach of contract cases involving municipalities.

The case concerns the restoration of the Hays Street Bridge in San Antonio. Built in the 1880s, the Hays Street Bridge consists of two-spans, a 225-foot Phoenix Whipple span and a 130-foot Pratt span, resting on columns made by the Pennsylvania Phoenix Iron Company.[39] By the early 1980s, the bridge had become unsafe for vehicles and pedestrians.[40] The city ordered it closed, and the Union Pacific Railroad made plans to demolish it.[41]

A group of residents formed the Hays Street Bridge Restoration Group (the "Restoration Group") to persuade the city of San Antonio to preserve and restore the bridge for community use.[42] The Restoration Group envisioned that the land surrounding the bridge would be acquired and developed to feature the bridge as a cultural attraction with parking, educational facilities, restrooms, a park, and a hike-and-bike trail.[43] The city obtained a $ 2.89 million federal grant administered by the Texas Department of Transportation, which accounted for 80% of the project's funding.[44]

In 2002, the city and the Restoration Group executed a Memorandum of Understanding (MOU) to "to outline each party's responsibilities" with respect to funding the project.[45] The Restoration Group promised to "[c]ontinue to raise matching funds through grant applications and other private resources" and to "[t]imely transfer" the funds to the city. In exchange, the city

[36] *Id.* at 153.
[37] *Id.* at 154.
[38] *Id.*
[39] *Hays St. Bridge Restoration Group v. City of San Antonio*, 570 S.W.3d 697, 699 (Tex. 2019).
[40] *Id.*
[41] *Id. at 700.*
[42] *Id.*
[43] *Id.*
[44] *Id.*
[45] *Id.*

promised to "[e]nsure that any funds generated by the Restoration Group . . . [would] go directly to the approved City of San Antonio budget . . . for the Hays Street Bridge project".[46]

Over the next decade, the Restoration Group raised and transferred to the City more than $ 189,000 in cash and arranged for significant in-kind donations, including the Bridge and adjacent property.[47] The City finished restoring the bridge but then decided not to use the adjacent property for a park. [48] Instead, the city adopted an ordinance authorizing the sale of the adjacent property to Alamo Beer Company for $ 295,000 as part of an economic-incentive package to induce Alamo to construct a microbrewery, restaurant, and event space that would create jobs and generate tax revenue for the City.[49] As part of the package, the City would return the $ 295,000 to Alamo as part of a landscape-improvement grant.[50]

The Restoration Group sued, alleging that a transfer of the adjacent property to Alamo Beer Company would breach the city's promise in the MOU to apply "funds" raised by the Restoration Group "directly" to the City's "budget . . . for the Hays Street Bridge project".[51] The Restoration Group sought only specific performance.[52] A jury ruled in favor of the Restoration Group, finding that the adjacent property was "subject to the terms of the MOU" and that the City "failed to comply with the MOU with respect to the [property]".[53]

The court of appeals reversed, holding that the city was immune from suit.[54] Specifically, the appeals court held that "the City's functions under the [MOU] are purely governmental," not proprietary, and that the Local Government Contract Claims Act does not waive the City's immunity from suit for specific performance of a contract.[55] The Restoration Group appealed to the Texas Supreme Court.

The main issue before the Texas Supreme Court was "whether the City is immune from suit for specific performance of its promise in the MOU to '[e]nsure that any funds generated by the Restoration Group ... go directly to the approved City ... budget ... for the Hays Street Bridge project' ".[56] The Texas Supreme Court provided the following roadmap for its analysis:

> Our caselaw prescribes a relatively simple two-step process for addressing the applicability of immunity. First, we determine the applicability of immunity in the first instance. Because governmental immunity is a common-law doctrine, determining its

[46] *Id.*
[47] *Id.*
[48] *Id.* at 701.
[49] *Id.*
[50] *Id.*
[51] *Id.*
[52] *Id.*
[53] *Id.*
[54] *Id.*
[55] *Id.* at 701-02.
[56] *Id.* at 702-03.

> existence, we recently reaffirmed, has historically been, and is now a job solely for the judiciary. Second, if immunity exists, then we look to statutory law to determine whether the Legislature has waived it."[57]

On the first question, the Court held that the *Wasson* factors on the whole support a finding that the city of San Antonio has governmental immunity because it was engaging in a governmental function by entering into the MOU with the Restoration Group.[58] Although entering into the contract was a discretionary action taken by the city, the restoration of the bridge and the revitalization of the surrounding area were intended to benefit the general public, not just city residents.[59] Furthermore, 80% of the project was funded through the Texas Department of Transportation.[60] Accordingly, the Court held that the project was intended to benefit not only the city, but also the State.[61] Finally, the Supreme Court found that the specific purpose of the project was sufficiently related to the governmental functions listed in Section 101.0215(a).[62]

On the second question, the Supreme Court held that the Local Government Contract Claims Act ("LGCCA"), codified in Chapter 271 of the Local Government Code, waived the city's immunity on the specific performance claim.[63] Section 271.152 "waives" a municipality's immunity from suit "for the purpose of adjudicating a claim for breach of contract" but only "subject to the terms and conditions" of Section 271.153.[64]

The Court cited its previous decision in *Zachry Construction Corp. v. Port of Houston Authority of Harris County*, in which the Court explained that the "subject to" phrase "incorporates the other provisions of the Act to define the scope of its waiver of immunity." [65] In other words, the "the [other] provisions of the Act [are] limitations on the waiver of immunity."[66]

The version of Section 271.153 in effect in 2012, when the case was filed, did not include any limiting language regarding specific performance or other forms of injunctive relief.[67] Rather, the statute's language limited only damages.[68] Accordingly, the Court concluded that specific performance is an available remedy under Section 271.153 in effect in 2012.[69]

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[57] *Id.* at 703 (internal citations and quotation marks omitted)
[58] *Id.* at 705-06.
[59] *Id.* at 706.
[60] *Id*.
[61] *Id*.
[62] *Id*.
[63] *Id*.
[64] Tex. Loc. Gov't Code § 271.151(2)–(3).
[65] *Hays St. Bridge Restoration Group v. City of San Antonio*, 570 S.W.3d 697, 706 (Tex. 2019) (citing *Zachry Construction*, 449 S.W.3d 98, 108 (Tex. 2014)).
[66] *Id.*
[67] *Id.* at 707.
[68] *Id.*
[69] *Id.* at 707-08.

Notably, in 2013, the Texas Legislature added the following provision to Section 271.173: "(c) Actual damages, specific performance, or injunctive relief may be granted in an adjudication brought against a local governmental entity for breach of a contract described by Section 271.151(2)(B)." The referenced section, section 271.151(2)(B), describes "a written contract, including a right of first refusal, regarding the sale or delivery of not less than 1,000 acre-feet of reclaimed water by a local governmental entity intended for industrial use."[70]

It is unclear what effect the *Hays Street Bridge* case will have on the judicial interpretation of the current version of Section 271.153, which has been in effect since 2013. Few cases have even cited the statue, no cases have addressed the issue. Accordingly, there appears to be an open legal question as to whether specific performance is an available remedy under the current statute for contracts not involving the sale or delivery of reclaimed water.

4. **Rosenberg Development Corporation v. Imperial Performing Arts, Inc**

On March 8, 2019, the Texas Supreme Court issued Rosenberg Development Corporation v. Imperial Performing Arts, Inc., 571 S.W.3d 738 (Tex. 2019). In that case, the Texas Supreme Court held that the a municipally-created economic development corporation is a statutorily-defined "governmental unit" which may appeal from an interlocutory order denying a plea to the jurisdiction, but as a matter of first impression, such a corporation is not a "governmental entity" in its own right for governmental immunity purposes.

On the interlocutory appeal issue, the Supreme Court cited Section 505.106(b) of the Development Corporation Act and Section 101 of the Texas Tort Claims Act, which together indicate that economic development corporations are properly considered "governmental units" under those statutes for purposes of an interlocutory appeal.[71]

However, on the immunity issue, the Court held that the Legislature did not intend for economic development corporations to have discrete governmental-entity status.[72] The Court noted that immunity benefits the public by preventing disruptions of "key governmental services", services which are not performed by economic development corporations.[73] The Court also noted that the allowing of suits against economic development corporations will not result in any genuine risk of unforeseen expenditures being imposed on the government.[74] Accordingly, the Court held that economic development corporations do not have governmental immunity in their own right.

Finally, the Court noted in dicta that it did not consider whether an economic development corporation might have "derivative immunity" by virtue of a corporation's relationship to another government entity. [75] The Court noted that derivative immunity is a distinct analytical inquiry,

[70] Tex. Loc. Gov't Code § 271.151 (West)
[71] *Id.*
[72] *Id.* at 748-50.
[73] *Id.* at 750-51.
[74] *Id.* at 751.
[75] *Id.* at 751-52.

which is ill-defined under current jurisprudence.[76] Accordingly, whether an economic development corporation could possess "derivative immunity" remains an open legal question.

[76] *Id.* at 751 (citing *Brown & Gay Eng'g, Inc. v. Olivares*, 461 S.W.3d 117 (Tex. 2015)).