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Contracting with Government Entities

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I. Introduction

“Rex non potest peccare”, “the king can do no wrong” – Herbert Broom, *A Collection of Legal Maxims, Classified and Illustrated*, 23 (London, A. Maxwell and Son 1845).

“Everyone who receives the protection of society owes a return for the benefit.” – John Stuart Mill, *On Liberty*, 1859

“Rights that depend on the sufferance of the State are of uncertain tenure.” – Suzanne LaFollette, “The Beginnings of Emancipation,” *Concerning Women*, 1926.

Contracts form the backbone of commercial transactions. A fundamental premise underlying every contract is that the other party may be sued in court if it breaches that contract, with damages collected as compensation. However, governmental entities contract under a different set of rules, and contracting with governmental entities has long been fraught with risk. Unlike non-governmental entities, governmental entities face limits on the obligations they may assume in transactions and protections against suit and liability if a dispute arises.

This paper will discuss some of these attributes of Texas governmental entities that differentiate them from non-governmental entities, examining issues in contracting with Texas municipalities, counties and state agencies for goods and services from the vantage point of a non-governmental entity. This paper does not address construction contracts, contracts with other governmental entities (*e.g.* municipal utility districts, school districts, or conservation and reclamation districts) or tort claims.

II. Limits on a Governmental Entity’s Powers to Contract

A. Incurrence of Debt

Despite their apparent broad authority to enter into contracts, governmental entities face significant restrictions in their contracting ability. For example, cities may not incur debts unless at the same time arrangements are 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.¹ “The term ‘debt’ means any pecuniary obligation imposed by contract, except such as were, at the date of the contract, within the lawful and reasonable contemplation of the parties, to be satisfied out of the current revenues for the year or out of some fund then within the immediate control of the” city.² “Obligations in good faith intended to be, and lawfully, payable out of either the current revenues for the year of the contract or any other fund within the immediate control of the

¹ TEX. CONST. art. XI, §§ 5, 7.

² *McNeill v. City of Waco*, 33 S.W. 322, 89 Tex. 83 (Tex. 1895).

corporation” are not debts.³ Stated differently, “a debt created by a city, in order to be valid without compliance with the constitutional requirements to which we have referred, must run concurrently with the current revenues.”⁴ This rule has been refined to state that “[a] contract which runs for more than one year is a commitment only of current revenues, and so is not a ‘debt,’ if it reserves to the governing body the right to terminate at the end of each budget period.”⁵

With respect to the acquisition of property,

“[i]f a contract for the acquisition, including lease, of real or personal property retains to the governing body of a local government the continuing right to terminate at the expiration of each budget period of the local government during the term of the contract, is conditioned on a best efforts attempt by the governing body to obtain and appropriate funds for payment of the contract, or contains both the continuing right to terminate and the best efforts conditions, the contract is a commitment of the local government's current revenues only.”⁶

An exception to this prohibition on the incurrence of debt exists if the debt is not required to be repaid from *ad valorem* taxes.⁷

This restriction on the incurrence of debt also limits a government entity’s ability to provide indemnities to contractual counterparties.⁸ The Texas Supreme Court has held that “an indemnity agreement is a ‘debt’ within the constitutional sense, and . . . , as a corollary thereto, provision must be made for the payment of any interest that may accrue thereon and for the retirement of the obligation.”⁹

B. Payment Timing - Texas Prompt Payment Act – Texas Government Code Section 2251

Texas has promulgated a statute, the Texas Prompt Payment Act, that designates the payment terms for governmental entities and their vendors.¹⁰ The Texas Prompt Payment Act establishes a payment date for governmental entities of thirty days after the later of: (i) the date the governmental entity receives the goods under the contract, and (ii) the date the performance of the service under the contract is completed or the date the governmental entity receives an invoice for the goods or service.¹¹ A governmental vendor must pay subcontractors by the tenth day following receipt of payment from the governmental entity, and subcontractors must pay their suppliers by the tenth day following their receipt of payment from the vendor.¹² Interest on

³ *McNeill* 33 S.W. at 324.

⁴ *City of Fort Worth v. Bobbitt-Concurrency*, 41 S.W.2d. 228, 232 (Tex. Comm’n App, Opinion adopted. 1931).

⁵ *City-County Solid Waste Control Bd. v. Capital City Leasing, Inc.*, 813 S.W. 2d. 705, 707 (Tex. App–Austin 1991).

⁶ TEX. LOC. GOV’T CODE §271.093.

⁷ TEX. CONST. art. III, § 52-a.

⁸ *Texas and New Orleans Railroad v. Galveston County*, 169 S.W. 2d 714, (Tex Comm’n App. 1943).

⁹ *Brown v Jefferson County*, 406 S.W.2d 185 (Tex. 1966).

¹⁰ TEX. GOV’T CODE §2251.

¹¹ *Id.* §2251.021.

¹² *Id.* §2251.022, .023.

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