Number 57
May 1994
© 1994
David M. Lawrence
Editor
Published by the
Institute of Government,
The University of
North Carolina at
Chapel Hill

Local Government
Law Bulletin

Individual Liability of Board Members for Illegal or Improper Expenditures

David M. Lawrence

A recurring concern of local government elected officials is whether they may be held personally liable if they vote for or otherwise approve an illegal or improper expenditure of public funds. Such an expenditure might be unconstitutional, or without statutory authority, or tainted by a conflict of interest, or made without following proper procedures, or in some other way illegal. The purpose of this *Local Government Law Bulletin* is to examine whether, and in what circumstances, personal liability can occur.

In a recent decision the North Carolina Court of Appeals raised this issue and, under the circumstances of the case, held that there was no personal liability. In *Bardolph v. Arnold*[1] the Guilford County Board of Commissioners had voted to purchase advertising in connection with two referendums to be held in the county. After the county had made some of its planned expenditures for the advertising, the plaintiff taxpayers sued to enjoin any further expenditures. They were successful in that respect, and once the referendum was over, they amended their complaint to seek repayment of the expended funds by the county commissioners who had voted in favor of the advertising. The trial court ruled against the plaintiffs, and the court of appeals affirmed. In its opinion the court held that there was no common law action against governing board members on the facts of the case; rather, plaintiffs had to rely on statutory remedies, and none fit the circumstances of the case. An investigation of the state supreme court decisions concerning these matters suggests that the court of appeals was correct in affirming the trial court decision in favor of the governing board members, but incorrect in suggesting that the only remedies were statutory.

1. 112 N.C. App. 190, 435 S.E.2d 109 (1993).

Liability under the Common Law

The Cases

Although there have been suggestions about a common law liability in a number of supreme court opinions,[2] only two decisions of that court deal directly with the question. In addition, a third case, in which no elected officials were defendants by the time the case reached the supreme court, speaks specifically to the point.

The earliest case is *Brown v. Walker*,[3] decided in 1924. To persuade railroad promoters to begin their railroad in Sylva (rather than in the nearby town of Dillsboro), Sylva's townspeople held a mass meeting in the summer of 1920. Apparently as a result of that meeting, the town's governing board voted to expend $5,000 of town funds to purchase a right-of-way for the railroad; once purchased, the right-of-way was donated to the railroad. The strategy worked: the line used Sylva as its terminus. But in August 1922, a Sylva taxpayer brought an action against (1) the members of the

2. In Horner v. City of Burlington, 231 N.C. 440, 57 S.E.2d 789 (1950), plaintiff taxpayers challenged appropriations from the city to the local chamber of commerce. The plaintiffs sought return of the money appropriated to the chamber and joined as defendants both the chamber and the city council members who voted for the appropriation. The supreme court reversed the demurrer sustained by the trial court, stating that "the complaint states a good cause of action to compel the restoration of funds which have been unlawfully diverted from the public treasury of the municipality." 231 N.C. at 446, 57 S.E.2d at 793. The court did not discuss the joining of the board members as defendants, and at the trial the plaintiff "submitted to a voluntary nonsuit" of them, leaving only the chamber. Horner v. Chamber of Commerce, 235 N.C. 77, 68 S.E.2d 660 (1952).

3. 188 N.C. 52, 123 S.E. 633 (1924).

town board who had voted to spend town money to purchase the right-of-way and (2) the railroad and its promoters. The plaintiff sought return to the town of the money expended for the right-of-way. The board members answered by claiming that the action against them was barred by the statute of limitations; the limitation in this circumstance, they argued, was one year. The trial court agreed, and the dismissal of the action against the board members was not appealed. That left the railroad as the remaining defendant, and the trial court entered judgment against it. The court ruled that the expenditures were unconstitutional and without statutory authority—a point not debated by any party to the case. Therefore the railroad was ordered to return the $5,000, plus interest, to the town. The company appealed.

In the supreme court's opinion the most important language was dicta because the city defendants were no longer party to the case. The court did say the following:

> Being entirely without warrant of law, and knowingly and wilfully done, authority is to the effect that the funds may be recovered by action against *the individuals composing the old board* [emphasis added], who are responsible and participated in the misappropriation ... and more especially against those who, having been aiders and abettors, are now enjoying the benefits of the same.[4]

This language directly indicates that the court would have been willing to hold the board members liable, had they not been dismissed from the action or had that dismissal been appealed. (The court then went on to reject the appeals of the railroad, so the company was required to pay the money back to the city.)

The second case, decided ten years later, is the only case in which the supreme court affirmed a decision under which local governing board members were actually held liable. In *Moore v. Lambeth*[5] the city of Charlotte awarded a contract, after competitive bidding, for repairs to the city's incinerator. The contract was for a specific amount, $1,370. Three days after the contract was executed, the contractor submitted a letter to the city engineer setting out per-unit rates for various categories of work associated with the incinerator repair, and the engineer initialed his approval on the face of the letter. The contractor then submitted invoices based on the letter, and the total paid to the contractor amounted to $6,150. There was no bidding for the additional work, there was no clear evidence that the council had approved the additional work, and there was evidence to the effect that the per-unit rates were at least twice the going rates charged by other contractors. After unsuccessfully demanding that the city council seek the return of all funds expended under the letter arrangements, two taxpayers brought an action against the contractor and a number of city officials, seeking refund of the money. Among the officials included as defendants were the mayor and one member of the city council. There was evidence that these two elected officials had participated in an executive session of the council at which money to pay the contractor was transferred from a contingency account to the project account. After the trial the jury found that the city officials in question had *intended* to evade the purchasing and contracting statutes, and the trial court entered judgment holding them, along with the contractor, jointly and severally liable for the return of the money. The amount of the judgment was for the total paid to the contractor, minus the $1,370 paid under the first contract and minus the reasonable value of the remaining work performed by the contractor for the city. All defendants appealed, and the supreme court affirmed.

The defendants argued that elected officials could not be held liable in these circumstances unless either a statute imposed liability or "they acted corruptly and of malice." The court explicitly rejected the argument. Rather, the court said, "[w]here public funds are wrongfully, wilfully and knowingly disbursed by municipal officers without adequate consideration moving to the municipality and with intent to evade the law, . . . those responsible for such illegal withdrawal of said funds may be required to make good the loss to the public treasury."[6] The court cited *Brown v. Walker* for these statements.

The final case was decided just seven years later, in 1941. During the 1935–37 term of municipal office, the Old Fort town board named one of their members as town police chief; he then served both as board member and as police chief for that two-year period. In *Town of Old Fort v. Harmon,*[7] the town, now apparently under new officials, sued the former board members (but not the man named chief), seeking the return of the money paid to the board member/chief. The trial court sustained the demurrers of all defendants, and the supreme court affirmed.

The court noted that the only allegation against the defendants was that they had authorized an illegal expenditure—no one disputed the impropriety of the town board's naming a continuing member as police chief—and that was simply not enough to create a liability for repayment. The court distinguished the *Moore* case from this one because in *Moore,* public funds had been wrongfully, wilfully, and knowingly disbursed without adequate consideration to the city and with an intent to evade the law. There were no such allegations in this case.

4. 188 N.C. at 57, 123 S.E. at 635.
5. 207 N.C. 23, 175 S.E. 714 (1934).
6. 207 N.C. at 26, 175 S.E. at 716.
7. 219 N.C. 245, 13 S.E.2d 426 (1941).

The State of the Law

The result of the three cases is that there is a remote possibility of governing board members being held liable because they approved illegal expenditures, but there must be a showing of more than the mere illegality itself. In *Old Fort* the only allegation was illegality, and in that case the court held that the complaint did not state a cause of action. So what else is necessary?

The court in *Old Fort* distinguished that case from *Moore v. Lambeth* on three grounds: in the earlier case (1) the illegal expenditure was "wilfully and knowingly" made; (2) the city did not receive adequate consideration for the expenditure; and (3) the expenditure was made with an "intent to evade the law." What is the meaning of these three elements? First, the requirement that the expenditure be made wilfully and knowingly probably means little at all. It does not seem to mean that the officials know the expenditures to be illegal: the court in the first of the three cases, *Brown v. Walker*, characterized the expenditures in that case as wilfully and knowingly made as well, and there is no suggestion that the city officials knew that purchase of the right-of-way was illegal at the time the expenditures were approved. Rather, this element seems merely to require that the officials in question have themselves taken some sort of action that indicates their personal approval of the expenditures. Governing board members may not be held personally liable simply because some person in the government, unbeknownst to the board, approved an illegal expenditure. If the phrase is understood in this fashion, it is clear that the board member defendants in *Old Fort* had wilfully and knowingly approved the expenditures in question as well. Therefore, more seems to be needed than this first element.

The requirement that the unit did not receive adequate consideration for the expenditure, on the other hand, may be quite important. In *Moore* the measure of damages was not the total amount paid to the contractor beyond the sum set out in the single executed contract. Rather, the jury first determined the reasonable value to the city of the disputed work, and it was only the excess for which the defendants were liable. If the city had received full consideration for its payments, as was the case in *Old Fort*, there would have been no damages to pay and therefore no individual liability. In *Brown*, the railroad case, the court made no mention of a failure of consideration, but it probably understood that to have been the case. The railroad company, after all, ended up with the property, and the placement of the railroad's terminus in Sylva was a benefit that ran to the entire community and not uniquely to the town government itself. One of the trial court findings, quoted in the statement of facts preceding the opinion, was that the property had been transferred to the railroad promoters without consideration; in addition the trial court found "[t]hat benefits may be said to have accrued to the business interest situated in the town of Sylva in the sense of individual benefit, not municipal."[8] So understood, the decision is entirely consistent with *Moore* in this respect: the *town* did not receive any consideration for its expenditures.[9]

The treatment of consideration in *Brown* suggests a narrow meaning of *consideration* in these cases. Clearly if a local government has acquired property or had property repaired, but has done so in an illegal manner as in *Moore*, the government has still received the property or benefited from the repair. It has received consideration. If the expenditure is for an unconstitutional purpose or without statutory authority, however, a court might almost automatically find a lack of consideration. If the government is not allowed to spend money for a particular purpose at all, when it does so, it might be considered to have received nothing at all that is of legitimate value to the government.

The third distinguishing characteristic of *Moore*, that the defendants acted with an intent to evade the law, seems less a condition precedent than a reinforcement. There is no language in the *Brown* opinion to suggest that the governing board members in Sylva intended to evade known legal requirements nor that it was necessary that they had such an intention. Of course, the language in *Brown* is dicta, in that the municipal defendants were out of the case, and therefore a current court might find this an essential element as well, particularly if the facts made such a course attractive.

Are there other relevant factors? None appear in the three North Carolina cases (and again, there are no other state

---

8. 188 N.C. at 56, 123 S.E. at 635.

9. The importance of consideration is also suggested by a statement of the supreme court in Brown v. Board of Comm'rs, 223 N.C. 744, 28 S.E.2d 104 (1943). In 1939 the General Assembly abolished the Richmond County recorder's court; in 1941 the legislature directed the county to pay the incumbent judge the salary he would have made had the court not been abolished. When the county commissioners refused to make the payment, the one-time judge brought suit. In *Brown* the supreme court held that to pay the plaintiff would violate Article I, Section 32, of the constitution, prohibiting exclusive privileges and emoluments. The plaintiff argued, in part, that the county had no standing to raise the constitutional argument because it was a creature of the state. The court did not respond directly to the argument, but focused on the individual commissioners: "If they expend such funds for private purposes without warrant in law they become personally liable." 223 N.C. at 747, 28 S.E.2d at 106. Because the plaintiff had done no work as judge, he was not entitled to any money from the county, and therefore any payment from the county would be without consideration. (*Brown v. Board of Commissioners* is not directly in point on the boundaries of a common law action because the court supported its quoted statement by citation to Hill v. Stansbury, 223 N.C. 193, 25 S.E.2d 604 (1943), which was brought under a statute—the predecessor to G.S. 128-10—rather than under the common law. Presumably the Court believed that a payment to Brown might also be recoverable under that statute.)

supreme court decisions in point), but a review of cases from other states is suggestive of at least two other factors that might either relieve an official of liability or fasten it on him or her. Most commonly, if there is evidence that the public official received some personal benefit from the unlawful expenditure, cases from elsewhere suggest that liability is likely; this might even be the situation if the government received adequate consideration for the expenditures.[10] On the other hand, if the illegality of the expenditure was not clear, particularly if the officials acted on qualified legal advice, then modern courts have often refused to hold them personally liable for the return of the expended funds.[11]

Given this understanding of the law, the court of appeals in *Bardolph v. Arnold* appears to have correctly dismissed the common law claim against the defendants. The court held that the county commissioners "were vested with appropriate authority to expend the funds in question." If the expenditures were lawful, then none of the common law cases are in point.[12]

The Need for Statutory Liability

As noted, the court of appeals in the *Bardolph* case implied that a governing board official may not be held personally liable for unlawful expenditures unless a statute specifically imposes such a remedy. The court wrote:

> As the defendants correctly point out, if there is a common law claim such as the one plaintiffs assert, elected officials could potentially risk their personal assets every time they voted on a controversial issue or exercised their political judgment in the expenditure of public funds. For that reason, the General Assembly has enacted specific statutory methods for addressing unlawful actions by elected officials. . . . [In *Flaherty v. Hunt*] [t]his Court held that "such actions [to recover wrongfully spent public funds] [*brackets in original*] against municipal officers are statutory," . . . . The statutory remedy is ". . . explicit and exclusive."[13]

To the extent that these statements argue that there is no common law remedy for illegal expenditures, regardless of the facts of the case, they are clearly wrong. First, they are clearly inconsistent with the case law discussed earlier. Neither *Brown v. Walker* nor *Moore v. Lambeth* was based on a statute; no statute then existed that created any liability under the circumstances of either case. Indeed, the defendants in *Moore* argued to the court that they could not be held liable without a statute (or evidence that they had acted corruptly or with malice), and the court expressly rejected the argument.

Second, the statute considered by the court of appeals was G.S. 128-10. This statute outlines a cause of action against a bonded public officer for return of moneys improperly retained by the officer. Quite properly the court rejected any right to recovery under this statute because the facts did not fit the statutory outline. But this was an odd statute on which to base any argument that the statutory remedy was exclusive. It was first enacted in 1913 and was the subject of an appeal in *Waddill v. Masten*,[14] decided in 1916. In *Waddill* a taxpayer sought the return to the county of moneys allegedly paid to a register of deeds in excess of his statutory salary. The overpayments had occurred in the years 1908 to 1912, and the defendant argued, successfully in the trial court, that because the payments took place before the statute was enacted, there could be no recovery. The supreme court reversed. It held that there had existed before the enactment of the statute, a cause of action in the county for return of the overpayments to the register of deeds, and that such an action could be brought on behalf of the county by a taxpayer. The court then characterized the 1913 statute as merely "remedial," providing an additional way to vindicate the county's existing common law rights but in no way extinguishing those rights. Therefore, the court held, shortly after the enactment of the statute in question, that the statute was not an exclusive remedy for local governments or their taxpayers seeking recovery of wrongfully retained funds; these plaintiffs could still proceed under the common law.

Third, the court's reliance on *Flaherty v. Hunt*[15] is misplaced. First, *Flaherty* was an action against a *state* official, so the court would not have *held* anything about actions against local officials. Second, the *Flaherty* court's discussion of the liability of governing board members is simply wrong as a factual matter. It states that since the enactment of the predecessor of G.S. 128-10, "actions against municipal officers are statutory, the statute providing the basis for the action as well as procedural requirements." For this proposition, which is clearly inconsistent with both *Brown* and *Moore*, both of

10. *Cf., e.g.,* Armino v. Butler, 183 Conn. 211, 440 A.2d 757 (1981).

11. Stanson v. Mott, 17 Cal. 3d 206, 551 P.2d 1 (1976); McCarty v. City of St. Paul, 279 Minn. 62, 155 N.W.2d 459 (Minn. 1967); Bear Creek Valley San. Auth. v. Hopkins, 53 Or. App. 212, 631 P.2d 808 (1981).

12. The court decided that the expenditures were authorized only at the end of this section of its opinion, and the holding might be in the alternative. To the extent that the court also said there was never a common law action against board members for illegal expenditures, and it is not clear that the court made such a statement, the court was clearly inconsistent with existing supreme court precedent.

13. 112 N.C. App. 190, at 193, 435 S.E.2d 109, at 112.

14. 172 N.C. 582, 90 S.E. 694 (1916).

15. 82 N.C. App. 112, 345 S.E.2d 426 (1986).

which were decided *after* the predecessor statute was enacted, the court remarkably enough cites *Brown* and *Moore*.

The argument that there can be no liability without a statute appears to be based on a misunderstanding of a number of supreme court decisions from the early part of this century. Two representative cases are *Hudson v. McArthur*,[16] decided in 1910, and *Noland Co., Inc. v. Hester*,[17] decided in 1925. In *Hudson* a tax-collecting sheriff had embezzled county funds, causing his sureties to have to make good to the county. The sureties then brought an action against the county commissioners who had approved the sheriff's bond and his settlement as tax collector, seeking recovery of the moneys they had had to pay as sureties. The supreme court held that there could be no individual board member liability for failure to conduct the settlement properly unless the statute imposing settlement duty imposed the liability. It did not, and the judgment against the commissioners was reversed. In *Noland* a school board had entered into a construction contract without requiring the contractor to post a payment bond, even though the statute required that it do so. The plaintiff had supplied materials to the contractor, who did not pay, and because there was no payment bond, the plaintiff sued the individual members of the school board for his damages. Here too the supreme court held that there could be no liability unless imposed by statute, and the statute imposing the duty created no such liability.[18]

These two cases, and other cases like them, differ from the situations that are the subject of this *Bulletin* in a fundamental way. In each of the two cases the plaintiff was seeking damages from the individual defendants arising from an injury to himself; he was seeking to make himself whole. But when the wrong is an unlawful expenditure, the plaintiffs in a common law action do not seek or receive personal damages. Rather, they are suing on behalf of the government that is or was served by the defendant officials, and the recovery is paid to the government; it is not retained by plaintiffs. Therefore the line of authority requiring a statutory basis for recovery is irrelevant when the recovery is to go to the government itself. These cases were cited and argued in *Moore*, the Charlotte incinerator case, and the court recognized this difference and rejected them on that ground.

16. 152 N.C. 445, 67 S.E. 995 (1910).

17. 190 N.C. 250, 129 S.E. 577 (1925).

18. See also Hipp v. Ferrall, 173 N.C. 167, 91 S.E. 831 (1917). In *Hipp* the plaintiff had been injured in the collapse of a bridge, and he sued the individual members of the Lee County Highway Commission for their allegedly negligent failure to keep the bridge in repair. The supreme court affirmed the trial court's judgment for defendants on a number of grounds, one of which was that there could be no liability for the negligent breach of these duties "unless the statute . . . imposing the duties makes provision for such liability." 173 N.C. at 169, 91 S.E. at 833.

The Nature of the Common Law Action

The common law action described earlier is grounded in the fiduciary character of local governing board members.[19] As fiduciaries, they owe a duty to their governments and their citizens to properly maintain and expend the public funds under their control. If they fail to meet that duty, then, as is true with all varieties of fiduciaries, they may have to answer for the failure with their personal assets. The model for the action is the stockholders' derivative suit known to the law of corporations.

In *Branch v. Board of Education*,[20] the supreme court set out the prerequisites to an action by taxpayers suing on behalf of their local government. First, the plaintiff must be and allege himself or herself to be a taxpayer of the government in question. Second, the plaintiff must allege facts sufficient to establish either that he or she has made demand on the government itself to bring the action, and it has refused, or that such a demand would be pointless. The early case of *Merrimon v. Paving Company*[21] set out the general circumstances under which a demand is considered unnecessary:

1. The challenged action is *ultra vires;* or
2. there was some sort of fraud involved; or
3. the board members are personally interested in the challenged action; or
4. the majority is oppressively and illegally violating the rights of the minority.

Two later cases added a fifth circumstance: when corporate management is under the control of the guilty partners, who will obviously not bring action against themselves.[22] (It is noteworthy that in the first two of the three cases discussed in the first part of this *Bulletin*, *Brown v. Walker* and *Moore v. Lambeth*, the taxpayer plaintiffs had first made demand on the municipal officials then in office that they seek recovery of the funds allegedly wrongfully expended. In *Old Fort v. Harmon*, the third case, the city itself brought the action.)

Liability as between Board Members and Recipients of the Illegal Expenditures

In both *Brown v. Walker* and *Moore v. Lambeth*, the recipients of the allegedly unlawful expenditures were joined as defendants in the action; indeed, as noted earlier, in *Brown* only the railroad company recipient was held liable. In *Old*

19. *E.g.*, Merrimon v. Paving Co., 142 N.C. 539, 55 S.E. 366 (1906).

20. 233 N.C. 623, 65 S.E.2d 124 (1951).

21. 142 N.C. 539, 55 S.E. 366 (1906).

22. Murphy v. City of Greensboro, 190 N.C. 268, 129 S.E. 614 (1925); Atkinson v. Greene, 197 N.C. 118, 147 S.E.2d 811 (1929).

Fort v. Harmon, on the other hand, the board member who had also been police chief and who had therefore received the illegal expenditures, was not joined as a defendant. (That fact was noted by the court in distinguishing *Old Fort* from a number of earlier cases, although it does not seem to be the reason the court affirmed the granting of defendants' demurrers.) The court of appeals in *Bardolph v. Arnold* also distinguished that case from some earlier cases on the ground that the recipient of the funds had been joined.

These facts suggest that the recipient of the funds may be the party primarily liable for repayment of the improperly expended funds to the local government. There is language in a number of the cases suggesting this possibility. For instance, in the passage quoted earlier from *Brown v. Walker*, the court says there is a cause of action "more especially" against those enjoying the benefit of the expenditures—in that case, the railroad company. Certainly it seems fair to require the party receiving the benefit of the expenditure to bear the initial burden of repaying the money. The decision in *Moore v. Lambeth*, however, stands against this suggestion of priorities of liability. In that case the judgment was entered against all the defendants, jointly and severally. In addition, although the court's opinion does not reflect this, the public official defendants briefed the question of whether it was error to enter such a judgment, arguing that the principal liability should run against the contractor.[23] The court did not expressly discuss the matter, but its opinion closes with the statement:

> The remaining assignments of error have all been examined with care. They are not sustained. Nothing appears on the record which would warrant the Court in disturbing the verdict or the judgment. They will therefore be upheld.[24]

23. Brief for Defendant-Appellants Lambeth, Pridgen, and Boyd at 24–25, *Moore,* 207 N.C. 23, 175 S.E. 714 (1934).

24. 207 N.C. at 26, 175 S.E. at 716.

The Appropriate Statute of Limitations

In *Brown v. Walker* the municipal defendants were dismissed from the case at the trial level on the ground that the claims against them were barred by the statute of limitations. They argued successfully to the trial court that the appropriate limitation period was one year. At that time the one-year limitation statute (the predecessor statute to G.S. 1-54) included actions against a public officer for trespass under color of the office. Although the dismissal of the governing board defendants was not appealed, the court made clear that this was not the correct limitation period. The railroad company argued that it should be subject to the same limitation period as the public officials, and this argument led the court to discuss the proper period. The court argued that the trespass limitation applied only to trespasses against third parties and not to breaches of official duty owed to the corporate entity: "We are well assured that the statute relied on, [now found in G.S. 1-52(13), a three-year statute], has no application." The court did not identify the appropriate statute, although it did suggest that either the three-year statute or the ten-year default statute might apply.

Summary

A local elected official might be held liable at common law to his or her government if he or she votes to make an illegal expenditure of public funds. But more is necessary than that the expenditure is illegal. Additional elements that might lead to liability include (1) that the local government received no consideration for the expenditure, (2) that the official personally benefited from the expenditure, or (3) that the official intentionally evaded the law. If a board member is liable, the action to recover the money belongs to the unit itself, or derivatively to any taxpayer in the unit. The party receiving the illegal expenditure may also be joined as a defendant, and the liability is joint and several.

The Institute of Government of The University of North Carolina at Chapel Hill has printed a total of 657 copies of this public document at a cost of $184.22, or $0.28 each. These figures include only the direct costs of reproduction. They do not include preparation, handling, or distribution costs.

♾ This publication is printed on permanent, acid-free paper in compliance with the North Carolina General Statutes.