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CLERK OF THE SHAWNEE COUNTY DISTRICT COURT
CASE NUMBER: 2016-CV-000424

Court: Shawnee County District Court

Case Number: 2016-CV-000424

Case Title: Jayhawk Racing Properties LLC, et al. vs. City of Topeka

Type: Memorandum Decision and Order

SO ORDERED.

/s/ Honorable Teresa L Watson, District Court Judge

IN THE DISTRICT COURT OF SHAWNEE COUNTY, KANSAS
DIVISION THREE

JAYHAWK RACING PROPERTIES, LLC,
and HEARTLAND PARK RACEWAY, LLC,

Plaintiffs

Case No. 2016CV424

CITY OF TOPEKA, KANSAS,

Defendant

MEMORANDUM DECISION AND ORDER

This matter comes before the Court on Defendant City of Topeka's ("City") motion to dismiss, filed July 7, 2016. The Court has also considered the response filed by Jayhawk Racing Properties, LLC ("Jayhawk") and Heartland Park Raceway, LLC ("Raceway") (collectively, "Plaintiffs") on August 29, 2016; the City's reply, filed October 7, 2016; and the Plaintiffs' sur-reply, filed on November 7, 2016. The parties came before the Court on October 27, 2016, for oral argument, at which time the Court denied the Plaintiffs' motion to strike, permitted the Plaintiffs to file a sur-reply, and granted the Plaintiffs' unopposed oral motion to file an amended petition with additional exhibits attached. The motion to dismiss has been fully briefed and argued and is submitted to the Court for decision.

STATEMENT OF FACTS

Background.

1. Heartland Park is a multipurpose motorsports facility located in Topeka, Kansas.
2. In 2006, the City issued more than $10 million in Sales Tax and Revenue ("STAR") Bonds to fund improvements to Heartland Park.

3. STAR Bonds allow municipalities to finance the development and redevelopment of major commercial, entertainment, and tourism districts ("STAR Bond Districts") to stimulate economic growth.

4. When the City issued the STAR Bonds in 2006, the City owned the Heartland Park realty in fee simple for a term of years, subject to Jayhawk's reversionary interest at the end of a term of years or upon payment in full of the City's bonds, whichever came later.

5. The City later became concerned when the sales tax revenue being collected within the STAR Bond District was not satisfying the debt associated with Heartland Park.

6. The City developed a plan to expand the STAR Bond District and acquire Jayhawk's interest in Heartland Park.

The MOU.

7. Four parties - Jayhawk, Visit Topeka, Inc., the Kansas Department of Commerce ("KDOC"), and the City - entered into a Memorandum of Understanding ("MOU"). It is attached as Exhibit A to the City's Motion to Dismiss.

8. The MOU contains the following paragraph in its "Recitals" section:

> "Whereas, the parties have concluded that it is in the best interests of the City of Topeka and the State of Kansas for the City to own both the fee simple interest in the property and the reversionary interest owned by Jayhawk; and accordingly the City desires to purchase from Jayhawk all right, title and interest of Jayhawk [therein]… including the reversionary interest, and Jayhawk desires to sell its reversionary interest…"

9. The final Recital contained in the MOU states:

> "Whereas, in connection with the purchase of Jayhawk's reversionary interest and cancellation of the Management Agreement, the City will commence the process of expanding the District, amend the project plan, seek approval of the Secretary of Commerce for the issuance of the additional Star Bonds and issue bonds sufficient to acquire Jayhawk's reversionary interest and pay certain security interests."

10. The Agreement section of the MOU includes the following provisions:

"3. Purchase Price. The City agrees to purchase and Jayhawk agrees to sell its reversionary interest to the City for the sum of $2,392,117.00 ('Purchase Price') to be paid on the date of closing.

4. Payment, Obligations of Parties. In connection with the above proposed transaction the City agrees to pay, as of the date of closing, the balance of the indebtedness listed in Exhibit B, including principal and interest and associated costs. Jayhawk shall assume and pay, on the date of closing, to CoreFirst Bank and Trust Co., ('CoreFirst') a certain promissory note in the amount of approximately $300,000.00, plus any accrued unpaid interest, obtained pursuant to a certain Workout Agreement by and between CoreFirst, Jayhawk, the City and other parties and in addition shall pay all unpaid vendors which obligations accrued prior to closing. City agrees to execute all documents necessary for Jayhawk to secure the proceeds from the above loan within five (5) days of the approval by the City Council of the Workout Agreement. The Parties acknowledge an indebtedness of $276,351.00 to the NHRA which sum shall be paid to the NHRA by the City within five (5) days of the approval of this MOU by the City Council. At closing Jayhawk shall reimburse the City the sum of $184,234.00; 2/3rds the amount of the NHRA indebtedness.

5. Date of Payment of Purchase Price. The City agrees to pay Jayhawk the purchase price by February 1, 2015 or within 90 days of the approval by the Topeka City Council of the Star Bond Project Plan. In the event of a protest under the provisions of K.S.A. 12-17,169, payment shall be made within 60 days of the approval of the Plan by a majority of the voters of the City of Topeka.

. . .

8. Agreement Contingency. The parties acknowledge that this Agreement is contingent on fulfillment of the current contract between the NHRA and Jayhawk and increasing the size of the Star Bond district to include the area shown on Exhibit "C", the approval of the Secretary of Commerce of the State of Kansas approving the redevelopment project plan for the Heartland Park of Topeka Major Motorsports complex and authorization by the City of the issuance of Star Bonds in an amount equal to the financial obligations set forth in this Agreement including all costs associated therewith. It is estimated that approximately $4.8M-$5.5M of Star Bonds will be issued to cover the acquisition and associated costs of issuance.

. . .

10. Parties Cooperation. The City and Jayhawk agree that they will make commercially good faith reasonable efforts to accomplish the objectives set forth in paragraph 8 of this Agreement in a cooperative manner and the City further agrees to comply with the requirement of good faith and fair dealing.

. . .

14. Mutual Representation and Warranties. Each of the parties represents and warrants that (a) the signatory on behalf of such party has the authority to bind such party to this Agreement and (b) such party has not sold, assigned, factored or otherwise transferred any interest in the claims released hereby.

. . .

17. Entire Agreement. Unless otherwise modified by the mutual agreement of the parties, this Agreement shall remain in full force and effect. The Parties further agree and acknowledge that neither they nor any agent has made any representation, warranty, promise or covenant whatsoever, express or implied, not contained in this Agreement to induce the other to execute this Agreement.

. . .

19. Severability. Should any provision of this Agreement be declared or determined by any court of competent jurisdiction to be illegal, invalid or unenforceable as a result of any action or proceeding, the validity of the remaining parts, terms, and provisions shall not be affected thereby and said illegal or invalid part, term or provision shall be deemed not to be a part of this Agreement.

20. Successors. This Agreement shall be binding upon and inure to the benefit of the respective heirs, personal representatives, successors and assigns of the parties. No party shall delegate its or their duties, obligations, benefits or rights hereunder without the written consent of the other parties."

11. The MOU expressly conditioned the City's obligation to acquire Jayhawk's reversionary interest in Heartland Park on the occurrence of several events, including the approval of the STAR Bond Project Plan by the Topeka City Council and the Kansas Secretary of Commerce, along with the City's issuance of full faith and credit STAR Bonds.

The Workout Agreement.

12. Concurrently with the MOU, the City, Jayhawk, CoreFirst Bank & Trust ("CoreFirst"), Raymond Irwin, and Heartland Park Raceway LLC ("Raceway")

entered into a Workout Agreement. It is attached as Exhibit D to Jayhawk's Response to the City's Motion to Dismiss.

13. The Workout Agreement included a representation that "the City is agreeable to expanding the current STAR Bond District to enable it to issue additional STAR Bonds and use the STAR Bond proceeds for the purpose of assuring the continued economic development of Heartland Park and the acquisition of Obligors' interest in [Heartland Park.]"

14. Principally, the Workout Agreement contained the following provisions:

> "2. Forbearance by CoreFirst.
>
> A. At the time of the execution of this Agreement, Obligors and the City will execute and deliver into escrow separate quitclaim deeds ("Deeds"), prepared by Lender and approved by Obligors and the City, under which Obligors and the City transfer any interest they may have in the following real property ("Property") located in Shawnee County, Kansas, to Lender:
>
> [A description of Heartland Park follows.]
>
> The Deeds will be held by Kansas Secured Title, as the escrow agent ("Escrow Agent"). If, prior to February 28, 2015, all amounts due under the Notes are paid to Lender, Lender will direct the Escrow Agent to return the Deeds to Obligors and the City. However, in the event that all amounts due under the Notes have not been paid by February 28, 2015, Obligors and the City agree that on or after March 1, 2015, Lender has the discretion to direct the Escrow Agent to file the Deeds with the Shawnee County Register of Deeds office.
>
> B. The filing of the Deeds will constitute a complete release and satisfaction of all Obligors' and the City's personal liability under the Notes, but the indebtedness represented by the Notes shall not be extinguished or released. Should such Deeds be filed, Obligors, Guarantor and the City promise to vacate the Property within 30 days from the date the Deeds are filed with the Shawnee County Register of Deeds. Lender, Obligors, Guarantor and City further agree that the delivery of the Deeds and the filing/recording of the Deeds do not, and will not, constitute a merger of the lien and security interests of the Security Documents with the fee estate in the Property, and that Lender may proceed with a foreclosure or other action to enforce the liens and security interests under the Security Documents should Lender, in its sole discretion, decide that such a foreclosure or other action is needed for Lender to acquire clear title to the Property and other property encumbered by the Security

Documents. Obligors, Guarantor and the City recognize and agree that they may have to be added as in rem defendants to such an action, and that they will not contest the foreclosure or other enforcement of the liens and security interests created under the Security Documents or that the liens and security interests encumber the interests of Obligors and the City in such property. Furthermore, upon the request of Lender, Obligors, Guarantor and the City will enter into an agreed journal entry in which Lender's ownership, liens and security interest are acknowledged, and that the mortgage dated September 17, 2013 and record as Document No,. 2013R20091 in favor of the Irwin Trust (the 'Trust Mortgage') will be included in the agreed journal entry as lien junior and subordinate to the liens created by the Security Documents.

C. In the event that the Deeds are filed with the Shawnee County Register of Deeds, the City will have thirty (30) days after the receipt of written notice from Lender of such filing to exercise the following right: Lender will quitclaim its interest in the Property to the City, if the City pays Lender the total of: i.) the amounts due under the Notes as the day of filing the Deeds with the Shawnee County Register of Deeds, including costs, expenses and attorney fees; ii.) the amount of interest that would have accrued on the Notes between the day of filing the Deeds with the Shawnee County Register of Deeds and the date of receipt by Lender of payment made by the City; and iii.) the amount of expenses, costs and attorney fees incurred by Lender, and related to the Property, Notes, Security Documents, and STAR Bonds or this Agreement, from the day of filing the Deeds with the Shawnee County Register of Deeds to the date of Lender's receipt of payment made by the City. The City understands that the Deeds will only transfer the interests of the Obligors and the City to Lender, and upon the conveyance by Lender to the City, the Property will remain subject to any mortgages and other interests or liens then of record, including the Trust Mortgage. Consequently, the quitclaim deed that the City will receive from Lender under this subparagraph will transfer Lender's interest in the Property (whatever that interest may be), but the Property will be subject to any mortgages and other interests or liens then of record, including the Trust Mortgage

D. The parties agree that the period of forbearance shall be no later than February 28, 2015, unless extended by the Obligors, Guarantor and Lender for successive 30-day periods at the written agreement of Lender, whose consent shall not be unreasonably withheld so long as substantial progress is being made toward closing the proposed STAR Bonds transaction. The City agrees that it does not have to be a party to any extension(s) that only extends the time for performance and that its rights and obligations under the Agreement will be subject to any such extension of time(s); provided, however, that no more than three 30-day extensions may be granted without the consent of the City and no extension that changes any of the terms and provisions of this Agreement, the Notes, the Guaranty or the Security Documents shall be binding on the City without the City's prior written consent. Obligors, Guarantor and Lender agree that the continuation of the forbearance period is conditioned upon the City's having taken the following actions on or before July 1, 2014: i.) the City has passed a resolution of intent to expand the STAR Bond district and amend the district

plan; and ii.) all required mailings and the publication of the notice of a public hearing have been started.

E. Beginning August 1, 2014, and upon the 1st day of each month thereafter through February 28, 2015, Obligors and Guarantor agree to provide Lender and the City a status report on the progress of the expanded STAR Bond district and amended district plan, including details regarding the progress to provide reasonable assurances to Lender that such expanded STAR Bond district and plan will be closed on or before February 28, 2015. In the event that such a progress report is not received on the 1st of each month as provided herein, or if such report is deemed as not providing reasonable assurances to Lender that such expanded STAR Bond district and plan will be closed on or before February 28, 2015, Lender may declare a default under this Agreement. If such a default is declared, Lender shall provide notice to Obligors, Guarantor and the City of Lender's concerns and what additional information is necessary to reasonably cure such default. Obligors shall have seven (7) business days after receiving such notice of default to cure such default."

15. In summary, the Workout Agreement contained an acknowledgement that Jayhawk and the Raceway (whom the Workout Agreement identified as "Obligors") were in default to CoreFirst on various notes and mortgages, and it required Jayhawk and the City to execute and place in escrow deeds conveying their interests in Heartland Park to CoreFirst.

16. Jayhawk and the City later executed and delivered into escrow the deeds described in the Workout Agreement.

17. In return for the delivery of the quitclaim deeds into escrow, as another of the terms, conditions and covenants, CoreFirst agreed to forbear collection of the Notes until February 28, 2015, on the condition that, among other things, the City initiate the process to issue STAR Bonds on or before July 1, 2014.

18. Under the Workout Agreement, CoreFirst agreed to forbear collection of the loans and recording of the deeds until February 28, 2015, which was the anticipated outside date for the issuance of the STAR Bonds contemplated in the MOU, although the date could be extended with CoreFirst's consent.

19. On June 17, 2014, the City Council, on motion, approved both the MOU and the Workout Agreement.

Resolution 8637.

20. On July 1, 2014, the Topeka City Council passed Resolution No. 8637, which set a public hearing for August 12, 2014, pursuant to K.S.A. 12-17,165(a) and 12-17,166, on the City's proposal to amend the Heartland Park Redevelopment Plan and to issue additional STAR Bonds for the redevelopment of Heartland Park.

Ordinance No. 19915.

21. On August 12, 2014, the Topeka City Council adopted Ordinance No. 19915. The text of the ordinance, along with its supporting exhibits, is attached to the City's Motion to Dismiss as Exhibit B.
22. Ordinance No. 19915 included notice of the sixty-day protest period required by Kansas law.
23. Ordinance No. 19915, adopted by the City Council after the public hearing on August 12, 2014, provided that the existing STAR Bond district "shall be expanded" subject to approval of Shawnee County and adopted and approved the STAR Bond plan for the expanded Redevelopment District.
24. Section 9 of Ordinance No. 19915 adopted and approved the Amendment to the existing STAR Bond District Plan, as described in Exhibit B to Ordinance No. 19915.
25. Section 11 of the ordinance authorized the issuance of additional STAR Bonds in the estimated amount of $5 million.

26. Section 14 of the ordinance authorized the City Manager "to apply to the Secretary for STAR bond issuance authority to issue additional STAR Bonds in excess of the amount previously approved by the Secretary in relation to the Project."

27. Ordinance No. 19915 has not been formally amended, repealed, rescinded or vacated by the City.

Kansas Department of Commerce approval.

28. On August 5, 2014, the Secretary of the KDOC sent a letter to Jim Colson, the Topeka City Manager, which is attached to the Plaintiffs' Response to the City's Motion to Dismiss as Exhibit F. In this letter, the Secretary wrote, in part:

> "Based on all the above, it is my determination that the proposed Heartland Park STAR Bond Project District is a 'major motorsports complex' as defined by KSA 12-17,162, and an 'eligible area,' for the purpose of establishing a STAR Bond Project District as contemplated by K.S.A. 12-17,165.
>
> This approval and designation of the proposed Project District as an 'eligible area' should not be construed as approval of the amended Project Plan and is expressly limited to a finding the proposed expanded Project District constitutes an 'eligible area' under the Act as a condition precedent to the city passing an ordinance creating the expanded STAR Bond Project District. Commerce will require additional information prior to being in a position to evaluate the Project for STAR bond financing and determining the appropriate level of STAR bond funding. It is my expectation the City will submit a proposed STAR Bond Project Plan with 60 days from the date of this approval.
>
> The Department of Commerce and I look forward to working with Topeka as this project continues through the STAR bond process."

29. On September 24, 2014, the Secretary of KDOC approved the City's request to expand the existing STAR Bond district and conditionally approved the City's application to issue additional STAR Bonds.

The Imming Petition.

30. Prior to the expiration of the protest period, on October 8, 2014, Christopher Imming filed a document with the City Clerk titled "A Petition for a New City of Topeka, Kansas Ordinance Relating to Heartland Park Topeka Redevelopment District and Additional Bond Authority" ("Imming Petition").

31. The Imming Petition sought to repeal Ordinance No. 19915 or to submit the question of repeal to the voters at a municipal election.

32. In response to the Imming Petition, the City filed a declaratory judgment action in the Shawnee County District Court, Case No. 2014-CV-1069, seeking a declaratory judgment that the Imming Petition was an invalid attempt at initiative and referendum.

33. Jayhawk subsequently intervened in Case No. 2014-CV-1069.

34. The City attacked the Imming Petition on several fronts: 1) it did not comply with the technical requirements of the initiative and referendum statutes; 2) the petition was invalid because it included more than a single point; 3) Ordinance No. 19915 was an administrative ordinance not subject to initiative and referendum; and 4) Ordinance No. 19915 was subject to referendum only under the specific STAR bond referendum statute.

35. On November 12, 2014, the Court ruled that the Imming Petition was invalid because: 1) Ordinance No. 19915 was administrative in character and thus not subject to initiative and referendum; and 2) a challenge to Ordinance No. 19915 could only occur under the terms of the STAR bond referendum statute.

36. Imming filed a notice of appeal on November 26, 2014. His appeal was docketed in the Kansas Court of Appeals on December 2, 2014.

Resolution No. 8658.

37. As reflected on pages 2 through 5 of the minutes of the City Council meeting on December 2, 2014, on that date the City Council passed Resolution No. 8658, which provided in relevant part:

> "That it is hereby determined to be necessary and it is hereby authorized, directed and ordered, that Taxable Full Faith and Credit STAR Bonds, Series 2014-A (Heartland Park), (the "Bonds") of the City of Topeka, Kansas (the "City") shall be sold at public sale and in the manner provided by law, on Tuesday, December 16, 2014, at 9:30 a.m. C.S.T. The Bonds shall be in the maximum principal amount of Five Million Dollars ($5,000,000) and shall be dated on or about December 30, 2014."

38. The remaining operative sections of Resolution No. 8658 authorized and directed various officers and representatives of the City to take the actions necessary to lawfully issue the Bonds.

39. The City was not prohibited, by either the Imming Petition or the subsequent Imming litigation, from proceeding with the sale of those bonds, and the City Council was made aware of that fact at its meeting on December 2, 2014.

40. No sale of STAR Bonds pursuant to the MOU, City Ordinance No. 19915 and City Resolution No. 8658 was held on December 16, 2014, or at any other time.

The Imming Appeal.

41. On March 11, 2015, the Court of Appeals issued a ruling affirming, in part, the district court's ruling. The case was published at 51 Kan. App. 2d 247 ("the *Imming* decision").

42. On March 17, 2015, corporate counsel for Jayhawk sent a letter to Colson, with a copy to City Attorney Chad Sublet, noting that "the City has agreed to make

'commercially good faith reasonable efforts' to expand the HPT STAR bond district, to obtain from the Secretary of KDOC approval of the amended STAR bond district project plan, to secure authorization by the City to issue STAR Bonds and to issue STAR Bonds in order to close the acquisition," further noting the Court of Appeals' decision in *Imming*, and stating:

> "It has been recently suggested that City management may no longer consider the MOU to be effective. While we have not been formally advised that the City no longer believes the MOU is effective, the suggestion raises a serious question in our mind about whether the City is proceeding in good faith. We have also been advised that the City Manager does not intend to move the process forward until the latter part of April 2015. The reason provided us for the delay is purely political. We do not consider political considerations to meet the criteria set forth in the MOU, which requires the City to use 'commercially good faith reasonable efforts' in issuing the bonds and to comply with the legal requirement 'good faith and fair dealing.'
>
> It is important that we know by March 19, 2015 if the City intends to take the position that the MOU is no longer effective and it is also important that we be assured that the City intends to move the process along in a timely manner."

43. On April 9, 2015, Imming filed a petition for review of the Court of Appeals decision with the Kansas Supreme Court. The City and Jayhawk filed cross-petitions for review on April 23, 2015.

The City's April 2015 election and beyond.

44. Members of the Topeka City Council are elected to staggered four-year terms.

45. At the regular local election held on April 7, 2015, four new members were elected to the City Council.

46. On April 25, 2015, corporate counsel for Jayhawk sent Sublet an e-mail requesting confirmation that the MOU was still in effect.

47. Sublet responded the same day that the MOU was still in effect.

48. On May 5, 2015, while the petition for review and cross-petition for review were pending before the Kansas Supreme Court, the Topeka City Council considered a resolution that would have authorized the City to proceed with the amended Star Bond Project Plan, including steps towards issuing the STAR Bonds.

49. After lengthy debate and taking public comment, the Topeka City Council voted 6-4 against the resolution.

50. On May 19, 2015, corporate counsel for Jayhawk sent Colson a letter which demanded, among other things, that the City "immediately cure its material breach of the MOU and promptly proceed to close the transaction or pay Jayhawk Racing the sum of $5,490,000 as damages for breach of contract."

51. The City did not respond to the demand letter, and never closed the transaction described by the MOU.

52. On August 7, 2015, CoreFirst acquired title to Heartland Park pursuant to the Workout Agreement by recording the deeds placed in escrow by the City and Jayhawk.

53. On October 7, 2015, the Kansas Supreme Court denied both the petition for review and the cross-petitions for review in the Imming Appeal. The decision of the Kansas Court of Appeals was final.

54. Jayhawk and Raceway filed the instant petition on May 26, 2016.

CONCLUSIONS OF LAW

Standard of review.

The City filed a motion to dismiss for failure to state a claim on Counts I and II of the petition. When deciding a motion to dismiss under K.S.A. 2016 Supp. 60-212(b)(6), "[t]he question for determination is whether in the light most favorable to plaintiff, and with every doubt resolved in plaintiff's favor, the petition states any valid claim for relief. Dismissal is justified only when the allegations of the petition clearly demonstrate plaintiff does not have a claim." *Knight v. Neodesha Police Dept.*, 5 Kan. App. 2d 472, 475, 620 P.2d 837 (1980).

The City's motion presents several matters outside the pleadings, as does Plaintiffs' response. When a motion to dismiss for failure to state a claim presents matters outside the pleadings and they are not excluded by the Court, the Court must treat the motion as one for summary judgment arising under K.S.A. 2016 Supp. 60-256, and must give all parties "a reasonable opportunity to present all the material that is pertinent to the motion." K.S.A. 2016 Supp. 60-212(d). Here, the City's motion will be treated as one for summary judgment.

> "Summary judgment is appropriate when the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. The trial court is required to resolve all facts and inferences which may reasonably be drawn from the evidence in favor of the party against whom the ruling is sought. When opposing a motion for summary judgment, an adverse party must come forward with evidence to establish a dispute as to a material fact. In order to preclude summary judgment, the facts subject to the dispute must be material to the conclusive issues in the case." *Thoroughbred Assocs. v. Kansas City Royalty Co.*, 297 Kan. 1193, 1204, 308 P.3d 1238 (2013).

Statement of the issue.

In this case the City entered into the MOU, a contract, for the purpose of purchasing Jayhawk's reversionary interest in the property. The purchase was contingent upon, among other things, the City's issuance of STAR Bonds to finance the purchase. The City did not issue the bonds. The purchase transaction was not completed and CoreFirst acquired title to the property. Plaintiffs assert that the City, by failing to issue the STAR Bonds and close the transaction, committed a breach of contract. The City argues that it cannot be held liable for breach of contract because any promise made by the City to issue STAR Bonds in the future is beyond its power to make, and thus it is void and unenforceable.

Municipal powers.

The power to create and define municipal corporations belongs to the legislature and is exercised through the adoption of statutes. A "municipal corporation is a creation of law and can exercise only powers conferred by law and take none by implication, and that the only power it may acquire in addition to that expressly granted is the power necessary to make effective the power granted." *Yoder v. City of Hutchinson,* 171 Kan. 1, 8, 228 P.2d 918 (1951).

Article 12, Section 5(b) and (d) of the Kansas Constitution says cities are "empowered to determine their local affairs and government" and the "[p]owers and authority granted cities pursuant to this section shall be liberally construed for the purpose of giving to cities the largest measure of self-government." K.S.A. 12-101 enumerates these powers:

> "*First.* Sue and be sued.
>
> *Second.* Purchase or receive, by bequest or gift, and hold, real and personal property for the use of the city.
>
> *Third.* Sell and convey any real or personal estate owned by the city, and make such order respecting the same as may be deemed conducive to the interests

> of the city, and to provide for the improvement, regulation and government of the same.
>
> *Fourth.* Make all contracts and do all other acts in relation to the property and concerns of the city necessary to the exercise of its corporate or administrative powers.
>
> *Fifth.* Have and use a corporate seal, and alter the same at pleasure.
>
> *Sixth.* Exercise such other and further powers as may be conferred by the constitution or statutes of this state."

A city's powers are exercised by the governing body of the city. K.S.A. 12-103. In regard to the City of Topeka, this includes the mayor and the city council. K.S.A. 12-104; Topeka Municipal Code Section A2-25(a) ("The Council and Mayor shall be the governing body of the city.")

Relevant to the instant matter, cities also have the power "to acquire certain property and to issue sales tax and revenue (STAR) bonds for the financing of STAR bond projects as defined in K.S.A. 12-17,162, and amendments thereto." K.S.A. 2016 Supp. 12-17,160. The various powers are set forth in a number of statutes within the Star Bonds Financing Act, K.S.A. 2016 Supp. 12-17,160 *et seq.*

Governmental versus proprietary functions.

A municipal corporation has dual capacities, governmental and proprietary. *Krantz v. City of Hutchinson,* 165 Kan. 449, 454, 196 P.2d 227 (1948). "Governmental functions are those performed for the general public with respect to the common welfare for which no compensation or particular benefit is received. Proprietary functions, on the other hand, are exercised when an enterprise is commercial in character or is usually carried on by private individuals or is for the profit, benefit, or advantage of the governmental unit conducting the activity." *State ex rel. Stovall v. Meneley,* 271 Kan. 355, 384, 22 P.3d 124 (2001).

Though the definitions seem straightforward enough, they are difficult to apply. "The difficulty arises in classifying particular acts. The cases involving the question are legion, and are replete with conflict and inconsistencies. In many cases it may, perhaps, be said that particular acts partake of both characteristics. Each situation should be approached in the light of the fundamental purpose of the distinction." *Krantz,* 165 Kan. at 455.

The distinction between governmental and proprietary functions arose at common law to help judges decide questions of sovereign (or as it is sometimes known, governmental) immunity. At common law, municipalities were immune from liability for performing governmental functions, but not proprietary ones. "This court has held on numerous occasions that where the state is involved in a proprietary or private function, it will be held to the same responsibility as a private person for injuries resulting from failure to meet its contractual obligations or as a result of its negligence." *Matter of Midland Industries, Inc.,* 237 Kan. 867, 870, 703 P.2d 840 (1985) (holding that collection of taxes is a governmental function).

Cases exploring the governmental versus proprietary distinction involve the question of whether a municipality is liable for its torts and breach of its contracts. See, for example, the numerous cases discussed in *KPERS v. Reimer & Koger Associates, Inc.,* 262 Kan. 635, 648-65, 941 P.2d 1321 (1997). Use of the distinction has become less frequent over time, notably with the advent of the Kansas Tort Claims Act, which defines the particular circumstances in which governmental immunity may apply in the tort context. See generally *Hopkins v. State,* 237 Kan. 601, 608, 702 P.2d 211 (1985) (discussing the history of sovereign immunity).

Most of the more modern cases discussing governmental versus proprietary functions involve the statute of limitations. K.S.A. 60-521, a remnant of sovereign immunity, says the statute of limitations applies to a cause of action held by a governmental entity if the cause of

action "arises out of any proprietary function or activity," but does not apply to a cause of action arising out of a governmental function. See *Meneley,* 271 Kan. at 384 (holding ouster proceedings in a quo warranto action are governmental functions not subject to a statute of limitations).

The most recent discussion of K.S.A. 60-521 appears in *Newman Memorial Hosp. v. Walton Constr. Co., Inc.,* 37 Kan.App.2d 46, 149 P.3d 525 (2007). In *Newman,* a county hospital brought breach of contract and implied warranty claims against architects who designed a medical building. The architects raised a statute of limitations defense. The county said its construction and lease of the medical building was a governmental function and the statute of limitations did not apply. The Kansas Court of Appeals disagreed, analyzing the distinction as follows:

> "Factors which have been utilized by Kansas courts in determining whether a governmental entity is carrying on a proprietary or governmental function include: (1) whether the activity is for the state as a whole or special local benefit (in our case, the economic benefit of the medical office building flows to Newman and Lyon County); (2) whether the activity arises out of a statutory duty or a privilege granted (in our case, it was a permitted and not a mandated duty); (3) whether the activity is normally done by private entities (in our case, Newman charges market rates and normally makes a gross profit-indicia of a proprietary business); and (4) whether the entity's actions were commercial in nature (in our case, the leasing of a building is a commercial act). These factors all point to requiring a holding that the actions of Newman in this case were proprietary in nature." *Id.* at 64.

Plaintiffs urge that the City's motion should be decided by application of the *Newman* factors to the undisputed facts here. But the *Newman* factors were used to analyze whether the claims of a government entity against a private entity would be subject to the applicable statute of limitations. This is a very different question than the one presented in this case.

Legislative and administrative functions.

Further complicating matters is the parties' discussion of the distinction between the legislative and administrative acts of a municipality. Plaintiffs accuse the City of conflating the notion of a "governmental" function with the notion of a "legislative" function, and insist that these are two completely different things. The City is not the first to mix these concepts. The Kansas Court of Appeals used the terms "governmental" and "legislative" interchangeably in *International Ass'n of Firefighters v. City of Lawrence,* 14 Kan.App.2d 788, 795, 798 P.2d 960 *rev. denied*, 248 Kan. 996 (1991) ("Negotiating an employment agreement is not an exercise of a municipality's governmental or legislative power, but of its proprietary or administrative power.") This does not appear to be a casual misstatement by the court – it was a quote from the McQuillin treatise at 2 McQuillin, Municipal Corporations § 10.05 (3d ed. rev. 1988), which said: "Governmental or legislative powers are exercised to administer the affairs of the state and promote the public welfare generally. Proprietary or administrative powers are exercised to accomplish private corporate purposes in which the public is only indirectly concerned and as to which the municipality is regarded as a legal individual." (Internal citations omitted.) 14 Kan.App.2d at 794.

The City appears to find the notion of a legislative function important based on the discussion in a different context in the *Imming* decision. The issue in that case was whether Ordinance No. 19915 was subject to initiative and referendum under K.S.A. 12-3013. K.S.A. 12-3013(e)(1) says administrative ordinances are not subject to initiative and referendum. Thus, in *Imming*, the Kansas Court of Appeals set out the test to determine whether an ordinance is legislative (subject to initiative and referendum) or administrative (not subject):

"1. An ordinance that makes new law is legislative; while an ordinance that executes an existing law is administrative. Permanency and generality are key features of a legislative ordinance.

2. Acts that declare public purpose and provide ways and means to accomplish that purpose generally may be classified as legislative. Acts that deal with a small segment of an overall policy question generally are administrative.

3. Decisions which require specialized training and experience in municipal government and intimate knowledge of the fiscal and other affairs of a city in order to make a rational choice may properly be characterized as administrative, even though they may also be said to involve the establishment of policy.

4. If the subject is one of statewide concern in which the legislature has delegated decision-making power, not to the local electors, but to the local council or board as the state's designated agent for local implementation of state policy, the action receives an 'administrative' characterization." 51 Kan.App.2d at 257-58.

The *Imming* court concluded that Ordinance No. 19915 was a legislative ordinance, not an administrative one:

"Looking at the first element of the *McAlister* test, we conclude that Ordinance No. 19915 creates a new law. First, it doubles the size of the redevelopment district. It permits the acquisition of Jayhawk Racing's interests to the racetrack, thus securing title in the property with the City. The Ordinance eliminates any debtors claim on the property. Thus, the City achieves an unencumbered interest in the track. This is a general and permanent solution to the revival of the development district.

Next, the declaration of public policy made in the Ordinance makes this a legislative act. Section 13 of the Ordinance states:

> 'The Governing Body hereby finds and determines that the proposal to request authority to issue additional STAR Bonds in excess of the amount previously approved is appropriate, desirable, and necessary to promote, stimulate, and develop the general and economic welfare of the City of Topeka, and to promote the general welfare of its citizens.'

These are legislative findings, not administrative.

We agree that there are administrative aspects to this Ordinance. The bonding details found in the Ordinance are examples of that.

> Finally, we cannot see this as a subject of statewide concern as contemplated by the *McAlister* test. The acquisition of a racetrack by the City is clearly a local concern.
>
> We agree with the district court that the centerpiece of Ordinance No. 19915 is the acquisition of the Heartland Park Raceway. This overriding purpose of the ordinance simply outweighs the procedural details that are necessary to obtain STAR Bonds. It does not appear that Ordinance No. 19915's administrative characteristics outweigh the general purpose of the ordinance, which is the purchase of a race track."

The legislative versus administrative distinction, at least as discussed in *Imming*, is not determinative of the analysis because the issue here is not initiative and referendum. And it appears that treatises and Kansas law alike have used the term "legislative" to describe governmental functions in some contexts. Likewise, the governmental versus proprietary distinction alone cannot answer the question in this case, which is whether the City may be held to the promise it made in the MOU to issue STAR Bonds. The City does not simply seek immunity for the performance of governmental functions. Rather, it claims that the promise it made in the MOU to issue STAR Bonds is ultra vires, or beyond its power to make, and thus void and unenforceable. This requires an additional layer of analysis.

Limits on municipal powers.

A municipality has the power to enter into contracts, but this power has limits. "One contracting with a municipal corporation is bound at his or her peril to know the authority of the municipal body with which he or she deals." *Genesis Health Club, Inc. v. City of Wichita*, 285 Kan. 1021, Syl. ¶ 8, 181 P.3d 549 (2008). When a city signs a contract that it is not legally allowed to enter into, the contract "is ultra vires in the sense that it is not within the power of the municipality to make." *Id.* at Syl. ¶ 7.

> "Generally, a contract entered into by an agent of a governmental entity is binding on the entity. However, to the extent the contract exceeded the scope of

> the governmental entity's power, the contract is unlawful, unenforceable, and void. *Templeton v. Kansas Parole Board*, 27 Kan.App.2d 471, 473–74, 6 P.3d 910 (2000). A party contracting with a governmental entity is presumed to know the scope of the entity's authority, and, when a governmental agent or entity acts outside the scope of its authority, or ultra vires, no ratification or estoppel can legitimize the exercise of such authority. *Blevins v. Board of Douglas County Com'rs*, 251 Kan. 374, 383–84, 834 P.2d 1344 (1992); *Red Dog Saloon v. Board of Sedgwick County Com'rs*, 29 Kan.App.2d 928, 930, 33 P.3d 869 (2001), *rev. denied* 273 Kan. 1036 (2002)." *Resolution Oversight Corp. v. Kansas Health Care Stabilization Fund*, 38 Kan.App.2d 899, 905, 175 P.3d 268 (2008).

The City argues that its promise to issue STAR Bonds is ultra vires because it purports to bind a future governing body in the exercise of its governmental or legislative powers. The City points to the following statements from the treatises: "The established rule is that municipal corporations have no power to make contracts which will control them in the performance of their legislative powers and duties." 10 McQuillin Mun. Corp. §29.07 (3d ed. revised). Further, a governing body "exercising legislative authority lacks the power to bind its successors with regard to governmental functions." 56 Am.Jur.2d Municipal Corporations §137 (2016).

Kansas law allows governing bodies to bind successor governing bodies in certain situations. Where a governing body has the general power to manage and control property, "it has the power to make a contract concerning such property extending beyond the term of the members thereof, if such contract is reasonable and not contrary to public policy." *Fisk v. Board of Managers of Kansas State Soldiers' Home*, 134 Kan. 394, Syl. ¶ 3, 5 P.2d 799 (1931) (upholding five-year lease of public property to dairy farmer in exchange for rent and provision of milk to soldiers under state care in the nearby soldiers' home).

"In determining the question of validity of a contract made by a board or other governmental agency extending beyond the official term of the contracting board or officials, one test generally applied is whether the contract is an attempt to bind successors in matters incident to such successors' administration and responsibilities, or whether it is a commitment of

a sort reasonably necessary for protection of the public property, interests or affairs being administered. In the former case the contract is generally held to be invalid and in the latter case valid." *Board of Com'rs of Edwards County v. Simmons,* 159 Kan. 41, Syl. ¶6, 151 P.2d 960 (1944) (upholding contract hiring attorney on contingency fee basis to represent county in litigation spanning terms of multiple boards).

These determinations are made on a case by case basis – there is no bright line rule. See *Zerr v. Tilton,* 224 Kan. 394, 581 P.2d 364 (1978) (test applied to contract for waste management and contract found to be valid because "solid waste disposal was an ongoing problem vitally concerned with public health and welfare"); *State ex rel. Cole v. City of Garnett,* 180 Kan. 405, 304 P.2d 555 (1956) (test applied to county commissioners' grant of an easement to the city for widening the street around the courthouse square and action found to be valid); *State ex rel. Fatzer v. Board of County Com'rs of Lyon County,* 173 Kan. 544, 250 P.2d 556 (1952) (county commissioners have power to lease temporary premises for courthouse while new one being built, even though term of lease extended beyond commissioners' terms, based on statutory duty to furnish offices for county business); and *Verdigris River Drainage Dist. No. 1 v. State Highway Commission,* 155 Kan. 323, 125 P.2d 387 (1942) (county may bind successors in contract to maintain a floodgate draining county road which later became a state highway, otherwise "no comprehensive program of road building could ever be carried out").

Kansas law does not allow governing bodies to bind successor governing bodies in other situations. In *Red Dog Saloon v. Board of Sedgwick County Com'rs,* 29 Kan.App.2d 928, 930, 33 P.3d 869 (2001), *rev. denied* 273 Kan. 1036 (2002), the Board of County Commissioners ("BOCC") passed a resolution banning nudity in establishments serving alcohol. Red Dog Saloon sued the BOCC claiming a violation of constitutional rights. The parties entered into a

settlement agreement whereby the BOCC would repeal the nudity ban in exchange for dismissal of the lawsuit. Ten years later, the BOCC passed a similar ban. Red Dog Saloon sued to enforce its earlier settlement agreement. *Id.* at 929.

The Kansas Court of Appeals concluded that the nudity ban was an exercise of the BOCC's police power, an "an inherent power of the sovereign and rests upon the fundamental principle that all property is owned subject to the limitation that its use may be regulated for the safety, health, morals, and general welfare of the community in which it is located." *Id.* at 930. "The Board, acting in 1990, did not have the authority to contract away all future actions under this portion of its police power. Accordingly, any contract which purported to make such an agreement would be ultra vires and unenforceable." *Id.* at 931.

In *Landau v. City of Leawood,* 214 Kan. 104, 519 P.2d 676 (1974), a developer operated a sewer system and contracted with landowners that charges to use the sewer system would never be more than $10.00 or $15.00 per year. Many years later, the developer deeded the sewer system to the City, purportedly pursuant to the terms of the earlier contract and its limit on charges. The sewer system's operations had generated a significant debt and required much more than $15.00 per year per homeowner to operate, so the City raised the rates. The landowners sued for breach of contract. *Id.* at 105-06. The court affirmed judgment for the city, saying: "even if the city intended to contract for such a limitation it would have been ultra vires. A city cannot contract away its statutory duties and responsibilities, particularly where they touch upon the police power." *Id.* at 108.

In *State ex rel. Hawks v. City of Topeka,* 176 Kan. 240, 270 P.2d 270 (1954), the City took private property by eminent domain for the construction of a parking garage to be financed by the sale of revenue bonds. The City contracted with a private group to operate the parking

garage. Part of the contract and lease agreement stated that the City agreed to lease any future parking garages to the private group; the City would rebuild or restore the facility if it were ever damaged or destroyed; and the private group's approval was required for establishing the facilities' hours of operation, fee schedules, rules and regulations, and any specifications for improvement of the facilities.

The county attorney filed a quo warranto action challenging: 1) the constitutionality of eminent domain statutes; 2) the city's ability to exercise eminent domain powers for a parking garage; and 3) the validity of the city's lease with a private operator. The first two questions were answered in the city's favor. However, the Kansas Supreme Court concluded that the lease agreement was invalid because the city did not have the power to bind future governing bodies to lease parking facilities not yet in existence to the private operator. *Id.* at 251-52. Further, the Court held that the rebuild provision was unreasonable because:

> "should the property be destroyed at some future date it would require the City to rebuild or repair, even though subsequent governing bodies might determine that it could no longer serve a public use and that it would not be advantageous to the general public to rebuild or repair. Under the authority delegated to a city by the statute, the matter of rebuilding or repairing would be a question to be determined by the then governing body of the city. The present governing body may not bind future bodies with the advisability of rebuilding or repairing such structures." *Id.* at 252-53.

Finally, the lease agreement impermissibly delegated the city's statutory rulemaking functions, at least in part, to a private operator because it said: 1) the city and the operator shall mutually agree to hours of operation and rules and regulations governing the conduct of each parking site; and 2) the operator had the right to approve plans and specifications for improvements on the parking sites and the contracts for the improvements. *Id.*

In *Marco Dev. Corp. v. City of Cedar Falls*, 473 N.W.2d 41 (Iowa 1991), the city signed an agreement which, according to Marco, obligated the city to widen a street adjacent to a

shopping mall Marco proposed to build. Following the election of a new mayor, the city decided not to follow through on widening the street. Marco sued the city for breach of contract. The district court ruled the contract was ultra vires on the part of the city and granted the city's summary judgment motion. The Iowa Supreme Court affirmed, concluding that a city "was not free to bind itself by contract in the exercise of its legislative functions." *Id.* at 43. Marco complained that the result was inequitable because he had already performed under the contract. But the court explained: "One who contracts with a city is bound at his peril to know the authority of the officers with whom he deals, and a contract unlawful for lack of authority, although entered [into] in good faith, creates no liability on the part of the city to pay for it, even in quantum meruit." *Id.*

In *Pippenger v. City of Mishawaka*, 88 N.E.2d 168 (Ind.Ct.App. 1949), the city contracted to vacate certain streets for the railroad's benefit at no cost to the railroad and without assessing the railroad for the benefits it received. A group of taxpayers sued to have the contract declared void. The court said the city had a duty to vacate the streets only if it was found to be in the public interest, not because it contracted to do so, and the city had a duty to charge the railroad for costs and benefits. *Id.* at 403. "The city could not absolve itself from these duties, or bargain away its right to exercise the discretion vested in it by law in the performance of a public duty, by a contract committing it to act in an agreed manner. The law demanded of the city that it retain its freedom of judgment up to the very moment it was required to act so that its decision when finally made would be influenced only by a regard for public welfare." *Id.*

Put another way, a government entity cannot contract away the ability to change course in the exercise of its governmental powers, notably because the decision might be necessary for the public good. "All parties dealing with a sovereign power, or one of its functionaries, in the

exercise of governmental power, the subject of which pertains to government, do so knowing it cannot contract away the power conferred for self–protection or self–preservation." *Board of Education of City of Leavenworth v. Phillips,* 67 Kan. 549, 73 P. 97, 98 (1903) (city not bound by contract provision prohibiting issuance of additional bonds for school district).

Conclusion.

The parties spend much space in their briefs arguing about whether the City action at issue in this case is governmental or proprietary. First, the Court must determine precisely what action is at issue. Plaintiffs cast the question as whether the City's purchase of a racetrack facility is governmental or proprietary. Plaintiffs paint with too broad a brush. The City's agreement to purchase the Jayhawk's interest in the property is contingent upon the issue of STAR Bonds. Without the issuance of STAR Bonds, there is no purchase transaction. The City action at issue here is the promise to issue STAR Bonds to finance the purchase of an interest in property.

Plaintiffs again try to reframe the issue by arguing that financing a real estate transaction is proprietary activity. But the MOU requires a specific method of financing – the issuance of government bonds. Issuing STAR Bonds is something that only a government can do, and this method of financing comes with certain benefits that do not accrue to private financing. See, e.g., K.S.A. 2016 Supp. 12-17,169(a)(3) ("All special obligation bonds issued pursuant to this act [STAR Bonds] and all income or interest therefrom shall be exempt from all state taxes.").

Issuing bonds, even to finance a for-profit venture, has been held to be a governmental function. *Cromeans v. Morgan Keegan & Co.*, 1 F.Supp.3d 994, 999-1001 (W.D.Mo. 1994). The Missouri Supreme Court has held that issuing such bonds is not just for the benefit of the municipality, but for the common good. "'[S]ome form of governmental financing for development serves a public purpose.... The continued existence of an established industry and

the establishment of new industry provide jobs, measurably increase the resources of the community, promote the economy of the state, and thereby contribute to the welfare of its people. The stimulation of the economy is, therefore, an essential public and governmental purpose.' *State ex rel. Jardon v. Indus. Dev. Auth. of Jasper Cnty.*, 570 S.W.2d 666, 675 (Mo. 1978)." *Id.* at 999-1000. The court's conclusion was based in part on a Missouri statute which states that bond issues serve "an essential public and governmental purpose." Mo.Rev.Stat. §349.090. *Id.*

Kansas' STAR Bond statutes are much more emphatic in the statement of public and governmental purpose. K.S.A. 2016 Supp. 12-17,160 *et seq.*, the STAR Bonds financing act ("the Act"), was adopted by the Kansas Legislature in 2007. The stated purpose of the Act is stated as follows:

> "It is hereby declared to be the purpose of this act to **promote, stimulate and develop the general and economic welfare of the state of Kansas and its communities** and to assist in the development and redevelopment of eligible areas within and without a city **thereby promoting the general welfare of the citizens of this state,** by authorizing cities and counties to acquire certain property and to issue sales tax and revenue (STAR) bonds for the financing of STAR bond projects as defined in K.S.A. 12-17,162, and amendments thereto. It is further found and declared that **the powers conferred by this act are for a public purpose and public use for which public money may be expended** and the power of eminent domain may be exercised. **The necessity in the public interest for the provisions of this act is hereby declared as a matter of legislative determination.**" K.S.A. 2016 Supp. 12-17,160. (Emphasis added.)

Even if, as Plaintiffs suggest, the Court were to apply the *Newman* factors to determine whether the issuance of STAR Bonds is governmental or proprietary, the question is much closer than the Plaintiffs think. The issuance of STAR Bonds is a statutory privilege, not a duty, and may be considered a commercial activity under the generic heading of "financing" a project. But given the express language of K.S.A. 2016 Supp. 12-17,160, the issuance of STAR Bonds is for

the benefit of the general and economic welfare of the state as a whole. It is not simply a matter of local concern. And issuing STAR Bonds cannot be done by private entities – it is something only a government can do.

In a different context, the Kansas Court of Appeals recently recognized that "a common-law distinction between 'governmental' and 'proprietary' functions has been employed to distinguish ordinary contracts from those particular agreements which are so intertwined with policymaking they cannot be made to bind succeeding government decision makers." *State v. Great Plains of Kiowa County, Inc.*, 2017 WL 542051, *6 (Kan.App. 2017) (unpublished) (a KORA/KOMA case). The MOU here is not an ordinary contract. While in broad terms it is a contract to purchase a reversionary interest in real estate, it contains terms so intertwined with policymaking (i.e., the future issuance of STAR Bonds) that it cannot be made to bind subsequent governing bodies. The Court concludes that issuance of STAR Bonds in this instance is a governmental function.

The ultimate question, though, is whether the City's governing body has the power to bind its successors to the promise it made in the MOU to issue STAR Bonds to finance the purchase of Jayhawk's reversionary interest. The answer is no. The Court believes this result is dictated by the reasoning in *Red Dog*, *Landau,* and *Hawks*. The Court is also persuaded by the reasoning of the out of state cases discussed above. Multiple Kansas decisions emphasize that the issues raised by the parties here must be determined on a case by case basis. The Court has analyzed the specific facts of this case to conclude that the City's promise to issue STAR Bonds here is ultra vires and void and cannot be enforced by Plaintiffs.

Given this conclusion, it is not necessary to examine the other arguments of the parties. The City's motion to dismiss Counts I and II of Plaintiffs' petition is granted. The parties are

ordered to contact the Court within 10 days of the date of this order to set a scheduling conference for the remaining proceedings in this case.

IT IS SO ORDERED.

HON. TERESA L. WATSON
DISTRICT COURT JUDGE

CERTIFICATE OF SERVICE

I, Angela Cox, hereby certify that the above document was electronically filed on the 3rd day of April, 2017, providing notice to:

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